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Discussion-Opinion-Editorial™

Corruption in the Minerals, Oil and Gas Industry (MOGIn) is now at a Dangerously Unacceptable Level and it is Eating into the Sector Wellbeing. A GST like Structure can bring change

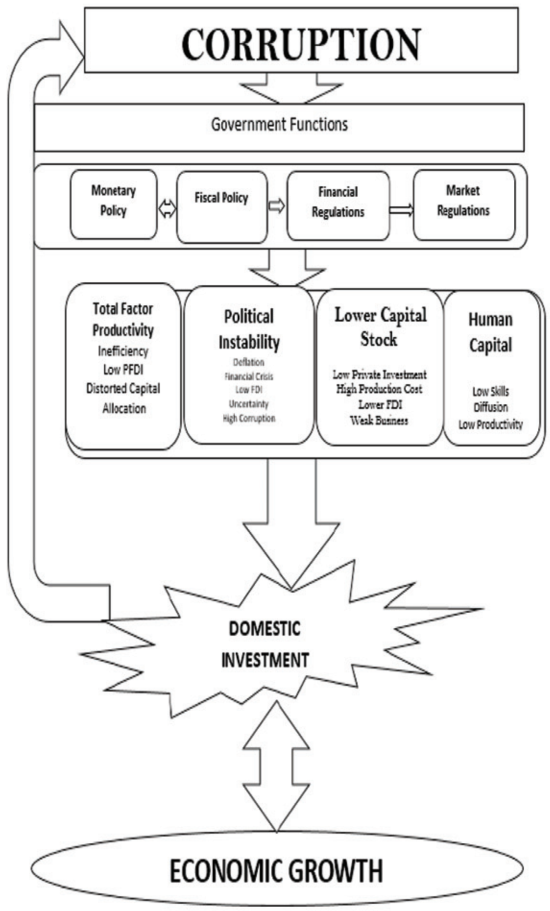
Background

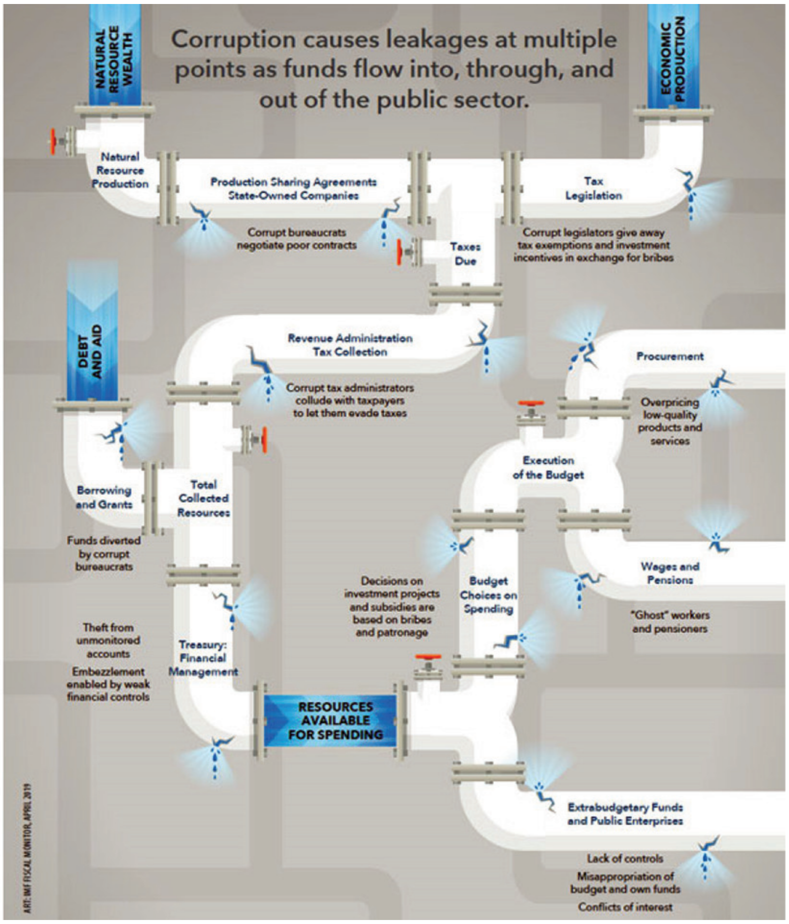
1. As per empirical research, a one-unit increase in corruption reduces GDP pc by 0.15% to 1.5%.
2. Globally, reducing every per cent of MOGIn corruption can contribute to 2 per cent more wellbeing to the local community.
3. 1 in 5 bribery cases of any country involve MOGIn, by IMF and OECD.
4. Nearly 2 trillion dollars or 2% of the global GDP is lost on bribery and about 4% of the MOGIn GDP is lost in bribery and corruption, by IMF.
5. According to an E&Y survey in 2008, 47% of the respondents contacted from the mining and power utility sectors, found bribery to be more prevalent in their sectors. The next big industry where there is a higher incidence of corrupt practices, was insurance with a 41% response.
6. An Indian steel ministry report said that from 2001 to 2007, the number of approvals given to steel companies was 88, while for merchant miners it was 172.The obvious link is corruption.
7. Corruption is widespread and endemic in the oil, gas, and mining sectors. The most common types are bribery and grand corruption. Some of the most corrupt countries according to the Corruption Perceptions Index, are Sudan, Iraq, Libya, Venezuela, Angola, Zimbabwe, Nigeria, and others. Petroleum revenue mismanagement in the Niger Delta is a typical case.

