National Oil Company of Liberia

Is Liberia producing oil?
No – Liberia is at least 5-7 years away from producing a drop of oil. We are still in the exploration phase, and the potential discovery made by African Petroleum in February needs to be evaluated further. That means scheduling a new rig to return to the area later in 2012 and drilling further wells to see how large or small the reservoir is. Only then can they say whether it is of large enough ('commercial') quantities to develop to production.

How is exploration done?
For offshore oil, NOCAL partners with a seismic data company (TGS-NOPEC) which does geological surveys of the sea-bed. The International Oil Companies (IOCs) buy this data and decide where to drill. The terms of the Production Sharing Contracts govern how long they have to interpret the data (usually 3 years) and how long they have to explore (usually 2 years). Once they have decided where to drill, they hire a drill-ship (which costs about US$1 million per day) and drill an exploratory well.

How is production done?
If the company finds oil and it is in commercial quantities they then have to build a well around it and a pipe for it to come up to a special floating platform (also known as a floating production, storage and offload facility (FPSO)), which takes at least 5 years to put in place.

Why are companies like Chevron or African Petroleum doing the work and not NOCAL?
Liberia today does not have the equipment, money or expertise to do exploration, or build wells. Every exploratory well costs over US$100m to drill, and there is usually a high chance of failure to hit oil. Compare that with Liberia's national budget of US$400m. Exploration also takes great expertise, so a partnership with private sector companies makes more sense so that the IOCs bring in the expertise and take on all the financial risk.

How much money will oil produce?
It is impossible to say until we know what is down there. The Narina-1 well which African Petroleum drilled found good quality oil in good quantities, but you need to drill more wells until you know how much and whether it is commercially viable. The oil in LB-09 is very deep down, which makes it harder to get, and more expensive. African Petroleum are currently arranging to hire a rig to return to Block 9 later this year to appraise the reservoir they found, to see if it is commercially viable.

What does commercially viable mean?
It basically means: "can the oil company extract that particular oil reservoir, at that depth, at today's oil prices, taking all costs into account, and still make a profit?" If oil is US$ per barrel, then their costs might far outweigh what they could make selling it. If it was US$500 per barrel, then lots more oil fields might be viable. Today's price is about US$110 per barrel.

Why do the PSCs vary with the Petroleum Law?

The simple reason is that given the extreme financial risk of drilling offshore Liberia, some provisions of the Law (especially 3.3, 3.4 and 3.7 regarding equity and royalties) were not realistic to expect from the companies given the risk at the time. Liberia was classified a 'frontier' region, which means maximum risk, which means to get the companies to come at all you have to offer them more. Liberia got the best deal it could under the circumstances. As Liberia develops, that risk reduces and Liberia can demand more from new contracts it signs. That is also part of the rationale for revising the Law and Model Contract.

How do PSC's work?
Production sharing contracts (PSCs) are different from Mineral Development Agreements because they are not concession agreements. A concession agreement effectively gives an area for a duration of time to a company to extract those resources, and the country benefits by charging royalties (which are taxes no matter what profit – see below) and taxes on the operations. A PSC, meanwhile, says that in addition to charging royalties and taxes, the company will share part of the petroleum produced with the country. This 'production share' is usually provided in the form of money, but in some countries they also take a share of the actual oil, for example to refine. The production share comes out of the 'profit oil'. The difference between concessions and PSCs is like the difference between a person who leases his land to a farmer and just charges rent (Concessions), and a person who charges rent **and** takes a portion of the harvest (PSCs).

What are 'cost oil' and profit oil'?
If an oil well produces a certain total amount of barrels per day, or per month, the company is making money selling it and also running up big costs to operate the well. 'Cost oil' is the amount of oil they need to sell to cover all their costs. 'Profit oil' is what is left over after all costs have been recovered by the company (see fiscal terms section below). In a PSC the money from the profit oil is then shared between the company and the country according to a sharing schedule agreed in the contract.

Should Liberia re-negotiate the 10 existing PSCs?
The high risk is that a renegotiation may drive investors away and would not result in better terms. We do not know if we have commercial oil yet, so we do not have a strong bargaining position. We have had huge success in attracting the world's best companies (like Chevron and Exxon-Mobil) to come and explore. They are taking all the risk of exploring – which can cost USD1 million per day. If we try and re-negotiate, we risk losing these partners. This is not like Firestone or Arcelor Mittal. In those cases we knew what rubber was there, we knew what iron ore was there, so we could drive a harder bargain. In the case of oil we do not know. People should not under-estimate the value of having top companies – they are safer, more effective, employ more staff and do more good for the country. They are not corrupt, and more likely to ensure transparency.

How do PSCs get agreed? Is it just NOCAL?

PSC's are negotiated between the companies and the Hydrocarbon Technical Committee. This is a cross-governmental committee, chaired by NOCAL. It includes Justice, Finance, Lands and Mines, NIC, EPA and the Legal Advisor to the President. All the PSCs are ratified by the Legislature before they come into effect.

