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Changes to Fiscal Regimes arising from Resource Nationalism  
and Political Risk

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# Political Risk in the Natural Resources Sector

- There are general risks present in any hydrocarbon - rich jurisdiction.
- The common goal of the host government and the oil and gas company is to increase the “size of the pie” and ensure that each gets their fair share of such pie.
- Industry considers that the risk of resource nationalism remains “every bit as critical as it was last year.”

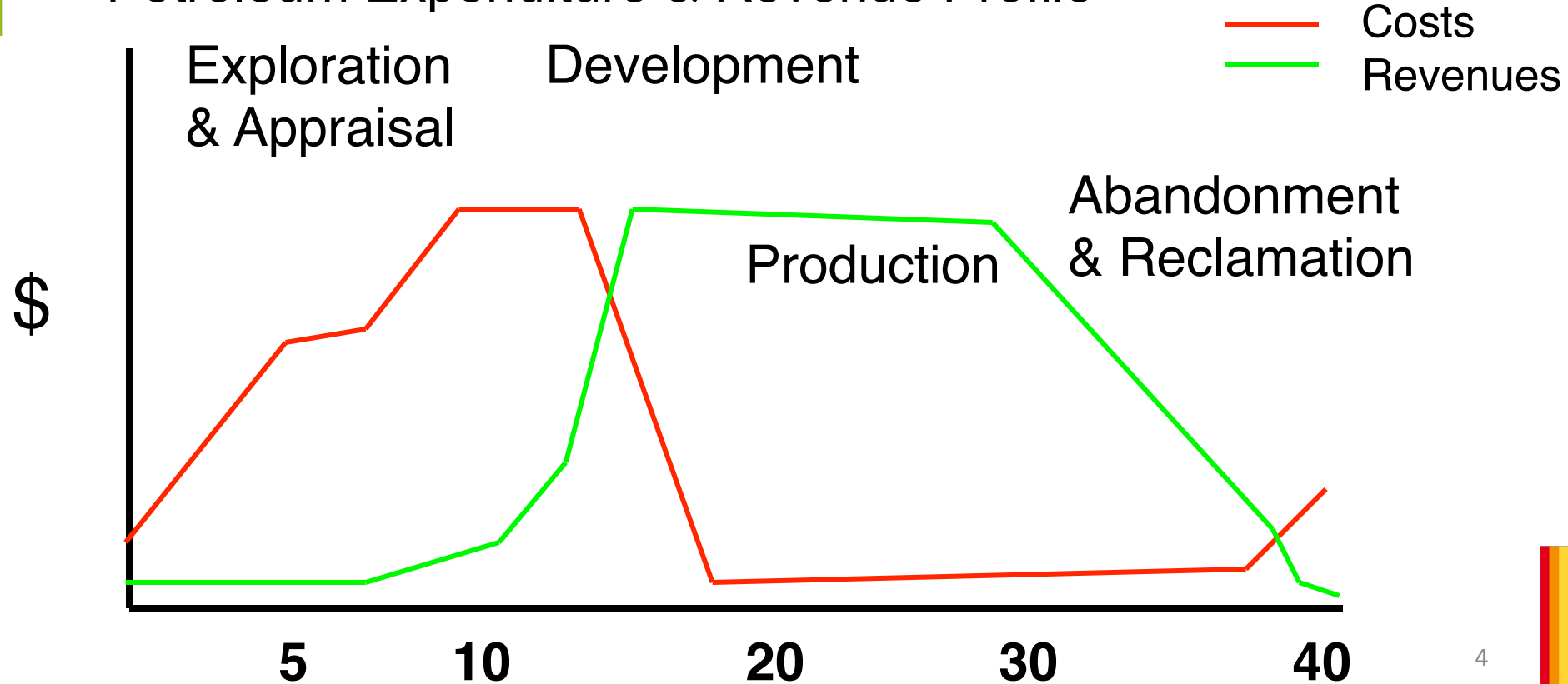
# Political Risk in the Natural Resources Sector

## The Problem of the “Obsolescing Bargain”:

- When does it arise? When the government no longer gets its fair share or at least perceives that
- In such cases, the government soon becomes dissatisfied and the contract will come under pressure
- Interestingly, this may occur regardless of the political views of the State

