Natural Resource Governance Institute
Oil, gas and mining for development

Lessons from Global Evidence & Experience on Natural Resource Revenue Management & Implications for Ukraine

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The Natural Resource Governance Institute (NRGI)

Ideas

- Extractive Industry Transparency Initiative (EITI) and mandatory disclosure standards
- Resource Governance Index
- Natural Resource Charter
- Research: Contracts, tax regimes, revenue sharing, revenue management, local content, transparency and accountability

Technical Assistance

- Fiscal regimes and contracts (e.g., Ghana, Guinea, Mongolia, Sierra Leone)
- Revenue management and distribution (e.g., Canada, Ghana, Indonesia, Libya, Mongolia, Myanmar, Nigeria, Peru, Timor-Leste)

Capacity Building

- Parliamentary training program
- Training hubs (e.g., Oxford, CEU, regional)

Extractive Industries Transparency Initiative

NATURAL RESOURCE CHARTER

Outline

- **Challenges of managing non-renewable resource revenues**
- **International experiences (& Implications for Ukraine) of Natural Resource revenue management:**
  - **Macroeconomic frameworks**
  - **Sovereign wealth funds**
  - **State-owned company reform**
  - **Resource revenue sharing**
  - **Transparency & Accountability (& EITI)**

  -- Tax Reform & Anti-Corruption Considerations

Macroeconomic management: Why treat oil, gas and mineral revenues differently?

Oil, gas and mineral revenues:

1. Can represent large capital inflows
2. Are volatile and uncertain
3. Are finite
4. Are “free money” that are not directly tied to citizens

Results in specific challenges

Common tools and institutions used to manage and distribute natural resource revenues

- Policies and tools
  - Macroeconomic frameworks and fiscal rules
  - Revenue forecasting
  - Transfers to subnational entities
  - Budget planning
  - Monetary policy
- Institutions
  - Sovereign wealth funds
  - National oil or mining companies
  - Development banks

How resource dependent is Ukraine?

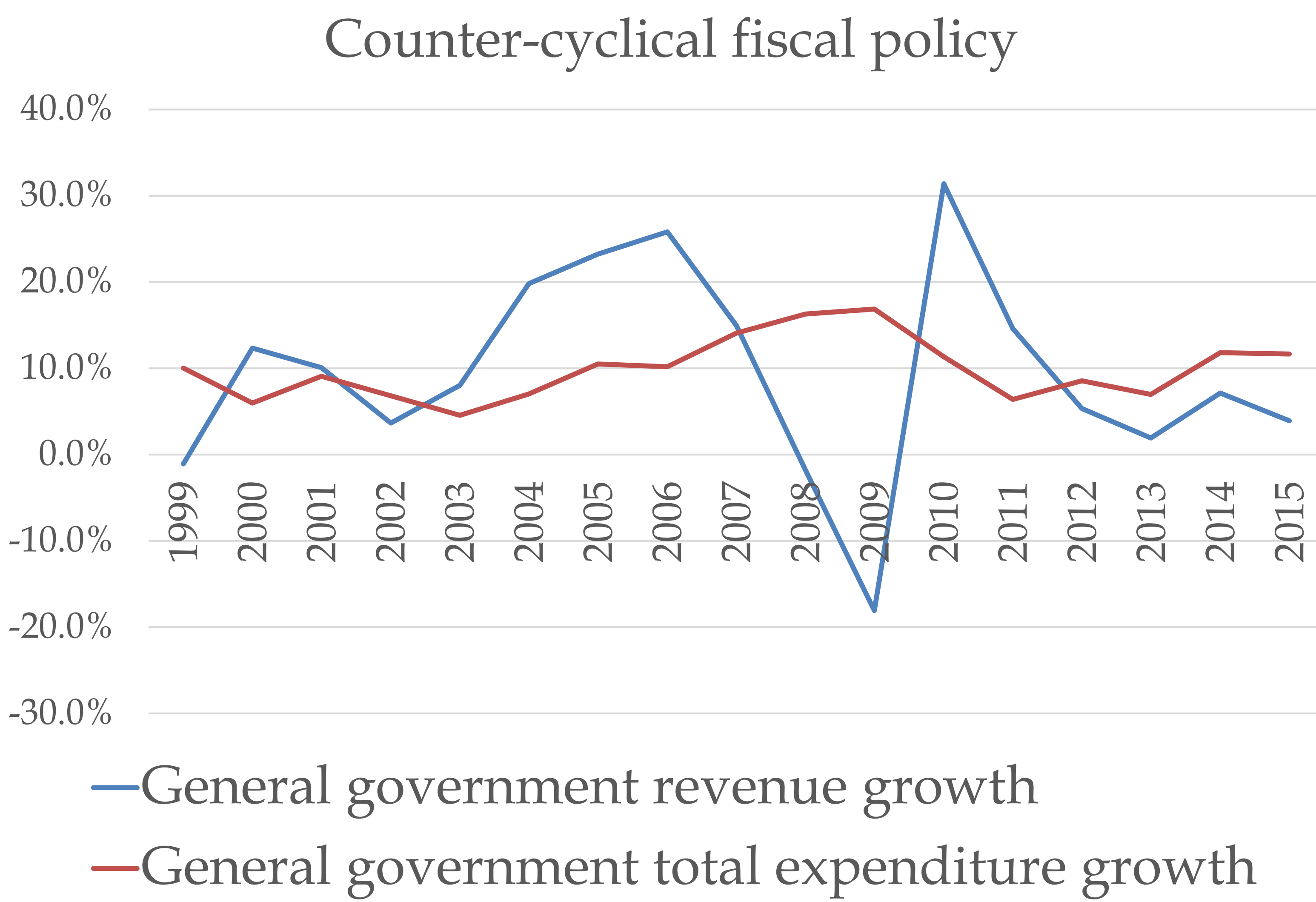
- Coal, iron ore, titanium ore, uranium and manganese ore producer, plus some gas production.
- Non-renewable resource rents represented approx. 7.7% of GDP in 2013.
- Gas transit revenues represented USD 2-4 billion per year from 2013-15 (5-15% of fiscal revenue).
- Minerals and fossil fuels represented 33.4% of exports in 2012.

Sources: World Bank; USGS; Eurasia Daily Monitor

Is expenditure volatility a problem in Ukraine?

