Introduction to the Extractive Industries(EI)

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TABLE OF CONTENTS

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CHARACTERISTICS OF THE EI

Definition/scope: Extraction of non-renewable resources(WGEI,AFROSAI-E)

scope of non renewable resources vary **BUT** Oil, Gas and Minerals

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CHARACTERISTICS OF THE EI

- Long and costly exploration & development
- Geological Risk
- Substantial rents (Super profit)
- Exhaustibility of natural resources
- Volatile/Uncertain prices
- Significant environmental and social impacts

OPPORTUNITIES/CHALLENGES OF THE EI

Opportunities

- Boosting revenue, Economic development and growth
- Improved infrastructure
- Employment oportunities

Challenges

- Extractive resources are finite
- Resource curse
- Inequalities of income and social exclusion
- Environmental and social challenges
- Sustainable development challenge

POLITICAL ECONOMY OF EI

Natural resources shape and are shaped by political context

POLITICAL CONTEXT

NATURAL RESOURCE WEALTH

POLITICAL ECONOMY OF EI

How natural resources affect politics?

- Centralization of power
- Rise of politics of allocation
- Democracy discouraged
- Lines between public and private sector become blurred(State oil companies ownership)
- Weakening of institutions
- Affects domestic conflict
- Corruption trends

RESOURCE CURSE

Paradox

- Natural resource rich countries not performing well (economically & socially) compared to countries with out the resource.

“Rich BUT Poor”

- Examples Nigeria, Guniea,Mali
- ***Exceptions*** e.g Norway

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Possible causes of the resource curse

- Dutch disease effect: Tendency of economies ignoring other sectors and concentrating of the natural resources
- Revenue Volatility due to volatile prices of natural resource commodities (hinders long term planning)
- Politics (Weak institutions, corruption)
- Increase in public debt(borrowing against resources)

What can be done

Revenue management initiatives(petroleum funds,transparency initiatives)

Building strong institutions

INTRODUCTION TO FISCAL INSTRUMENTS

FISCAL REGIMES

- **Definition:**General frameworks used by Host Governments(HGs) to manage(generate revunue) natural resources

- **Dilema:Balancing** the need to maximise revenue and attracting investment/service

Main fiscal regimes

- Contract based system

- Concessionary/licence system

FISCAL REGIMES

Concessionary/licence

- Company provides the financing
- Company bears all risks
- Contractor owns the resource
- Contractor recieves all the Oil, Gas and minerals produced/extracted
  - Revenues (IOC/mining profits) petroleum profits) are taxed

- ***Common** in mining (there are exceptions like Philipines has Contract based mining PSC)*

Examples: Norway, Brazil, Egypt, Tunisia, Colombia, Ghana, Argentina

FISCAL REGIMES IN EI

Contract based

Production sharing system (PSA/PSC)

- Government & company sign an agreement that prescribes rules under which the company can explore and produce
- Economic risk on Contractor (Petroleum/mining Company)
- Resource belongs to the government till extraction when its shared
- Revenues (IOC petroleum profits) are taxed
- *Contractor owns a share of the resource once it is extracted:*

