

Financing social protection through taxation of natural resources



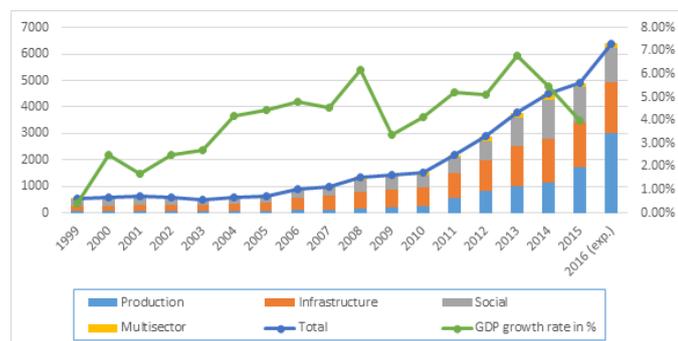
International Labour Office

Bolivia

Bolivia is an example of how countries with natural resources can create fiscal space to expand social protection and generate government revenues to support social and socio-economic development and to help mitigate inequality and reduce poverty.

Bolivia's annual economic growth averaged 4.9 per cent between 2004 and 2014, with poverty rates falling from 59 per cent in 2005 to 39 per cent in 2014. The Gini index fell from 0.6 to 0.47 in the same period, while social spending increased significantly, as indicated in Figure 1. Bolivia's development over the last decade is closely linked to policy changes regarding its natural resource extractive industries.

Figure 1: Public investment spending (in US\$ millions, nominal) and annual GDP growth (in %)



National social protection floors (SPFs) guarantee access to essential health care and basic income security for children, persons of working age and older persons.

185 countries have adopted the Social Protection Floors Recommendation, 2012 (No. 202), an approach to achieve universal social protection.

This note presents a successful country experience of expanding social protection.



Main lessons learned

- Natural resource rich countries can boost their social protection system through the taxation of natural resources, increasing government revenues and supporting the expansion of social protection expenditures.
- Earmarking government income generated from natural resources can directly link the allocation of funds to social protection programmes.
- The process of increasing social expenditures was accompanied by a transparency initiative that requires local and national governments to disclose their revenues and transfers. Civil society organizations in parallel carry out monitoring of company payments to the State and the management of related revenue at the national and subnational levels.
- Through the taxation of natural resources and the expansion of social protection spending, the Government managed to reduce poverty rates and inequality, while also supporting economic growth.

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1. Natural resource extraction tax and global trends

Adjusting the taxation of extractive industries is a strategy many countries have used to increase fiscal space. Due to the rise of commodity prices during the past decade and a sharp increase in profits among the world's largest mining companies, a number of governments around the world have reviewed their shares in the distribution of the rents. The United Kingdom increased the supplementary tax on oil production in 2011, and the Government of Australia, against heavy opposition from the booming mining sector, introduced a mineral resource rent tax of 22.5 per cent in 2012.

Countries around the world are revising the regulatory environment for extractive industries. In recent years, discussions among different stakeholders on reforming tax and ownership regimes took place in Brazil, the Democratic Republic of the Congo, India, Mali, Mozambique, the Philippines, South Africa and the United States. In South Africa, for instance, there have been extensive debates on the nationalization of the mining sector, with the conclusion that a fairer redistribution of mining profits can be achieved through the introduction of a resource rent tax of 50 per cent and the creation of a state mineral company to develop strategic minerals.

While developed economies have a broad base to collect taxes and social security contributions to finance social protection, developing countries often struggle to generate government revenues through taxation and contribution collection. Tax authorities tend to be weak and taxation systems often lack transparency, while a relatively large share of the population is employed in the informal sector, making it difficult and costly to collect social security contributions and income taxes. This also limits the means for redistributive policy to reduce inequality and poverty.

In many developing countries, collecting higher public revenues through rents from natural resources and extractive industries is of particular importance for the financing of development. Developing countries can raise revenues either by directly extracting the natural resources through a state-owned enterprise, joint-ventures or other forms of co-extraction, or by selling

the exploitation rights and taxing the profits of a single industry. Both avenues can provide revenues for social and socio-economic development.

2. Taxing hydrocarbons in Bolivia

Bolivia is the second largest supplier and largest exporter of natural gas in South America. Over the past 10 years, natural gas production in Bolivia increased from 2.8 billion cubic metres in 1998 to 13.9 billion cubic metres in 2008. Hydrocarbon revenues contributed to 35 per cent of the country's GDP and 55 per cent of total exports in 2013.

