# Briefing Note 8

## Incentivising Local Economic Development in the Extractive Industries Sector through Transaction Chain Analysis

## with Case Example from Timor-Leste

### Reframing 'Local Content' as Local Economic Development

Investors and operators of oil, gas and mining development projects increasingly view the delivery of '*local content*' as a central value proposition to the host country, affording operators and joint ventures competitive advantage when bidding for new concessions or negotiating host government agreements.

From a public sector perspective, *local content* in the extractive industries sector can be viewed as a type of public good generated through 'backward' economic linkages. As such, the *local content* strategies of oil, gas and mining companies could better align with aspects of public economic policy and priorities for industrial development, private sector development, investment promotion and competitiveness. For example, the local content conventions of training and employment for nationals, and preference to local suppliers, could more closely align with public policy for human capital development, employment generation, technology transfer and export promotion.

There are three broad strategies available to pursue local content:

#### ➔ 'On-Project' Strategies

To date, the local content strategies of companies who exploit mineral assets have tended to focus largely on the immediate scope of work, ie. those construction or management functions and activities essential to develop or operate the project. We term this '*on-project*' strategies. Thus, recruitment drives may intentionally target the local area, staff made more employable through training to do the 'job-in-hand', and suppliers made more efficient through the support of the client to ensure materials and services meet the minimum quality, health and safety standards of the project. Unintentional public goods may also arise from the construction of operational infrastructure (eg. road widening and bridge rehabilitation) or the interaction of the project sponsors with regulatory authorities resulting in more effective institutions.

> The 'local content' strategies of large enterprises could better align with aspects of public economic policy for industrial development, private sector development, investment promotion and competitiveness

Looking forward, reframing local content as a contribution to public economic policy and priorities opens up a far wider range of opportunities than the aforementioned.

To exploit these opportunities, the company needs to not only look at the immediate scope of work of the project, but also the business's wider range of core management functions and assets, and those of its joint venture partners and its lead (often international) engineering contractors.

#### ➔ 'Project-Link' Strategies

Most important, operators and lead contractors need to reposition the project as a 'spring board' to enhance the transferability of skills and the marketability of suppliers in the wider market place, as well as contributing to local infrastructure and institution strengthening in a deliberate manner. There are at least two ways to frame these broader '*project-link*' strategies:

- **inward linkages** – outreach programmes of recruitment, skills development and enterprise development where some, but not all, of the programme beneficiaries go on to secure contracts with the operators or lead contractor, whilst others benefit by accessing the external job or supplier markets;
- **outward linkages** – during the contract term operators and lead contractors work with current employees or suppliers to develop competencies for utility in skill or supplier markets outside the immediate contract, either on another aspect of the same project, or more likely in other markets altogether such as the broader energy market, or the construction, tourism or manufacturing markets. Outward linkages also cover situations where operational infrastructure requirements are combined with the public service needs (and budgets) of the provincial authorities; for example, integrating occupational health services with public health facilities, or entering into public-private partnerships to generate power, supply water or wastes management.

#### ➔ 'Off-Project' Strategies

A third category of local content strategies are '*off-project*'. Here the operator or lead contractor looks beyond the project altogether. Consideration is given to providing skills training for alternative income earning potential (eg. as a result of employee retrenchment); general support to small and medium enterprises (eg. through short-term equity stakes, business management skills development and access to micro-finance); project management support for the construction of local infrastructure; or support to local regulatory institutions such as an environmental protection agency. Such strategies can tap into not only the relevant Human Resources, supply chain management and health, safety and environment departments within the business, but also its social investment or corporate social responsibility programmes and budgets.

## Incentivising Enhanced Local Content through Transactions

Different types of transactions and transaction negotiations can influence the extent to which local content in the extractive industries is delivered at different stages of project development. Specifically, host government agreements (Production Sharing Contracts, Development/Investment Agreements, Concession Agreements etc.), the procurement and contracts policy of operators, and procurement contracts between operators and their lead engineering contractors (Engineering, Procurement and Construction contracts, and various types of operations, maintenance and service contracts) offer opportunities to incentivise the broadening of local content considerations to include the full suite of *on-project*, *project-link* and *off-project* strategies. The opportunity is to align these transactions more closely with public economic development policies, and to do so in ways that provide competitive differentiation for operators, joint venture partners and lead contractors.

