



## **Report of a Round Table on Oil and Gas Contracts for Sustainable Development in Kazakhstan, April 18 2007**

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This is a report of a Round Table discussion which was held at the Radisson-SAS hotel in Astana on 18<sup>th</sup> April 2007, with approximately 35 participants drawn from government, parliament, businesses, think-tanks and civil society.

The main goals of the event were:

- a) to identify the links between oil and gas contracts and sustainable development, and
- b) to begin a discussion on how future contracts might best be designed from a sustainable development perspective.

Key issues raised round the table concerned implications of oil revenues for socio-economic development of oil-producing regions of Kazakhstan, transparency of oil contracts, quality of corporate social investments, public access to information, and questions of environmental governance. Participants ranged from representatives of the government of Kazakhstan — Ministries and Parliament — to oil and gas companies, academics and NGOs.

The Round Table was held under the Chatham House Rule of non-attribution to encourage free and unencumbered discussion. The event was organized by the International Institute for Environment and Development with the sponsorship of the British Embassy, Astana. Not all participants were present for the entire day and balance between different stakeholder groups during individual round table and breakout group sessions was mixed.

### **Transparency and Public Participation**

A very engaged discussion surrounded this issue. Kazakhstan's participation in the Extractive Industries Transparency Initiative was presented by a government representative as one of the current industry responses to the demands for increased transparency, and as such to be applauded and encouraged. At the KIOGE-2005 conference, a Memorandum of Understanding regarding EITI implementation in Kazakhstan was signed by the Minister of Energy and Mineral Resources, Parliament, non-governmental organization (NGO) (52) and industry (92) representatives. Official updates and reports of activities are available to the public on the [www.eiti.kz](http://www.eiti.kz) website.

One official pointed out that EITI itself is still a relatively young voluntary global initiative. Even at its minimum, compliance with EITI ensures budgetary and taxation transparency, and in Kazakhstan it has been extended to transparency of tendering processes. However, since compliance with EITI is mandatory only for new companies entering the Kazakhstan market, not existing investors, some issues are unresolved and will need to be addressed in the near future.

The fact that reporting is available is already a step in the right direction and this is a process that cannot be implemented in a revolutionary manner.

One of the parliament representatives in the area of natural resources and environment supported these views about gradual advancement toward transparency. EITI is indeed a controversial process in investor as well as public and government circles and much debate and battles have been fought even over the first stage of compliance with EITI. He noted that illusions or maximum expectations about the process could offend or scare off investors.

NGO representatives pressed throughout the day for civil society to have access to oil and gas contracts. Suggestions ranged between full and soonest disclosure of all contracts new and old to the partial disclosure of social and environmental provisions in a gradual fashion, and parliamentary approval of new oil and gas contracts. Wide-ranging participants agreed that transparency should gradually be enlarged beyond EITI's focus on revenue transparency.

Whilst state representatives were more cautious about the possibility of full contract disclosure in the future, non-governmental representatives pressed for it to become mandatory for all companies if transparency is not to become "*just another imitation or a sham, but is to become a real thing*". NGO representatives also stated that reporting on revenues alone in the absence of transparency over taxation requirements set in contracts makes it difficult to assess the extent to which compliance is achieved.

After disclosure, the key question becomes how the revenues are being spent and distributed—itsself a question of the state's responsibility to its citizens—as members of the public "*should know and understand how national exhaustible resources can be managed most effectively in the short and long runs*". In the long run, openness on behalf of the companies and the government will increase public trust and ensure stability of investment.

