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POLICY BRIEF
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South Sudan's Petroleum Revenue Management Act

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Introduction

At independence, South Sudan inherited an oil industry with pre-existing infrastructure and a number of production sharing agreements (PSAs) with multinational oil companies; however, it did not inherit the human resources, institutions, and experience necessary to manage them. The Government of South Sudan has since begun a process of creating a legal environment that is amenable to a transparent, equitable, and sustainable petroleum industry; beginning with Chapter 3 of the *Transitional Constitution* (2011) followed in 2012 by the *Petroleum Act*. On July 17, 2013, the Legislative Assembly passed and, pending review and approval from the Council of States, will soon enact the newest addition to the ongoing reform process: the *Petroleum Revenue Management Act (*2012).[1] The Petroleum Revenue Management Act (PRMA) establishes a formalized structure for distribution of petroleum revenues to immediate budgetary needs, savings and revenue stabilization, and direct transfers to petroleum producing states and affected communities. It sets a high bar for reporting requirements for both the Government and oil companies, with the overarching principle of transparent and accountability management. As it stands, the PRMA has the potential to be a 'game changer' for South Sudan, avoiding capital flight and unstable public expenditures while ensuring that long-ignored communities in the oil-producing regions see direct benefit from the petroleum sector.

This brief begins with an overview of Natural Resource Funds as a tool for resource-rich states, followed by an overview of the strengths and weaknesses of the PRMA as the legislation currently stands in the context of international best practices. The brief concludes with a discussion of additional considerations and recommendations necessary for ensuring the success and sustainability of the ongoing petroleum industry overhaul in South Sudan.

[1] Although the *Petroleum Revenue Management Act* passed it's final reading in the Legislative Assembly in July

Why Natural Resource Funds?

Natural Resource Funds (NRFs) are financial structures such as the Petroleum Revenue Management Act that have been established by high-value resource producing states to manage revenue, cushion national economies from fluctuating commodity prices, and, in many cases, act as a mechanism to balance immediate budgetary needs with saving for 'future generations'. NRFs emerged from current thinking on the role of natural resources in achieving long-term development outcomes: instead of offering a 'big push' for development, resources are a 'curse' that must be managed.[2] High-value resource exporters are argued to have weakened institutional capacity and slow long-term growth. Frequently cited explanations to this 'paradox of plenty' include violent international commodity price fluctuations, lack of transparency, and poor institutional capacity to manage revenues.[3] Recent studies have suggested that NRFs can offer the structure required to mediate some of these tendencies (Engel & Valdés, 2000).

Presently, NRFs are used by states that are considered 'high-capacity' petroleum producers such as Norway, Canada (Alberta), United States (Alaska) as well as countries traditionally viewed as 'low-capacity' (*e.g.*, Gabon, Cameroon, and Timor-Leste). As such, a wealth of best practices for NRFs has emerged and South Sudan has been able to draw on these lessons in the structure and goals of the Petroleum Revenue Management Act (2012).

The Petroleum Revenue Management Act

South Sudan's Petroleum Revenue Management Act (2012) has already been welcomed by international organizations and high-value resource watchdogs as an important step for South Sudan's move toward a more predictable and accountable petroleum industry. The following section provides an overview and critical assessment of financial, social, as well as transparency and accountability measures included in the current draft of South Sudan's Petroleum Revenue Management Act before the Council of States.

Financial

Providing a clear structure for the division of oil revenues is the principle concern of the Petroleum Revenue Management Act. All revenues collected by the Government of South Sudan will be managed by two components: the Petroleum Revenue Account (75 percent) and Petroleum Revenue Savings Funds (25 percent).

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2 See: Karl (1997); Ross (1999); Isham, *et al*., (2005); Rosser (2006); Humphreys, *et al*., (2007).

3 The 'resource curse' debate has had a lively history and has devolved into multiple discussions surrounding (geo)political, institutional, economic, and social factors as determinants to growth in resource-rich states - this has also produced a number of critiques questioning whether such a causal 'curse' in fact exists. This debate is out of the scope of this paper, but it is important to mention the way in which it has influenced on-the-ground policy making.