The Overseas Development Institute (ODI) has been working with Engineers Against Poverty, AMEC plc, Shell International, BG Group plc and others to develop a methodology for anlaysing the role of transactions in aligning local content with national and international development goals. For example *Briefing Note 3* in this series identifies options to enhance local content through modifications to the procurement process between the operators of oil, gas and mining projects and their lead engineering contractors.[1] Further, working with the World Bank's Foreign Investment Advisory Service ODI developed a framweork which expands the conventions of Value Chain Analysis to include a search for competitive differentiation for firms and countries based on 'non-price factors', including local content strategies.[2]

## Transaction Chain Analysis

Transaction Chain Analysis brings these threads together. The analysis requires three broad steps:

1. **Map the full suite of supply-side opportunities to enhance local content** (*on-project*, *project-link* and *off-project*) in the context of local public economic, industrial and private sector development policy. This involves joint analysis by the operator, its lead contractors and principal subcontractors, and relevant government departments (eg. Ministry of Economic Planning, Ministry of Mining/ Petroleum, Department of Economic Planning at the Provincial and District levels). Key considerations include:
   (i) the existing capabilities of the energy services sector;
   (ii) the level of dependency for local procurement on lead contractors (as opposed to human resourcing and local supply chains being managed directly by the operator); and
   (iii) the extent to which national (or provincial) economic development plans align with the core competencies and assets of extractive industry operations.

**The proposition is that surgical interventions in the transaction chain can provide incentives that enhance 'local content' in ways which both align with local economic development policy, and provide the private sector with a means of competitive differentiation.**

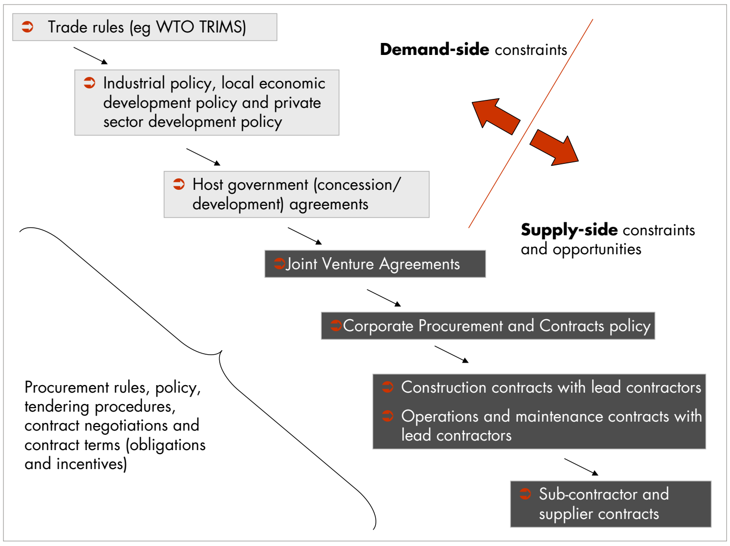
2. **Assess the strength of supply-side and demand-side constraints** on operationalising these strategies, for example:
   (i) the stage of resource development (operations may offer more local supplier opportunities, whilst construction may favour development of local skills); (
   ii) the current level of local content requirements for employment quotas and national ownership (or location) of suppliers within the regulatory framework;
   (iii) the relevance of WTO TRIMs rules;
   (iv) the cost and risk considerations for the operator regarding critical assets and project schedules;
   (v) the low profit margins of lead contractors;
   (vi) 'crowding out' and 'resource movement' (Dutch Disease) effects that might work against certain local content strategies; and (vii) public sector governance considerations.

3. **Identify modifications to the transaction chain** (see *Figure 1*). Analysis is undertaken of the cascading influence (intentional and unintentional) of international trade rules and government economic policy on host government agreements, Joint Venture agreements (eg. between national and international companies), procurement contracts and sub-contracts. The aim is to identify tendering procedures and contract clauses that could overcome the principal constraints and provide incentives to broaden and enhance local content; and to do so in ways both aligned with local public economic development policy and leave scope for operators and contractors to achieve competitive differentiation.

**Transaction Chain Analysis is the investigation, vertically down the chain of obligations and incentives, that links together trade rules, national and local public economic policy, investment agreements, joint venture agreements, and international and local procurement and contracts.**

The results of one such an analysis are given opposite.

