African Fiscal Forum

Strengthening Revenue Mobilization and Fiscal Regimes for Extractive Industries

Fiscal Affairs Department
International Monetary Fund

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Presentation plan

- **Domestic revenue mobilization in Africa:**
  - ❑ Why revenue mobilization is needed
  - ❑ Tax policy and revenue administration reforms

- **Fiscal regimes for extractive industries**
  - ❑ Tax policy and revenue administration reforms

- **Summary**

Revenue mobilization in African countries

Why increased revenue mobilization is needed

Poverty reduction

- MDGs – strengthening social safety nets

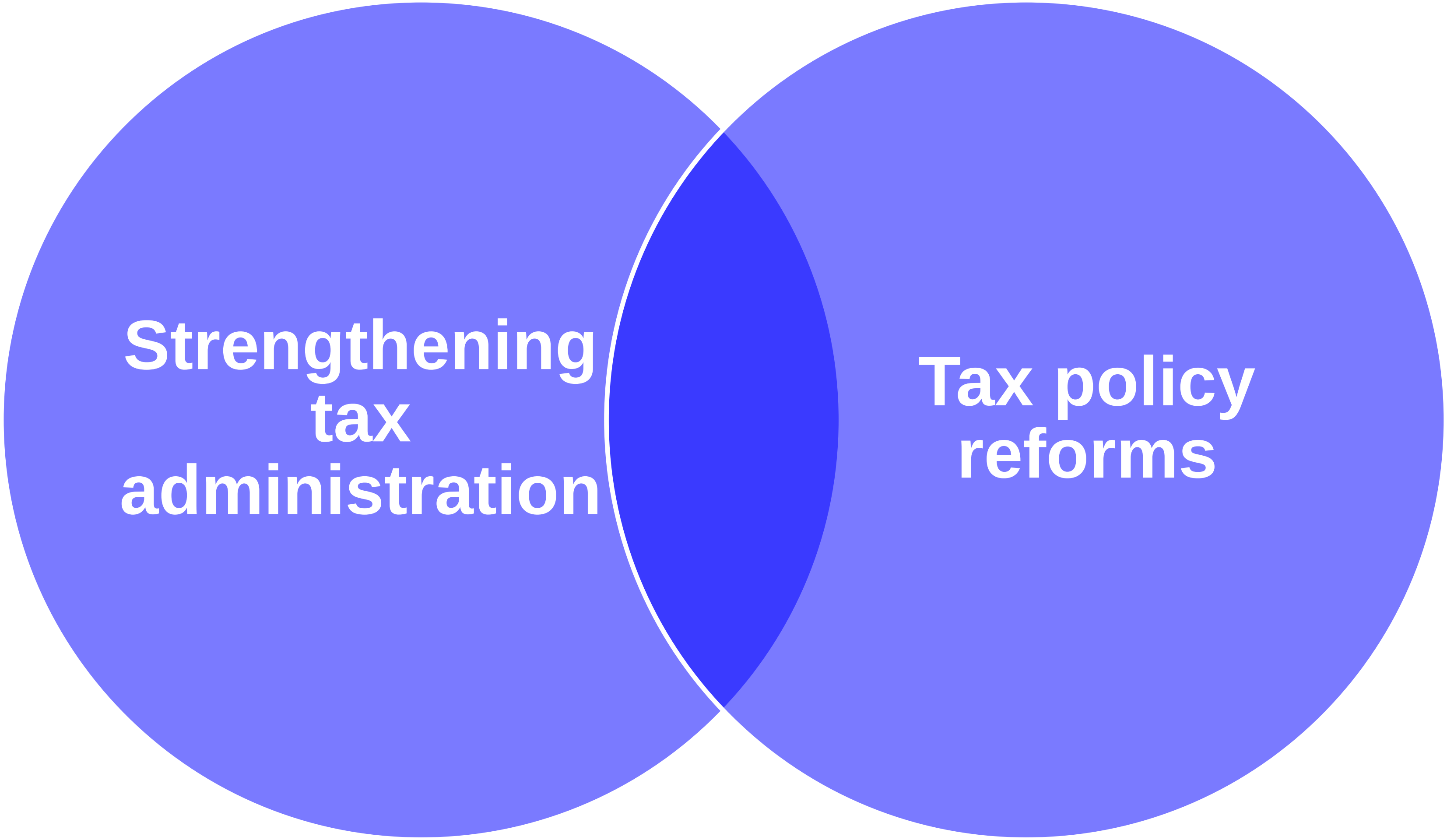
Infrastructure development

- Increasing public investment ratios

Supporting growth and fiscal buffers

- Limiting tax distortions
- Rebuilding buffers without cutting productive spending