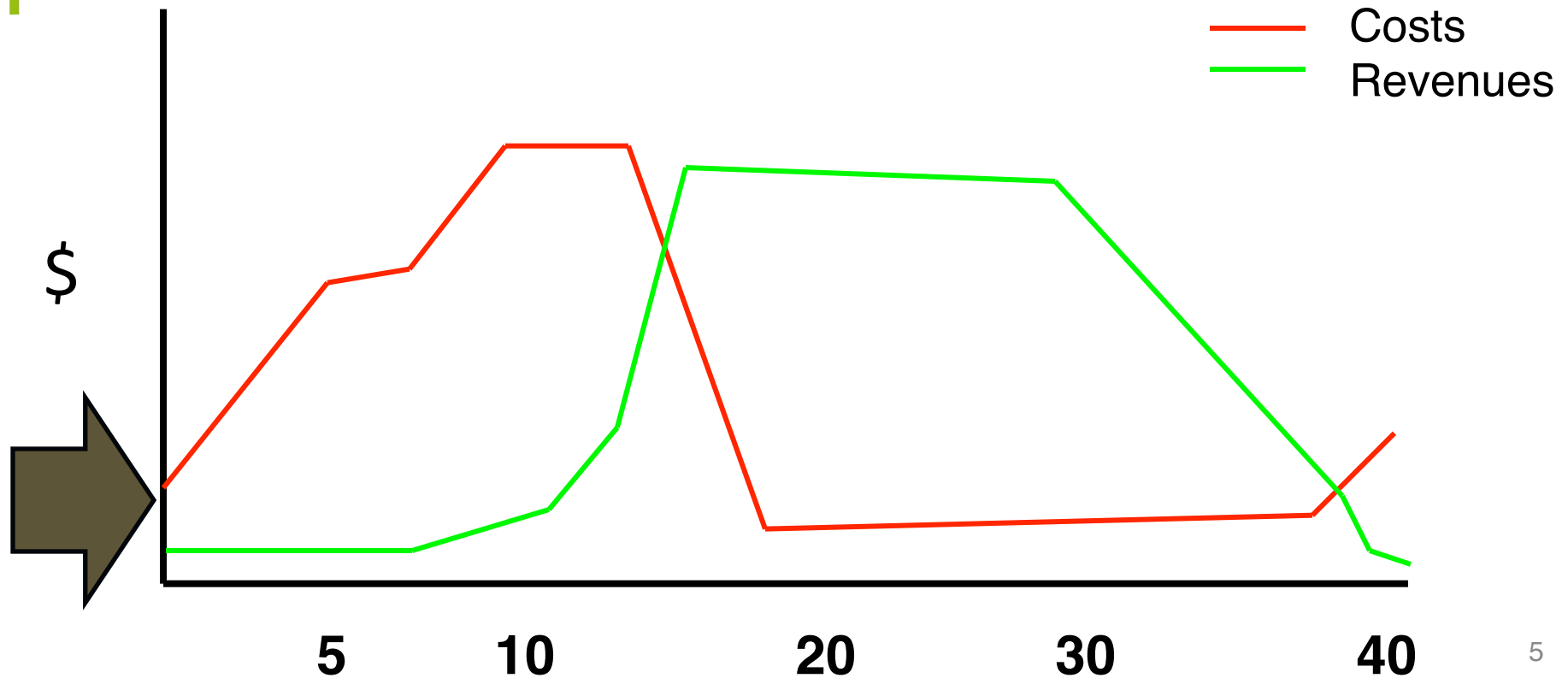
# Political Risk in the Natural Resources Sector