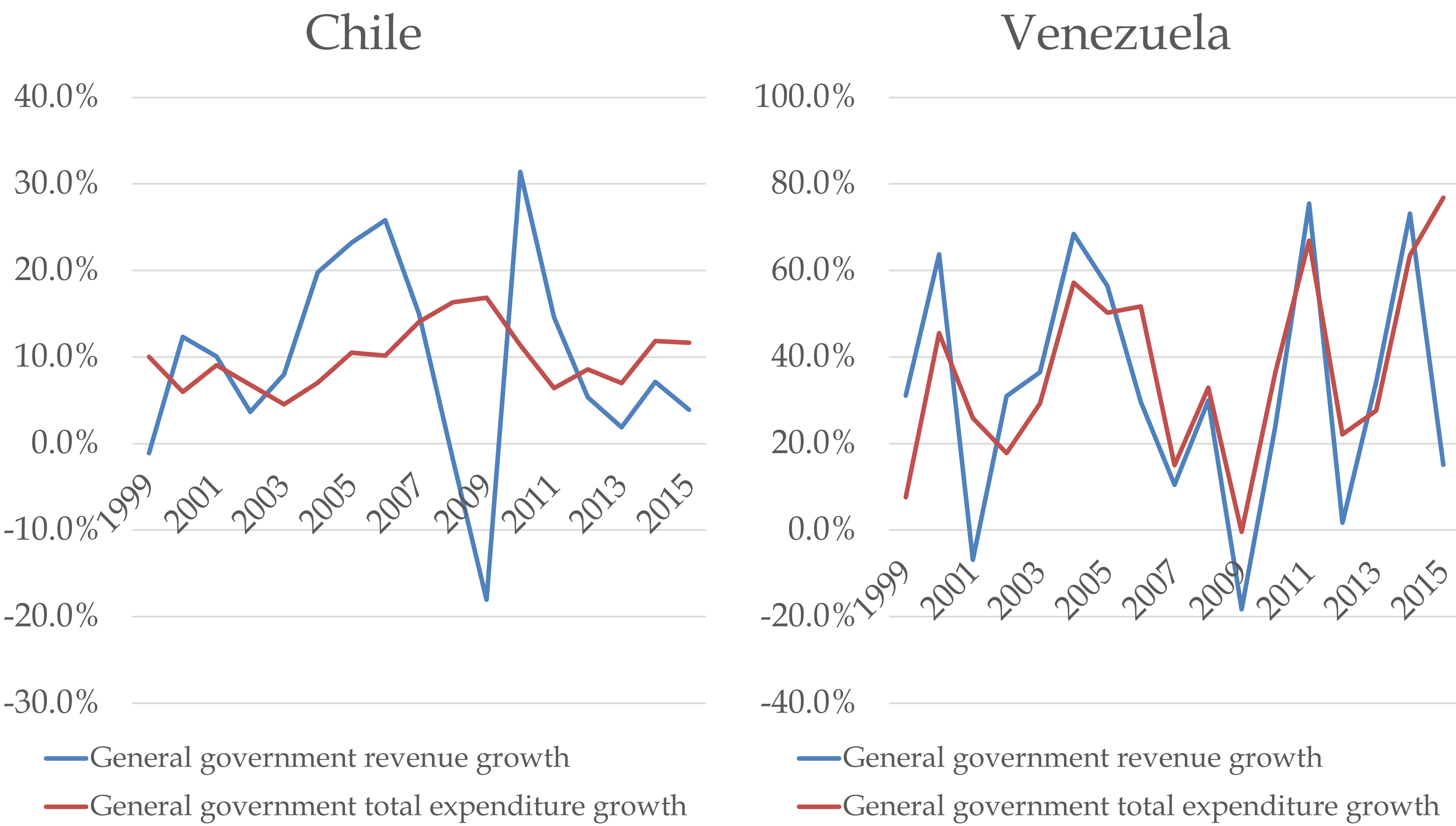
Data source: IMF WEO

Expenditure volatility in Chile



Data source: IMF WEO

Expenditure volatility in Chile and Venezuela



Data source: IMF WEO

What revenue management tools exist in Ukraine?

- Macro management: Annual deficit targets as part of IMF program; no fiscal rules
- National oil / mining companies: Large deficits and cash calls; off-budget borrowing (e.g., Naftogaz; Severgeologiya; Zaporozhye Titanium & Magnesium Complex (ZTMK))
- Subnational transfers: Existing fiscal decentralization, currently under review
- No sovereign wealth fund (ok for now)

Three questions following a discovery in extractives

1. How much resource revenue should we *spend* and how much should we *save*?
2. How should we *save*, by paying down public debt or in a sovereign wealth fund?
3. What mechanisms should we use to *spend* our resource revenues most efficiently?

What is a fiscal rule?

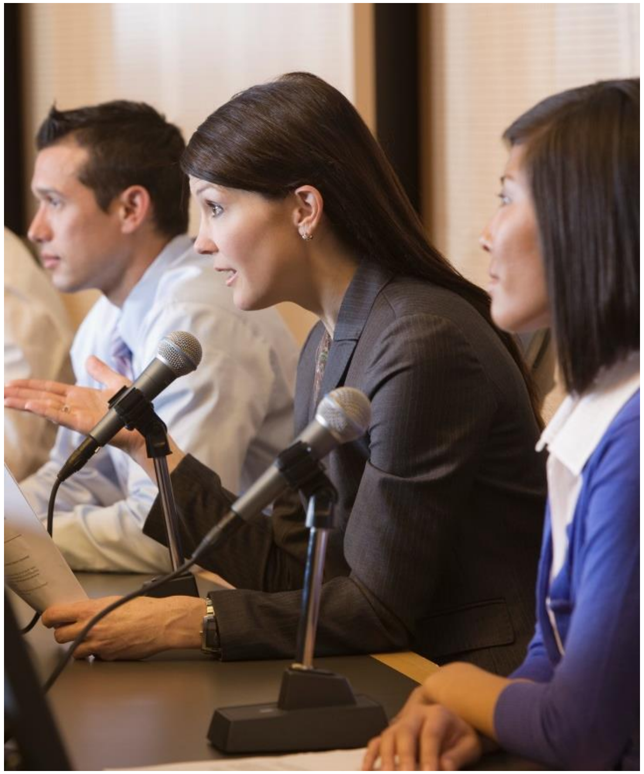
Definition: A permanent quantitative constraint on government finances

How do they work?

