



Revenue Sharing



IGAD Symposium

July 16, 2002

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Outline of Presentation

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- Key Considerations in Revenue Sharing Model Design
- Different Models of Revenue Assignment
- New Mechanisms for Revenue Management, Accounting and Transparency
- Best Practices Suitable for Sudan

Summary Points

- Sharing natural resource wealth – a persistent developing nation challenge
- Failure rate is high
- New models evolving to address problems of transparency and accountability
- Sudan will require a hybrid of modern systems
- Sudan can be the model of the future --or a target

Revenue Sharing Challenges

- Producing versus non-producing entitlements
- Concentration in one area (Russia, Columbia, Nigeria, Argentina)
- Creating a stable model
- Creating sustainable development

Why Most Revenue Sharing Models Fail

- Poor governance
- Ineffective development planning
- Failure to address local environmental degradation
- Corruption
- Excessive inequality leads to war, threat of secession and instability

Why Developed Nations Succeed

- Transparency
- Accountability
- Agreed expenditure goals
- Sound macroeconomic planning

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Traditional Models of Revenue Sharing

- Centralized

- Central revenue collection with subnational entities receiving a fixed percentage formula or agreed share of a national program of expenditure

- Decentralized

- Delegation of right to collect certain production taxes to subnational producing and transporting entities
- Reservation of other taxes and earnings to central government

- Hybrid Systems

New Models of Revenue Sharing

- New mechanisms for oil revenue monitoring, revenue management and oversight of national development programs
- International financial institution (IFI) oversight
- IFI Auditing
- Stabilization and Future Generation Funds

Key Considerations in Revenue Sharing System Design

- A coherent energy policy
 - Adopt coherent, competitive national policy for revenue generation and taxation to attract capital and avoid distortion
 - Agree if revenue will be generated from royalties, taxes, equity or in kind payment, or a combination
 - Coordinate national and local taxes (Bad example: Russia)
 - Agree on economic development obligations of international oil companies

Key Considerations in Revenue Sharing System Design

- Distributional Principles
 - Derivation
 - Population
 - Basic needs, unique historical circumstances
 - Caution: Inequality of distribution fosters political instability (Nigeria)

Key Considerations in Revenue Sharing System Design

- Compensation to producing area for costs of production
 - Costs come before profits
 - Environmental degradation and displacement
 - Infrastructure required for production (housing, roads, services)
 - Temporary influx of workers
 - Standards for producing areas parallel standards for nonproducing areas

Key Considerations in Revenue Sharing System Design

- National and Local Economic Stability
 - Central governments need adequate revenue to carry out agreed national functions
 - Subnational entities need stable income, insurance against resource price fluctuations – oil prices are uniquely volatile

Key Considerations in Revenue Sharing System Design

– Expenditure responsibility

- What does national government provide (national roads, water, defense, power grid)?
- What do state and local entities provide (local roads, education, social services)?
- Match expenditures with responsibility

Different Models of Revenue Assignment

– Share the Tax base

- Allow subnational entities to impose production, excise or other taxes on units of production (US, Canada, Russia) or collect equivalent in profit oil
- Revenue level can be capped at agreed level (cost of environment, infrastructure costs)
- Can be combined with system of tax revenue sharing
- Advantages: Security of revenue generation for locality; ease of administration

Different Models of Revenue Assignment

- Sharing the Tax Base -- Disadvantages:
 - Locality dependent on volatile source of revenue
 - State fiscal policies need to be coordinated with national macroeconomic policy (Argentina)
 - Can promote wasteful spending at local levels
 - Can promote beggar thy neighbor tax policies
 - Efficient taxes (rent resource taxes) can be too complex for subnational entities to administer

Different Models of Revenue Assignment

– Sharing Tax Revenue

- Most states are unitary and address distributional issues through national budget
- In centralized model the government collects and shares on agreed basis (Venezuela, Nigeria, Colombia)
- Advantages: Allows central government to manage equalization among states, within agreed limits; facilitates centralized revenue monitoring and management; enhances macroeconomic management

Different Models of Revenue Assignment

- Sharing Tax Revenue
 - Disadvantages: Difficulty of agreement on percentage allocation; reliance on central government respect for sharing agreement
- Unitary examples: Colombia, Ecuador, Indonesia post 2000; Kazakhstan
- Federal examples: Mexico, Nigeria, Russia, Venezuela, Australia, Brazil, Argentina, Canada

