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Oil Rents Management and Distribution In the Global South

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ABSTRACT
This paper investigates fiscal policy options and regulatory framework for harnessing resource rents from the oil industry. The aim is to demonstrate that for the nations of Global South to benefit from oil industry they have to adopt mechanisms of progressive extractive rents regime, better policies for oil resource funds, and regulation and proper control of state-owned enterprises. This has been a demanding task for the nations of the South due to weak pre-existing institutions, lack of implementation of fiscal rules and lack of political good will. Through a review of the literature, this paper concludes that developing states should focus on crafting country-fit fiscal policy decisions in revenue management, ensuring transparency and accountability in the institutions that convert the oil rents to sustainable development outcomes.

Keywords: Management, Fiscal, Oil, Revenue

INTRODUCTION

There is an uneven distribution of non-renewable natural resources on earth. They are placed on different poles of the earth crust haphazardly, and this random spread results in unequal distribution. These resources are part of a massive wealth of many economies, and their management can have either positive or negative impacts on the social, political, and economic development of a country. Oil is some of the unique underground assets that are subject to volatility, exhaustibility and large enough to cause economic damage if not well managed. According to the resource development experts like Collier and Sachs, the impact of these resources have far-reaching consequences on the economic growth and development of nations in the Global South (Collier & Venables, 2011; Soros, 2007). Too often, resource-extensive countries in the developing countries have been unproductive in exploiting the transformative value of own natural resources. These resources generate streams of revenues; as a consequence, there is a need to manage and distribute them in a different way from other categories of revenue regime.

Collier (2013) points out that many past resource booms in developing countries had left the economy in an almost worse situation than before the discovery. Bilal (2013) adds that adverse effects of resources in these nations have been due to poor governance and weak institutional arrangements. Bilal contends that (mis)management of income streams from natural resources plays a vital role in determining whether the rents can yield riches or it can turn out to be a 'curse'. It is therefore of requisite to understand the national context as well as international factors that tended to reinforce these adverse propensities. Stiglitz, Sachs, and Humphreys (2007) explored that countries with a large endowment of natural resource tend to perform poorly than non-resource nations. Paradoxically, such capability often hinders development outcomes. On the contrary, economies with fewer resources have achieved sustainable development. The East Asian Tigers like Taiwan and Singapore has had rapid growth economic growth based on booming export of manufacturing sectors. (Ibid)

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The study proceeds as follows. It first situates the theme of extractive sector in the South in the existing literature. The paper then delves much more into the fiscal policy arena and regulatory framework for harnessing revenue into sustainable development. Finally, it offers some reflection on oil revenues, drawing on general conclusions about the significance of good policy responses and regulatory arrangement in enabling sustainable resource use in developing countries.

METHODOLOGY

This is desk-based research. This study is based on the review of relevant literature on government official documents, organizational documents like World Bank, academic and non-academic articles, gray documents and other studies in the region on oil and gas revenue management, institutional and fiscal regimes across the globe.

Review of extractive industry in the Global South

The Global South, the emerging economies of Third World (Africa, Latin America and the developing countries in Asia) is known for its endowment with abundant sub-soil resources, which can be a multiplier to its domestic economy and consumption at the global scale. Extractive sectors are those sectors that deal with exploration and extraction of exhaustible sub-soil assets in oil, gas and mineral ores sector. For instance, 66% of minerals used in electronic industry originate from Africa, and over 50% of worldwide production of coal comes from Latin America. Additionally, Asia hosts more than 33% of global mineral ores used in steel and energy industries (Besada, Lisk, & Martin, 2015). Intuitively, these resources provide for broad-based and long-term sustainable development for the country. Tapping these benefits has been a dilemma for many countries in the Global South.

Unlike the countries in the Global North like Norway and Canada, which have made tremendous use of revenue from its oil or other resources, Global South countries have suffered from what economists call 'resource curse', a situation where the resource flow into the economy hinders growth and development. The nature of resource extraction regime causes this disparity. The regulatory framework for resource extraction in the developing countries is formulated to serve the interest of the multinational companies working on the extractive sector and a section of elites instead of providing employment and welfare for the citizens (Campbell, 2009)

THE OBJECTIVE OF THE STUDY

The policy paper aims to assess fiscal policy options and regulatory frameworks in the management and distribution of oil rents in the Global South.

