Non-renewable Natural Resources in Federations
Outline of a Proposed Collation of Basic Information

Background

“The curse of oil” and “blood diamonds” are two phrases that have entered popular usage, reflecting one side of the potential impact of resource wealth on a country. Of course, the impact need not be negative, but there is no denying that managing significant resource wealth is a major challenge, even for advanced economies. The importance of these issues is reflected in the large number of studies done around various aspects of non-renewable resource management, including fiscal and environmental regimes, and transparency. The World Bank and IMF have sections that specialize on this. There has also been a flowering of international forums and organizations, such as the Extractive Industries Transparency Initiative, Resource Watch, and Transparency International which focus on these questions.

Given all this, it is striking that there has been almost no structured focus on the management and development of non-renewable resources in federations. The Forum of Federations proposes to take a first step in this regard by collating some basic information on oil and gas governance and fiscal regimes and issues in federations. It has been decided to focus on oil and gas because it is by far the most important non-renewable resource in most federations, it is important in a large number of federations, and, not least, federations have a significant share of global oil production.

Oil and Gas Production of Federations, 2006

<table>
<thead>
<tr>
<th>Federation</th>
<th>Oil (M bbl/day)</th>
<th>Gas (tcf/day)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>9,677</td>
<td>23.167</td>
</tr>
<tr>
<td>United States</td>
<td>8,370</td>
<td>18.531</td>
</tr>
<tr>
<td>Mexico</td>
<td>3,707</td>
<td>1.713</td>
</tr>
<tr>
<td>Canada</td>
<td>3,288</td>
<td>6.548</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>2,945</td>
<td>1.672</td>
</tr>
<tr>
<td>Venezuela</td>
<td>2,803</td>
<td>1.006</td>
</tr>
<tr>
<td>Nigeria</td>
<td>2,442</td>
<td>.996</td>
</tr>
<tr>
<td>Brazil</td>
<td>2,166</td>
<td>.349</td>
</tr>
<tr>
<td>Iraq</td>
<td>2,007</td>
<td>.106</td>
</tr>
<tr>
<td>India</td>
<td>854</td>
<td>1.067</td>
</tr>
<tr>
<td>Argentina</td>
<td>802</td>
<td>1.628</td>
</tr>
<tr>
<td>Malaysia</td>
<td>723</td>
<td>2.218</td>
</tr>
<tr>
<td>Australia</td>
<td>552</td>
<td>1.512</td>
</tr>
<tr>
<td>Sudan</td>
<td>380</td>
<td>0</td>
</tr>
<tr>
<td>South Africa</td>
<td>204</td>
<td>.071</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0</td>
<td>1.112</td>
</tr>
<tr>
<td>FEDERATIONS</td>
<td>41,018</td>
<td>61.625</td>
</tr>
<tr>
<td>WORLD</td>
<td>84,632</td>
<td>104.849</td>
</tr>
</tbody>
</table>
This table, which ranks federations in order of their oil production, shows that federations have a very significant share of global oil (48 per cent) and gas (59 per cent) production in 2006. While not all of the above countries would be recognized as fully functioning federal systems, and some are very centralized, there is no doubt that the importance of federations for global oil and gas production merits attention as to how federations manage this valuable and strategic commodity. Moreover, the issue is important in a number of other countries which are debating decentralized or federal models (Peru, Ecuador, Columbia, Bolivia), as it is in formally unitary systems that have adopted asymmetric models of governance (UK with Scotland; Indonesia with Aceh). Longer term it could be significant in China. And Ethiopia, a young federation, has a nascent gas industry with some significant discoveries.

The table above gives a sense of the absolute size of the petroleum industry in different federations. The political significance of the industry in any given country is a function not just of its absolute size but more importantly its size relative to the domestic economy. Thus oil and gas is central to the economies of Nigeria and Iraq and very important to those of Russia, Venezuela and Sudan (in all these countries oil and gas dominates exports). It is also important economically in all the other countries shown in the table, with the exception of South Africa. The recent dramatic increases in oil (and to a lesser extent gas) prices have added to the importance of these industries because their revenues have ballooned as have, disproportionately, the rents available for government.