Policy options:
Reforms could raise 2 to 4 percent of GDP



Strengthening tax administration

Governance

- Ensure a clear legal and regulatory framework
- Minimize rent-seeking opportunities

Risk management

- Allocate administrative interventions where risks to revenues are greatest
- Exploit withholding and third party information as much as possible

Taxpayer segmentation

- Strengthen large taxpayers offices to tailor services to distinct groups
- Include units for specialized sectors

Strengthening tax administration

Strengthening organizational structures is critical to improve revenue mobilization

- **Key areas of reform:**
  - ⇨ Complete the shift from a tax-by-tax organization to a function-based structure that segments by taxpayer size for better control and servicing of distinct tax groups.
  - ⇨ Improved business processes built on effective IT is essential but the track record has been poor.

Priorities for tax policy reform

- Eliminating tax exemptions
- Implementing a broad based VAT
- Broad-based corporate income tax
- Property tax
- Target excises to address social concerns

Priorities for tax policy reform

Reforms to the VAT have the greatest potential in many countries to mobilize additional domestic revenues

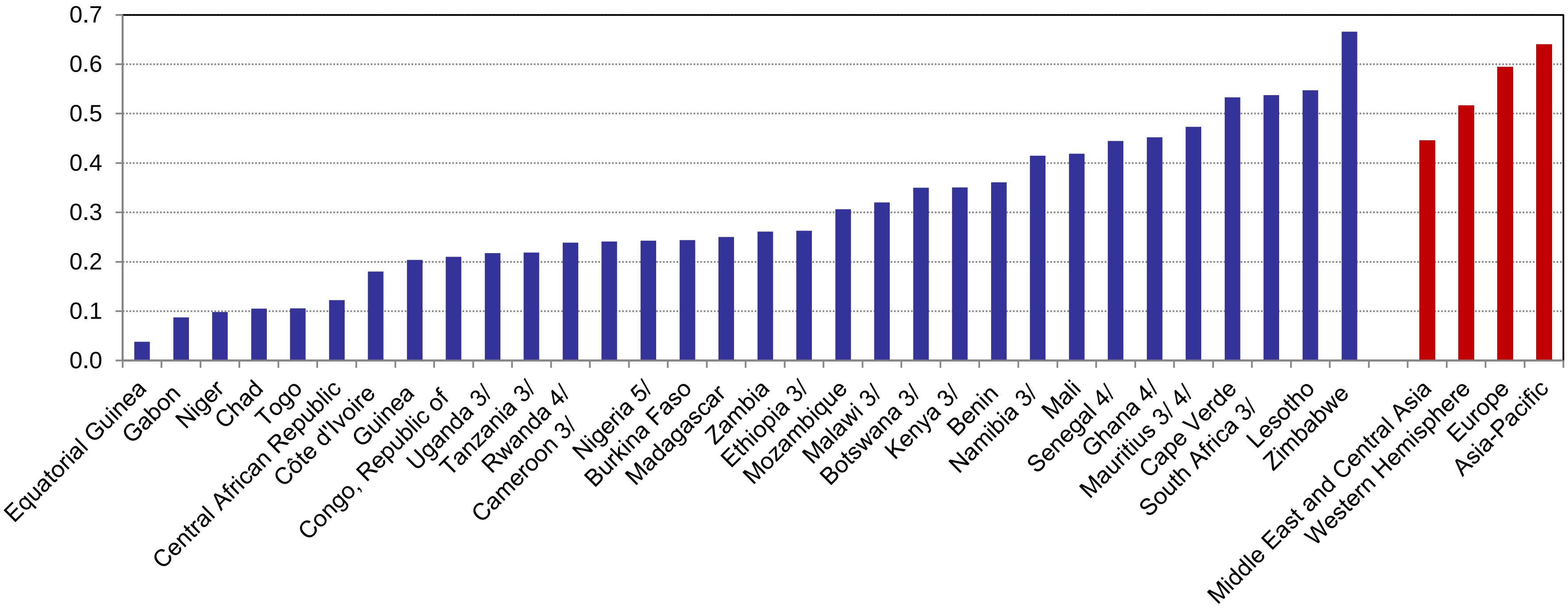
- Most effective approach: a broad tax base with a single rate and a high reporting threshold based on turnover
  - ⇨ A high threshold excludes small traders that would be costly to administer with low revenue yields
- Flawed design and implementation has undermined VAT effectiveness in some countries
  - ⇨ Extensive exemptions, zero-rated products and delays in processing VAT refunds due to false claims
  - ⇨ Low VAT revenue productivity of about 36 percent compared to about 50 percent in advanced economies