Figure 1 Transaction Chain in the Oil and Gas Development Sector




## Case Example: Timor-Leste

*The following case is adapted from a recent report prepared by the Overseas Development Institute and Engineers Against Poverty.*[3]

### Background

In August 2005 the government of Timor-Leste launched a new offshore licensing round for hydro-carbon development in the Timor Sea. The relevant area extends from the southern coastline of the country to the northern edge of the Joint Petroleum Development Area (JPDA), and is the exclusive jurisdiction of Timor-Leste. Four concessions or 'blocks' have been offered for exploration and development, ranging in size from 3,770 square kilometres to 5,770 square kilometres. Each lies in water of 70 metres to 1,000 metres. Two areas contain gas discoveries, one area lies near existing oil fields and another near known gas fields.

The government has a strong economic policy commitment to 'local content', wishing to see the oil and gas industry make a substantial contribution to the economy of Timor-Leste, not only via public expenditure of resource revenues but directly as an industrial sector in its own right (see *Box 1*).

### Analysis of Existing Transaction Chain

To achieve this, changes are needed to the terms of the bid application process for new Production Sharing Contracts, as well as to the formulation of construction, operations and maintenance sub-contracts. At present, neither the Petroleum Mining Code nor the relevant Timor Sea Designated Authority (TSDA) guidelines carry a clear interpretation of what constitutes an adequate proposal by applicants for a Production Sharing Contract in relation to the acquisition of goods and services from Timor-Leste. For example, guidance is not given on what proposal might look like with regard to economic infrastructure, human resource training or supplier support.

Neither the model Production Sharing Contract for the JPDA or the proposed Production Sharing Contract (PSC) for the new acreage release (ie. the non-JPDA zone) is explicit about whether expenditure on staff training and economic infrastructure to support the acquisition of goods and services in Timor-Leste (including equipment, buildings and constructions) is eligible for cost recovery from oil and gas production. Furthermore, the model PSC could be clearer as to the type of local content strategy envisaged, be that training and economic infrastructure directly related to the petroleum operations bounded by the scope of work in the PSC (ie. '*on-project*' strategies), or local content contributions more broadly directed at developing the oil and gas industry or other economic activity consequential of the oil and gas industry, ie. '*project-link*' and '*off-project*' strategies.

### Providing Incentives and Minimising the Risks

If future PSCs are to adopt a broader definition of, and incentives for, 'local content' that includes '*project-link*' and '*off-project*' strategies (and therefore be consistent with the Prime Minister's address in September 2005), then it would be prudent to be explicit about what is cost-recoverable under these categories. For example, for every USD$1 billion of capital investment a ceiling might be set of, say, USD$0.3 million of cost-recoverable expenditure for training of Timorese, USD$0.5 million for development of local economic infrastructure and USD$0.3 million for support to local enterprises. This approach would provide a financial incentive, and yet limit also the risks of abuse.

Article 5.4(a) of both the JDPA and non-JDPA model PSCs – on Goods, Services, Training and Employment – is explicit in obliging a preference for the "acquisition of goods and services … from persons based in Timor-Leste … provided they are

**Box 1 Policy Statement by the Prime Minister on Expectations of Local Economic Performance from the Oil and Gas Sector in Timor-Leste**

"While petroleum will be the dominant revenue stream in our nation's economy for the foreseeable future, we look to it for more than a source of funds. We look to the sector to be a much broader and dynamic contributor to the national economy. This contribution will come in many forms: in capital investment, in employment generation – both directly in the oil and gas industry and indirectly as the increased investment and activity drives up demand for other goods and services. In addition it will be seen in personnel training and education, in infrastructure development and as an agent of change for the enhancement and development of Timor-Leste's society as a whole."

Keynote address by Prime Minister Mari Alkatiri, Timor-Leste,
Inaugural Acreage Release, Singapore, 2 September 2005

offered on [internationally] competitive terms and conditions" (TSDA, 2004).[4] Competition from suppliers in Darwin explains in part why low levels of sub-contracts have been awarded in Timor-Leste to date. Sound macro-economic policy suggests that protecting national firms from international competition is, in the long-term, unwise and can lead to market distortions. However, with such a weak private sector in Timor-Leste and such very low capability in local firms to service the oil and gas sector, there may be justification, at least in the medium-term (5-10 years), to allow some moderate protection.