The oil industry is few policy-making arenas in the economy in which a country can yield maximum return from good decision-making and disastrous consequences for poor decisions. Amid these choices states make is the design of tax regime. As discussed by Collier and Venables (2011) a well-designed taxation regime is suitable for the investor and the state due to the nature of changing prices of oil in the international market and depletion properties of oil or/and discoveries made.

FISCAL REGIME DESIGN

Oil sector provides many benefits to the population through employment, revenue extraction to local content. Taxing resource wealth is an uphill task for the resource-dependent countries of the Global South. The process of revenue extraction starts at exploration and allocation stage of the resource value chain. Realising these rents requires well-designed fiscal regime that needs to incorporate government capacity, information between government and potential

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investor and unpredictability in the oil industry. The choice of the fiscal system requires administrative arrangement and scrutiny on the entity of the government entitled to manage the wealth, Mayorga Alba (2009) and understanding of the political economy of the country (Barma, Kaiser, & Le, 2012). At the exploration phase of EI value chain, petroleum laws as defined in other countries state the nature of the specific commercial terms in contracts regarding the division of revenue. All income streams and payments like taxes, royalties and bonuses must be adequately accounted for by the regulating state entity. The sale of oil products follows clear and arms-length procedures as stipulated in the sectoral law or as indicated in the contract law to ensure efficient management of the resource earnings.

According to Natural Resource Charter, Daniel, Keen, and McPherson (2010), fiscal regime is a set of instruments that stipulates how the state and the investor share the rent flow from oil sector. These budgetary tools include royalties, dividend, corporate taxes, bonus, resource rent tax and surface rents payments. The state may have its preference of the fiscal rule, but they also need to put the interest of the investor into account. The volatility nature of oil earnings calls for the establishment of stable financial policies and development of spending plans (Sy, Arezki, & Gylfason, 2011). In a nutshell, the design of fiscal regime should consider both the government take as well as investors take.

REVENUE COLLECTION

The ability of the state to efficiently collect rents depends on the choice of fiscal regime, the capacity of the institution delegated to capture the revenues and compliance to the internationally accepted framework of accounting. Mayorga Alba (2009), demonstrates that verification of information on the volume of oil produced, export market prices and the amount received by the seller will help in the compliance of international standard procedures, which are unique to EI. This regulation simplifies resource rent assessment and curbs gross misinterpretation by bureaucrats. Bearing in mind that these resources are volatile, exhaustible and that resource extraction implies depletion in the long-run, the government need to have distinct revenue collection method (Daniel et al., 2010).

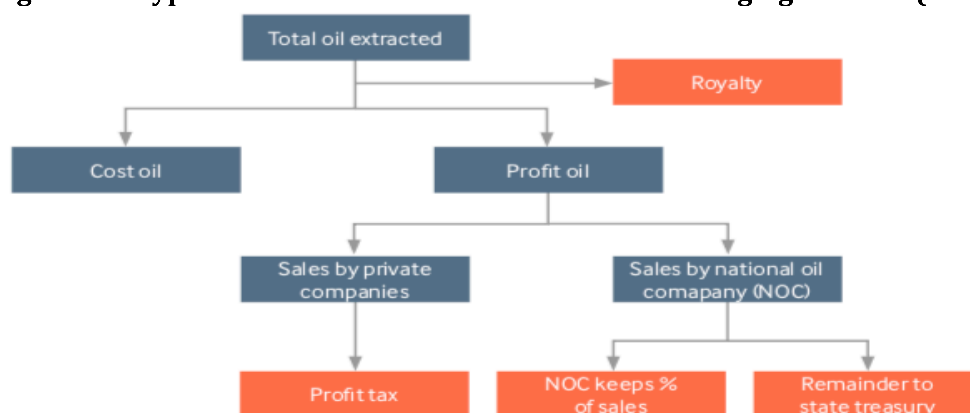
The management of oil rents is the fiscal arrangement between the oil-producing countries or National Oil Company (NOC) or entity of the government delegated to capture rent and the investor. Daniel et al. (2010) discussed two regimes of granting rights to an investor. First is the concessionary term, started in the mid-1800s, which gives the company ownership over the extracted resource. The Organization for Economic Co-operation and Development countries like UK, Norway, and Canada practice concessionary regime. The second design is the contractual regime, which grants private investor the ownership part of the oil produced while the state retains control and participation in ownership and decisions making. The most common form of contract regime still at large in Global South countries like Angola, Kenya, Nigeria, and Azerbaijani is the Production Sharing Agreements (PSA). Due to the many financial tools present under a different regime and their variation in terminology and legal framework, PSA arrangement will be the primary focus in the section (Karasalihovic-Sedlar, Barbir, & Brkic, 2017).