Enhancing VAT revenue efficiency

Low VAT revenue efficiency compared to other regions suggests significant potential to raise revenue

VAT Revenue Efficiency

(revenue as a percent of consumption per VAT tax point)

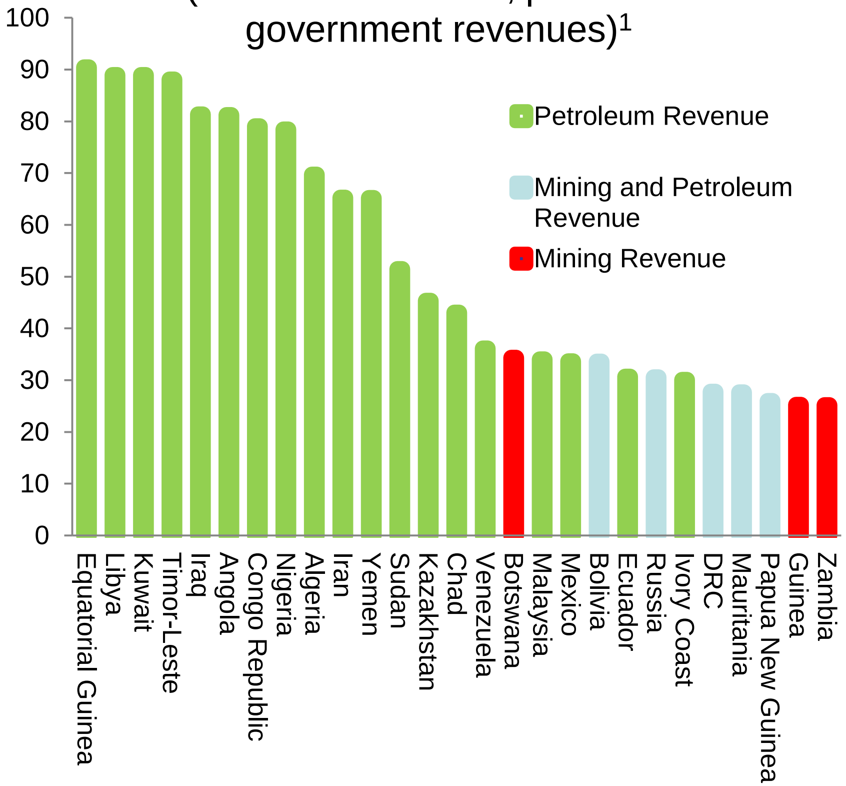


Source: Fiscal Affairs Department, IMF. Based on 2006 revenues, consumption and VAT tax rates.