- Petroleum Expenditure & Revenue Profile



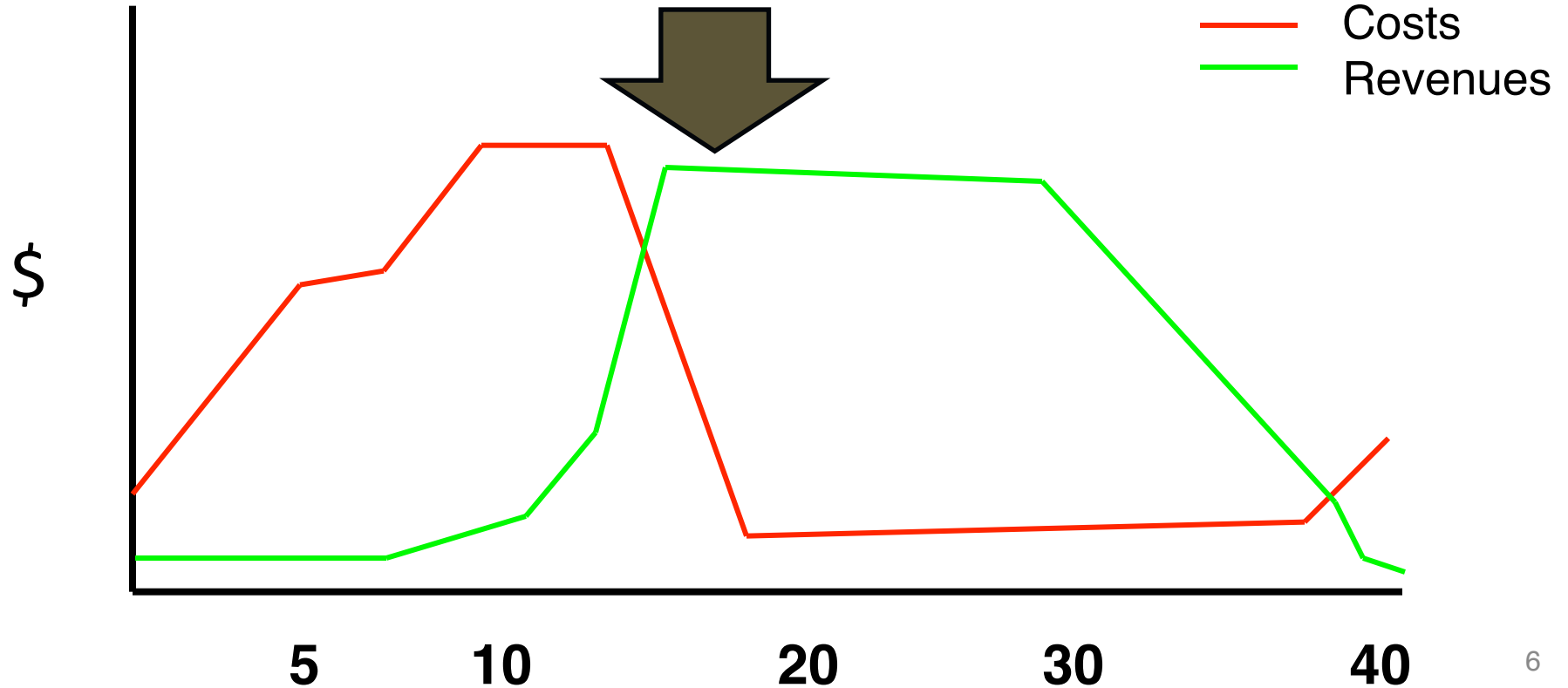
# Political Risk in the Natural Resources Sector

- When is the Original Bargain Made?