Afghanistan, Libya, Ghana, Indonesia, Libya, Uganda,Philipines

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FISCAL REGIMES IN EI

Contract Based

Technical service agreements

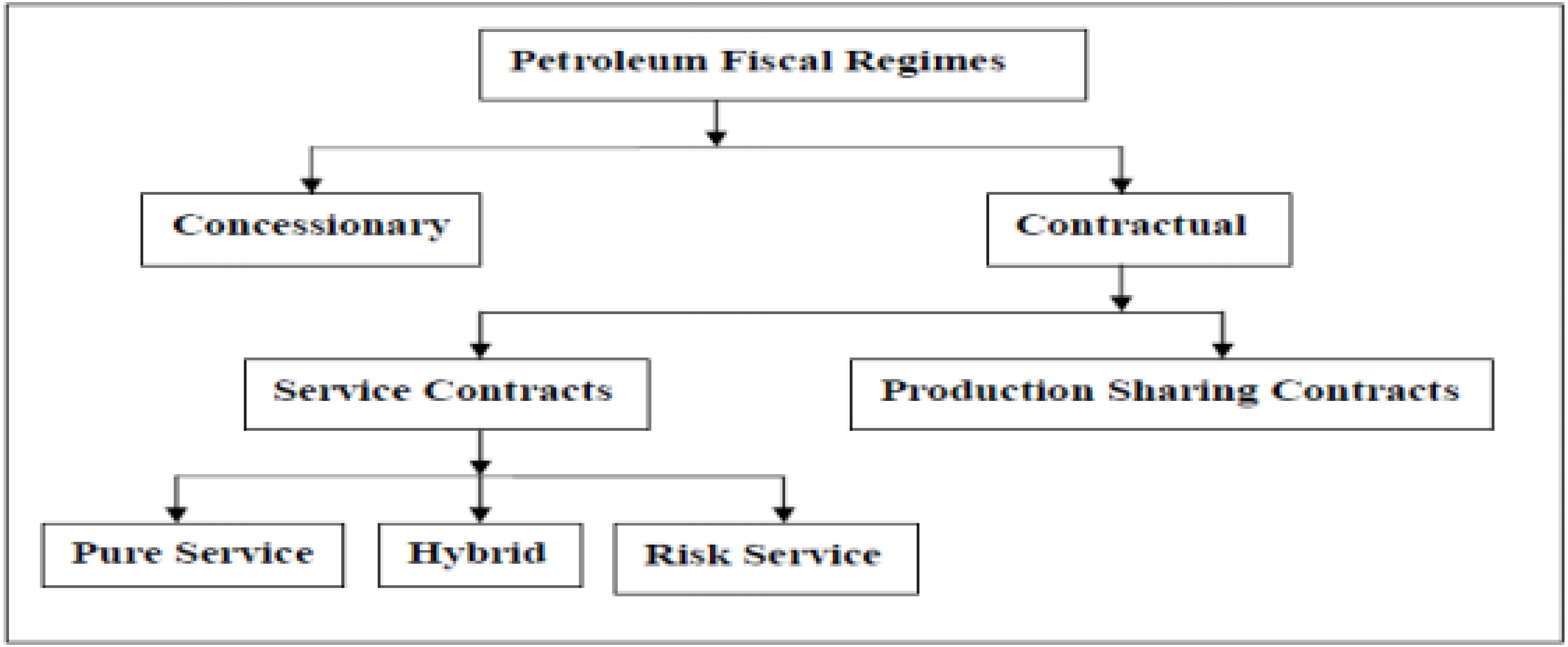
Risk Service: Company takes all risks of exploration and production and receives a cash fee per barrel of production from the HG

Pure service: Company is paid a flat fee for its expertise or service in exploration and production. HG bears all risks

Iraq, Bolivia, Peru, Mexico, Philipines,

- ➢ *Contract based systems are more common in petroleum*

Example of Fiscal regimes in petroleum



FISCAL INSTRUMENTS:

These are specific components in the regimes discussed

Bonuses:One off lumpsum payments trigerred by events(Signature Fee,discovery,Production bonus)

Royalty: payment for right to use anothers property.(on volume or value of extracted resource)

Production Sharing : Profit petroleum/profit minerals

surface rental: payment for use of land(for a particular period e.g annual)

State participation/joint venture: (Full equity/carried interest)

Domestic taxes(Income Tax/corporate Tax, , Value Added Tax Act, import duty, Capital gains tax etc)

Sustainable development clauses(Social investments/infrastructure, environmental conservation)

FISCAL INSTRUMENTS

Concessionary/licence

Government take mainly comes from;

