

Fiscal Affairs Department

Potential Economic Benefits, Challenges and Risks of Deep Sea Mining for Pacific Islands



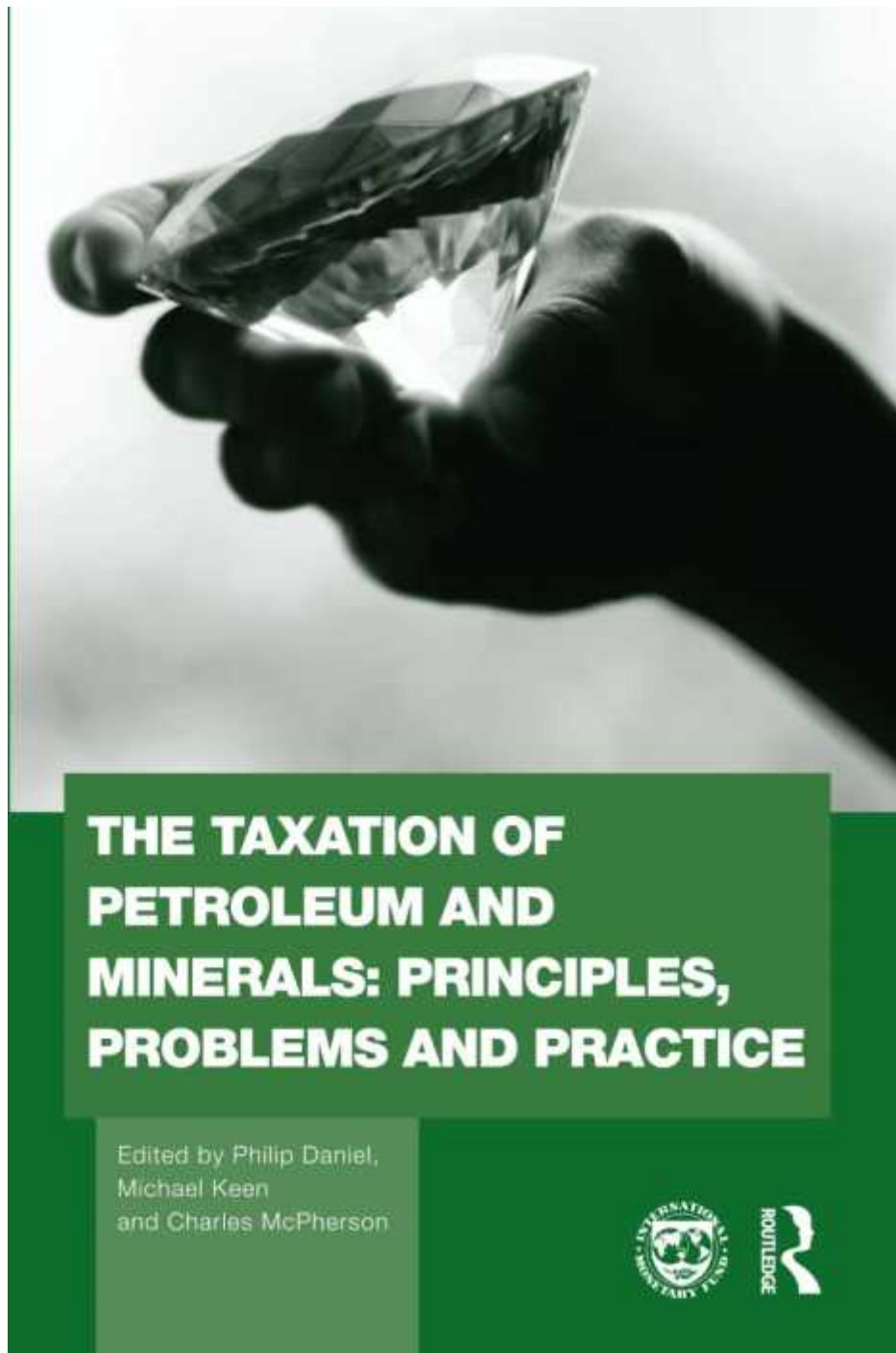
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Presentation Outline