> **As an incentive, the operator's third-party anual spend on local content in Timor-Leste could be made eligible for cost recovery up to a ceiling, eg. USD$0.5 million.**

Thus it seems plausible for provisions to be introduced into future PSCs to enable the operator (or its lead contractors) to preference the acquisition of non-competitive goods and services from Timor-Leste. Depending on the country and how the policy is implemented, this practice is allowable under WTO TRIMs rules (see *Box 2*).[5] Given the due concerns that this might cause the contractor and investors, it would be necessary to retain the general requirement in the PSC for internationally competitive terms and conditions, and require local bidding firms released from this clause to: (i) *meet minimum standards for health and safety* (including customs requirements); and (ii) *pose no demonstrable risk to the effective operation of critical facilities and assets*.

At present, the JPDA and non-JPDA model PSCs require the contractor (ie. operator) only to "draw to the attention of suppliers based in Timor-Leste … opportunities for the provision of goods and services" (TSDA, 2004, p34). The same clause in future PSCs could be strengthened by requiring the contractor to also configure such opportunities in a way that maximises the participation of local Timorese firms and nationals. Guidance issued by Shell International,[6] for example, recommends that operators identify early civil works that might provide the basis for training, preparing smaller 'work packages' tailored to the capabilities of local firms, and developing model minor construction and service contracts that support joint ventures between foreign contractors and local firms.

Many international and national oil and gas companies voluntarily establish social funds, community development foundations or contribute community (or social) investment programmes. This is a strategy for going beyond direct asset compensation: creating good will and an informal 'social license to operate' with peoples adversely affected by construction or operational activities. It is also a means to bridge the 'economic benefits gap' – the situation that arises due to time lag between the commencement of physical project activities and the visible realisation of development and economic benefits for the broader population from production revenues. Local content activities within community investment programmes are generally based around '*project-link*' or '*off-project*' strategies, for example outreach skills training and micro enterprise development.

In both the JPDA and non-JPDA model PSCs there is no requirement on the contractor/operator to establish a social fund to support community investment programmes. Indeed, costs and donations relating to "public relations or enhancement of the Contractor's corporate image and interests" (TSDA, 2004, p51) are explicitly ineligible for cost recovery. One modification to future PSCs could be make a series of 'explicit exceptions' to these ineligible costs. These exceptions could cover costs incurred in the provision of training, enterprise support or economic infrastructure in Timor-Leste in relation either directly to the oil and gas industry or indirectly to social investment activity consequential of the oil and gas industry.

## Modifying the Transaction Chain

Based on this analysis, options for modifying the bidding and contractual framework for 'local content' so as to align with local economic development policy are given in *Table 1*.

### Box 2 What Local Content Strategies are allowed under WTO Rules

The WTO Agreement on Trade-Related Investment Measures (TRIMs) seeks to ensure that goods purchased within a country do not discriminate against international competitors. The rules however make some allowances for domestic regulation to require or incentivise local procurement by an enterprise ('local content requirements') on a discriminatory basis (ie. allowing local firms to supply goods that are not competitive in relation to international markets). The rules also make allowances for domestic regulations to restrict the volume or value of imports that an enterprise can purchase in order to further incentivise demand for local goods. The volume of this restriction is related to the level of products that the enterprise exports ('trade balancing requirements').

Under TRIMs, developing countries who are members of WTO are granted these allowances for a 'transitional' period of five years (seven years for the category of Least Developed Countries). In July 2001, the Goods Council of WTO extended this transition period for certain requesting countries, taking into account the individual financial, trade and development needs of the Member in question.

In many countries TRIMs is not applied to 'government procurement', which is considered a 'pluri-lateral' area of agreement (in contrast to 'multi-lateral' agreements to which all member countries subscribe). 149 countries are members of the WTO.

