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Public Policy on Non-Tax Revenue: Analysing the Impact of Mining Royalty on Competitiveness

LEKHA CHAKRABORTY, *Associate Professor, National Institute of Public Finance and Policy, New Delhi, India. Email: lekha.chakraborty@nipfp.org.in*

The orthodox view is that the competitiveness of the mining sector is largely determined by firm level factors. Recently, there is a growing recognition that public policy has a significant role to play in determining competitiveness in the mining sector, especially in reforms related to non-tax revenue. It is all the more relevant particularly in the context of recent policy transition in legal and fiscal stance related to the mining sector in India.

This one pager is based on Chakraborty (2014); it looks at the legal and fiscal policy transition in the mining sector, against the backdrop of Planning Commission's *High-level Committee Report on National Mineral Policy, 2006, and the subsequent passage of Mines and Minerals (Development and Regulation) Bill, 2011.*

The new mining policy of India has been successful to a great extent in redefining the mining code to recognise the negative externalities of the mining sector on human development and environment. However, the methodology suggested to address these issues by generating a Development Fund through *profit sharing formula* – 26 per cent of profits from the coal miners and 100 per cent royalty equivalent money from other miners has become controversial.

The onerous mining royalty regime in India has severe repercussions in terms of competitiveness. India has one of the highest royalty rates in the world. Though India has broadly moved away from tonnage royalty regime to *ad valorem* royalty regime, the rationalisation of rates to internationally competitive rates has not yet materialised[1].

Chakraborty (2014) focused on the non- tax revenue estimation of the non-ferrous non-atomic mining sector and it was identified that the estimation was based on an *ad valorem* basis on the ore, linking to London Metal Exchange (LME) reference prices. The mineral royalty estimated on the basis of ore is becoming redundant across the globe, and many countries have moved towards concentrate as the base of estimating royalty. As recently as five years ago, the Government of India had notified that the levy of royalty rates for non-ferrous non-atomic minerals would be on the basis of concentrates. However, the royalty based on ore was not discontinued. A dual royalty regime, based on ores and concentrates, came into being.

From the public policy perspective, the mining royalty estimation should incorporate the mineral value chain and estimate the mineral royalty on the basis of concentrates, and in plausible cases, the metal at the end of the mine value chain, after the process of beneficiation and smelting process. However, this process has not yet been followed in India for estimating the base of royalty, and the rates are revised every three years, based on the recommendations of Study Group of Mineral Royalty, which needs a relook, particularly the criteria on which the rates are revised so frequently.

Policy recommendations

1. System of royalty based on '*ad-valorem*': The shift in royalty regime from tonnage-based to 'ad-valorem' is an apt policy step, as the latter is market linked, to LME reference prices.
2. No Differential Rates of Royalty: Global best practices show that the royalty is calculated on concentrates, and not on ores. Discontinue the royalty based on ores.
3. Incorporate the 'value chain' in methodology: The wastage of metal units throughout the value chain – beneficiation, smelting and tailings – needs to be taken into account while computing the royalty base. Assessable value of royalty should be arrived at by deducting the treatment costs as well.
4. There is an urgent need to rationalize the royalty rates to international best practices to protect the competitiveness. The High Power Committee of Planning Commission for National Mineral Policy suggested that the rates prevail in Western Australia to be the benchmark.
5. Upward revisions in the royalty rates every three years may not be appropriate, and it can affect the competitive edge of the mining firms. Why the rates are hiked so frequently, especially when the royalty rates are market-linked to reference price of LME? Levy of cess in addition to royalty (as per MMDC 2011) is equally a matter of concern, as it can affect the firm level competitiveness.
6. Net Smelter Returns (NSR) Royalty may be a good alternative of computing royalty in India under *ad valorem* mining regime.

References

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[1] Global mining royalty arrangements are broadly categorised into three: unit based, *ad-valorem* based, or profit based. Unit based royalty is determined with reference to the volume of production, or with reference to gross revenues. It is also referred to as tonnage-based royalty. *Ad valorem* royalty is calculated by applying a percentage rate to the gross sale value. It is also referred to as value-based royalty. This is usually 'ex- mine' or pithead value (sale realisation) less allowable expenditure. Net smelter return (NSR) royalty is a common mode of *ad valorem* royalty, where the royalty is expressed as a percentage of the enterprise's NSR. NSR is generally defined as gross revenues, minus shipping, smelting, refining, and marketing costs. Profit-based royalty is calculated as a percentage of gross/net profit.