Under PSA, which is mostly applicable to hydrocarbon sector, a certain percentage of output, customarily called, 'cost oil' is put aside for the investor. The cost oil covers the cost incurred by the company in its extraction stage. The government and the company share the portion of the output, which is the 'profit oil'. Despite these various nomenclatures in fiscal regime, the oil-producing country takes risk and timing of revenue receipts in a way that is line with countries development plan and ensures optimal value for the welfare of the citizens. A progressive tax regime is best practice for resource-endowed nations. Due to high uncertainty,

volatility of the global oil prices, the unpredictability of oil wealth, as well as political climate of developing countries, the government need to adopt the progressive tax regime (Barma et al., 2012). Progressive design is usually a 'good enough' practice for the South countries due to its ability to curb regulatory capture and revenue leakage (Ibid).

To ensure public confidence and clear rules of accountability the government and the company should publish the benefit accumulated from resource extraction and account for it in the state budget. Regular review and reconciliation of the investors and treasury accounts will further enhance transparency as well as strict observance of international accounting ethics (Mayorga Alba, 2009). In conclusion, to this, the economic philosophy for oil rent extraction implies that the use of sub-soil assets in the economy needs to fit a country situation. There is no notion of the best-fit model oil industry. As shown in Daniel et al. (2010) there is nothing like "Norwegian Model' of wealth resource extraction, Norway developed high profile Petrol Fund long after the discovery, close to 30 years. The proposition is that Global South nations should not transplant policies and framework but rather design a country-fit fiscal regime that is simple, feasible and transparent while putting into consideration the government aims and also the nature of the political landscape.

Figure 2.1 Typical revenue flows in a Production Sharing Agreement (PSA)



Source: (Natural Resource Governance Institute)

The orange boxes indicate oil rents flow to the state. The percentage retained by NOC and the amount of revenue submitted to the state treasury is enshrined in the legislation or/and as agreed in the contract, based on the nature of the project. In some countries, there are petroleum laws specific to the industry while in some there is general legislation relating to these fiscal instruments.

DRAWBACKS AND LOOPHOLES

Fiscal instruments are the means for capturing earnings from oil and gas sector. Just like many taxpayers in other economic activity, foreign companies can try to evade tax obligations. As both the state and investor endeavor to get a fair share of this wealth, Daniel et al. (2010) argued that an intense political contestation may take place where political dogmas surpass the development agenda accompanies the sharing of oil revenue. According to Natural Resource Governance Institute Reader (2015), the investors can evade tax payments through:

- **Transfer pricing**- this takes two forms. Firstly, the investor company sell its oil at low prices to its sister company in their home country to reduce taxable income in the operating region. Secondly, the subsidiary company operating in the resource-rich nation may buy products and service at inflated prices. This over-invoicing will increase the company's cost thus reducing their declared profit. A recommendation to overcome

the dangers of 'formal cheats' is by using global market price for tax purpose rather than relying on the receipts proclaimed by the multi-national enterprises.

- **Productions costs**- this occurs through fraudulent accounting. Increasing production costs commonly referred to as gold plating in extractive taxonomy. The state can minimise this risk through developing rule regarding efficient production and auditing of the company's expenditures on the production processes.

This section concludes that fiscal regime has to be designed to fit the country context. The framework of a fiscal structure has to seal the loopholes that come with different regime type. Design of fiscal regime itself does not make proper management of oil rents; therefore, there is need to illustrate how management of resource funds is done explicitly. The next piece of discussion will deliberate on public investment management of oil revenue.

NATURAL RESOURCE FUNDS

Oil industry injects enormous revenues into the economy. If not well governed and managed these income streams can damage the domestic market as well as foreign exchange market. A percentage of these rents are used for the development of infrastructure, environmental protection, provision of essential public utilities like health care and increase human capital. Other countries may choose to spend their resource fund in foreign financial assets and packing them abroad in wealth fund for their future generations. Whether a state decides to invest in the economy or elsewhere, transparency and accountability of the institutions mandated to that operation are essential. Through appropriate governance mechanisms, oil revenue provides avenues for a country for the furtherance of their strategic plans and achieves development goals.