Corporate representatives stated that transparency is very much an issue of government regulations and mandatory requirements for corporate compliance. Whether Kazakhstan's development will gradually bring publication of contracts remains uncertain, but the issue is largely simply "*a matter of coordinating between government and industry*". One opinion from a corporate representative was that some companies, especially the leaders and well-established companies, might go for it even now, if their corporate ethics allow them to do so—as long as the governments permit this. But for newcomers and some companies this action may sacrifice a commercial competitive advantage by full disclosure of their positions. This opinion also contained a notion that the "*transparency issue overall might not have such a high sensitivity for the companies, as long as it remains voluntary and contains no risk*". If, however, it becomes mandatory (and especially if some modifications are introduced to tax rates), there will be a risk of losing investor confidence. Even if an investor decides to publish or make something available publicly, approval of the government is likely to be necessary under confidentiality clauses incorporated within oil and gas contracts. A major related point was that investors overall should not dictate or interfere in the domestic political process and should leave such decision-making to politicians and the public. Political will and wider strategic considerations on the part of government are considered key factors at both national and local levels.

One expert suggested that availability of *new* contracts should be mandated by law. In this process, EITI is but a quarter of a step towards transparency and sustainability of the extractive industries. Society has to be aware of the contents as well as of the process surrounding conclusion of contracts. The importance of ensuring that national companies – not just foreign investors – are addressed by such steps – was also highlighted. Kazakhstan's national oil and

gas company, KazMunaiGaz, is an increasingly powerful entity, even *vis-à-vis* government. The lack of separation of regulatory and business functions – with both being responsibilities of KazMunaiGaz - was also noted.

During working group discussions this issue remained a hot topic of the discussion and participants continued returning to the subject of contracts transparency. While consensus was not achieved, most participants seemed to support the notion of partial disclosure of contracts, particularly social and environmental provisions.

### **Corporate Social Investment and Corporate Social Responsibility**

The subject of social investment was raised in close connection with the transparency issue, generating much discussion on contents, implementation, distribution and public access aspects of the social investment process.

In general, little distinction was made in the discussion between companies' 'voluntary' social investment processes, and those carried out as a result of contractual commitments. Consequently, many of the suggestions made can be understood as recommendations on how the whole process of social investment on the part of companies could be improved – whether within or outside contracts. However, it is worth noting too that there was no consensus on the relative roles of government and business in social provision, with at least one participant suggesting that companies should not be expected to deliver social investment, which should be considered a responsibility of the state. Complementing this perspective was a view that social investment should be spread equitably across the entire country, not centred in oil-producing regions.

One of the concerns raised round the table was over the distribution of the resources and lack of information on the decision-making process associated with social investment, and monitoring of its quality and implementation. NGOs actively raised a concern over the lack of public access to the tender process associated with social investments and lack of public involvement when such decisions are made. *“CSR becomes an episodic and non-systemic way to address social problems in the regions where extractive industries operate”*. Lack of public access leads to lack of trust and increased concerns over corruption.

Experts agreed that the tendering process for social investment projects has to be open to the public and that it is the responsibility of local authorities to ensure social investments address the most prioritized concerns in the region. In this regard, local authorities should hold public hearings on the prioritization process and have public input. Otherwise, social projects become *“PR campaigns to promote local government”*. This opinion led to constructive discussion later in a working group. In fact, the overall connection but practical divide between national and local decision-making, motivation and goals constituted a significant concern raised at the working group level.

In this light, one suggestion from experts and government representatives concerned the need to build partnerships between State and business (public-private partnerships) with inputs from NGOs to address CSR and sustainability issues in a coordinated fashion, drawing on the strengths of each group. Such partnerships could in turn strengthen activity/capacity of other national sustainable development institutions and at the same time address any issues insufficiently covered by contracts and ensure compliance with social investment provisions.

State officials present tended to agree on the subject of corporate social responsibility and investment, e.g. emphasizing that the state should be more proactive in addressing this issue

and doing so in partnership with private investors both foreign and domestic, especially in terms of workforce training and education at different levels of management. They suggested that this process has to be systemic at the national level, trickling down to addressing local/regional concerns and needs. In this regard, emphasis was placed on the insufficiency of current efforts and the lack of cohesion and coordination between national and local authorities in addressing these problems.