- Constrain spending in good years so the government can spend more in bad years
- Stronger monitoring of government budgeting since there is a benchmark to measure against

What mechanisms promote compliance?

- Robust organizational structure
  - Economic development ministry or agency
  - Compliance or audit within the bureaucracy
- External oversight
- Consensus building



Sovereign wealth funds: Help or hindrance?

Some have helped countries escape the "resource curse."

- Chile
- Norway
- Timor-Leste
- Some Persian Gulf states
- Several U.S. states

Others have been mismanaged, not met objectives or become slush funds.

Some in :

- Central Asia (e.g., Russia)
- Latin America (e.g., Venezuela)
- MENA (e.g., Libya)
- SE Asia (e.g., Malaysia)
- Africa (e.g., Equatorial Guinea)

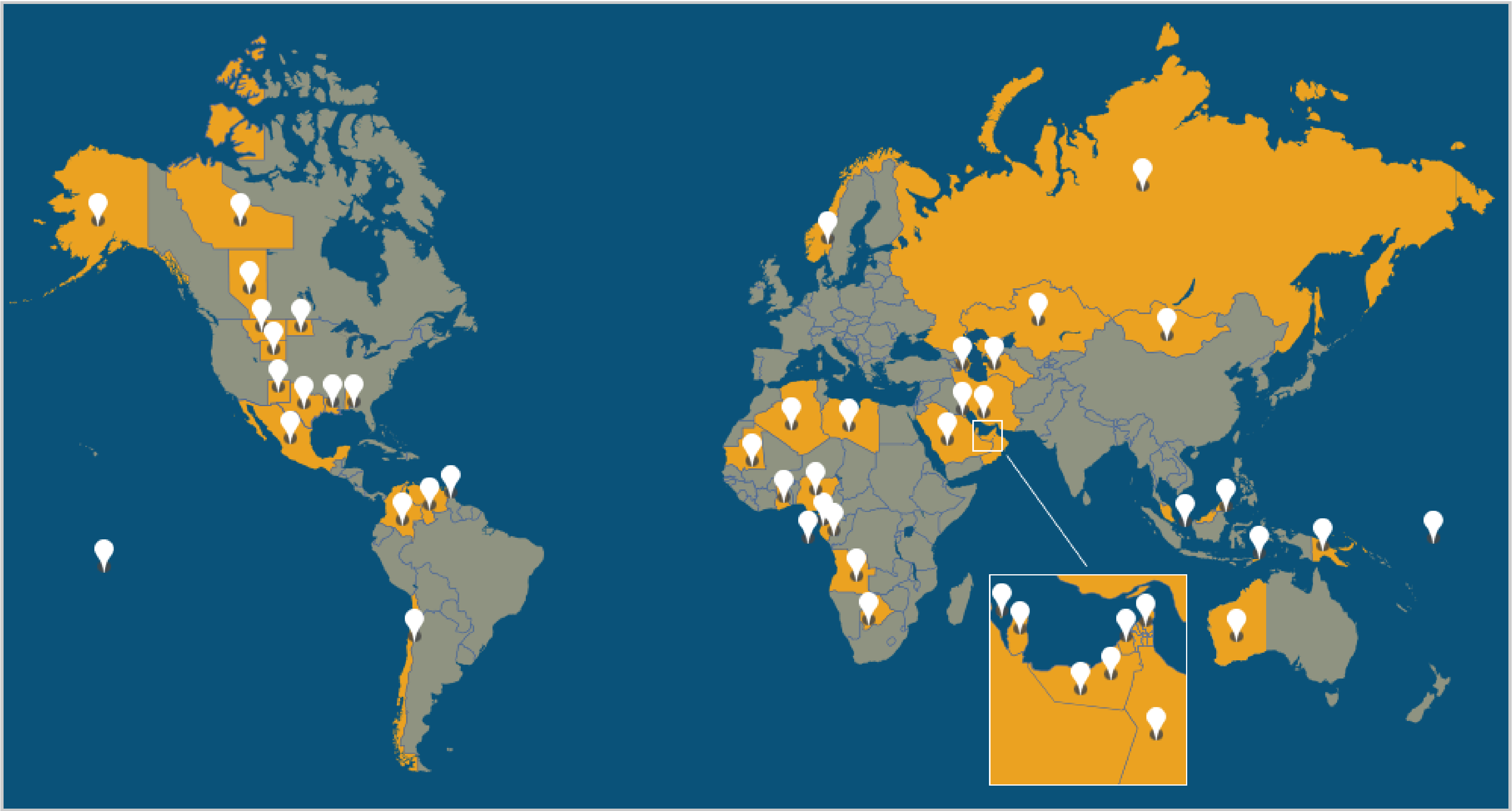
What has made the difference are the rules, institutions and oversight.

Good Governance of SWFs

1. Set clear fund objectives
2. Establish fiscal rules
3. Establish investment rules
4. Clarify good institutional structure
5. Require extensive disclosure and audit
6. Establish strong independent oversight

If Ukraine establishes a Sovereign Wealth Fund at some point…

- Stabilization objective is more important than savings
- Have clear deposit and withdrawal rules
- Limit investment risk in legislation
- Integrate with budget (no ‘off-budget’ funds)
- Require extensive disclosure and independent audit (& with EITI)