PUBLIC FINANCIAL MANAGEMENT

The previous section focused on the overview of natural resource funds and fiscal rules, and realistically strategic interventions cannot operate in a void. There is an institutional arrangement to ensure policies come into effect. This section argues that pre-existing institutions status merged with weak and unstable fiscal mechanisms have resulted into underdevelopment of resource wealthy nations of Global South. For these countries, it is not the question of how to save but rather the kind of investment decisions. If the government choose the options of investing in public infrastructure, it is essential to check the quality of investment management to achieve sustainable development results. Low-income countries are capital scarce; it is, thus, the role of the state to come up with an investment strategy and financial discipline to invest in human capital and physical infrastructures like road, airports, and harbours. For such an investment to achieve high social returns, the state requires investing in their capacity to spend, Sy et al. (2011), which requires appropriately managed public investment.

In resource-rich countries, the government has used different mechanisms for management of oil revenue. For example, budget legislation controls complemented with additional legislation in Norway and Alaska oil income stream, Sao Tome and Principe and Mauritania used the organic law adapted to their needs and capabilities as enshrined in their constitution to curb patronage and rent-seeking (Cangiano, Curristine, & Lazare, 2013). States have used different institutional framework like particular treasury account for oil rents; others have used the separate entity to manage resource funds and management of resource fund off- budget. The public investment management in this section dwells on investment and oversight bodies.

Hands-on experience across oil-producing countries have shown that political interference as well as public pressure to use the fund both in developing and developed countries weakens

the effectiveness of resource funds (Cangiano et al., 2013). Stevens and Mitchell in Cangiano et al. (2013) for instance, pointed out that, in the Canadian province of Albert, government bureaucrats aspired to change the rule governing the management of Albertan Heritage Fund. Aforementioned indicates the level of political interference of resource funds. In this regard, it is essential for the state to institute a body with a mandate of shielding public fund from patronage and insatiable government officials. The creation of these bodies enhances effective decisions making of resource use and insulating the fund from politicians. Effectiveness only occurs when such institutions are independent and free from political pressure.

In some cases, the establishment of oversight bodies as an addition to the already existing layers of mechanisms in resource fund management improves investment decisions. As discussed by Cangiano et al. (2013) there are several layers of such oversight authorities in many countries. Sao Tome and Principe merged two options in fund supervision, the joint operating between civil society and the state, the Petroleum Oversight Commission which enjoys judicial and investigative powers and secondly the mandatory auditing of oil fund by an internationally well-known accounting firm. These measures are implemented to ensure prudent management of fiscal policies and development of a sound framework for the management of oil wealth. Nevertheless, this framework is not a panacea to the management of resource fund. It posed diverse challenges for the nations of Global South. Low-income countries lack skilled human capital in the management of such funds, and also institutional deficit represents a more significant problem to the operation of such bodies. In some extreme cases, there is a conflict between various authorities where law and legislation did not correctly define their roles often resulting in dual operation of oil budget and asset management.

Investment in different commission and oversight authorities may ensure prudent management of oil rents. In the context of Global South countries, most of the oil operation from upstream to downstream sector is under the control international oil companies. This operation calls for the establishment of a state-owned entity to oversee and control the management of oil income streams. Succeeding sections expounds on this institutional arrangement putting into consideration the role national oil companies plays in management and distribution of oil rents.

A succeeding chapter addresses the issues of how national oil companies participate in the oil rent management. It reviews the rationale for state participation in the oil industry; the role played by SOEs backing up with country context models and discusses drivers behind state participation. It concludes with challenges of NOCs and comments on the recommendation for the future of Global South countries.

STATE-OWNED ENTERPRISES (SOEs)

Who holds the most significant share of world's 'black gold'? Instinctively people think the most considerable part of the oil is in the hands of multinational oil companies like ExxonMobil, BP, and Chevron. However, 70% of world oil reserve is managed by a state-owned entity without private shareholding, and thirteen national oil companies control more reserve than the largest oil company, ExxonMobil (Rosenberg, 2007). Rosenberg continues to argue that demands of nationalisation are expected to increase due to exhaustibility of oil in developed nations that host most of the IOCs and breakthrough in oil sector Global South. For an extended period, petrol sector has been strategic importance in the developing and developed countries. Consequently, they need state participation and control. Oil is among the commercial industry identified by Vladimir Llyich Ulyanov as the "commanding heights" of the economy that demands full state autonomy (McPherson, 2008). The move towards

nationalisation in oil sector started in the 1920s with the development of national oil enterprises from Latin America countries. The idea of state participation gained momentum in the 1970s with demand for nationalisation and confidence in the benefits of state control and tenure. (Ibid)