The following gives a sampling of oil and gas issues in certain federations:

- In Nigeria, the country has had a long-running debate over the allocation of oil revenues as between the federal government and the producing and non-producing states. The country has a serious insurgency in the Niger Delta because of local discontent around oil and gas management and revenue sharing.
- In Russia, the central government has reasserted control of the oil and gas resources after a period when it was highly decentralized. Producing subjects of the federation now get only 5 per cent of oil revenues and none of gas revenues.
- In Canada, the offshore petroleum-producing provinces launched a successful political challenge to federal control of the offshore and have recently won concessions regarding how oil and gas revenues are treated in the federal-provincial fiscal arrangements. Oil and gas rich Alberta is now debt free, with Canada’s lowest taxes and highest spending and the prospect of ever growing surpluses.
- In the USA, while the federal government owns the offshore, a number of coastal states have succeeded in blocking offshore oil and gas activity. There is a major debate over oil and gas development on federal lands, notably in Alaska.
- Argentina turned over ownership of non-renewable mineral resources to the provinces when it amended its constitution in 1994. Some of the
smallest provinces in the country now control this increasingly strategic resource. The federal government is using levers such as export taxes to pursue its objectives.

- Both Sudan and Iraq are fragile, transitional democracies which have failed to resolve conflict over the ownership and control of oil resources. Sudan has an interim, but vulnerable, deal on sharing and it has a major dispute regarding boundaries affecting some oil and gas resources. Iraq has a highly ambiguous constitutional provision and has been unable to come up with an oil and gas law.
- Mexico has a highly centralized regime based on a state oil company that has proven unable to meet public demands on it for revenue while ensuring adequate longer-term investment. Mexico’s federal-state fiscal regime is quite ad hoc.
- Brazil and India both largely control oil and gas from the centre, but have provisions for providing a share of oil and gas revenues to the state of origin. However, these provisions are contested and there are also demands for a greater local role in regulatory decisions.

The ownership, management and fiscal arrangements around oil and gas resources differ greatly amongst the above federations. In each case, the arrangements chosen (or inherited from previous generations) can affect the nature and pace of the development of the oil and gas industry, relations with local communities, relations amongst the constituent governments and with the federal government, and the broader pattern of political alignments and issues within the country. The emergence of climate change as a major issue of public policy, combined with continuing high oil and gas prices, will only heighten the significance of oil and gas economics and politics in federations.

The Purpose of the Project

The Forum of Federations proposes to conduct an initial scoping project to collate baseline or scoping information on oil and gas arrangements and issues in selected federations. Given the complexity of these issues, the Forum proposes to engage experts knowledgeable about the oil and gas arrangements in each of the federations studied with a view to having them answer a series of questions about their respective countries. The objective is to have completed country reports by the end of March, 2008. The papers would normally be 20-25 pages in length, plus any annexes. The project will be directed in the initial phase at least by the Forum’s President, George Anderson, who has served as Deputy Minister of Natural Resources in the Government of Canada as well as in other senior positions in the energy portfolio.

Once the initial papers are complete, the Forum will consider, in consultation with potential partners and the authors contributing to the project, what further work might be done in this area. This staged approach is being adopted as a way to help define what might be the most promising issues for focus in further work. It is expected that the next stages of the project will involve one or more workshops or conferences, as well as an eventual publication. As well, the Forum expects that there may be substantial interest in
the project in some of the countries where it is active (such as Iraq, Sudan, and Nigeria) and this could lead to a number of country specific activities.

Eleven countries have been selected for the initial phase: Argentina, Australia, Brazil, Canada, India, Malaysia, Mexico, Nigeria, Russia, the United States, and Venezuela. (Sudan and Iraq are excluded because of the unsettled nature of their arrangements. Pakistan and South Africa are excluded because of the relatively small size of their petroleum industry. The UAE calls itself a federation, but is more confederal in nature, and does not have popularly elected governments.)