www.resourcegovernance.org/nrf

SWFs & SOEs & Subnational

- **SWFs: Not top priority now**

- **SOE reform & beyond: a key priority**

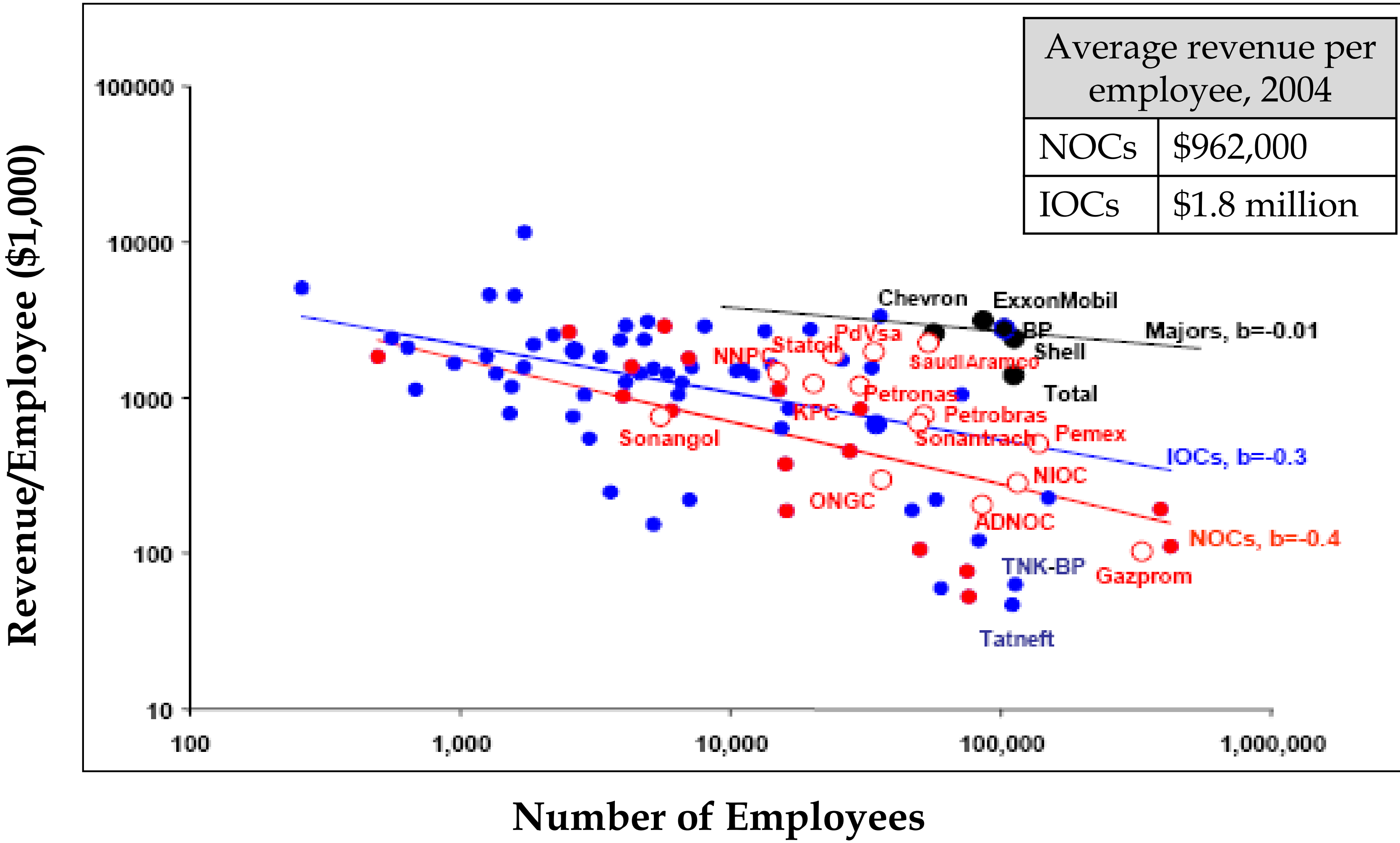
- **Subnational / Revenue Sharing: priority**

Benefits and risks of SOE participation

Some benefits that a country can gain from an SOE in NRs?

- **Development of national skills**
- **Long-term economic control and financial returns**
- **More effective state control over the pace and development of the industry**
- **Stimulator of local content and positive economic spillovers**

Inefficient project development and revenue collection



Average revenue per employee, 2004	
NOCs	$962,000
IOCs	$1.8 million

NOCs IOCs Majors

Source, Victor 2007

Extra-budgetary expenditure

$31 billion

SONANGOL

Financial risk to taxpayers

- Mexico
  - Pemex's $127 billion in unfunded pension liabilities; one third to be taken over by Mexican government
- Nigeria
  - "Cash calls" are a major drain on taxpayers ($7 billion in 2010)
  - Petrol subsidies cost $11 billion in 2008-09
  - Refineries lose hundreds of millions of dollars per year

Sources: The Economist; NRGI

Good Governance of SOEs

1. Define mandate clearly
2. Develop a workable revenue retention model
3. Publicly list SOE shares where feasible, allow private participation
4. Independent and professional boards
5. Invest in staff integrity and capacity
6. Audits, transparency and legislative oversight

Objectives of resource revenue sharing (subnational)

- **Compensation for the negative impacts from extraction**
- **Conflict mitigation and prevention**
- **Local claims for benefits based on idea of local ownership**
- **Regional income inequality between producing and non-producing regions**
- **Balancing Objectives**

Key points on resource revenue sharing

- **A** No 'best practice' in fiscal decentralization except for rules, transparency and oversight
- **B** Fiscal transfers should be linked to expenditure responsibilities
- **C** To reduce conflict and ensure stability, any specific allocation regime for oil, gas or mineral revenues should serve one or several nationally-agreed objectives