- Tax
- Royalty

Contract based

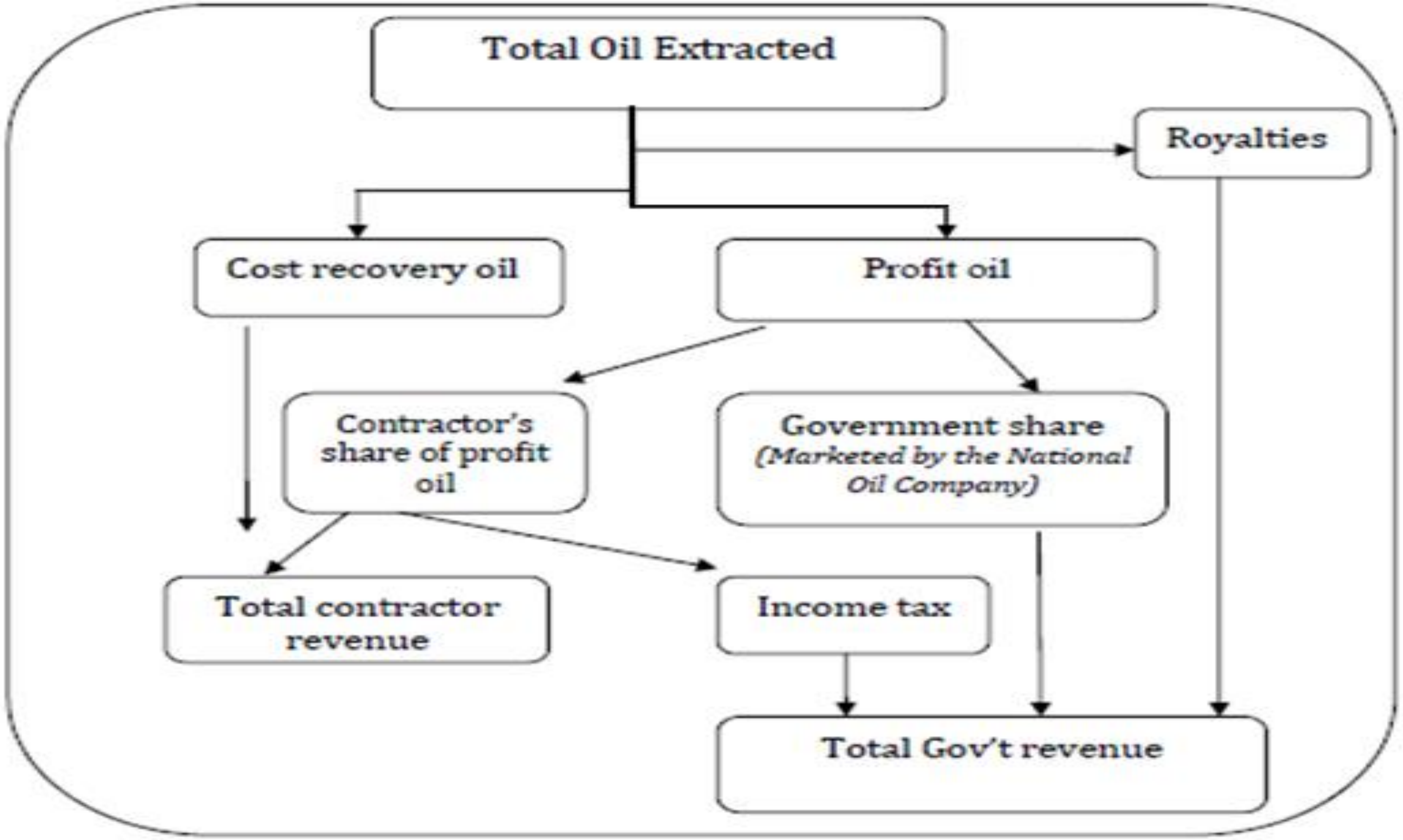
Production sharing agreements

- Bonus
- Royalty
- HG share
- Tax

Technical service contracts

- Tax on fees

Example of Uganda’s PSA



Top 50 Country Ranking for Total Hydrocarbon Resources

Production Sharing Agreements

Russia	Qatar	Iraq
Nigeria	China	Kazakhstan
Libya	Indonesia	Algeria
Azerbaijan	Turkmenistan	Malaysia
Angola	Oman	Egypt
Uzbekistan	India	Bolivia
Ukraine	Trinidad	Vietnam
Pakistan	Ecuador	Syria
Yemen	Sudan	Equatorial

Royalty Tax

Russia	Venezuela	UAE (Abu
Dhabi)		
Nigeria	USA	Kazakhstan
Algeria	Australia	Norway
Brazil	Canada	United
Kingdom		
Oman	Netherlands	Argentina

Upstream Service Contracts

Iran, Mexico, Iraq, Kuwait

Source: IHS & Wood McKenzie March 2010

Study carried out by Wood Mckenzi analyzing fiscal regimes in the top 50 petroleum countries

Observation

- A country can run more than one regime for the same resource

FISCAL INSTRUMENTS:

Attributes of a desirable Fiscal Regime

- Easy to administer(cost, complexity)
- Flexible(Respond to the varying conditions like profitability
- Stability: Change over a certain period of time or is changes are predictable
- Risk sharing

FISCAL INSTRUMENTS:

CONCLUSION

- There is no one size fits all
- Each of the above regimes and Instruments has pros and cons
- Should be applied specific to the country's prevailing conditions and circumstances e.g Stage of value chain the country is at, HG requirement(capital or expertise)

As Auditors;

Need to understand the fiscal regimes of EI in our countries

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