WTO TRIMs Agreement

www.wto.org/english/tratop_e/invest_e/invest_e.htm#trims

Table 1 Results of Transaction Chain Analysis to Enhance the Local Economic Performance of Oil and Gas Developments in Timor-Leste

| Transaction Type | Proposed Modification (*in italics*) |
|---|---|
| Petroleum Mining Code for JPDA | By ministerial decree or other such instrument, **publish an official 'interpretation' of Article 5.4b of the Petroleum Mining Code** on the terms by which applicants may enter into an Authorisation (such as a PSC), as follows:<br><br>Current Article 5.4b on 'Applicant's Proposal in Respect of Training, Employment, and Local Goods and Services', states that: *"An application for an Authorisation shall include proposals for … the acquisition of goods and services from persons based in Timor-Leste".*<br><br>Proposed additional interpretation: *"The proposal shall include details of economic infrastructure, human resource training and supplier support programmes (costings, locations, activities and schedule), and estimates and schedule for third-party capital and operational expenditure in Timor-Leste, over the period of the contract term."*<br><br>The following definition of economic infrastructure should then also be included in Article 1.1 Definitions of the Code:<br>*"Economic infrastructure" means any physical structure or set of physical structures, including equipment, buildings and constructions involved in structuring economic activities.* |
| TSDA Guidelines for Applications for Production Sharing Contracts and Criteria for Assessment of Applications (2003) | **Revise the TSDA Guideline issued under Article 5 of the Petroleum Mining Code** for the purposes of assisting companies in lodging applications for production Sharing Contract Areas in the Joint Petroleum Development Area, as follows:<br><br>2.3 Timor-Leste's Economic Development:<br><br>Current Article (b) states: 'Applications must contain the following information … proposals for the acquisition of goods and services from persons based in Timor-Leste'.<br><br>Recommend modifying to:<br>(b) Applications must contain the following information … proposals for the acquisition of goods and services from persons based in Timor-Leste. *The proposal shall include details of economic infrastructure (including equipment, buildings and constructions), human resource training and supplier support programmes (costings, locations, activities and schedule), and estimates and schedule for third-party capital and operational expenditure in Timor-Leste, over the period of the contract term.* |
| Production Sharing Contracts (JPDA version) | **Revise future PSC for the JPDA** as follows:<br><br>Pursuant to Article 6.2(a) – Recoverable Costs, include the following new articles in Annex C, Clause 2 Exploration Costs:<br>*2.1(g) training costs incurred in prioritising the acquisition of services from persons based in Timor-Leste*<br><br>*2.1(h) economic infrastructure costs (including equipment, buildings and constructions) incurred in prioritising the acquisition of goods and services from persons based in Timor-Leste*<br><br>Repeat inclusion of the same article (g) and (h) under 2.3 [recoverable] Capital Costs and 2.4 [recoverable] Operating Costs |
| Production Sharing Contracts (JPDA version) | Pursuant to **Article 6.2(a) – Recoverable Costs**, include the following new articles in **Annex C, Clause 3** – [recoverable] **Costs, Expenses and Credits**:<br><br>*3.2(h) and 3.4b (iv) training costs incurred in prioritising the acquisition of services from persons based in Timor-Leste for Petroleum Operations*<br><br>*3.2(i) and 3.4b (v) costs incurred in the provision of training to persons based in Timor-Leste in relation both directly to the oil and gas industry and indirectly to economic activity consequential of the oil and gas industry, up to a maximum of no more than two hundred thousand United States Dollars*<br><br>*3.8(e) and 3.4b(iv) economic infrastructure costs (including equipment, buildings and constructions) incurred in prioritising the acquisition of goods and services from persons based in Timor-Leste for Petroleum Operations*<br><br>*3.8(e) and 3.4b(iv) costs incurred in the provision of economic infrastructure (including equipment, buildings and constructions) to persons based in Timor-Leste in relation both directly to the oil and gas industry and indirectly to economic activity consequential of the oil and gas industry, up to a maximum of no more than five hundred thousand United States Dollars.*<br><br>The following definition of economic infrastructure would be included in Article 1.1 Definitions of the model PSC:<br><br>*"Economic infrastructure" means any physical structure or set of physical structures, including equipment, buildings and constructions involved in structuring economic activities* |