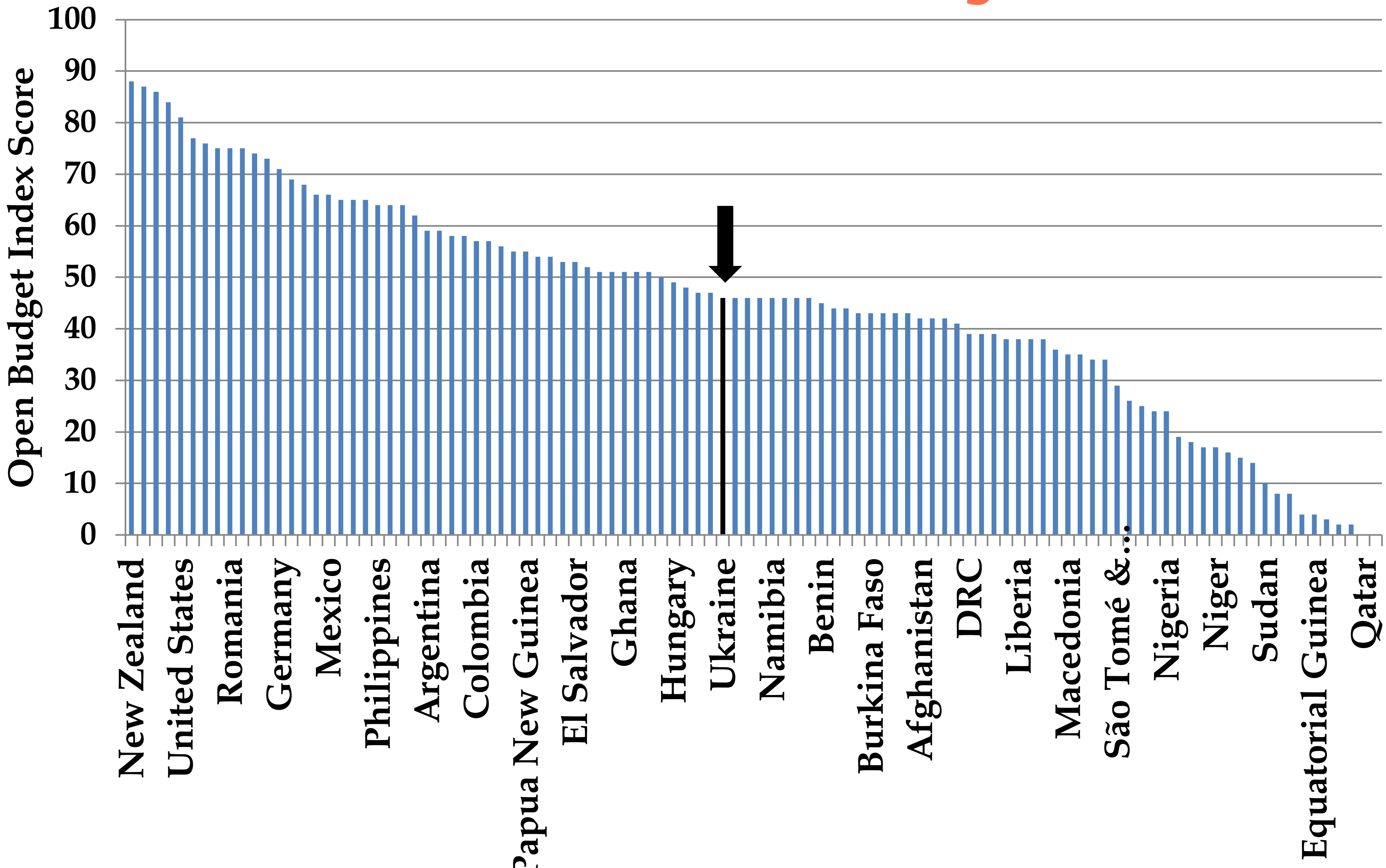
Complementary Reform Measures to Improve Revenue Management: 1. Tax Reform

- **Simplification of the Tax Code Regime**
- **Closing extensive tax loopholes**
- **Tax Rates consistent with major deficit reduction (*cannot be lowered now*)**
- **Reformed tax code for natural resources/gas, shifting form royalties to profit tax in gas: better incentives for investment (but ensure tax collection and No transfer pricing/tax loopholes)**

Complementary Reform Measures to Revenue Management: 2. Anti-corruption measures

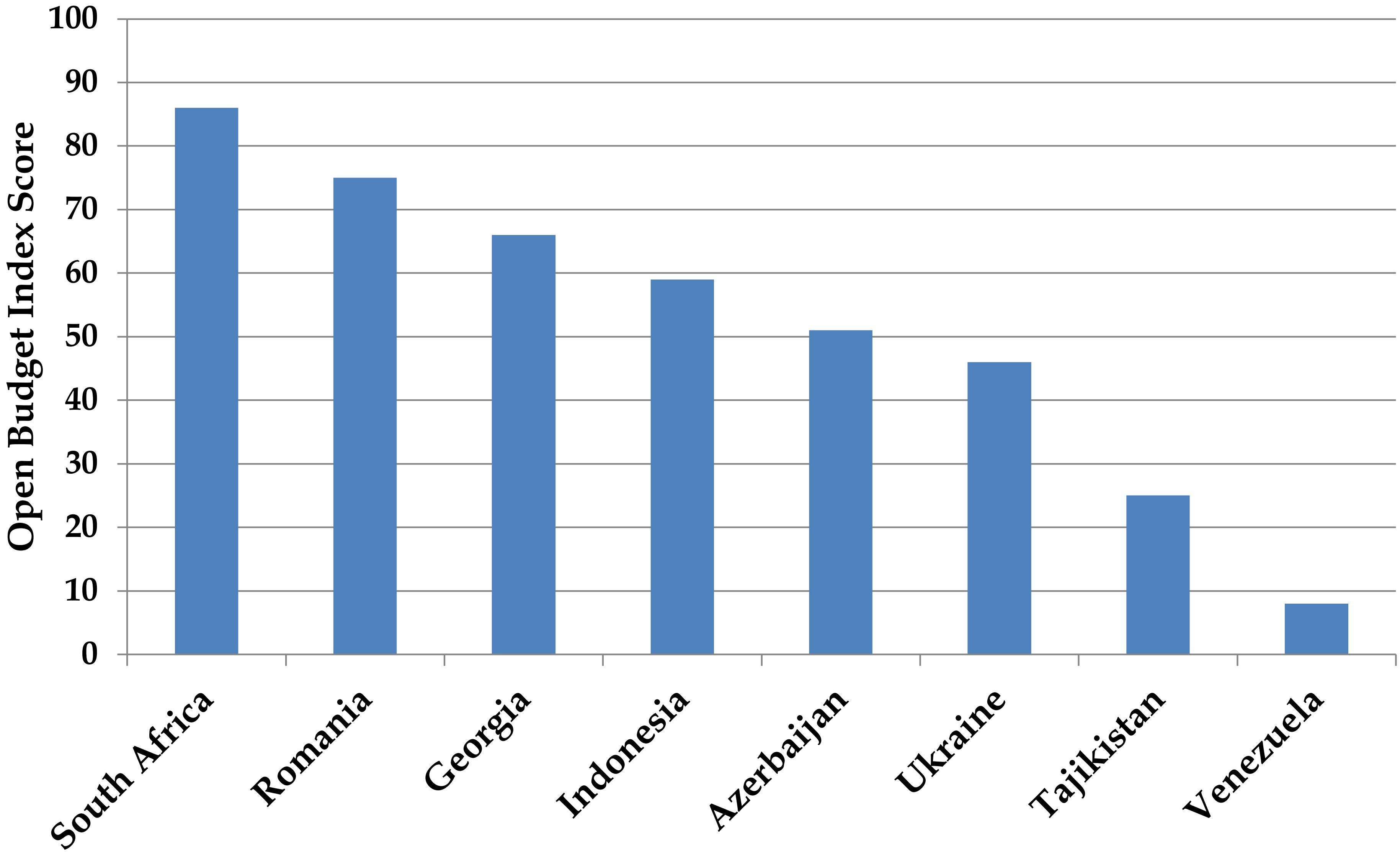
- Rules-based: i) budgeting; ii) project appraisals; ii) procurement, & iv) monitoring, for all budget expenditures (national & subnational) *and* SOEs
- Strong conflict of interest rules: *business out of gov't*
- Independent external audits for capital projects, special funds and state-owned enterprises
- Parliamentary oversight and independent boards of state-owned enterprises
- Transparency of all resource revenue flows – online and easy-to-read format -- & working towards Ukraine validation/compliance in EITI; Contracts/B.O