It will be important for each country paper to describe the relevant constitutional and legal provisions of the federation, each author will be asked to comment on how such provisions have been interpreted and used (or perhaps misused) over time. An issue that may be central in one country—revenue sharing—may have little political salience in another. As well, authors will be encouraged to provide some historical background to the issue in their country and not simply a snap-shot or static account. For example, the relevant country studies would need to explain the historic importance of the oil industry to the Mexican revolution and nationalism, of federal protection of the US oil and gas market for many years, of the National Energy Program in Canada, of Menem’s constitutional deal-making in Argentina, and of Russia’s disorder under Yeltsin.

Questions to be answered

Authors will be asked to address the following questions and sub-questions. The questions are interspersed with comments on their relevance or on particular angles that might be given particular attention.

1. Context

Give the current size of the upstream oil and gas industry in the federation: volume of oil and gas (metric units) produced annually; current estimated reserves; brief overview of historic production and forecasts. What is the oil and gas industry’s share of GDP and of export revenues? Are these shares changing significantly?

Indicate the location of the on-shore upstream oil and gas industry by constituent unit (CU) of the federation (states or provinces) showing each producing CU’s share of national oil and gas production and of national population. Indicate each CU’s disposable income per capita (not GDP per capita which can be misleading for oil rich jurisdictions). Are there any particular features (ethnicity, language, religion, education) that distinguish the population of any major producing CUs from the population of other units? As well, mention any other sub-national jurisdiction with significant production (e.g. territories or districts that do not have full status as states or provinces, e.g. federal lands, indigenous or tribal lands).

Indicate the same for the location of the offshore oil and gas industry relative to CUs. Typically the offshore is federal jurisdiction (see below), but where possible indicate
what share of national production comes from offshore zones contiguous to relevant constituent units, along with the CU’s share of national population and its disposable income per capita.

2. Constitutional and legal provisions: non-fiscal

The following questions focus on a series of key jurisdictional issues. It will be important prior to responding to them to establish the context within which the oil and gas industry has been developed and managed in the country. Is there largely a market oriented approach? Are local markets protected in some degree (e.g. import controls protecting producers or export controls producing consumers), and if so is this significant? Is investment largely by state-owned or private enterprises—and if private, is the industry relatively open to foreign investment? Is the management regime largely transparent (and competitive) or non-transparent? Is corruption a major issue? Detailed answers are not expected.

(a) Oil and gas “ownership”: onshore

Are there explicit constitutional provisions establishing which order of government has “ownership” of onshore oil and gas resources? Have the courts or has statute law played a role in establishing ownership? Is it clear that one order of government has ownership jurisdiction (e.g. for issuing licenses, regulating exploration and production, levying royalties). Does one order of government have “oil and gas” or petroleum legislation (typically such legislation includes licensing, exploration, appraisal, development, production and abandonment procedures)? If there is some overlap in ownership between the federal and CU jurisdictions, are there special management arrangements to coordinate their responsibilities?

What are the principal means by which the relevant government(s) exercise ownership responsibilities? Governments can choose to exercise their ownership responsibilities in very different ways: through a state-owned oil company (that may be largely self-regulating or essentially regulated by government); through a petroleum ministry (that may be transparent and market oriented or non-transparent and subject to political intervention on contracts etc); and, through arms-length or independent regulators. Outline the basic philosophy or approach adopted in the subject country. (In Mexico, the constitution states that resources belong to the people and this has been interpreted in a way which prohibits foreign equity investments in the upstream sector. Drawing out such twists on “ownership” would be valuable.)

(b) Oil and gas “ownership”: offshore

“Ownership” is strictly limited to territorial waters, but in practice is effectively present throughout the exclusive economic zone of the offshore. Do contiguous CUs have any ownership of the offshore beyond the high water mark? Have the CUs been given a management or quasi-ownership role in relation to the federal part of the offshore? If so,
what is its broad character? Are there special issues in the zone managed by the federation beyond its economic zone?