Orthodox neoliberal policies in the 1980s resulted in the majority of the extractive industries being privatized and in the hands of foreign companies. Producers earned high profits, but paid little in royalty payments, leading to widespread dissatisfaction among the Bolivian population. The widespread dissatisfaction initiated an activist movement and the so-called "Gas Wars" that led to the resignation of President Sánchez de Lozada and a national referendum on the regulation of the distribution of hydrocarbon wealth. The previous share of 82 per cent of oil revenues for the producers and 18 per cent for the State was equalized at a 50-50 split. Bolivia introduced stronger state control starting in 2003 with the introduction of a direct tax on hydrocarbons (IDH) and with the renegotiation of contracts. Revenues from IDH and royalties increased from US\$338 million in 2004 to over \$726 million in 2005. In 2006, the newly elected president, Evo Morales, "nationalized" Bolivia's oil and gas sectors and changed state royalties to 80 per cent, thus greatly increasing government revenues from the sector. Government revenues rose from \$1.55 billion in 2006 to \$2.7 billion in 2008 and to \$6 billion in 2014. Taxing hydrocarbons became a key to Bolivia's national and, in particular, social development

As of 2006, Yacimientos Petroliferos Fiscales Bolivianos (YPFB), the country's national oil company, was the only entity authorized to undertake activities in the exploration and sale of hydrocarbons. YPFB, consisting of mostly state-owned subsidiary companies, administers service contracts with international companies, including British Gas, Canadian Energy Enterprise, Pluspetrol, Bolivia Corporation S.A., Petrobras, Repsol YPF, Total and Vintage Petroleum.

Investors initially threatened to take legal measures against the Bolivian State and to freeze their investments, but as the Government still offered attractive returns even after the new measures, most of them eventually signed the new agreements without legal actions.

Another measure that contributed to Bolivia's success in creating fiscal space for social and socio-economic development is the revenue transparency initiative that requires local and national governments to disclose their revenues and transfers. Civil society organizations carry out monitoring of company payments to the State and the management of related revenue at the national and subnational levels, thus supporting the oversight of government finances and the efficiency of social spending. All the rules regulating resource revenue sharing with subnational authorities, including earmarking provisions and transfers to subnational authorities, are available online and for public consultation.

3. Hydrocarbon taxation and social protection

A portion of revenue from hydrocarbon taxation is earmarked for a universal old-age pension scheme, Renta Dignidad, and additional portions are directed to other cash transfer programmes, such as the Bono Juancito Pinto, for schoolchildren. Public spending increased in all areas, with a particularly high increase in social spending.

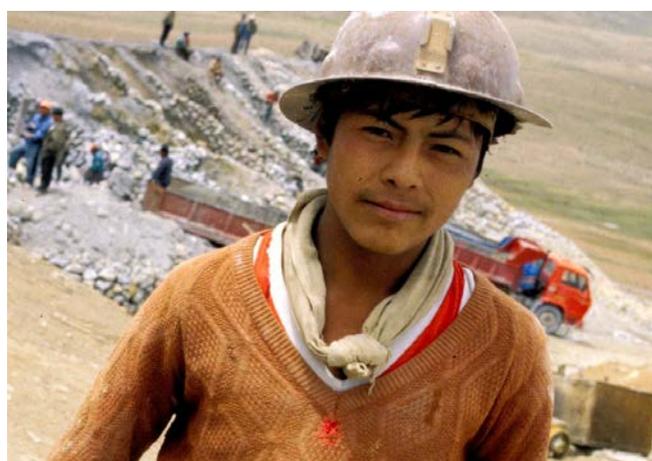
The Bono Juancito Pinto is a cash transfer in Bolivia whose beneficiaries are children going to public schools. It was established in 2006 with the aim of reducing dropout rates among students enrolled in government schools. They were provided with an annual grant of 200 Bolivian Bolivianos (BOB) (\$25) conditional on their attendance at school. Financing came entirely from the additional 32 per cent share that YPFB had in total revenues from the hydrocarbon sector. In 2007 and 2008, YPFB and the state mining consortium (COMIBOL) financed 47 per cent of the programme and the treasury provided the remaining funds. In 2010, 1.6 million children received the Bono Juancito Pinto at a cost of \$54 million, about 0.24 per cent of Bolivia's GDP.

From 1997 to 2007, Bolivia had non-contributory benefits provided through Bolivida and Bonosol for people over 65 years of age. In 2007, a new programme called Renta Dignidad was created, replacing Bonosol, providing universal social income for people over 60 years of age. The programme started in 2008 and pays an annual benefit of \$340 for people without a pension income, and 75 per cent of that amount to people with another existing pension. The programme is funded using up to 30 per cent of all IDH revenues, as well as from dividends from renationalized companies.

4. Conclusion

The increase in taxation on the oil and gas industry enabled the Government of Bolivia to generate sizeable rents that are transferred to sectors and regions with developmental needs and supports the extension of social protection measures. Universal social pensions and other cash transfer schemes, such as the Renta Dignidad and the Bono Juancito Pinto programme, are financed through earmarked hydrocarbon tax revenues. Bolivia, thanks to its extractive industries, has managed to significantly reduce poverty and inequality, while also guiding its economy towards a positive development path, with annual growth rates averaging around 4.9 per cent since 2004.

Taxing natural resource extraction is one of the many alternatives that countries have to expand fiscal space for social protection. Governments normally use a mix of taxes and social security contributions to fund social protection, combined with other options explained in the paper, "Fiscal Space for Social Protection: Options to Expand Social Investments in 187 Countries".



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