Fiscal Regimes for Extractive Industries (EI)

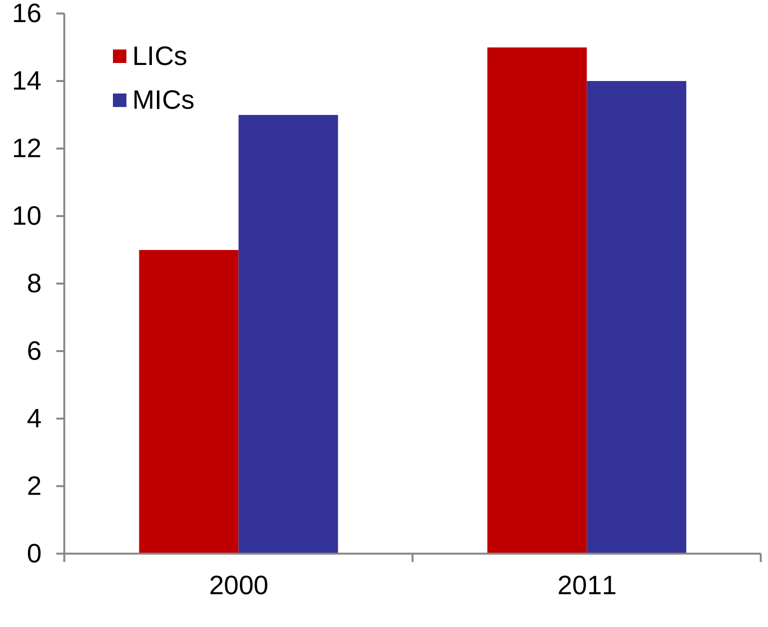
Resource revenues are increasingly important for many developing countries

Receipts from Natural Resources in 2011
(Selected countries, percent of government revenues)[1]



[1] 27 LICs and MICs have mineral & oil revenue above 25 percent, in 2011.

Number of LICs and MICs with mineral and oil revenue above 25 percent of government revenue 1/



1/ Latest data for five countries are as of 2010 and earliest data for five other countries are as of 2001-2004.

Distinct fiscal regimes for EI

- ❑ **Substantial rents**
- ❑ **Pervasive uncertainty**
- ❑ **Asymmetric information**
- ❑ **High sunk costs and long production periods**
- ❑ **Extensive involvement of multinationals in some countries and state-owned enterprises in others**

Exhaustibility

—Revenues are a transformation of finite assets in the ground into other kinds of assets

Objectives of fiscal regimes for EI

- Maximize present value of net government revenues
- Timing of receipts
- “Progressivity” or a higher government tax share with rising resource prices
- Ease of administration (for authorities) and compliance (for taxpayers)

