Introduction to the Extractive Industries (EI)

By Juliet Stella Mutesi
At International Training on Audit of Extractive Industries
<table>
<thead>
<tr>
<th></th>
<th>TABLE OF CONTENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CHARACTERISTICS OF THE EI</td>
</tr>
<tr>
<td>2</td>
<td>OPPORTUNITIES/CHALLENGES OF THE EI</td>
</tr>
<tr>
<td>3</td>
<td>POLITICAL ECONOMY OF THE EI</td>
</tr>
<tr>
<td>4</td>
<td>RESOURCE CURSE PARADOX</td>
</tr>
<tr>
<td>5</td>
<td>INTRODUCTION TO FISCAL INSTRUMENTS</td>
</tr>
</tbody>
</table>
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
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 opportunities

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, Guinea, Mali

• Exceptions e.g Norway
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 (HG) to manage (generate revenue) natural resources

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

**Main fiscal regimes**
- Contract based system
- Concessionary/licence system
Concessionary/licence

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

- Common in mining (there are exceptions like Philippines 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, Philippines*
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, Philippines,*

- *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 triggered 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
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

<table>
<thead>
<tr>
<th>Production Sharing Agreements</th>
<th>Russia</th>
<th>Qatar</th>
<th>Iraq</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>China</td>
<td>Kazakhstan</td>
<td></td>
</tr>
<tr>
<td>Libya</td>
<td>Indonesia</td>
<td>Algeria</td>
<td></td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>Turkmenistan</td>
<td>Malaysia</td>
<td></td>
</tr>
<tr>
<td>Angola</td>
<td>Oman</td>
<td>Egypt</td>
<td></td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>India</td>
<td>Bolivia</td>
<td></td>
</tr>
<tr>
<td>Ukraine</td>
<td>Trinidad</td>
<td>Vietnam</td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td>Ecuador</td>
<td>Syria</td>
<td></td>
</tr>
<tr>
<td>Yemen</td>
<td>Sudan</td>
<td>Equatorial</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Royalty Tax</th>
<th>Russia</th>
<th>Venezuela</th>
<th>UAE (Abu Dhabi)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>USA</td>
<td>Kazakhstan</td>
<td></td>
</tr>
<tr>
<td>Algeria</td>
<td>Australia</td>
<td>Norway</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>Canada</td>
<td>United Kingdom</td>
<td></td>
</tr>
<tr>
<td>Oman</td>
<td>Netherlands</td>
<td>Argentina</td>
<td></td>
</tr>
<tr>
<td>Ukraine</td>
<td>Pakistan</td>
<td>Thailand</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Upstream Service Contracts</th>
<th>Iran, Mexico, Iraq, Kuwait</th>
</tr>
</thead>
</table>

Source: IHS & Wood McKenzie March 2010
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
GET IN TOUCH

The Office of the Auditor General.
Apollo Kagwa Road,
Plot 2C, Kampala

+256 0417 336 000

info@oag.go.ug

http://www.oag.go.ug
GET IN TOUCH

www.wgei.org  wgei@oag.go.ug  @IntosaiWgei

https://www.intosaicommunity.net/wgei/