

Paper 42 (abstract only)

Title:	Applying the Institutional Economics to Understand the Transaction- Costs in Oil Exploration Agreements: a Brazilian case study
Author keywords:	Concession/Taxes Agreements Production Sharing Contracts Qualitative methodology Contratual analysis Transaction Cost Economics
Abstract:	<p>Introduction: The oil industry has developed very complex contractual schemes mainly since the mid-1960s. Over more than 40 years two major contractual traditions have dominated the oil scene, almost splitting the world in two major contractual cultures based on Concession/Taxes Agreements (CTAs) and Production Sharing Contracts (PSCs) (Smith and Dzienkowski 1989). For each nation, the choice between CTAs or PSCs is explained by historical reasons, the existing institutional environment as well as by the goals the government aims to achieve. This paper adopts the theoretical elements from the New Institutional Economics (NIE) to explain how the contractual governance of oil activities is related to economics (Williamson 1996). The authors are particularly concerned with the Transaction Cost Economics (TCE).² The TCE shows how contracting is costly for the involved parties – the host government and the investors.</p> <p>Methodology: The method was qualitative and based on the TCE parameters (i) the uncertainty; (ii) the frequency with which the transactions occur; and (iii) the degree to which durable transaction- specific investments are incurred. In the current analysis about the uncertainty parameter, the focus concentrated on two questions: Are there provisions in the Brazilian CTAs that would increase the political risk?; And what are the safeguards in the Brazilian CTAs that would reduce political risk? Regarding frequency parameter, we asked this question: have been held Annual Biddings? On specific investments: Which provisions prescribe the long term relationship on investments?</p> <p>Results and discussion:</p> <p>The Brazilian concession agreement includes many provisions about ANP's sole discretion. Also, national and public interest expressions can be found. From the investors' point of view, these provisions create higher political risk because the open meaning from these expressions could justify arbitrary decisions. The transactions costs are increased, creating more costs and less profit for the company. ANP's budgets are defined by article 15 of the Petroleum Law which seems to guarantee that its decisions are independent. It appears that the political and regulatory risks, as well as the transactions costs are minimised. Regarding frequency parameter, with the Annual Biddings, the ANP maintains the regularity and the credibility of its relationship with the petroleum companies in the market place. Moreover, the concession agreement has many provisions that create a continuing relationship between ANP and the concessionaire, which results from ANP's inspection role. On specific investment parameters, petroleum production is characterized as a capital intense industry, and the concessionaire is liable for the costs and risk of the petroleum operations, including the specific assets and information for performing its activities. According to the Brazilian concession agreement, the concessionaire must make its investment in each phase under the ANP inspection. The concessionaire must demonstrate financial guarantees to perform the Minimum Exploratory Program, such as irrevocable letters of credit, insurance- guarantee, mortgage agreement, and Oil Pledge Agreement. Besides the Work Exploratory Program, more provisions about the specific investments are included in the concession agreement, such as the obligation of the Development Plan, the Local Content Clause, The Relinquishment, and the Inactivation and Abandonment Program.</p> <p>Conclusion:</p> <p>The concession agreement and the Petroleum Law were drafted in a specific and singular</p>

moment of the Brazilian history. The institutional changes were a significant step to increasing investments and attracting both international and national oil companies. Key changes were the transfer of the produced petroleum ownership from the government to the concessionaire and allowing more investor control over exploration, development, and production operations.

Nevertheless, it is important to stress that the concession agreement and the Petroleum Law include provisions that seem to create political risk and ex post transactions costs. The non-existence of clear standards for ANP's regulatory decisions and the presence of vague expressions of the oil field standards and public interest are prime examples.

The amendment clauses of the concession agreement make a trade-off between higher ex post transactions costs and flexibility, which create a comfortable environment for the concessionaire to perform its operations.

From the investor's point of view, the concession agreement provides a 25 continuous relationship with ANP, the higher ex post costs of keeping ANP informed are compensated by the increase of credibility between the parties.

The ex post costs in the specific investments may be increased for the concessionaire by the local-content requirements. Because of the intensive investments, it is essential to create more guarantees that the investors' rights can not be violated by the government or by ANP. If the Brazilian Federal Government wishes that the country become an attractive option in the petroleum world the government must consider provisions to minimize political risk. The results could be improved by adding others parameters into the qualitative analysis, as well as a quantitative analysis from any econometric model could be done.

Also, the current paper could be extended with the governmental point of view and an analysis about the regulatory process in Brazil carried out by ANP.

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