Institutional agreements for distribution of rent from petroleum exploitation – The Brazilian Experience

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INTRODUCTION

- There are several reasons to support centralization of oil revenues with a sharing agreement:
  - Philosophical and equity considerations: the oil revenue is a kind of scarcity rent which belongs to all society and must be applied on capital formation in favor of present and future generation.
    - Central government is more able to do these investments.
  - Macroeconomic: oil revenue is highly volatile and thus difficult for sub-national management.
  - Federative: avoid or limit regional disparities since oil is typically concentrated in a few regions.

INTRODUCTION

- "Optimal policies": oil revenue centralization must be unfeasible in federations.
- Second-best solutions: to improve the sharing rules of oil revenues.
- The Brazilian experience is illustrative of the challenges to face: how feasible is an agreement around a second-best in context of a federative conflict?
  - Vertical conflict: Union x States/Municipalities
  - Horizontal conflict: Producing x No Producing

BRAZILIAN EXPERIENCE

- What Brazilian government is doing?

$\Rightarrow$ Its first priority in 2009 was to send a bill to Congress creating a producing-sharing arrangement (PSA) in the hope of broadening the government-take over oil rent of pre-salt (mixed regime: concessions to old discoveries and PSA to unexplored fields).

$\Rightarrow$ President Lula tried to prevent a conflict among states, by keeping unchanged the current sharing rules for concession and by proposing new rules only to PSA revenue.

BRAZILIAN EXPERIENCE

- What does change in PSA tax structure?

⇒The special participation fee (a kind of resource rent tax of concession system) will be abolished and substituted by a share of profit-oil, extracting a larger government-take.

SPF-RTT: medium aliquot of 20% (Current)

PSA: minimum share of 50% (New)

⇒Corporate Income Taxes (CIT) and royalties follow the same.

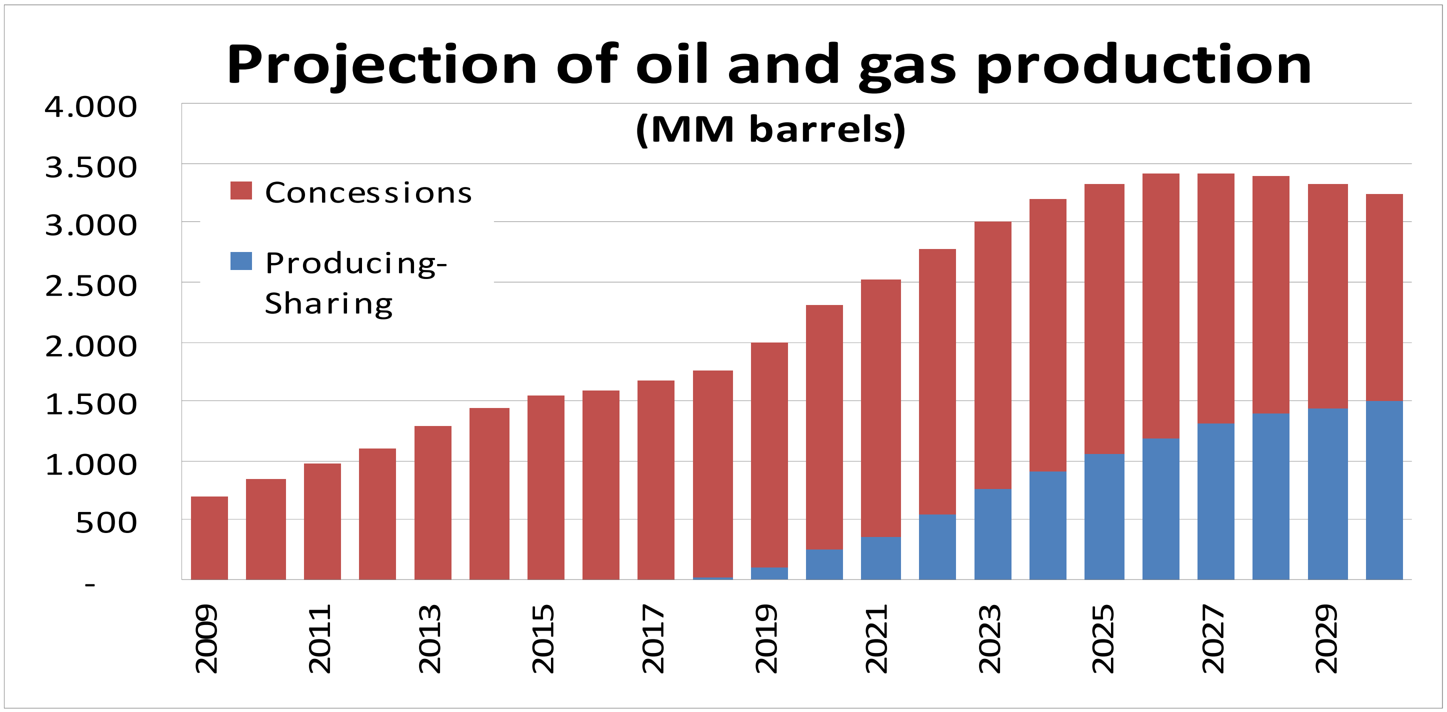
BRAZILIAN EXPERIENCE

- PSA arrangement must allow the government to increase the public share over oil rent…

Regime	**Concession**	**PSA**
Oil Barrel Price (A)	75,00	75,00
Royalties (B=10%*A)	**7,50**	**7,50**
Cost (C)	20,00	20,00
Profit-Oil (D=A-B-C)	47,50	47,50
Public-Share (E=20%or50%*D)	**11,88**	**28,50**
Private Gross Profit (F=D-E)	35,63	19,00
Interest and other deductions (G)	7,00	7,00
Private Net Profit (H=F-G)	28,63	12,00
Corporate Income Tax (I=34%*H)	**9,73**	**4,08**
Government Revenue (J=B+E+I)	**29,11**	**40,08**
Government-Take (K=J/(A-C))	**53%**	**73%**

BRAZILIAN EXPERIENCE

- … and to decrease the share of sub-national entities, because the public share of profit-oil will be exclusively of the Union (and CIT will be smaller).
- But the production under PSA must start at 2019.



BRAZILIAN EXPERIENCE

- What happens with this bill?

⇒The bill was voted in House of Deputies and Senate, but was changed and must be voted in second turn.

⇒The majority of Congress agree with the PSA regime but doesn't agree to keep the current sharing rules of concessions.

⇒An amendment passed by deputies and senators established that all oil revenue must be shared in equality basis (with no special benefit to Rio).

⇒Governor of Rio de Janeiro can go to Supreme Court against this amendment.

BRAZILIAN EXPERIENCE

- President Lula and new president Dilma Roussef have signalized they would reject the amendment and propose an alternative way, but the governor of Rio doesn't accept any negotiation.
- Guidelines of this alternative agreement:
  1. Sharing rules of revenues subject to concession must also change.
  2. Keep a special (but smaller) share to bordering states due to constitutional requirements.
  3. Apply a transitional rule to minimize the losses of current beneficiaries.

THANK YOU!

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