PEER REVIEW OF RESEARCH PAPERS ON OIL AND GAS GOVERNANCE IN KENYA

Policy Perspectives on the Challenges and Recommendations in the Paper:
"Legal and Policy Framework Governing Oil and Gas Sector in Kenya"

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Comments based on challenges identified in the paper rendering economic policy perspective

- Comment on fresh focus on challenges facing the industry:
  - Challenges expected at different stages of development of the industry (nascence, youthful, early maturity, late maturity)
  - Challenge of predictability of policy and governance regimes
  - Inter-generational equity challenge (sharing of finite resources between present and future generations)
  - Investment Challenges (creating permanent wealth from transitory wealth)
  - Allocative challenges (compensation, fair distribution, who to benefit more etc)
  - Macroeconomic and governance challenges
  - Capacity challenges (limited local skills and experience, limited capacity of domestic investors,
- Policy responses to the challenges

The challenges expected at different stages of the development in the industry cycle

- Nascent stage of the mineral economy: the country requires more mineral investment flow
  - Understandable that terms might be generous to investors
- Youthful stage: The country experiences rapid mineral expansion
  - High possibility for exchange rate appreciation,
  - Dutch Disease effects and governance challenges set it
- Early-Maturity stage: Slowdown of mineral output;
  - growing tax and foreign exchange constraints
- Late-maturity stage: Country experiences decline in mineral output
  - Persisting tax and foreign exchange shortages, rising unemployment

Policy and Governance Predictability Challenge

- The paper notes a weak and outdated legal framework governing the sector. Notes also that policy-making is evolving faster than knowledge of the sector, which is a challenge.
- But, investors require predictability of policy and law. A key challenge, thus, is to ensure we establish and ensure an efficient, equitable and predictable legal, regulatory and fiscal regime that will encourage mineral creation?
- The second challenge is how to craft policy and law to help balance the need to maximise revenue generation without undermining social preferences for environmental quality and social and cultural considerations, especially of locations where the ‘finds’ have been made?
- Third challenge is how to reconcile conflicting interests (investors vs. gov’t, env’t vs. growth)?

The inter-generational equity challenge

- How to balance the relative costs of access to these resources vis-à-vis the choices/preferences of the present relative to the future?

- What set of policies should be put in place to ensure sustainable exploitation of mineral resources in a manner today that is inter-generational equitable?

The investment challenge

- Mineral resources such as oil and gas are natural capital endowments that should Kenya overcome her capital shortfalls and provide revenues to sort out several development challenges like wealth and employment creation.
- But, given that such resource are finite, their wealth is also transitory. Are there considerations in policy and provisions in law on how to transform this into permanent wealth?
- How do we invest the oil and gas wealth to create a stream of wealth that will outlast finite mineral resources?
- Under PSC, should investors recover their costs fully first or can it be distributed to ensure GoK can start enjoying early revenues to address urgent development needs?
- What proportion of the wealth should be saved and the proportion to be invested? Need to be explicit on how and in what areas to invest the oil and gas wealth e.g. in capacity-building to increase local content, reinvest to raise national shares in such investments.

Allocation and revenue sharing challenge

- How to share benefits from mining equitably (e.g. county vs. national oil-producing vs. non-producing regions)?
- What form should the revenue sharing take in order to be considered are fair? Do we adopt,
  - *Aristotle's Proportionality Principle?* –that would mean revenues are shared in proportion to each party's contribution.
  - *Jeremy Bentham's Utilitarianism* –revenues are shared in such a way that it creates the greatest good for the greatest number of Kenyans
  - *John Rawls' Theory of justice* –revenues are shared such that the least well-off group in society is be made as well off as possible as the rest.
- Who is eligible for more? What are the eligibility criteria? Who has the highest priority –the current of future gen.?

Macro-economic and governance challenge

- The paper underscores the paradox of plenty, risks of Dutch disease, inflation and volatility of commodity prices.
- Arising from the above concerns:
  - Are there policy and legislative provisions stating how we will address such externalities as declining and unstable commodity prices, Dutch disease?
  - Are there effective provisions in policy and law on how to avoid rent seeking and corruption?
  - Thirdly, ensuring progressive local politics, managing expectations and identifying international “power games”

The capacity challenge

- How to balance aspirational goals and the reality? The oil and gas revenue cannot be regarded as a silver bullet.
  - Need to identify clear areas of capacity needs to invest the revenue generated.
- If we establish policies, laws, standards & guidelines, there is need to ensure they are congruent with our capacity to enforce them?
  - The paper needs to shine a spotlight on this aspect too
- How to bridge the capacity gap?
  - How do we progressively take over the full or maximum management of the sector in view of the capacity gap we are facing?
  - Develop and expand national capacity to administer the sector, and manage and restructure the economy
  - Strength of local private sector to invest more into the sector

Policy responses to challenges at different industry cycles (Richard Auty)

Stage	Character	Macro effects	Policy response
Nascent stage	Requires more mineral investment flow. Terms might be more generous towards investor	Exchange rate pressure	Create rent tax, build capital funds, establish revenue stabilization funds, grant Central Bank independence
Youthful stage	Rapid mineral expansion	Exchange rate appreciation, Dutch Disease effects	Sterilize windfall rents, expand domestic absorptive capacity, strengthen governance systems
Early-Maturity	Slowdown of mineral output	Growing tax and foreign exchange constraints	Substitute new tax sources, encourage domestic savings, promote sectoral diversification
Late-Maturity	Decline in mineral output	Persisting tax and foreign exchange shortages, rising unemployment	Depreciate real exchange rates, boost skills acquisition

Final take

Perhaps, a combination of different development paradigms should inform policy responses but there is need to strike careful balance between them:

- Push for nationalization of production and management.
- Push for privatization and public-private partnerships in investment and management
- The ongoing search for a new social contract for mining

Thank You