A particular priority is to increase competence, professionalism, vocational diversity—and thus competitive edge—of the local workforce in the light of Kazakhstan's plans to join the World Trade Organization (WTO) in the near future. One of the corporate representatives supported this notion, stating that *"it is especially important for Kazakhstan to strengthen education and health of its sparse population, so that human capital quality becomes the key competitive advantage...[as Kazakhstan is unlikely to compete with the countries which have large populations and can have a very diversified and cheap production capacity]"*. However, there was relatively little discussion of the relative roles of different actors – or of regulated contractual provisions versus voluntary corporate initiatives - in achieving these goals. One participant noted recent labour-related social tensions in Atyrau, and suggested that oil and gas contracts should be designed to address labour and social stability.

A fairly recent process of national companies (though not in the oil and gas sector) joining the UN Global Compact initiative was considered by one of the participants to be a positive step in the right direction that sets a good example for national companies in the extractive industry. This measure could complement a broad framework for encouraging incorporation of necessary social and environmental provisions into oil and gas contracts and within the licensing process.

Another strategic consideration concerned distributional effects of oil and gas revenues at the national level, or how the revenues are being spent. The Ministry of Finance does not reveal the numbers or the process related to revenue expenditure. One participant from the government side suggested that this fact leads to a lack of systemic discussion at the government level on the country's overall education, health and poverty reduction problems. Another participant from the corporate side noted, however, that investors cannot be expected to solve all of these problems, but it is the government determining how to deal with oil and gas revenues (as well as the revenues from other extractive industries). This discussion went beyond the direct scope of the round table, but it was an indication of participants' enthusiasm to air their concerns. For purposes both of informing oil contracts and wider public policy, one suggestion from a working group was to carry out surveys of national and regional needs for different kinds of social provision that could provide a baseline for future decision-making.

### **Environmental Governance for Sustainable Development**

A government representative suggested that adoption of Kazakhstan's Concept on Sustainable Development and of a new Environmental Code in 2006 represent major state commitments to a sustainable future. Whilst the extent to which these instruments address pressing problems is arguable and there is not a unified view on the subject, most participants agree that they still represent progress in the right direction.

Another official stated that *"sustainability can only be achieved incrementally, especially in the context of Kazakhstan's transition"*. A well-known legal expert suggested that *"despite adoption of the Environmental Code, present environmental legislation doesn't solve or address some real problems, especially in the oil and gas sector. North Caspian environmental issues are not fully covered by the legislation either, and even the existence of the most ideal laws will not be effective until companies and state understand that contracts made previously need to be*

*revised, and until all stages of the extraction process are in full compliance with all the laws and regulations”.*

One of the important EcoCode deficiencies, in another expert’s opinion, is the lack of elaboration of other legal and economic instruments for increased environmental compliance. He considered that there is a need for better integration between environmental impact assessment processes and processes for the negotiation of oil and gas contracts. Environmental impact assessments need to be central in the process – itself governed by oil and gas contracts – of setting annual Work Programmes for oil and gas projects.

The direct link between the effectiveness of provisions contained within oil and gas contracts and their wider governance context was made here. A concern was raised over the presence of too many checkpoints for environmental protection dispersed throughout numerous agencies and at different levels of the government—leading to oversight without a unified approach. The result is a slow and encumbered process of compliance not much coordinated by the government. In this light, even the best contractual provisions on the environment will not lead to effective environmental protection and will result in confusion.

Incorporation of ISO 14000 standards at the level of national and local operators with subsequent compliance are considered to be a significant development in the direction of sustainability. A few words of advice included the necessity to train compliance experts for companies and for the government, and the need for joint formulation of future steps ‘beyond compliance’, which is envisaged as necessary when Kazakhstan starts implementing the Concept on Sustainable Development.

