

Taxation of Natural Resources in Developing and Emerging Countries

Forum ökologisch-soziale Marktwirtschaft (FÖS)

Jahreskonferenz: Welchen Rahmen braucht die Green Economy?

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1. Revenue from (non-renewable) natural resources – some basic facts
2. What are the fiscal instruments?
3. Natural resources and democratic governance – what does the literature say?

Revenue from natural resources (I)



“... how can **taxes on natural resources** in developing and emerging countries contribute to achieve a **fair price**, to let society **participate in the wealth** generated from natural resources and, at the same time, produce **incentives for a sustainable use** of natural resources?” *(from the conference programme, my translation)*

Fair price

=

Income

Participation

=

Distribution

Sustainable use

=

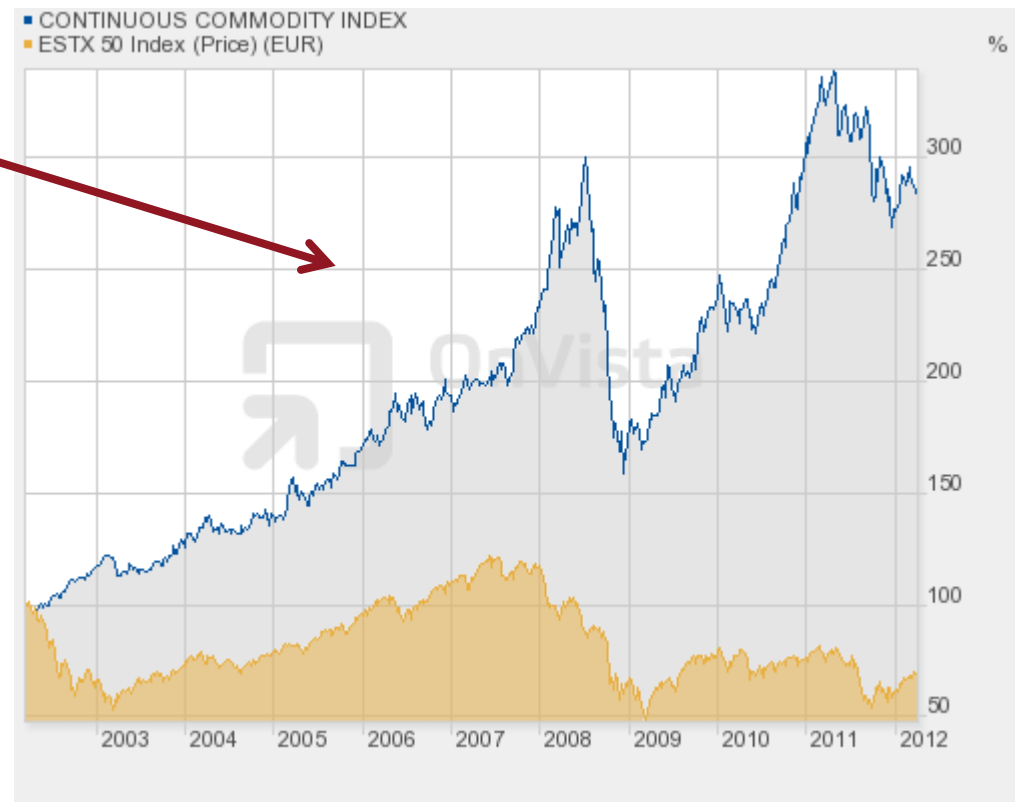
**Ecological sustainability
& inter-generational equity**



Income

Difference between rising **global** commodity prices and revenue from natural resources in **individual countries**.

For instance, **re-negotiations** of mining contracts in Bolivia, Ecuador, Peru reflect a widespread feeling that the exploitation of a nation's sub-soil wealth is priced too low.