2015 Open Budget Index: Ukraine score: 46. It ranks 49th among 102 countries



Source: International Budget Partnership 2015 Open Budget Index, http://internationalbudget.org/opening-budgets/open-budget-initiative/open-budget-survey/

2015 Open Budget Index: Select Countries



Source: International Budget Partnership 2015 Open Budget Index, http://internationalbudget.org/opening-budgets/open-budget-initiative/open-budget-survey/

How good revenue management can reduce corruption

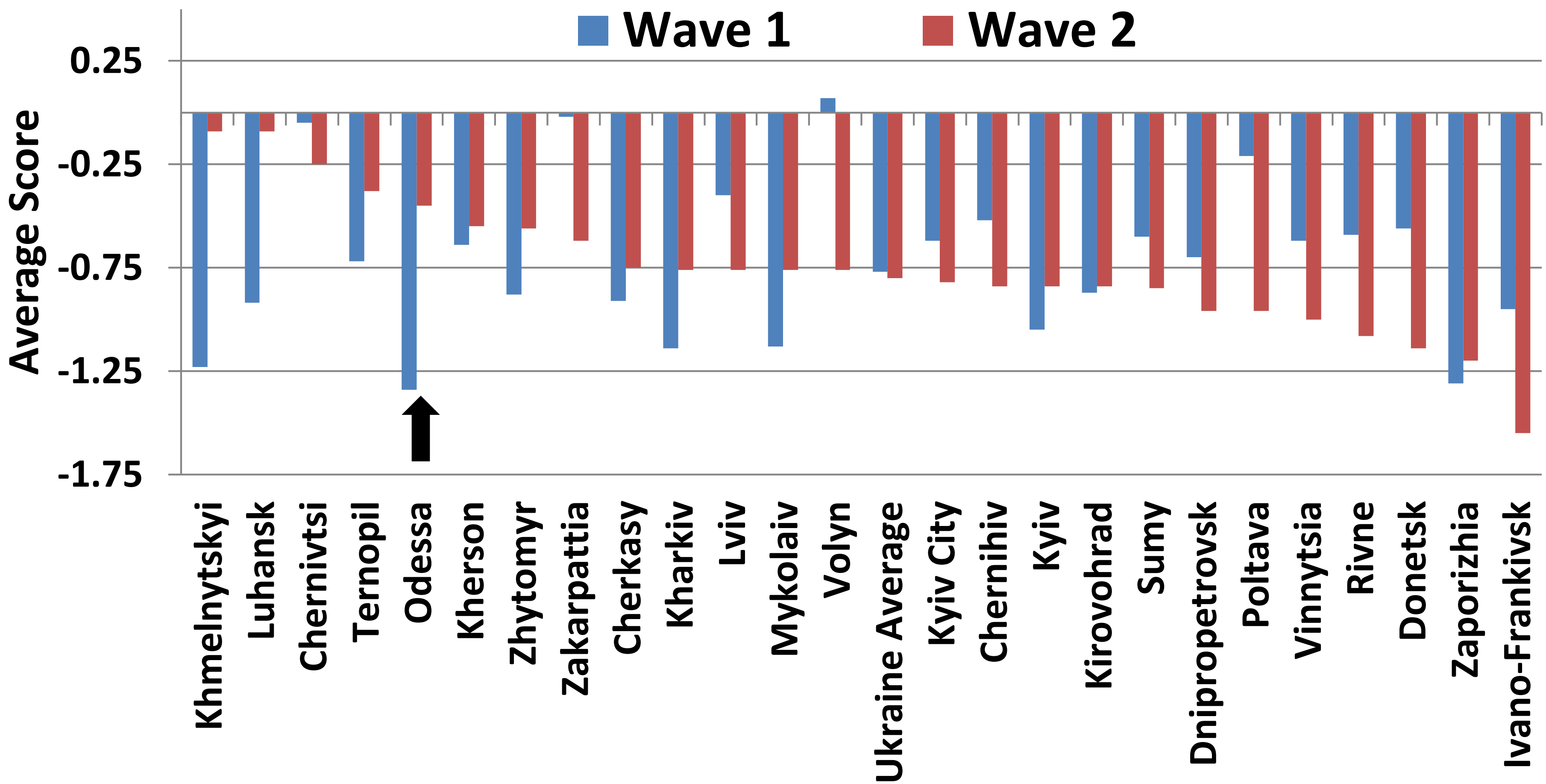
- **Smooth budget spending focuses government on social services rather than infrastructure projects, the largest sources of corruption**
- **Sovereign wealth funds can be huge sources of corruption, especially via asset allocation and patronage positions – strong rules on asset allocation and conflict of interest, along with transparency and independent oversight, can prevent mismanagement**
- **State-owned enterprises can also be huge sources of corruption, especially via procurement and patronage positions – strong financing and procurement rules, audits, independent boards, transparency and parliamentary oversight can help reduce incidences**

CONCLUDING: SIX PRIORITY AREAS

1. **Adoption of macroeconomic framework with rules to improve fiscal sustainability and lower budget volatility**
2. **Transparency and oversight of natural resource revenues (as key for effective revenue management) with EITI**
3. **Reforming State enterprises in extractives (independent boards, etc.)**
4. **Governance & Accountability in Subnational transfers**
5. **Tax Reform that simplifies, no loopholes, & improves fiscal sustainability**
6. **Effective implementation of Anti-corruption program with: i) support from the top; ii) tax reform; iii) subnational anticorruption; iv) civil society & accountability; & v) focus on enforcement: No impunity**