(c) Non-ownership powers

While one order of government may have ownership of the resource, other significant powers can also bear on the management of the resource, e.g. control of pipelines, environmental regulation, land use regulation, criminal law powers (aside from fiscal powers, dealt with below), powers over the internal market or over imports and exports. Outline the significant non-ownership powers (with their constitutional basis) that each order of government has that have significantly affected the development and management of the oil and gas industry. Have these powers typically been used for their ostensible purpose (e.g. environmental regulation), or have they sometimes been used as a lever to achieve some broader purpose relative to the oil and gas industry (e.g. states imposing moratoriums on offshore oil and gas activities by denying onshore access)? Has the management of large oil and gas projects or oil and gas policy required significant coordination and joint decision-making between the two orders of government (e.g. joint environmental assessment)? Has one order delegated some responsibilities to the other order? Are non-ownership powers exercised in a largely transparent manner? Are there special laws regulating the non-ownership (exploration, development and production) aspects of the petroleum industry? If so, by which order of government based on what constitutional powers?

Finally, authors should draw out key elements of the oil and gas management regime that provide for public participation in oil and gas decision-making. This would include major regulatory hearings, and public consultations. In some countries, indigenous or tribal peoples have special rights of consultation or even consent on projects relating to their traditional lands. If applicable, they should be outlined (as should any significant debate around them). Are such rights constitutionally based and imposed by the courts or a matter of legislation or government policy?

(d) Key issues around management

Authors should indicate what have been the principal political debates around oil and gas management, particularly as it relates to the role or activities of the two orders of government. For example, in the Niger delta a central debate has been around the role of local people and the political and administrative mechanisms for Niger delta development. In Canada, the offshore provinces forced the federal government to concede effective management of the offshore to them. In India, producing states such as Assam have complained about lack of influence and an inadequate shares of revenues.

3. Fiscal issues

(a) Extraction of government revenues
There is a wide range of fiscal instruments that can be applied to raise revenues from the oil and gas sector. They include:

- Royalties
- Corporate Income Tax, possibly with a differentiated rate by sector
- Resource rent tax
- Import and export duties
- VAT
- Surface fees
- Up-front licensing fees and bonuses
- Environmental taxes and bonds
- Foreign exchange controls
- Government equity participation (paid or carried)
- Production sharing and profit oil splitting

In addition, hydrocarbon regimes can be based on the allocation of concessions, where the title passes to the rights holders, on contractual arrangements (either pure service arrangements or production sharing). As well, state oil companies can hold and manage interests and make payments to government (based on profit, cash flow, or the need of government).

It is not the purpose of this exercise to go into the maze of details that characterize the fiscal regime in any country, still less to do an assessment of them. Instead, authors should identify the principal sources of revenue from oil and gas for each order of government and give the relative magnitudes of these. For example, in Russia, export taxes are now the largest single source of government revenues from the petroleum sector, while in Mexico, payments from the state oil company, Pemex, have always been central. In Canada, the US and Australia, the corporate income tax is especially important for the federal governments, while royalties are more important for the states and provinces. In some countries, there has been competition between the two orders of government in trying to extract revenues from the oil sector. A dramatic example was the Canadian federal government’s imposition of export taxes on oil and gas in the 1970s, which Alberta in particular saw as extracting rents that properly belonged to the owner; the Canadian constitution was amended in the early 1980s to eliminate this federal right. The Argentine government recently raised export taxes on oil and gas, which may have been designed to increase its share relative to producing provinces. In some federations there have been efforts to coordinate and harmonize the federal and CU tax regimes on the upstream sector, e.g. in the treatment of royalties for corporate income tax purposes; the Canadian and Alberta governments coordinated adjustments to their fiscal regimes to promote oil sands development. Without going into the details, authors should indicate what are the major sources of revenues for each order of government and whether there have been important conflicts or coordinated approaches.

As well, they should highlight any other significant issues affecting government revenues: these might include major revenues foregone because domestic oil or gas is directed to local consumers at non-market prices or because of costly local content requirements imposed on the upstream sector.
(b) Revenue sharing

Whatever the sources and amounts of revenues flowing from the upstream petroleum sector to the federal and CU governments, in most federations there are issues around sharing these revenues both in their own right and as part of the larger envelope of government revenues. Obviously, these issues of sharing are most significant when oil and gas revenues are large (at least within the context of a CU) and when they are derived principally from only some parts of the country.