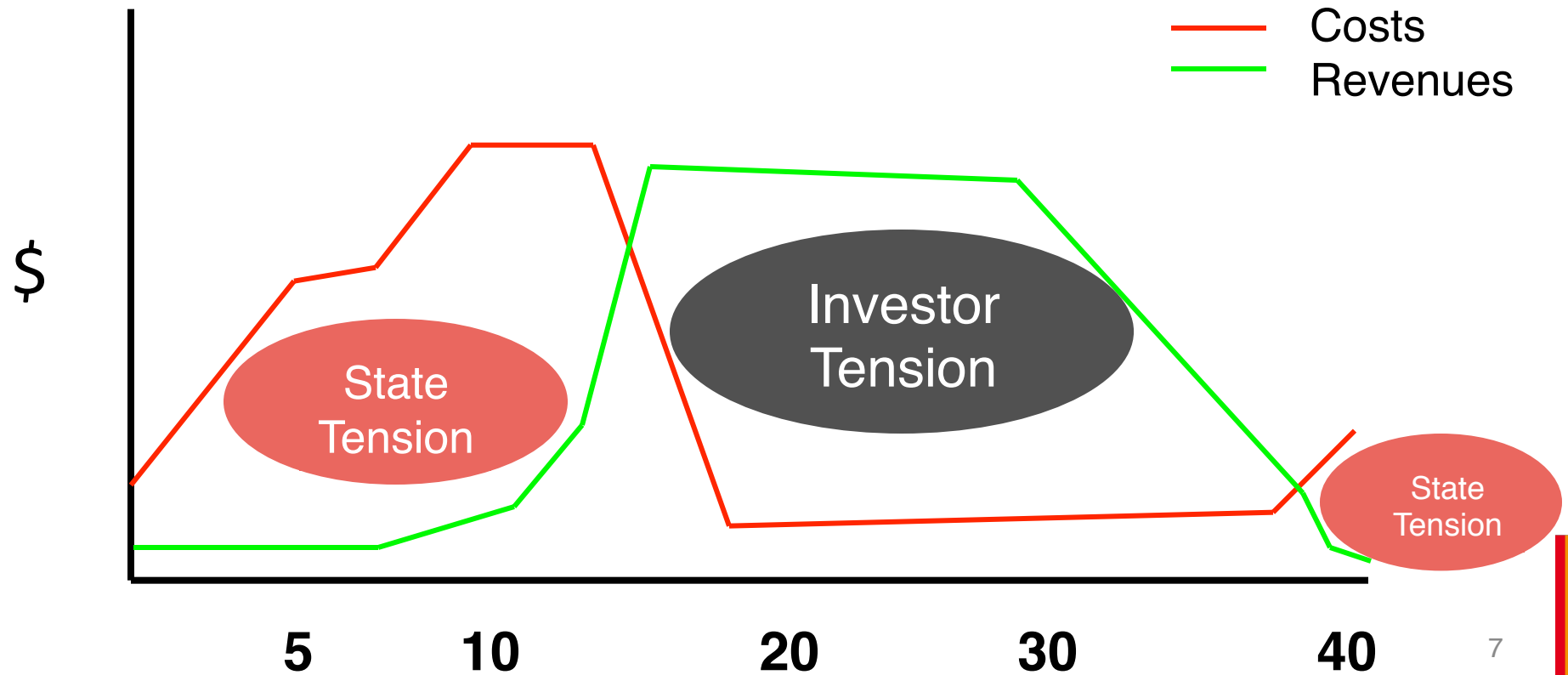
# Political Risk in the Natural Resources Sector

- When is the Original Bargain Obsolete?



# Political Risk in the Natural Resources Sector

- When is the Original Bargain Obsolete?



# Political Risk in the Natural Resources Sector

- Preventing the "Obsolescing Bargain" Problem:
- There need to be credible threats or incentives or both ("sticks") to enforce a **stable fiscal and legal regime**, such as:
  - fiscal and legal stability guarantees
  - international arbitration mechanisms to enforce performance of these guarantees



# Political Risk in the Natural Resources Sector

- **Better still, prevent the problem from occurring by using "carrots":**
  - creating alignment between the State's objectives and the investor's investment incentives
  - establishing a fiscal regime that is durable across a broad range of revenue and cost environments

# Political Risk in the Natural Resources Sector

- **Natural Resources projects are:**
  - unique, involving investors and host states
  - capital intensive
  - long-term, fixed investments – quasi-irreversible
  - vulnerable to resource nationalism

# Political Risk in the Natural Resources Sector

- **Resource nationalism vs contract sanctity**
  - ideological agendas
  - domestic political considerations
  - geopolitical tensions
  - greater claims to natural resources
  - reversal of trends, or mere cyclical progression?

# Mitigating Political Risk

- **Stabilization and Freezing clauses**
- **Allocation of risk clauses (an indemnity for governmental measures)**
- **Adaptation clauses (right to renegotiate)**
- **Political risk insurance**
- **Other contractual solutions**

# Quick Summary

- Political risk remains a critical factor to be considered by investors
- Political risk cannot be avoided entirely and many times leads to changes in the fiscal regime
- Structuring of mitigation strategies is of particular importance
- Resource nationalism may well be subject to a cycle

# Quick Summary

- Hostility towards investment often gives way to periods of investor friendliness, and vice-versa
- Mitigation strategies reduce risk, but do not eradicate it
- Flexibility, adaptability and a long-term view are essential for maintaining successful engagement with host states