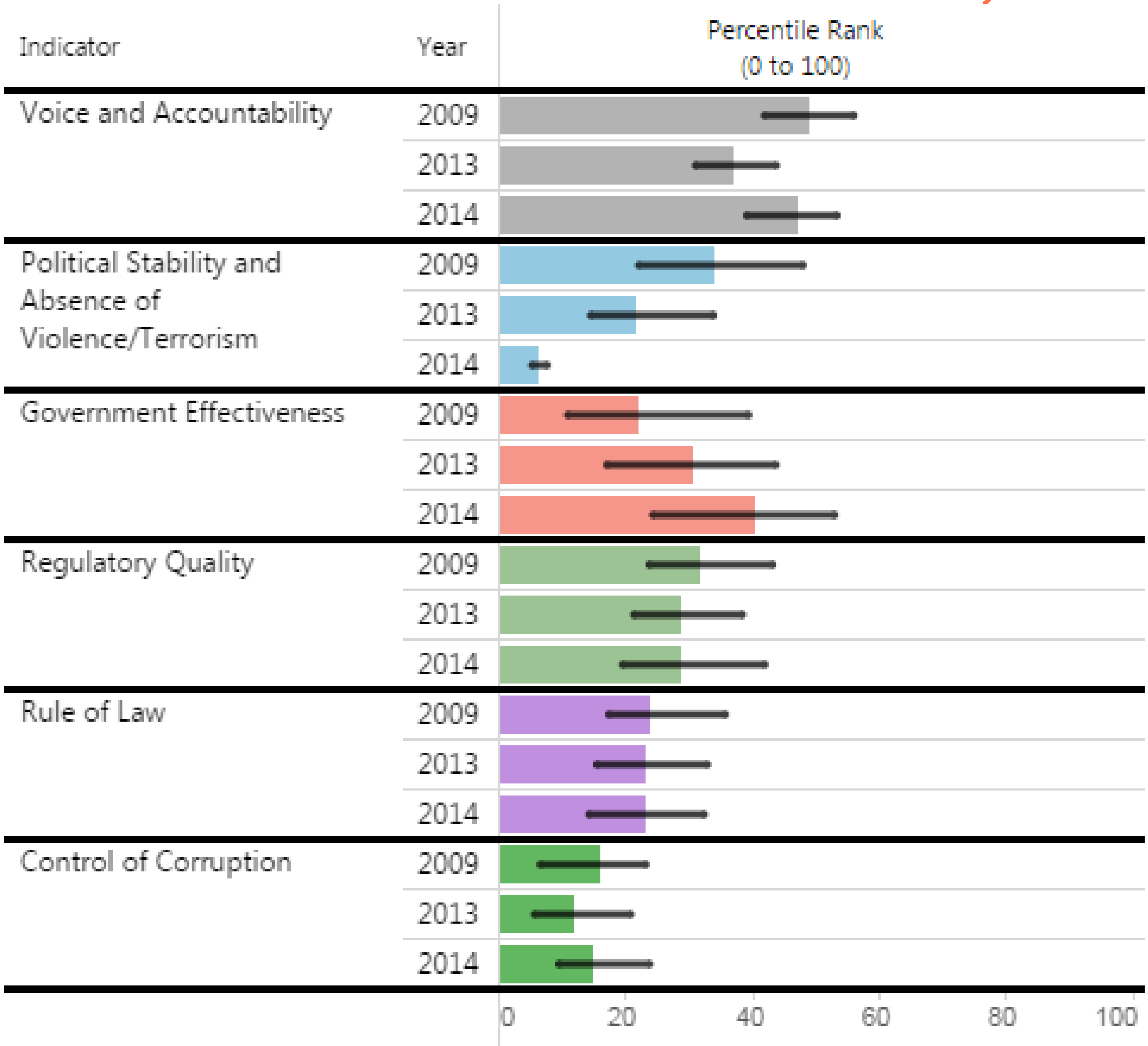
Perceived Trends in Corruption by Oblast (Early vs Late 2015): *Survey of Companies, Perceived Changes prior 6 months)*

[Source: TI, Gfk, PrvtBnk, PWC, see footnote, Preliminary chart]



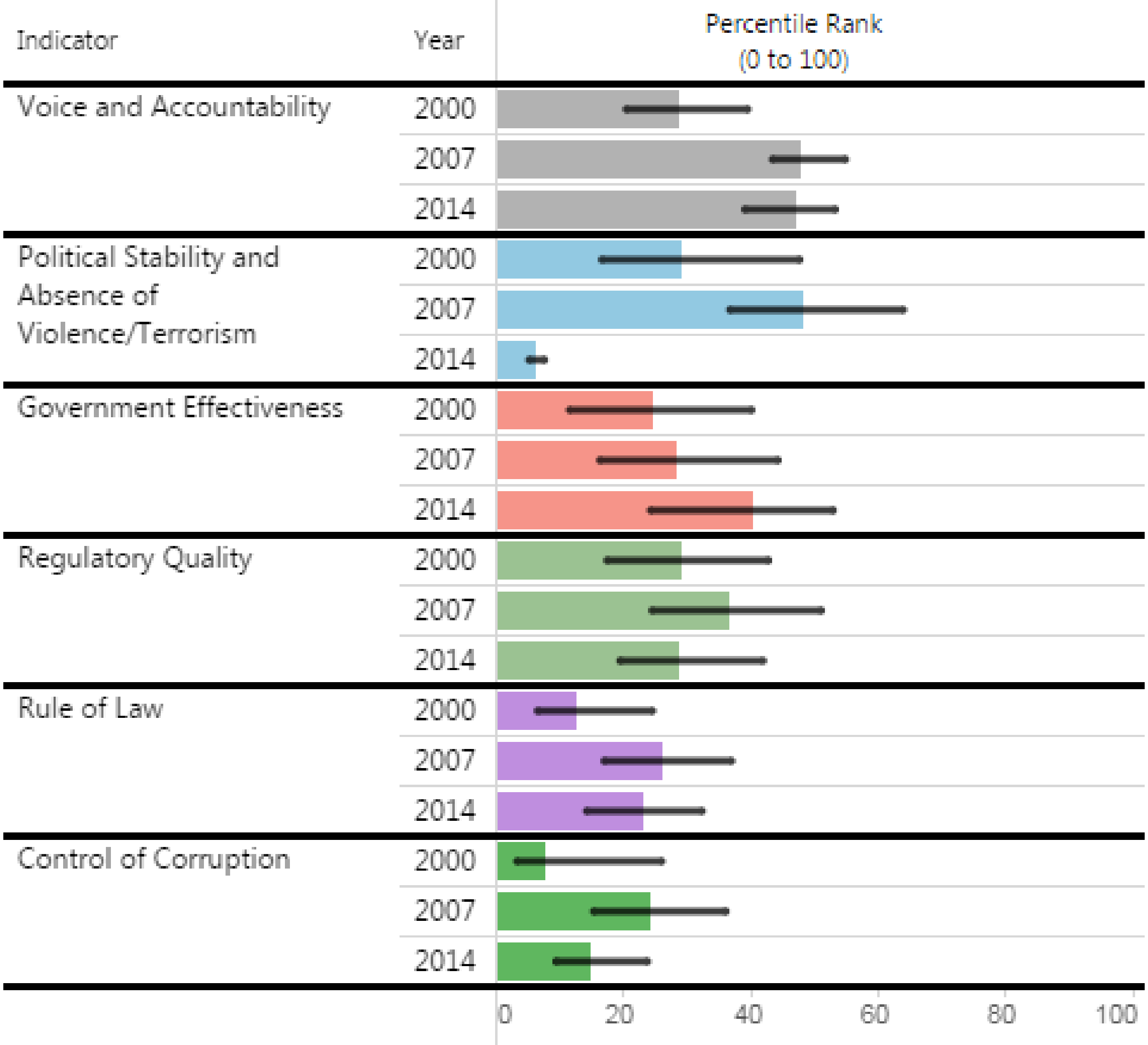
Note: Scale is from -5 to +5 where -5 is significant deterioration, +5 is significant improvement, and 0 is no change. Columns pointing downwards below zero means deterioration. Wave 1 conducted in early 2015 (?); Wave 2 in late summer 2015. Preliminary, cation in interpretation is warranted. Source: Transparency International, Gfk, Privatbank, and PricewaterhouseCoopers, survey of company directors (2471 respondents) http://www.corruption-index.org.ua/index_en.html