The potent breeding ground of corruption

Corruption occurs when both motivation and opportunity is present. Personal benefit motivates individuals to be corrupt, but they depend on opportunity as well. Official bureaucrats may have vast discretionary powers over natural resources. Opportunities for corrupt behaviour arise when decision-making accountability for these people is low. The perfect scenario for corruption is when:

1. a few individuals hold all the power to make certain decisions,
2. public information about decision-making is scant,
3. procedures to hold decision-makers accountable do not exist, and
4. decisions can yield personal (private) rewards for decision-makers.
5. The executives of the country are either ignorant or party to the crime.
6. The constituent legal system is incapable, inappropriate, complex and slow to deliver justice.
7. Corruption increases when the country's currency falters vis-à-vis the major trading currency.





Some figures are stark

Oil, natural gas, and minerals and metals are critical energy sources for societies to function. They affect both the economy and national security. In fact, the fossil fuels are the predominant energy source for the world's population. Because of this, extractive industries are under heavy government controls. Governments limit the public's insight into their resource management activities. They control permits, licenses, extraction contracts, and tax collection, and enforce environment and safety regulations. The opacity between authorities and operators present corruption risks.

The relation of corruption with different macroeconomic environment measures is intense. Corruption reduces innovative strategies, discourages instant foreign direct and total investment, reduces the emergence rate of new workplaces, and increases the prices of products and services. Furthermore, corruption causes significant problems to the distribution of wealth in the economy. Also, foreign and private donators and organizations that intend to invest in different countries prefer to give their resources to governments that will use them more effectively. In many surveys, it is evident that corruption cumbers state expenditures and revenue and worsens the quality of services. Also, it is positively correlated with the informal economy size and is a taxation burden. Corruption is strongly connected with governance.

While corruption can occur almost anywhere, it is most prevalent in a few hot spots. One involves natural resources, especially oil and mining. The outsized profits associated with extraction of natural resources are strong incentives for payment of bribes, or even state capture, where public policies and laws are influenced by corrupt practices to secure control over a country's natural wealth. Indeed, resource-rich countries tend to be more corrupt because they struggle with weaker institutions and poor accountability in the use of their natural wealth.

Firms Supply Corruption to Gain Advantages

Governments represent the demand-side of corruption in extractive industries. Public officials may demand bribes from companies in exchange for access to resources.\ On the supply-side we find individuals and organisations using corruption to get access to resources. The supply of corruption increases if the resource is worth a lot of money, is non-renewable, and in limited supply. Combined with strong government resource control – this raises the potential for corrupt firms to gain lucrative advantages.

Firms may view corruption as an easy way to get advantages. These may be access to resources and reduced political interference with their operations. Many also maximise profits by, for instance, evading tax payments.

Large Investments and Potential Benefits Increase Corruption

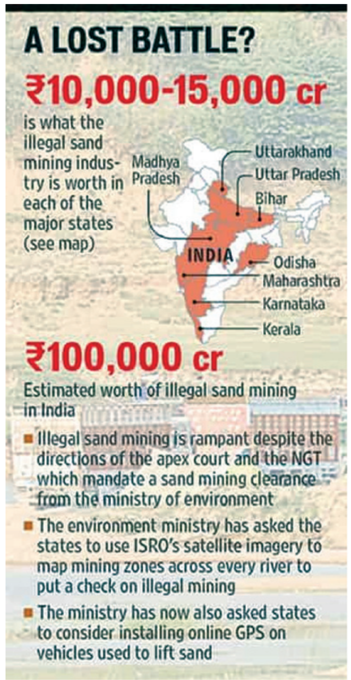
Extracting and producing oil, natural gas, and minerals and metals requires large investments and specialized knowledge. Poor yet resource-rich countries often lack both. This increases the risk of corruption. Once a firm has set up a large-scale extractive project and hired skilled workers, closing the operation down is costly. Many firms therefore continue despite demands for corrupt transactions. Years can pass before firms see returns on their investments – another incentive to keep working even with endemic corruption.

Corruption Risks in Global Transactions

Traders who deal in oil, natural gas, and minerals and metals operate in international markets. Buyers and sellers transport high-value commodities across the globe. Corruption results in big winners and big losers which is bad for the industry as big winners increase risk and big losers discourage decent players to leave. International financial systems and transactions that facilitate this trade bring their own corruption risks. Tax havens and shell companies help public and private leaders hide wealth. Multinational companies are known to engage in transfer mispricing to evade tax.