Petroleum Revenue Account

Arguably, one of the first victories of this legislation is the broad definition of 'Petroleum Revenue'. Often NRFs will differentiate between "direct" (royalties, contracts) and "indirect" (taxation) revenue streams or simply ignoring indirect revenue sources altogether. Instead, the PRMA directs all petroleum revenues including domestic sales, taxes, royalties, and, explicitly "any amount received by the Government relating directly to Petroleum Activities not covered [in section 7.2]" into the Petroleum Revenue Account. Channeling all revenue into a single account requires less institutional capacity to manage, making it more manageable for the Government, CSOs, NGOs, and citizens to understand and monitor (Pegg, 2009).

However, revenue reported by South Sudan is Net Petroleum Revenue: "Petroleum Revenue accruing to the government from oil production less Administrative and Transportation Costs and transfers to the Reserve Fund". Although not specifically addressed in the legislation, the Government should ensure that the calculation of "Administrative and Transportation Costs" be made in a public manner as misreporting offers a window for revenues to be diverted from entering the fund in the first place. Due to geographical constraints and limited infrastructure, South Sudan must cooperate with neighboring countries for transport, shipping, and refining. Consequently, it will be much more difficult to ensure transparency across the production chain. Regardless of whether South Sudan continues to develop partnerships with Kenya, Ethiopia and Djibouti on new pipeline, port, and refining projects or South Sudan continues cooperation with Sudan for these services, clear fee structures in the Intergovernmental Agreements (IGAs) will be essential to ensuring civil society can monitor Administrative and Transport Costs and ensure accurate reporting of Net Petroleum Revenues. Natural resource funds only manage revenue when it is in the account – which means careful regulation of inflows is necessary.

Petroleum Revenue Savings Funds

Revenues channeled in the Petroleum Revenue Savings Funds are divided into two funds: the Oil Revenue Stabilization Account and the Future Generations Fund. Together, the balance in these accounts constitutes the "only savings of the Government" (13.3). The PRMA stipulates that a guaranteed portion of Net Petroleum Revenues, 15 percent and 10 percent respectively (14.4), will enter into government savings. The remaining 75 percent is available for transfer to the Consolidated Fund – which is the pool of money from which the national budget, based on predicted oil revenue, is built.

As the name would suggest, the Oil Revenue Stabilization Account is a mechanism intended to protect the budgeting process and associated public expenditures against fluctuations and uncertainty in international oil markets. South Sudan has followed standard NRFs practice that functions against a benchmarked rate set on a historical average of international crude oil prices. If actual quarterly revenues fall below benchmarked oil revenue, the Stabilization Account may be drawn upon to provide the difference – this is the only circumstance in which withdrawals can be made from the Stabilization Account. In the event that oil prices exceed benchmarked rates, surplus revenue is transferred directly into the second Savings Fund: The Future Generation Fund.

The Future Generation Fund recognizes the inevitable exhaustion of petroleum resources and, in the spirit of intergeneration equity, aims to ensure a smooth transition to the post-petroleum economy. The Future Generation Fund will not be accessible for withdrawals until five years after the PRMA is signed into law. After this waiting period, the Fund can be withdrawn at a maximum of 10 percent of the Fund balance per year for capital investments deemed to "benefit future generations and foster long-term growth" (15.5(c)). Providing a limit on annual withdrawals from the account discourages short-term projects approval by the Legislative Assembly before any transfer can be made.

South Sudan has taken a slightly different approach than many NRFs in regards to saving mechanisms. Usually, the approach has been to "save in plentiful years, and spend in meager years" (Humphreys & Sandbu, 2007: 198) as opposed to mandating portions of Net Petroleum Revenue which must enter savings every year. South Sudan's approach of 25 percent savings might mean that the government may need to dip into the Stabilization Fund more frequently to balance its budget; however, pre-determined percentages offer simplicity in administration and monitoring as well as leaving less room for saving to only occur at the government's discretion.

Social

It is well documented that petroleum production has not historically benefitted civilians in South Sudan as indicated by the high levels of violence and displacement in the oil producing regions (HRW, 2003; Moro, 2009), particularly in the years leading up to the Comprehensive Peace Agreement. The PRMA attempts to address growing grievances among local communities in oil-producing regions by legislating direct financial benefit to Petroleum Producing States and communities in these states directly affected by petroleum production: 2 percent and 3 percent of Net Petroleum Revenues respectively. Although transfers to Petroleum Producing States seem straightforward, the process for transferring funds to 'communities' is more ambiguous. As it stands, the 55 percent of the allotted 3 percent will be divided amongst "affected communities" while the remaining 45 percent will go to "neighboring communities". The geographical distinction between "affected" and "neighboring" is slight at best and it is unclear what criteria determine a community's membership to either category Assuming "affected" refers to a community which surrounds an active oil well, many communities who experience direct impacts of oil petroleum production may be excluded from compensation; it is well documented that direct local impacts are also associated with petroleum infrastructure – principally oil pipelines and refineries.[4] The differentiation of communities also raises the question about inequality forming within states themselves. Will certain counties with Petroleum Producing States be excluded from these revenue streams, with the exception of any 'trickle down' from state portions? The Government must be cautious in creating additional sources of local grievance within an already fractured and fragile political arena.