- Overview of key economic objectives for deep sea mining (DSM)
- Benefits, challenges and risks
- Level of government participation in projects



**THE TAXATION OF
PETROLEUM AND
MINERALS: PRINCIPLES,
PROBLEMS AND PRACTICE**

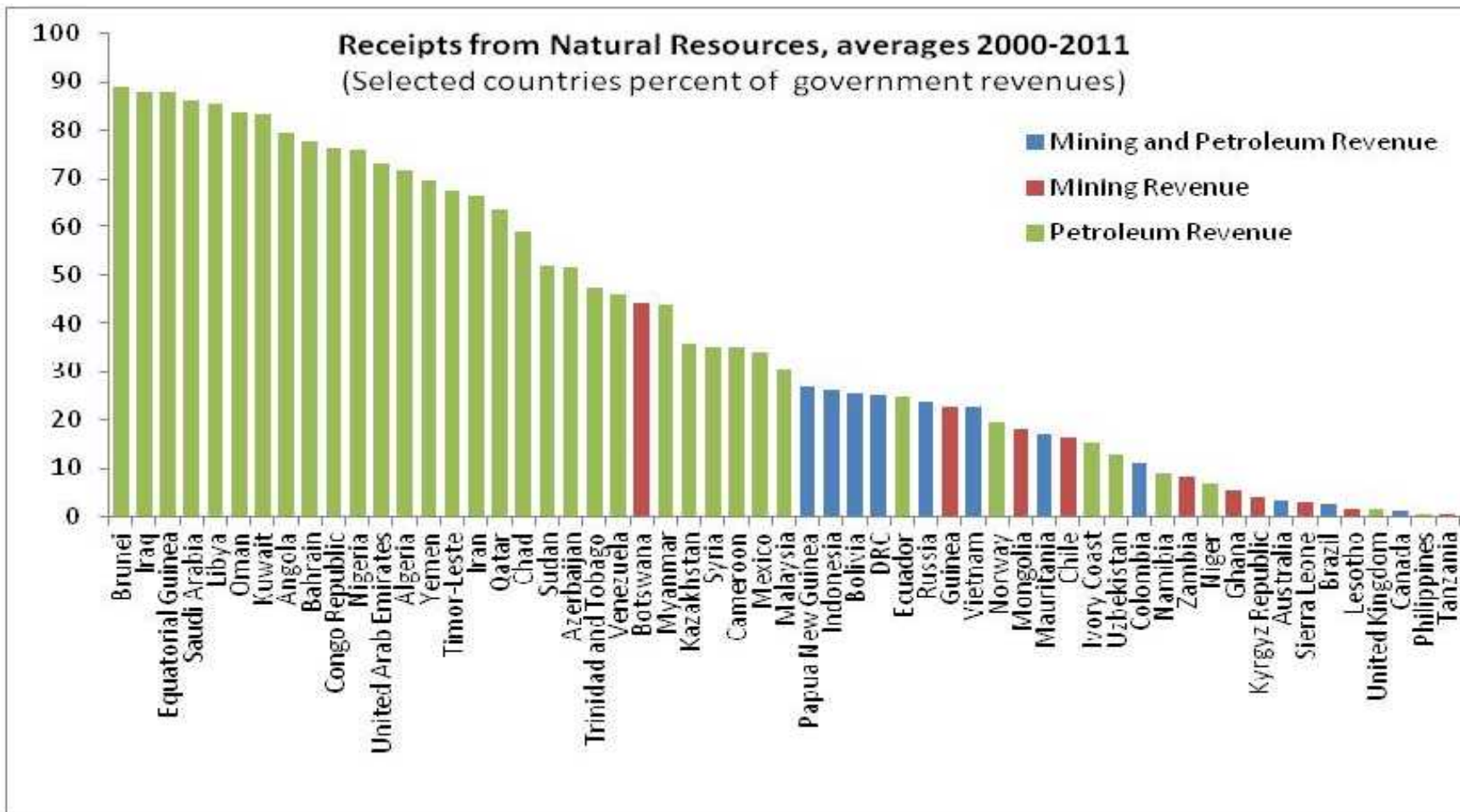
Edited by Philip Daniel,
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and Charles McPherson