Ukraine Governance Indicators: 2009, 2013, 2014



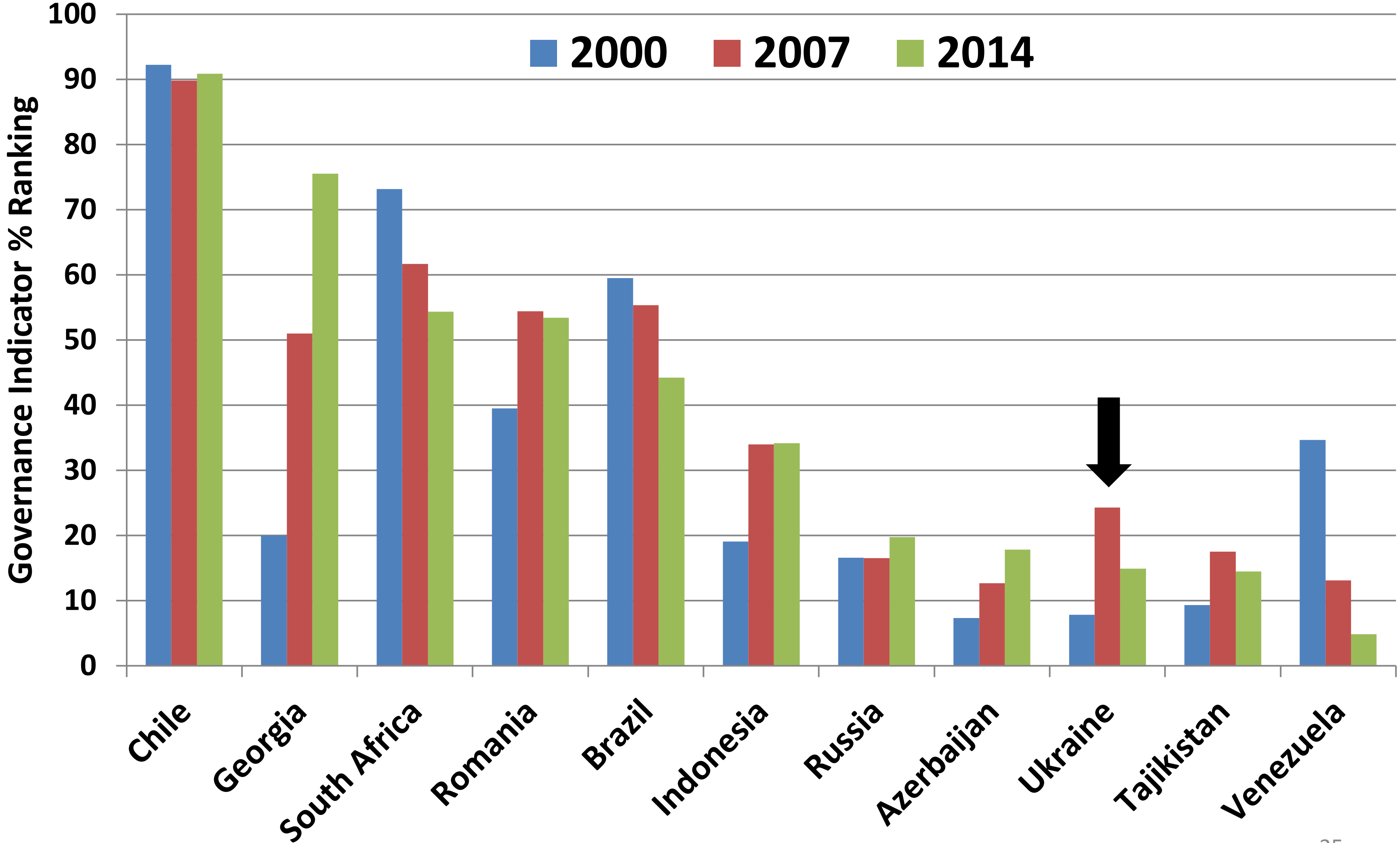
Source: Worldwide Governance Indicators, http://www.govindicators.org

Ukraine Governance Indicators: 2000, 2007, 2014



Source: Worldwide Governance Indicators, http://www.govindicators.org

Worldwide Governance Indicator Trends: Control of Corruption in Select Countries



Source: Worldwide Governance Indicators, http://www.govindicators.org Kaufmann, D. and A. Kraay

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Thank You!

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