When will the next bidding round take place?
Not until we have the new policy, law and contract in place to fix the new governance and regulatory structures.

What about equity share in oil blocks?
There are two different kinds of equity being debated. First is 'state equity', i.e. whether NOCAL has a share in the blocks on behalf of the Republic of Liberia – like an investor. Second is 'citizen equity' or share purchase – which is the opportunity for ordinary Liberians to buy shares in the oil companies (section 3.4 of the 2002 Petroleum Law).

For the first type, the old Petroleum Law says NOCAL should have 20% state equity share in the blocks (Section 3.3). In practice that is unrealistic and not reflected in all the PSCs inherited by the new NOCAL, for the reasons above. The new law will review this section.

When it comes to citizen equity or share purchase, the PSCs are silent, for the same reason. No country has ever been able to make this work on a practical level and the few attempts have led to corruption and increasing inequality. Most countries and best practice these days focus on local content and effective revenue management to increase the benefits to citizens.

When will Liberia receive money?
The main revenue comes when production starts. Even if the recent discovery is commercially viable, which we don't know yet, it takes years and up to US$1bn investment to build the infrastructure at the well to do production. Until then, Liberia raises money from selling seismic data (shared with TGS NOPEC), from social development payments, and fees under the PSCs for 'surface rental' (money for using the area during exploration).

Where does the current money go?
NOCAL uses part of this money to cover its operating costs, some for scholarships and capacity building, and the rest (like surface rentals) go to Ministry of Finance. Liberia also currently receives taxes from the IOCs, which go to Finance.

NOCAL also gives funds to the University of Liberia and scholarships for Liberians to study oil-related subjects abroad. NOCAL advertises the scholarships in the newspaper, and applicants go through an open process. So far we have sent over a dozen Liberians abroad to study. This is very important for our local capacity.

How do people not on scholarships benefit now?
NOCAL supports UL. NOCAL also carries out social projects – like the housing projects in Lofa and Buchanan that were completed – and is building youth centres (one was

opened in July in Logan Town). The oil companies also spend social development funds. For example, Chevron is spending US$10.5 million over 5 years on education, health and enterprise development.

What is the US$10.5 million figure that has been talked about?
That figure is the total value of the Social Development Fund that Chevron committed to as part of its PSCs. It is calculated based on SD payments of US$700,000, for three blocks, over 5 years. This money is managed by Chevron, not NOCAL or the government, to make sure it is spent properly. Chevron is focusing their support on Health, Education and Enterprise Development. They are open about their program and should be contacted directly for more information.

What is the US$10.7billion number that has been mentioned?
That number was an estimate made by the US Embassy at one time as a guess at the total, eventual, **possible** value of the Chevron investment in Liberia. It is a hypothetical number and has nothing to do with the PSC deal or the social development funds.

When will oil generate jobs for Liberians?
This will take time, and people have to have realistic expectations. Oil is not a labour-intensive industry, and it requires specific skills. That said, over time it will be possible to employ more Liberians, especially through the different business opportunities that an oil sector creates for services ('local content'). The Government will push as hard as it can to make sure the companies employ Liberians, but if there aren't candidates with the necessary skills then we will handicap the sector if we force them. It's more important to focus on 'local content' – that's where the benefit comes. Liberians have to be entrepreneurial too, and take the initiative to create businesses that can take advantage of the oil sector's needs (like transport, waste management, hospitality and other services).

What is 'local content'?
Local content means the opportunities for local businesses to benefit from the oil sector – for example providing support services to the big companies. This could be everything from maintenance of the rigs, to catering, transport, housing for workers etc. Countries usually establish rules that make the companies use local contractors. However, we need to make sure again that we don't handicap the development of the oil sector. If we create local content rules that mean the IOCs can't do their work, then Liberia won't get any money from oil at all. It's a balance, and NOCAL has plans to promote and train businesses to benefit from oil.

Will we refine oil in Liberia?
We can't say one way or the other until we have reviewed the policy. The current process is to create a policy and Law to cover Exploration and Production (also known as 'upstream and midstream activities'), not 'downstream' activities like refining. It may be a good idea for Liberia to refine, or it may not be good return on investment. It all depends on the scale of reserves.

How will the revenue be used?
It's too early to say, because we do not know the geology yet. We can't count chickens before they hatch. Also, this is a question that should be debated nationally – in an inclusive way. One thing we can say for sure – the revenue has to benefit ALL Liberians, not just certain people or certain areas. Managing oil revenues is complex and must be done correctly. In doing so it is necessary to get the correct balance between:

1. Investing in the urgent development needs of the country (like infrastructure, education)
2. Saving money for future generations (because oil belongs to them too)
3. Putting aside money to stabilize the economy in the (likely) event of volatile oil prices
4. Not flooding the economy with money (especially foreign exchange) which can hurt the economy and lead to Dutch Disease (see below for details on Dutch Disease)
5. Boosting the government budget (but not overspending on recurring costs).