Different Models of Revenue Assignment

– Sharing Tax Revenue

- Sector Specific Examples: Columbia, Bolivia. Papua New Guinea, Italy
- In decentralized model (UAE) states collect revenues and share allocation with central government

– Hybrid Systems

– Sudan: Calculate equivalent in profit oil

Different Models of Revenue Assignment

- Equalization and Transfer
 - Subnational entities can trade revenue share for delivery of services by central government and transfer payments in times of low prices
 - Some countries allocate a percentage share to producing and transporting states, with balance shared with other states for minimum income/basic needs

Different Models of Revenue Sharing

- Equalization and Transfer
 - Some revenue sharing is vertical (central government distributes funds) other systems are horizontal (producing state distributes to other states)
 - Formulas are complex: can be tailored to ensure those with other resources or higher income do not disproportionately benefit

New Mechanisms for Revenue Management and Accounting

- Stabilization Funds
 - Reserve a percentage of income for national financial reserves and national emergencies
 - Examples: Azerbaijan, Norway, Kuwait (Reserve Fund)
- Intergenerational Funds: Save share of income for future generations (Alaska, Alberta, Kuwait)

New Mechanisms for Revenue Management and Accounting

- Key issues for Funds
 - Who manages? Who audits? Who decides disbursements?
- Key factors in success
 - 1) clear goals on what the fund objectives are
 - 2) transparency of operations
 - 3) fund management rules that guarantee accountability

Mechanisms for Transparency

- Public Budgeting and Accounting
 - Report oil company income publicly (Soros)
 - Report income to Subnational entities
- World Bank audit of revenue management (Angola)
- World Bank monitoring of national development spending (Chad-Cameroon)

Mechanisms for Transparency

- Examples
 - Angola World Bank Audit
 - Chad-Cameroon
- Angola
 - Public accounting of funds going in and out of sector
 - Can improve on Angolan system by agreement on depth of audit; obligation of all levels of government to cooperate

Mechanisms for Transparency

- Chad-Cameroon

- National Development Program; oversight committee, World Bank conditionality.
- Provides agreed program of national expenditures (Special Petroleum Revenues Account; Future Generations Fund; and procedures for asset allocation
- Created national oversight and monitoring institutions (Oil revenues Control and Monitoring Board)

Mechanisms for Transparency

- Chad-Cameroon

- Revenues deposited in offshore accounts and externally audited
- Can be improved on:
 - No sectoral, regional allocation plan
 - Committees need budgets and offices to function
 - Need enforcement mechanism or penalty for sovereign breach of agreement
 - Better agreement on rules of procedure for operation of oversight groups

Best Practices Suitable for Sudan

-- Expenditures

- Agree on production costs to be allocated to producing and transporting areas (environmental, infrastructure, transition costs)
- Agree on capital budget for national development projects (roads, power, ports) and special reconstruction needs
- Agree on economic development obligations of international oil companies -- associated gas and power?

Best Practices Suitable for Sudan - Expenditures

- Agree on operating budget for minimum standards for each citizen (education, clean water, health services)
 - Tie to realistic long term oil price; windfall profits go to capital budget or stabilization
- Agree on some reservation for macroeconomic stabilization
- Create development and stabilization funds, revenue sharing for equalization

Best Practices Suitable for Sudan

--Revenue Assignment

- Consider assessment on profit oil, collected directly by subnational entity, pay “production costs”
- Agree on fixed revenue percentage to be paid to subnational entities providing basic needs; adopt formula considering population and considering existing wealth and assets, to bring each citizen up to equal minimum standards
- Reserve balance of oil revenue for national development fund, stabilization fund
- Evaluate utility of intergenerational fund versus development

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Best Practices Suitable for Sudan -- Transparency and Accountability

- Consider creating national institutions to manage funds and make expenditure decisions; create detailed rules of procedure, including appointments
- Apply system to all resource development throughout country
- Agree on public budgeting and IMF/World Bank auditing of revenue management system at national and local levels

Conclusion

- Sudan can be a developing country model
- NGO attention to environment, democracy and transparency is here to stay
- Sustainable national plan will mobilize donor community
- IFI involvement essential to Sudan's development
- IFI involvement will require transparency and a national development plan
- Sudan will be the darling or a target