“There are few areas of economic policymaking in which the returns to good decisions are so high – and the punishment of bad decisions so cruel – as in the management of natural resource wealth”

Why so important?

A key revenue source for (increasingly) many...



Key Objectives

Transform exhaustible natural resources into assets—human, domestic, and private capital and foreign financial assets—that will generate future income and support sustained development

- Need good policy framework, especially for revenue and spending, to ensure natural riches are not squandered
- If used properly, natural resources can help enhance growth and reduce poverty

Potential Economic Benefits of DSM

There are a number of potential economic benefits of DSM for PICs:

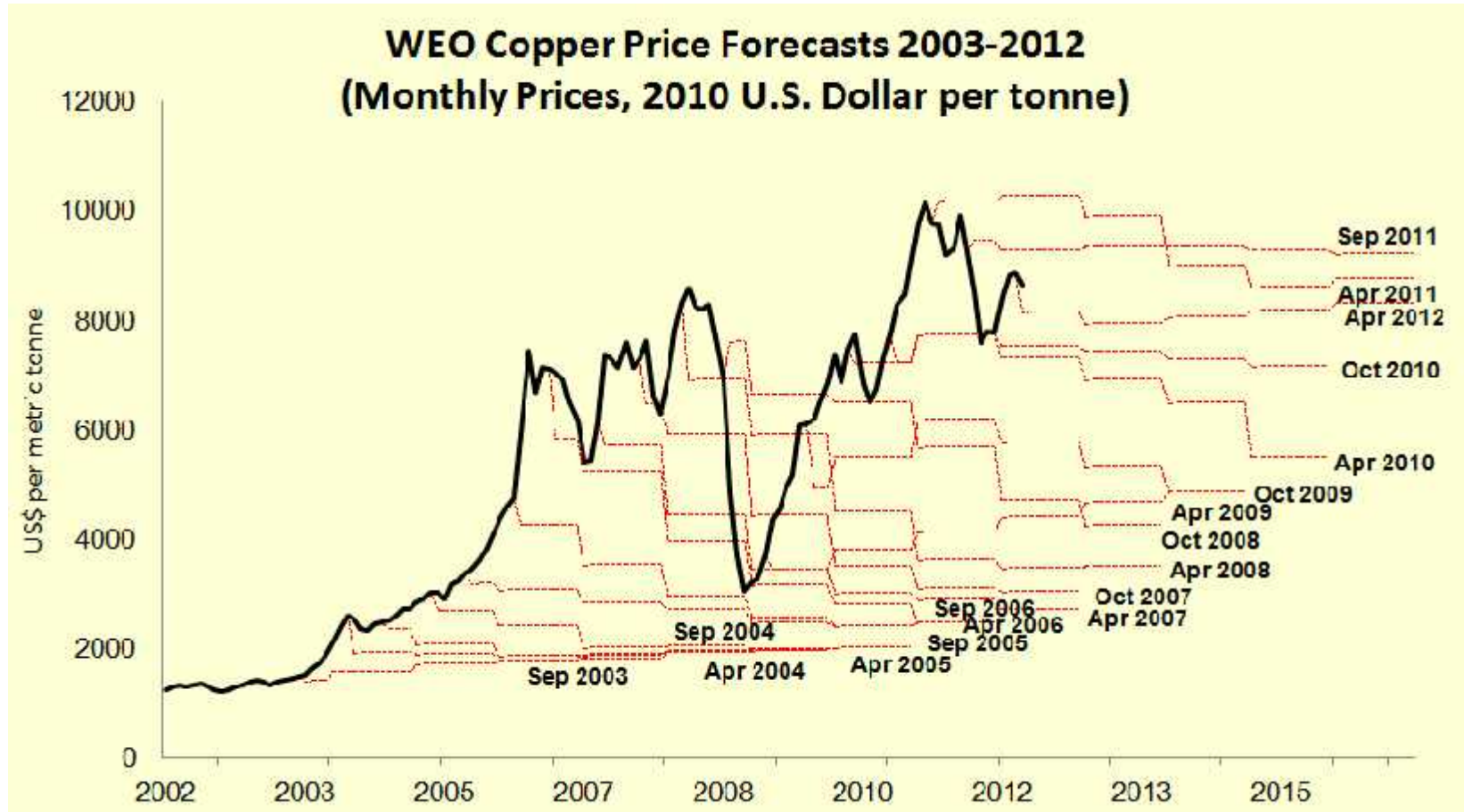
- Enhancing growth
- Providing much needed government revenue
- Providing employment opportunities
- Possible infrastructure investment
- Aiding overall economic development