Getting this balance right usually means creating special Funds alongside the main budget to cover investment, stabilization and future saving (also called Heritage Finds). These funds then have to be managed in a transparent and accountable way, involving all stakeholders and guided by the countries' national development strategy and the public priorities.

Who will control Liberia's oil revenues?
This is another question under review by the policy making process, but the best practice is that revenue should be controlled by central government, with enough retained by the national oil company to operate autonomously. Currently under Liberian law, almost all revenues go to the Ministry of Finance. This includes current sources of revenue – such as surface rentals – and possible future revenue through production sharing and taxation. That arrangement is unlikely to change. The Government is looking carefully at international benchmarks (especially Brazil and Norway) to determine how best to ensure that our national oil company (NOC) has the right financing to play its proper role in the long term – an autonomous operational budget, but without limiting revenue to the central coffers (like Nigeria or Angola) or leading to an NOC that cannot function (like Mexico where over-taxation of the NOC led to disaster).

What is the oil curse and how can Liberia avoid it?
The 'oil curse' refers to many poor countries which find oil but see falling economic indicators instead of progress. This has been especially true in Africa where institutions of governance and accountability are weaker. There is much debate about why this happens, but it is usually attributed to two failures: one political, one economic.

The political failure is when a government fails to put in place the correct governance, transparency and accountability mechanisms, and educate the public. When the money starts to flow, the existing problems like corruption, capital flight, patronage, cronyism and 'rent-seeking behaviour' all get worse and divert resources away from development and good governance. The reform process is trying to put in place exactly these proper structures and processes, to international benchmarks.

The economic failure is to do with bad economic policy, especially handling and spending revenues. Oil can generate so much money that a small country with weak governance, low government capacity and low absorptive capacity can struggle to spend it well. Avoiding that means structuring how you manage the money in government (with dedicated funds and proper oversight) and spending it well (with good programs and policies).

The priorities are 1) getting the right balance between spending and saving (for future generations), 2) making sure money spent is on investment rather than just the general government recurring costs, 3) choosing areas to spend on carefully – especially things that will lead to a strong economy when the oil runs out (like education, infrastructure), 4) setting aside enough money to avoid price shocks (the oil price is very volatile) and 5) making sure the economy is being diversified to avoid Dutch disease.

What is 'Dutch disease'?
Dutch disease refers to a cluster of economic effects first observed in Holland in the 1970s. Firstly, when an oil sector starts booming it tends to attract labour away from other sectors and dwarf salaries .Secondly, it makes manufacturing and exports less profitable because the money coming into the country causes the local currency to appreciate rapidly. The result is that other exports and domestic industry become uncompetitive, and the country is left with a lop-sided economy with few jobs. Liberia is not manufacturing or exporting much yet, so it will not damage other parts of the economy so much as discourage and prevent them developing.

How major is the issue of NOCAL's dual role?
There is an accepted model that separates the roles of regulation, commercial interests of the state, and policy making. While there are clear merits to this benchmark, there is also increasing recognition that it is not something to do too hastily.

The first issue is 'conflict of interest', where a national oil company (NOC) is a player and a referee at the same time. However, conflict of interest only arises when the NOC has a commercial interest – when it becomes a player. That commercial interest can be in the form of an equity share in operations, or as a company actually doing exploration and production (E&P). Neither of these currently apply to NOCAL, so there is no conflict of interest at present. NOCAL's equity share of Blocks 11, 12 and 14 will only start at the start of production, and it is probably decades before NOCAL has the money and the capacity to do its own E&P.

Secondly, capacity constraints must be taken into account. It is unwise to spread very limited capacity too thinly too early on, especially when there is no question of a national oil company actually conducting operations. There are business cases in Africa that explain why it is important to take time to build capacity first when trying to create a separate regulator entity. Liberia's capacity (in terms of qualified, experienced geologists, geo-physicists, geo-chemists, engineers and environmental experts) is still very limited, and it is concentrated in NOCAL at the moment.

For now the priority for Liberia is to monitor and regulate the IOCs to make sure they are doing what they are supposed to. Thus separation is something to aim for, but many gold standard countries, like Norway or Brazil, took years or even decades to separate. We have to choose the right timing to split – which will probably be the start of significant commercial production when a conflict of interest begins. The new policy will address this issue.

What kinds of transparency measures is Liberia putting in place for oil?
Liberia already leads the rest of Africa with introducing EITI. As a result, Liberia was the highest African country on the Revenue Watch Institutes Index on transparency in 2010. But we will go further – NOCAL has already published its annual budget and announced a full external audit for the previous 3 years. We are looking at other material that we can put in the public domain – especially around bidding, contracts and financial records.

We are also looking at international benchmarks about how to involved and build the capacity of civil society to shoulder its share of accountability – monitoring contracts and environmental and social impact assessments. We want a close partnership with civil society.