The recently adopted Concept on Sustainable Development needs to be concretized and should generate legislative provisions and mechanisms to ensure effective inter-sectoral coordination and clear provisions for corporate and public engagement. Sustainable development needs to be translated for different sectors and stakeholders in order to be implemented at different levels. Otherwise, it will remain “*a beautiful but unattainable principle*”—as one economic expert noted.

A need for the long-term environmental planning was noted separately as an important factor to build into the model oil and gas contracts. That environmental concerns are still inadequately formulated and insufficiently provided for in contracts was mentioned a number of times by different participants.

Many key themes of sustainable development are already addressed in Kazakhstan’s contracts, one business participant suggested. There is a significant challenge remaining to build understanding on what sustainable development really means for the oil and gas sector – but major reform of the overall framework for developing and implementing oil and gas contracts is unlikely to be required from a sustainable development perspective.

An ‘environmental’ working group in the afternoon suggested that a Model Contract could be developed, to incorporate a minimum normative base for environmental requirements, together with optional additional provisions for those projects, or companies, that wished to go further. The value of working to develop ‘Model Contract’ provisions for Kazakhstan was reflected in suggestions from other working groups, too.

#### **Other concerns and issues highlighted**

There were occasional calls during the day for review of existing contracts – though non-governmental participants were pragmatic in focusing on recommendations and suggestions for future contracts. In fact, many contracts have been renegotiated, but one participant noted that forced rather than voluntary renegotiation would not be in the country's best interest. One expert noted that the circumstances in which the contracts of ten years ago were negotiated were completely different to the contemporary situation and it was not fair to judge old contracts against today's socio-economic circumstances. However, another noted that members of the public believe that the earlier contracts were not fair, with companies worried for that reason about participating in public debates.

On a positive note, more than one participant noted Kazakhstan's excellent record on investment stability. Others congratulated the government of Kazakhstan on its record in attracting foreign direct investment, and noted how much progress there had been in developing the overall enabling environment for investment.

Most participants considered the round table a useful and promising exercise, considering it only a start in a longer-term process. Many commented that in the future, it would be beneficial to ensure a higher degree of involvement from the government side—both national and local representatives—and more diversity among private industry representatives from foreign and national companies. There were warning signals that if, in fact, more diversity of participants from the government and industry is secured, it might be much more difficult to reach consensus on any given issue. But there was also recognition of the value of dialogue across stakeholder groups on the issues, perhaps through a specific forum, but building on existing processes and spaces for dialogue. The value of international experience in such a process was also highlighted – whilst recognizing that Kazakhstan herself has a great deal of experience and could offer positive insights to other countries.

Another recommendation aired at the table was to have a more concrete goal for the discussion, so that participants try to reach a consensus at least on something. One of the examples was to have an exercise to design a model oil and gas contract tailored to Kazakhstan's sustainable development needs and priorities (an option favoured by many), or to have a set of concrete recommendations for the government.

On transparency, a recommendation on moving forward involved getting on-board a couple of companies which might be willing officially to disclose parts or all of their contracts, in agreement with the government.

Some of the issues raised at the round table but not addressed in any detail concerned:

- relationship between local and national decision-making,
- policies governing companies that contract local operators,
- rules on public engagement both on the government and business side,
- risks faced by the companies and the government regarding strategic considerations,
- poverty reduction measures and the extent to which they are addressed in oil and gas contracts.

Overall, the subject matter of the Round Table, whilst undoubtedly sensitive, offered a positive entry point for discussion of the wider sustainable development contributions of the oil and gas sector; issues of public participation and transparency in relation to oil and gas sector investment; the importance of considering not only formal legislation or contractual terms, but also the wider institutional and socio-economic context in which oil and gas contracts are

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implemented; and the balance of roles and responsibilities between state, civil society and investors as they relate to management of oil and gas resources for sustainable development.

Finally, participants completed feedback forms designed further to inform deliberations on whether and how to structure any future process of analysis and engagement on oil and gas contracts and sustainable development in Kazakhstan.

Astana and London, April 2007