| Transaction Type | Proposed Modification (*in italics*) |
|---|---|
| Production Sharing Contracts (JPDA version) | Pursuant to **Article 5.4(a) – Goods, Services, Training and Employment**:<br><br>Current article 5.4(b) 'preferences to the acquisition of goods and services from persons based in Timor-Leste, provided they are offered on [international] competitive terms and conditions'.<br><br>Recommend modifying to:<br><br>*5.4(b) preference to the acquisition of goods and services from persons based in Timor-Leste, within the boarders of Timor-Leste, provided such provision does not compromise health and safety requirements (including customs requirements) nor the effective operation of critical facilities and assets. Expenditure under this provision is eligible for the recovery of costs up to a limit in any one year of not more than 500,000 United States Dollars.* |
| Production Sharing Contracts (JPDA version) | Pursuant to **Article 10.1 (c) – Notice**:<br><br>Current Article 10.1(a) states: 'Except with the consent of the Designated Authority, the Contractor shall draw to the attention of suppliers based in Timor-Leste, in such manner as the Designated Authority agrees, all opportunities for the provision of goods and services for Petroleum Operations'.<br><br>Recommend modifying to:<br>*10.1(a) Except with the consent of the Designated Authority, the Contractor shall draw to the attention of suppliers based in Timor-Leste, in such manner as the Designated Authority agrees, all opportunities for the provision of goods and services for Petroleum Operations, and shall configure such opportunities in such as way as to maximise the participation of local firms and nationals and permanent residents of Timor-Leste, by, inter alia, identifying early civil works that might provide the basis for training; preparing smaller 'work packages' tailored to the capabilities of local firms, preparing model minor construction and service contracts that support joint ventures between foreign contractors and local firms, and restricting competitive tendering for selected goods and services from persons based in Timor-Leste.* |
| Model Production Sharing Contract under the Petroleum Act (non-JPDA, ie that applicable to the inaugural acreage lease)[7] | **Revise future non-JPDA PSCs** as follows:<br><br>❑ *Pursuant to* ***Article 6.2(a) – Recoverable Costs****, include the following text in Annex C, Clause 2* – same revisions as directly above.<br><br>❑ *Pursuant to* ***Article 6.2(a) – Recoverable Costs****, include the following new articles in* ***Annex C, Clause 3*** *– [recoverable]* ***Costs, Expenses and Credits*** – same revisions as directly above.<br><br>❑ *Pursuant to* ***Article 5.4(a) – Goods, Services, Training and Employment*** – same revisions as directly above. |
| Model Production Sharing Contract under the Petroleum Act (non-JPDA version) | Pursuant to **Article 12.1 (a) – Notice:**<br><br>Current Article 12.1(a) states: 'Except with the consent of the Ministry, the Contractor shall draw to the attention of suppliers based in Timor-Leste, in such manner as the Designated Authority agrees, all opportunities for the provision of goods and services for Petroleum Operations'.<br><br>Recommend modifying to:<br>*12.1(a) Except with the consent of the Ministry, the Contractor shall draw to the attention of suppliers based in Timor-Leste, in such a manner as the Ministry agrees, all opportunities for the provision of goods and services for Petroleum Operations, and shall configure such opportunities in such as way as to maximise the participation of local firms and nationals and permanent residents of Timor-Leste, by, inter alia, identifying early civil works that might provide the basis for training; preparing smaller 'work packages' tailored to the capabilities of local firms, preparing model minor construction and service contracts that support joint ventures between foreign contractors and local firms, and restricting competitive tendering for selected goods and services to persons based in Timor-Leste.* |