Authors should describe the basic revenue sharing regime in the federation. These can differ greatly:

- In some federations, the central government dominates the collection of oil and gas revenues. However, this can lead to an explicit petroleum revenue sharing formula, where CUs get a share of certain oil and gas revenues levied within their borders (e.g. Brazil, India, and Russia—to a very limited extent) or where virtually all federal revenues are put into a pot for sharing (perhaps with a formula identifying petroleum revenues separately as in Nigeria). In such cases, authors should identify the practices and underlying principles for sharing, including the mechanisms for decisions on sharing (e.g. periodic commissions). In Mexico, a significant share of gross oil and gas revenues were paid directly into electricity subsidies, meaning that in the 1990s the petroleum sector produced negative net revenues for larger governmental purposes.

- In some other federations, the federal government has no particular rules for sharing federal oil and gas revenues, but does have an equalization program. A key issue in such cases can be the treatment of CU oil and gas revenues when their income is being assessed for equalization. Thus in Canada, a province’s non-renewable resource revenues count less than other revenues when its needs are being assessed for equalization support from the federal government. Does the equalization regime only equalize up to a standard or both equalize up and down to a standard? If the latter, how is this done?

- Yet other federations have little or no sharing of revenues. For example, the United States has no equalization regime and does not share federal petroleum revenues with states, whatever their origin.

- Authors should pay particular attention to offshore revenues, which are typically under federal “ownership” (whether beyond the high water mark or the three mile limit). Do CUs get some share of offshore revenues generated in the federal zone? If so, how significant is this and what is the basic sharing arrangement?

- In some cases, such as Brazil and Nigeria, sharing arrangements for oil and gas revenues include provisions for municipalities. This has been very problematic in Nigeria in that many municipalities appear not to receive their due share. Authors should report on such arrangements, again not in detail, and mention whether other groups (e.g. indigenous populations) might have a right to a share of oil and gas revenues.

- Finally, with the recent dramatic rise in oil and gas prices, a number of federations have directed a significant share of oil and gas revenues to debt relief and
stabilization funds. Russia and Nigeria are notable examples. Authors should describe whether this has been an issue in the subject country and whether there have been clear rules around this, decided by whom, based on what authority?

(c) Transparency and accountability

A major issue in various federations is whether the declared oil and gas (and other) revenues of a government (most often the central government) are the real revenues. This is critically important in terms of corruption and diversion of revenues. And it has a major federalism dimension when one order of government counts on knowing the true number of oil and gas (or other) revenues that are to be shared. Interestingly, Nigeria is one of the countries most engaged with the Extractive Industries Transparency Initiative to develop greater transparency.

Related to this is the practice in various countries (notably with a history of military involvement in politics) have developed off-budget accounts (e.g. in Sudan about half of government revenues are thought to be off-budget) that are not reported and are used to finance large parts of the government (typically the military, security and police). Of course, such accounts can facilitate corruption as well. Thus authors should report on the apparent transparency of oil and gas revenues and the mechanisms that are in place to promote such transparency.

The obverse of the transparency of revenues is the transparency of the expenditure of oil and gas (and other) revenues by the two orders of government. In some federations (e.g. Nigeria) the federal government collects upwards of 85 per cent of all government revenues and then makes major transfers to the CUs. When these CUs are formulaic or block transfers, there can be important questions about what the CUs have done with the money. In some federations, there is concern that CU politicians skim off significant amounts and their governments are under no obligation to report on what use was made of the transfers. (Conditional transfers for particular programs typically do not pose this issue because the central government can hold the CUs to account if they expect to receive the money.) A number of federations have developed fiscal accountability laws, which can bind the federal and (sometimes) the CU governments. (The purposes of these laws can include other issues, such as debt management and spending controls.) Thus authors should report on whether there is transparency in how governments receiving transfers of oil and gas revenues are using the funds and what mechanisms promote this.

4. Concluding Observations

Each author is encouraged to conclude with some brief observations that summarize the place of oil and gas policy, management and revenues in the history of the federation and that identify the major current issues that are unresolved and the subject of public debate, especially as they relate to the federal sharing of roles and revenues.