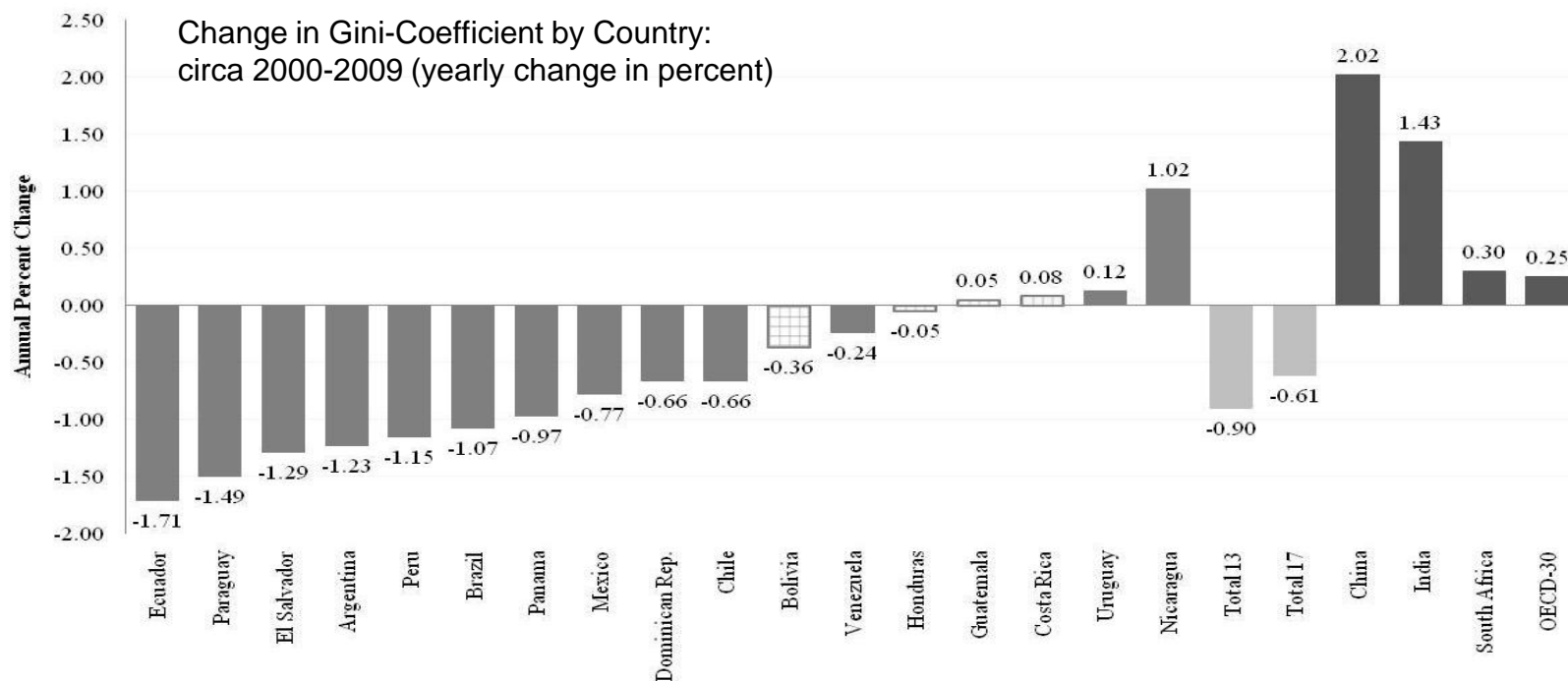
Thomson Reuters Equal Weight Continuous Commodity Index
Source: www.onvista.de

Revenue from natural resources (III)



Distribution

Resource-rich Latin America: Progress in wealth distribution due to high growth rates, better targeting of social policies and sound macroeconomic / fiscal policies



