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

Sérgio Wulff Gobetti
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?
  ⇒ 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).
  ⇒ 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...

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

E-mail contact: swgobetti@gmail.com