Regulatory Weakness is the Main Reason

Take sand mining. Rampant corruption has been taking place in these sector of mining for three principal reasons: one, away from the public view, corruption is being systematized, going unreported/unnoticed; two, general lack of rural jobs encouraging people to cling to the wrong practices. Even knowingly; three, political governments and political economy are thriving on the ill-gotten money of corruption. All the Indian elections are funded by the ill-gotten money of sand mining corruption.



Sand has been notified in India as a "minor mineral" under Section 3(e) of the Mines and Minerals (Development and Regulation) Act of 195755 (hereinafter referred to as "the MMDR Act"). The term "ordinary sand" that is used in clause (e) of Section 3 of the MMDR Act, 1957 has been given a clear understanding through Rule 70 of the Mineral Concession Rules, 1960/66 as follows:

1. Sand shall not be treated as a minor mineral when used for any of the following purpose, namely: (i) purposes of refractory and manufacture of ceramic; (ii) metallurgical purposes; (iii) optical purposes; (iv) purposes of stowing in coal mines; (v) for manufacture of silvicrete cement; (vi) for manufacture of sodium silicate; and (vii) for manufacture of pottery and glass.
2. Section 15 of the MMDR Act states that "the State Government may, by notification in the Official Gazette make rules for regulating the grant of quarry leases, mining leases or other mineral concessions in respect of minor minerals and for purposes connected therewith".
3. Further, Section 23-C of the MMDR Act states that: "The State Governments may, by notification in the Official Gazette, make rules for preventing illegal mining,

Sand mining

transportation and storage of minerals and for the purposes connected therewith." Acting in accordance with the provisions of Section 23-C of the Act, 21 State Governments, namely, Andhra Pradesh, Bihar, Chhattisgarh, Goa, Gujarat, Haryana, Himachal Pradesh, Jammu & Kashmir, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Nagaland, Odisha, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand, and West Bengal have brought forward rules to control the menace of illegal mining.

But the report card of performance of regularizing sand mining is poor, to say the least in all states.

State Governments Pathetically Lacks Understanding and Capacity

1. State Governments have set up task forces at State and district levels to curb illegal mining and assess the action taken by departments for checking the illegal mining activities at State and district levels. These task forces are populated by
2. Section 4 of the Act specifically states that mining without necessary permits is illegal. This includes sand mining also. An amendment was brought forward in 2015 to the MMDR Act, 1957. The amendment was enforced on 12-1-2015.
3. The Amendment Act has increased punishment for illegal mining that now exceeds to imprisonment for up to five years and fine that may extend to five lakh rupees per hectare of the area.
4. Provisions have also been included in the Act to set up Special Courts that help in providing speedy trial of offences relating to illegal mining. Under this Act, a statutory obligation is cast upon the State Governments to enact laws and adopt rules that govern mining activities; there is a lack of consistency from State to State.

All good intentions but where is the motivation, capability and capacity? It is important now that sand mining as well as stone and other aggregate mining must be brought under larger legal ambit of the mining regulation in India. A method like Good and Services Tax (GST), where the state and the central governments both share revenue with strict compliance must be enforced immediately. Success requires political will, perseverance, and a commitment to continuously upgrade institutions over many years. Governments should start with areas of higher risk— such as procurement, revenue administration, and management of natural resources— as well as effective internal controls. A fiscal governance framework also requires a professional and ethical civil service as a key pillar. The heads of agencies, ministries, and public enterprises must promote ethical behavior by setting a clear tone at the top.

What GST like Structure of Tax, Royalty and Rent Sharing can Bring

The implementation of the GST captured the spirit of federal cooperation despite persisting political distrust and differences between the centre and states. All the states willingly ceded most of their taxation powers and consented to surrender the exiting multiple imposts that got accommodated within the GST regime. As a result, many entries in the State List under Schedule 7 of the Constitution were in-effectuated and the State legislative assemblies could no longer legislate on issues such as the sale and purchase of goods with few exceptions like petroleum and liquor. The GST has brought in more efficiency and transparency in tax collection. While it has relieved the State's of the burden of tax collection, it has been able to give share of the taxes that are higher than they usually used to get.

Such structure for minerals, fuels, oil and gas taxation would auger well for the MOGIn in India.It will also open up the eyes of the central government to understand the potential and actual contribution of the sector in the country, and for that matte almost all countries.

Following the recommendations of the 14th and 15th Finance Commissions he Indian government gradually increased the amount of money transferred from the Union to the States each year nnual transfers from the Union to the States, for example, have climbed from 4.7% of GDP in the fiscal year 2013-14 to 6.7% of GDP in updated forecasts for the fiscal year 2021-22. It is wrong to assume that the states would continually suffer from a GST like regime.