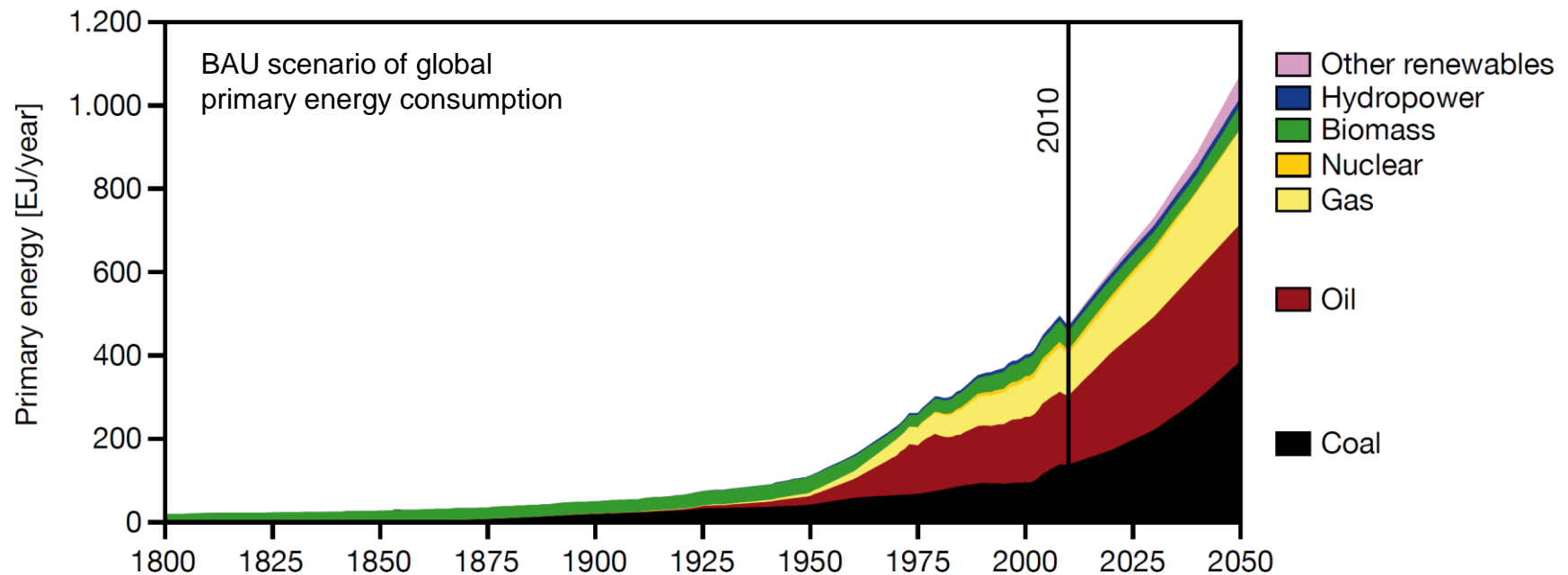
Source: Lustig 2011

Revenue from natural resources (IV)



Sustainability

Until recently, almost totally **absent** from public debate. Clear prevalence of **income generation** and (territorial / social) **distribution** over **sustainability** goals in national policies.



Source: WBGU 2011



Obtaining revenue from natural resources

- **State-owned enterprises** transfer profits to the treasury
- **Taxes** on corporate income, profits or cash flow from extractive activities
- **Production-based taxes:** (i) royalties levied as a share of produced value or as a fixed amount per product unit, (ii) sales taxes, (iii) foreign trade duties
- **Other options** (especially in the oil & gas sector): (i) Production-sharing contracts, (ii) auctions of exploration or extraction rights
- **“Pigouvian” taxes** on the use of natural resources (air & water pollution, logging, etc.) address **sustainability**, but not common in developing countries
- In contrast, fiscal instruments, for instance **tax exemptions**, are often used to **subsidize** energy consumption (transport fuels, household kerosene), compromising **income** and **sustainability** for the sake of **distribution**



Mayor problems

- Many natural resources are non-renewable – a **finite** source of income (*Hartwick's rule* emphasizes inter-generational equity)
 - Negative externalities from environmental degradation are rarely taken into account – the case for **environmental taxes and international finance schemes!**
 - Prevalence of large (international) firms, uneven distribution of technical competencies and access to capital, high initial investments (sunk costs), uncertain profitability: it can be difficult to determine the actual rent to be taxed later on – **difficult bargaining situation**
 - High rents generate **perverse incentives**: economic (dutch disease) as well as political (rentier states)
- **Weak states are particularly challenged in meeting these problems**



Governance counts

- The institutional setting and the political context are key in determining the sustainable and common interest-oriented use of natural resources
- **Conventional wisdom:** natural resources are a **curse** – they spoil the political game, lead to corruption and bad government, stabilize authoritarian regimes and block democratization. Why? **Three causal mechanisms** (Ross 2001):
 - **Rentier effect:** Appropriation and distribution of natural resource rents enables governments to engage in patronage politics and avoid accountability.
 - **Repression effect:** Resource wealth enables governments to pamper security forces and spend on repression.
 - **Modernization effect:** Natural resource-based growth produces economic and social structures not helpful for democratization.



New research draws a more differentiated picture

- **Types of resources matter:** Non-fuel mineral resources do not seem to have a significant effect on democratic transitions or democratic failures or autocratic survival – oil does
- **Oil** helps explain the **islamic democracy deficit:** non-oil Islamic countries have democratized at roughly the same pace as the non-Islamic countries
- **Regions matter:** Oil blocks democratization in all regions – except **Latin America**
- **State capacity matters:** Nationalization of oil industries has enabled states to capture larger shares of the resource rent, but reduces the prospects of democratization
- **Types of democracy matter:** **Presidential systems** are more vulnerable to rent-seeking and corruption than **parliamentarian systems**



New research draws a more differentiated picture

- **Representation and accountability** are key drivers of sustainability and common interest-orientation in natural resource taxation
 - **The “diffusion effect” could matter:** The political regimes of **neighbouring countries** affect the regime type and prospects for democratization in a given country
 - **Neither curse nor blessing:** Natural resource wealth endows leaders with greater policy autonomy. It does not necessarily lead to weak and autocratic states
- Promote **governance and transparency**, pursue **multilateral approaches**, be aware of **limitations to external interventions**



Many thanks!

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