In addition to the lack of clarity surrounding which communities will be entitled to revenues, the process for distributing and operationalizing local windfalls are vague in their current form. The community dispersals are to be controlled by Community Development Committees (CDCs) that are composed of community leadership, farmers, women, youth, and CSO representatives who will guide the use of funds for local priorities. In some communities, such committees already operate as decision makers in local development plans. The CDCs in communities who will receive funds are to be overseen by a Community Advisory Committee composed of state authorities and political representatives. Presumably the Council of States will further refine Schedule B to make it suitable for state and local contexts. However – this cannot be the final step in establishing guidelines for transfers to communities; a process to help define specific processes to manage the 3 percent must be undertaken in cooperation between government, civil society and the community representatives in order to ensure clear expectations and transparent procedures.

Transparency and Accountability

South Sudan has made remarkable progress creating institutions and legal frameworks to manage the petroleum industry. Exceeding international guidelines, the Petroleum Revenue Management Act has the potential to pave the way for a well-managed, equitable and accountable industry. It sets reporting standards for both the Government for in- and out-flows as well as overall performance reporting on the Petroleum Revenue Account and the Petroleum Revenue Savings Funds; mandatory industry reporting on all payments made to the government; and independent annual auditing.

Whether or not the PRMA achieves these goals comes down to the challenge of implementation. According to the Revenue Watch Institute's Resource Governance Index for 2013, South Sudan is ranked 50 out of 58 on natural resource governance. Countries are ranked based on 50 indicators in four categories: institutional and legal setting; reporting practices; safeguards and quality control; and, 'enabling environment' (*i.e.*, rule of law, corruption, and accountability). South Sudan receives 'failing' scores on the latter three indicator categories, but scores 'satisfactory' (80/100) in the institutional and legal setting category – scoring higher than some top-ranked exporters including Canada (67/100) and the United Kingdom (79/100) (RWI, 2013). Hopefully the past is not a predictor of what is to come for the PRMA - *The Petroleum Act* (2012) was passed last year and promised public access to

[4] See: Watts, 2004; Nelson, 2006; Pantuliano, 2010; Behrends, 2011; Lo, 2012; Swing, 2012

government records regarding contracts, revenue and expenditure data, and development plans, but so far no information has been published about agreements negotiated since independence (Global Witness, 2013). If the rules are broken or ignored early on, it is not an encouraging sign of a government's willingness to honor its commitments.

Conclusion

The Petroleum Revenue Management Act has the potential to substantially alter the future of South Sudan's petroleum industry by providing a framework for accountable and sustainable revenue use. It also goes without saying that sound fiscal management does not depend on the creation of a Natural Resource Fund; numerous studies have demonstrated that NRFs tend to be managed in a similar manner as the general economy (Fasano, 2000; Humphreys & Sandbu, 2007). The PRMA only sets parameters for revenue inflows and providing structure for dispersal and savings of those inflows. The PRMA does not dictate *how* petroleum revenues are spent once they leave the Petroleum Revenue Fund or the Petroleum Revenue Savings Funds as the case may be – they only ensure that public expenditures do not fluctuate based on global petroleum prices. The Government must grapple with other institutional and political challenges that are preventing budgeted resources from reaching people on the ground.

The PRMA cannot be viewed as a stand-in for addressing root causes of macroeconomic turmoil that continues to plague the country. Having revenues to manage through the PRMA is dependent on South Sudan's ability to export crude oil and benchmarking against international for national budgeting processes only goes so far in absorbing price shocks; such stabilization procedures are meant to balance regular fluctuations in international market prices – not complete and unpredictable industry shutdown. Although renewed talks between Sudan and South Sudan appear to be moving in a positive direction, securing oil revenues on which both countries are highly dependent, concrete long-term agreements will need to be reached. Disregarding the ongoing tension between Sudan and South Sudan precipitates the highly unstable political environment and urgent financial demands that incentivize rule breaking and amendment making.

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