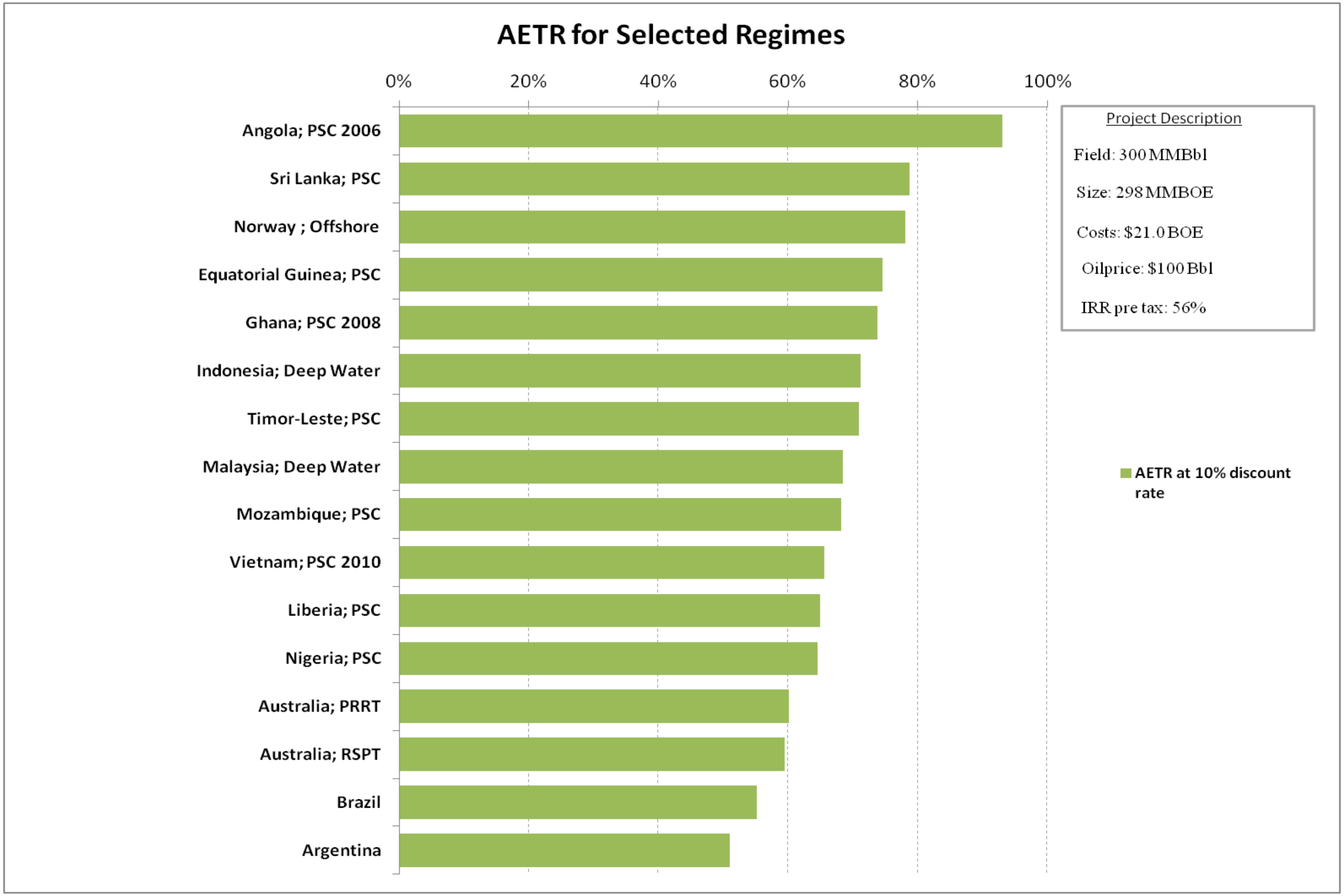
Fiscal instruments for EI taxation

- Bonuses (with bidding)
- Royalty
- Corporate income tax
- Explicit rent taxes
- State participation

Three main fiscal regimes

- **Contractual, including production sharing or service contracts**
- **Tax and royalty, with licensing of areas**
- **State ownership or participation**
  - These can be made fiscally equivalent
    - Design to achieve efficiency and transparency in each case

Average effective tax rates (AETR)



Average effective tax rates (AETR)

Fiscal regimes for EI vary greatly

- Simulations for mining suggest government shares of 40-60 percent—but collection data suggest lower in practice
- For petroleum the simulated shares are higher: 65 to 85 percent

Tax administration of extractive industries

- EI tax administration should not in principle be hard
- In practice, administration has been difficult
- Claims that administration of profit/rent-based EI taxes is too hard, and that countries should rely on royalties, are often misplaced
- Principles of effective modern tax administration are equally relevant to EI

Recommended approaches

Country circumstances require tailored advice, but generally a framework combines:

- A royalty on gross revenue
- A tax targeted explicitly on rents (and thus on the achieved results of extraction)
- Together with normal corporate income tax
- Bonus-bidding may have a role in promising environments

This framework:

- Ensures revenue from day one and rising fiscal revenues as economic rents increase – whether from rising prices or from favorable geological or cost conditions

Summary

Summary

Domestic revenue mobilization provides a means to achieve key development goals linked to poverty reduction, infrastructure and growth.

Strengthening revenue mobilization requires a mix of tax policy and administrative reforms. Resource revenues will increasingly play a role.

Fiscal regimes for extractive industries need to reflect the unique characteristics of taxing natural resource wealth.

Fiscal regimes for extractive industries vary across countries but can be made equivalent. The key is ensuring transparency and efficiency.

THANK YOU

Presentation is based on:

Revenue Mobilization in Developing Countries, IMF, March 8, 2011. Available at:

http://www.imf.org/external/np/pp/eng/2011/030811.pdf

Fiscal Regimes for Extractive Industries: Design and Implementation, Fiscal Affairs Department, IMF, August 15, 2012.

Available at: http://www.imf.org/external/np/pp/eng/2012/081512.pdf