Challenges and Risks

...but the sector comes with challenges and risks:

- Ensuing EI sector does not choke off other sectors (i.e., Dutch disease)
- Exposure to volatile commodity prices—can make economic policy decision making difficult
- Ensuring government maximizes revenue without creating disincentives for investment and production
- Ensuring revenues are managed well (how much to spend and save?)
- Governance issues

Forecasting prices is hard...



Sources: IMF World Economic Outlook (2003-2012).

Note: Solid lines are spot Cu prices. The dashed lines are price projections.

Extent of Government Participation

- Government participation (i.e., taking some kind of financial participation in the project), in addition to the usual regulatory role, may be seen as a mechanism to enhance the economic benefits and limit the risks

... but has drawbacks

Forms of Participation

1. Full Equity Participation—includes:
 - Full government ownership, usually through a state owned enterprise (e.g., National Resource Company (NRC))
 - Acquiring ownership interest (e.g., shares) in private sector operations
2. Carried Equity Participation—private investor “carries” the state in the early stages of the project with the state having some financial obligation to compensate the private investor
3. “Free” Equity Participation—state obtains equity interest without financial obligation
4. Production Sharing—state obtains a share of production as a commercial partner (common for oil and gas but not mining)

Why Participate?

- Protection of national interest
- Maximize revenue flows
- Monitor private sector (ensure appropriate behavior)
- Help resolve asymmetric information ('seat at the table')
- Build capacity through the transfer of management and technical skills and information
- Pursue other development goals (e.g., job creation, promotion of local content, provision of infrastructure)

Challenges of Government Financial Participation

- Potential budgetary issues (if have to pay for interest)
- Governance issues
 - Participation by elite can lead to pursue own agenda
- Risks for macroeconomic management
 - Danger of NRC operating outside usual fiscal processes and discipline, as well as raising transparency issues
- Conflict of interest with regulator role
- Commercial efficiency
- Capacity of NRC or responsible ministry to deal with issues

Possible Responses

- Caution about state participation due to challenges
... can address concerns with better taxation and good regulatory laws and administration
- Role between ministries should be clear
- Transparency is essential (for both government and private sector)

Downstream Participation?

Should governments participate in downstream operations (e.g., mineral processing)?

- Raises similar issues to upstream participation:
 - Budgetary impact
 - Local capacity
 - Infrastructure needs

Conclusions

- DSM offers potential economic benefits to a country
- ... but there are also many challenges
- It is important to ensure a good policy framework, especially for revenue and spending, to ensure natural riches are not squandered
 - Direct government participation in DSM projects may be seen as a way to enhance economic benefits, but there are drawbacks
- ... an alternative is to ensure a sound tax regime and good regulatory laws and administration