Revenue Sharing

IGAD Symposium
July 16, 2002
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Outline of Presentation

- Summary Points
- Revenue Sharing Challenges
- Why Most Revenue Sharing Models Fail
- Why Developed Nations Succeed
- Traditional Models of Revenue Sharing
- New Models of Revenue Sharing
- 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
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 polices 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
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