RATIONALE FOR STATE INVOLVEMENT IN OIL REVENUE MANAGEMENT

The state can be a medium for transforming oil income streams into sustainable development through building of infrastructures to being a centre for training experts and technocrats in the petroleum industry. In other countries particularly the developing countries, the national oil company has become a loophole for syphoning rents, discouraging foreign investors and diverting revenues meant for development into private conduits. This mix of benefits and adverse impacts that accrue to nationalised oil sector has called for an explicit understanding of the mandate of SOEs. To avoid conflict of interest and hindrance to revenue maximisation, and subsequent fall of nationalised oil company there is need to stipulate functions of the enterprise, define the limits of its operations and use of the revenue and above all insulate this sector from politicians. This section will examine the commercial and non-commercial roles of the NOC and closes with some successful proposals that may enhance the decision making of state oil company.

The nationalisation of oil companies is vital in improving the revenue for the development of the economy and welfare of the citizens. According to Natural Resource Governance Institute, the proponents of government ownership of natural resource mention three principal benefits of such operations; capturing of rents, development of domestic linkages between the oil sector and other industries like agriculture and finally the diffusion of technology and best business practices to the local economy.

Despite these opportunities that arise with the nationalisation of oil companies, it poses a significant risk to the economy if its role is not clearly defined. The commercial purposes of the NOC according to Heller, Mahdavi, and Schreuder (2014) as the name suggests, can be described as the involvement of state entity in the economy of generating rents from the extractive industry. They further argued that roles of this entity in capturing rent from oil often ill defined. These moneymaking roles include leading financial positions in the execution of exploration operation at the upstream stream sector, the sale of government oil as well as marketing of fuels and its refined products. For the high-performing state-owned extractive enterprises like Norwegian Statoil and Saudi Aramco, these mandates are specifically and strategically defined in their NOC company documents. Those large state-owned companies engage in massive operation just like international oil companies, for instance, having projects in the global market.

For the developed nations like Norway and Saudi, the state and the company designed well-articulated financial documents in a business-oriented way to target the market and also to accommodate changes as the company progresses with time (Heller et al., 2014; McPherson, 2008). The company directors and shareholder, and oversight authority defined the contents of the commercial paper. For instance, Malaysia Petronas invested in the international market in areas perceived as risky by other companies. On the other hand, companies specifically those from the nations of Global South like GNPC (Ghana) and Timor Gap in Timor Leste has a narrow scope of commercial operation, limiting themselves to minority shareholding and sale of the government share of oil (Heller et al., 2014). All these variations occur due to lack of transparent governance, roles and strategic path for a profitable portfolio.

Outside the demand to unpack enterprise's profitable path, it is prerequisite to accurately describe non-profit-making roles which Ralf (2007) and Heller et al. (2014) divided into two principal mandates. Firstly, regulatory functions which state the rules of licensing rights, provisions about the performance of the company, regulation of contracts and tenders and observance of sector regulation by other companies. Secondly, the quasi-fiscal roles defined as other operations carried upon by NOC when called, for example, building of infrastructure, fuels subsidies, and servicing public debt.

The liability of the state-owned enterprises to undertake commercial and non-commercial roles is a factor of what it can retain from the oil income streams. Countries in the South capture part of the revenue through taxation, royalties, selling state share of petroleum and bonuses paid by the foreign entities. To pursue their commercial roles, these companies need access to finance to continue with their linking strategies. In developing nations, giving full autonomy to the NOC to manage such a massive amount of fund is a risky operation primarily in the face of institutional weakness and governance deficit coupled with weak public financial management. Enacting mechanisms that balance these risks is crucial. There is no universal model suitable for oil-producing nations to follow regarding management of SOEs but Heller et al. (2014) proposed several recommendations of which I will focus only on two proposals. The twin suggestions are the dilemmas faced by NOCs in developing countries.

First is the political interference in technical decision making within the realm of SOEs. McPherson (2008) points out that the global significance of SOEs has issues and abuses especially from political economy that discourages its growth and encourages its failure. He continued to assert that policy response that would lead to state withdrawal in the involvement of oil economy would have severe consequences in the long run. In the developing countries, as argued by Kim (2017) there is no separation of management of SOEs from the ownership as ruling party controls the enterprise. Therefore, entrusting key decision making roles to independent management and committees would allow the entity to build a lucrative long-term portfolio.