| Transaction Type | Proposed Modification (*in italics*) |
|---|---|
| Model Production Sharing Contract under the Petroleum Act (non-JPDA version) | Pursuant to **Article 12.3(b) Tender Invitations**:<br><br>Current Article 12.3(b) states: '…all goods and services shall be procured on an arm's length basis by competitive tendering, and the Contractors, before inviting any tender for goods or services, shall consult [*emphasis added*] with the Ministry in respect of:<br>(i) the list of bidders which the Contractors propose to invite to tender; and<br>(ii) the bid package to accompany the invitation, which shall include:<br>(a) a draft contract;<br>(b) the scope of work;<br>(c) a technical proposal form;<br>(d) a commercial proposal form; and<br>(e) the basis upon which bids will be evaluated.'<br><br>Recommend modifying to:<br><br>*12.3(b) … all goods and services shall be procured on an arm's length basis by competitive tendering, and the Contractors, before inviting any tender for goods or services, shall submit to the Ministry, for its approval [emphasis added]:*<br>*(i) the list of bidders which the Contractors propose to invite to tender; and*<br>*(ii) the bid package to accompany the invitation, which shall include:*<br>*(a) a draft contract;*<br>*(b) the scope of work;*<br>*(c) a technical proposal form;*<br>*(d) the use of Timor-Leste content, training and economic infrastructure*<br>*(e) a commercial proposal form; and*<br>*(f) the basis upon which bids will be evaluated.* |
| Approval of goods and services – contracts by the TSDA | Members of the TSDA to **publish guidance for the TSDA on granting approval to contracts for goods and services under Article 10.3 of the JPDA model PSC**.<br><br>Recommendation on augmented guidance:<br><br>'*Material considerations in granting approval shall include whether the draft contract:*<br><br>(a) *has significant potential for realising practical training, employment, supplier development and economic infrastructure development opportunities for Timor-Leste both in the medium and long-term.*<br><br>(b) *places an obligation on the Sub-contractor to commit to realistic programme of local development and resourcing from Timor-Leste in the provision of the Services over the medium term, and to report regularly to the Contractor on progress.*<br><br>(c) *places an obligation on the Contractor to monitor implementation by the Sub-Contactor's programme of local development and resourcing from Timor-Leste in the provision of the Services over the medium term, and to report regularly to the Designated Authority on progress.* |
| Approval of sub-contracts by the Oil, Gas and Energy Directorate | **Under Article 12.3(b) Tender Invitations** of the model Production Sharing Contract for the inaugural acreage release, the Ministry has no rights of approval (only the right to be consulted) over draft contracts for procurement of goods and services.<br><br>*If this situation changes, the above guidance for approval of contracts for the procurement of goods and services could be applicable.* |
| Cost recovery for social funds and community investment<br><br>(Applicable to both the JPDA and non-JPDA model PSCs). | Pursuant to **Article 6.2(a) – Recoverable Costs**, *under* **Annex C, Clause 2.8(r)** – Ineligible Costs:<br><br>Current Article 2.8(r) states: 'Except with consent of the Designated Authority / Ministry, costs, including donations, relating to public relations or enhancement of the Contractor's corporate image and interests'.<br><br>Recommend modifying to:<br><br>*2.8(r) Costs, including donations, relating to public relations or enhancement of the Contractor's corporate image and interests, except where these costs are:*<br>*(i) with the consent of the Designated Authority/Ministry*<br>*(ii) incurred in the provision of training, enterprise support or economic infrastructure (including equipment, buildings and constructions) to persons based in Timor-Leste in relation either directly to the oil and gas industry or indirectly to investment and activity consequential of the oil and gas industry.* |

## Conclusion

*Transaction Chain Analysis* is the investigation, vertically down the chain of obligations and incentives, which links together trade rules, national and local economic policy, investment agreements, joint venture agreements, and international and local procurement contracts. The proposition is that surgical interventions in this chain in relation to policy reform, competitive bidding (including pre-qualification thresholds, tender procedures, post award discussions) and contracts terms, can provide incentives that broaden and enhance local content in ways that both align with local economic development policy, and encourage competitive differentiation by operators and contractors.

## End Notes

[1] ODI (2004) 'Levers & Pulleys: Extractive Industries and Local Economic Development – Incentivising Innovation by Lead Contractors through Contract Tendering' *Briefing Note 3*, London: Overseas Development Institute, Business and Development Performance
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[2] World Bank & ODI (2006) 'A Corporate Social Responsibility (CSR) Diagnostic Module for Application in Value Chain Analysis (VCA)' Washington DC: Foreign Investment Advisory Services, Private Sector Development Department
www.odi.org.uk/iedg/Business_Development_Performance/Papers/ODI_PubSecCSR_CSRDiagnosisModuleVCA.pdf

[3] ODI & EAP (2007) 'Learning from AMEC's Oil and Gas Asset Support Operations in the Asia Pacific Region *with case-study of the Bayu-Undan Gas Recycle Project, Timor-Leste*' London: Overseas Development Institute and Engineers Against Poverty
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[4] TSDA (2004) 'Production Sharing Contract for the Joint Petroleum Development Area' *Draft for Consultation*, Dili: Timor Sea Designated Authority
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[5] Summary of the WTO TRIMS Agreement
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[6] Shell International (2004) 'Social Performance During Construction: Involving Contractors in Impact Management' London: Social Performance Unit, Shell International

[7] OGED (2006) Annex VII, Model Production Sharing Contract, Final Tender Protocol (Edital), Dili: Oil, Gas and Energy Directorate

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