Leadership is vital in the management of revenues and insulation of useful technical teams is a call for excellent performance and accountability (Heller et al., 2014). Highest performing enterprises like Norway's Statoil has politically autonomous management team hired through rigorous, transparent processes. Investment in human capital is an antidote to poor governance and administration. Developing high calibre professional staffs is stringent move to safeguard the company from politicised decision-making (Ibid). Saudi Aramco is one of the world-class management and training centres for the oil engineers and managers that being an "Aramcan ‘ is a high-status job in the Gulf region.

The second recommendation is the promotion of transparent and oversight authority. Many NOCs countries in the Global South face challenges of opaque and unaccountable institutions due to unsatisfactory performance. There is need to publicize information on the financial operation of the entity promptly. According to Heller et al. (2014), SOEs should face same disclosure of information just like in the case for private companies. The information that is important for publication includes revenue collected, accounting of the fiscal relationship between the NOC and the government, the amount spent on non-commercial operations, debts, entity budget, report of oil sales and corporate structure. This public disclosure of information will enhance the confidence of international investor in the oil exploration and production as well as other linking industries. A prime example is the Malaysia Petronas in 1993-2010 through its financial openness boosting external investment of more than $19 billion in bond, which will further support financing of long-term development projects (Lopez, 2011).

In addition to the publication of SOEs financial documents, effective legislative oversight, independent audit and transparency practices are some of the most useful tools for ensuring corporate governance in state-owned enterprises. As a vehicle for overseeing the functions of SOE, Heller et al. highlighted the need for the legislators to have knowledge of company's activities and annual reports as well as revenue envelope available for the budget. The effects of legislative control depend on the professionalism where members are well versed and have adequate skills in oil sector revenue governance, and free from partisan concerns. The incentive for reliable performance and excellent governance practice is independent accounting standards, which boost investors' confidence. Subscription to the global standards of the Extractive Industries Transparency Initiative (EITI) is a corrective mechanism to expose the state-owned company's illegal practices, and shady deals; successful in engaging in this transparency initiative is Colombia's Ecopetrol.

Despite this wave of nationalisation of oil companies and the vast recommendation to improve their corporate governance and management, SOEs in the Global South operates behind a curtain. There is high-level political interference, lack of explicit mandates and unclear separation of powers between who owns the company and who manages it, leading to a conflict of financial and social goals as Budiman, Lin, and Singham (2009) put it. Notwithstanding hard economic times, SOEs has potential to improve its governance and undertake lucrative revenue management mechanism.

Extractive sectors can have significant effects on the economies of resource-extensive countries of Global South if the management of revenue streams is streamlined. These countries are far from achieving this because of poor governance, weak fiscal regime, and lack of transparent state-owned enterprises. For effective management of oil revenue, the state requires actions of various institutions ranging from, policy focus, political to a partnership between different stakeholders. At the policy level, these nations should move away from the narrow perspective of considering oil industry as an enclave sector, towards a well-integrated approach that focuses on linking with other local and manufacturing sectors. Within the political realm, commitment from politicians and observance of principles of good governance is fundamental to curb elite capture and focus on broad-based economic transformation.

Utilizing the perspective of oil sector for the development of the country is among the primary concern of Global South. Resource-rich developing countries should strike a balance between maximising resource value and minimising the harmful effect of the resource. As Besada et al. (2015) point out, there is a need for innovating policy options in the areas of resource tax, royalties and other useful decisions for generating sustainable rents. Coupled with transparency, accountability frameworks and corporate reforms in oil economies can achieve development aspirations of developing nations.

CONCLUDING REMARKS

Oil producing countries in the Global South encounter challenges associated with oil rents flow into the economy. Due to these problems in oil rent management and distribution in developing countries, policymakers need to come up with effective fiscal policy measures to realise development outcomes. In developing countries, such as those in Africa, Latin America and Asia, undesirable effects of oil revenue is widespread. Inflexible and fragile taxation regime, mismanagement of resource funds due to the weak institutional arrangement in resource investment and additionally, ill-defined roles and responsibilities of state-owned enterprises are all compounding factors in the mismanagement of oil revenue.

Resource development experts in the oil industry and organisation like Natural Resource Governance Institute suggested various fiscal policies and diagnostic framework moderate the adverse effects of oil income streams into the economy. However, these recommendations for oil rents management in the Global South face problems from political influence, lack of skilled labour and governance deficit. Succinctly, oil sector reforms start with the end in mind. A need for overarching integrated plans that would last beyond the exhaustion period of the oil well is essential for sustainable development. Suitable fiscal policies in oil rent management and distribution rely on principles of good governance, stable institutions reinforced by better public investment management

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