GOA FOUNDATION

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To:
International Public Sector Accounting Standards Board

Subject: Comments on the draft IPSASB Work Plan 2019-2023

We congratulate the IPSASB on its well-thought-out draft Work Plan for 2019-2023. We strongly support the projects that the IPSASB proposes to prioritize for addition to the Work Plan 2019–2023 on Theme A (**SMC 4**), and in particular, the standard for natural resources.

Background

In most sovereign nations, the state owns all sub-soil minerals. The minerals are a part of the "commons" – assets owned ultimately by the citizens. A major problem is that the IMF, UN & IPSASB standards for government accounting, statistics and disclosure treat the receipts from minerals as "revenues" rather than "capital receipts on account of the sale of a non-renewable natural resource asset." Similar to the non-accrual of pension liabilities, which justified their funding on a pay-as-you-go basis and led to governmental fiscal crises, this accounting treatment of minerals has even bigger and more dangerous implications. The World Development Indicators show that the energy and mineral depletion that occurred between 1970 and 2013 totals $27 trillion. Most of these receipts have been already spent or consumed, aided in part by government accounting for mineral receipts as revenues instead of their actual status – sale of assets.

Who we are

The Goa Foundation is a non-governmental organization (NGO) in India with a long history of work on the environmental issues involved in mining. Goa is a world biodiversity hotspot. The Foundation also works on the conservation of Goa's beaches, forests, mountains and agricultural fields.

The Foundation petitioned the Supreme Court of India in 2012 to cure the illegal mining then rampant in the State of Goa. The Supreme Court allowed the petition in 2014, declared mining activity over a 5-year period illegal, and issued directions that in future, 10% of the sale value of iron ore would be transferred to a new Goa Iron Ore Permanent

Fund to meet the demands of intergenerational equity.[1] This direction by a court to set up a Permanent Fund is a first for India and, to our knowledge, a global judicial precedent. Pursuant to the judgement, the Government of India amended the mineral law to ensure that in future all leases for extraction of minerals would be auctioned.

Our recommendations

We support the overall draft Work Plan. We strongly support the three projects in Theme A (SMC 4), and in particular, the IPSAS for Natural Resources. The present treatment of natural resources having a zero cost and the receipts as revenue creates significant errors in the calculation of the "revenue deficit" or Net Operating Balance (IMF GFS), depending on how resource rich the region is. In turn, this incentivizes politicians to sell off natural resources, enabling them to buy the support of a winning coalition. The equivalent standards in the Global Finance Statistics and System of National Accounts also create similar distortions. We provide a couple of examples later in this representation.

The other two projects on discount rates and the differential reporting and conceptual framework review align with the project on natural resources. Discount rates are critical to valuing natural resources. We have already pointed out that the GFS and the SNA would need equivalent changes, which we advocate.

Within the broad gamut of natural resources, minerals have the largest monetary value. Further, they are almost always a depleting asset, and the distinction between revenue and capital is fairly clear. It would be useful if the IPSAS could consider at the time of scoping the Natural Resources project to first set out a standard for spectrum (entirely revenue because non-depleting) and minerals (entirely capital because fully depleting). This framework could then be extended to all other natural resources, which would be more contentious as the determination of when an asset is impaired is crucial.

We enclose two notes that we sent to the IMF, UN and IPSASB in 2016 and 2017 that elaborate our reasoning. We argue that accounting for mineral receipts as capital receipts is desirable. The present accounting as "revenue" creates the fertile conditions for many problems including (i) increasing inequality, (ii) strengthening authoritarian regimes, (iii) unmanageable volatility in the government budget, (iv) human rights violations, (v) environmental damage, (vi) crony capitalism, (vii) armed conflict, (viii) poverty, and (ix) unsustainability. This "revenue" accounting is clearly motivating, for instance, the opening of the critical wetlands of the Arctic National Wildlife Refuge to oil drilling.

We provide below a couple of case studies to underline the importance of the standard on Natural Resources, and more particularly minerals.

Distortion to government deficits

Under the Indian Constitution, states like Goa own sub-soil minerals, as a public trustee on behalf of the people and especially future generations. Minerals are depleting assets, and mining is essentially the sale of the mineral with royalty, taxes and other sums as the

[1] http:// supremecourtofindia.nic.in/outtoday/41437.pdf

consideration. An obvious standard is zero loss in value when selling assets.

We studied iron-ore mining in Goa for the eight-year period 2004-2012, using the annual reports of the largest miner (1/3rd of the volume), volume statistics from the industry body and the government financial statement. Over this period, we estimated the loss to be over 95% of the economic rent (sale price minus all expenses and a generous profit). In other words, for iron ore worth 100 (after all extraction costs), the State Government of Goa as owner received less than 5.

The majority of the value (60%) was captured by miners, while a large part was captured by the national government (35%). This amounts to a transfer of wealth from the commons to private individuals, and is astonishing for its scale – an average of 22.8% of State GDP was redistributed each year.

An important accounting metric for evaluating the performance of government entities is revenues minus expenses, the revenue surplus / deficit or the Net Operating Balance (NOB). An entity constantly incurring deficits is not in a position to sustain its operations in the long term. At some point, it would have consumed its capital, and creditors would stop financing the deficit, resulting in a crisis.

Over the 8 years, Goa's mineral receipts were reported at merely 8% of government revenues, and 1.3% of GDP. This report conceals a catastrophe. The table below illustrates how Goa's public finances would change with better accounting for mineral receipts.

<table>
<tr><th colspan="5" align="right">Cumulative amounts for 8 years in Rs. billion</th></tr>
<tr><th>Aggregate</th><th colspan="2">As Reported</th><th colspan="2">In Reality</th></tr>
<tr><td>Transaction narrative</td><td>Revenue from mining</td><td align="right">23.87</td><td>Opening capital : mineral
Mineral sold
Capital receipt : cash
Change in net worth : loss
Closing capital : cash</td><td align="right">516.55
-516.55
+23.87
-492.68
23.87</td></tr>
<tr><td>Reported Revenue</td><td></td><td align="right">274.02</td><td>True revenue
Reported revenue
Less: mineral receipts</td><td align="right">250.15
274.02
-23.87</td></tr>
<tr><td>Reported Expenditure</td><td></td><td align="right">320.08</td><td>True Expenditure
Reported expense
Add: Loss from mining</td><td align="right">812.76
320.08
492.68</td></tr>
<tr><td>Reported Revenue Deficit / NOB</td><td></td><td align="right">1,872.97</td><td>True Revenue Deficit / NOB</td><td align="right">562.51</td></tr>
<tr><td>Reported Goa GDP</td><td></td><td align="right">1,872.97</td><td>True GDP (Subtracting the economic rent[2])</td><td align="right">1,356.42</td></tr>
<tr><td>Goa net worth</td><td>Increase</td><td align="right">23.87</td><td>Loss</td><td align="right">-492.68</td></tr>
<tr><th colspan="5" align="right">As a % of cumulative GDP over 8 years</th></tr>
<tr><th>Aggregate</th><th colspan="2">As Reported</th><th colspan="2">In Reality</th></tr>
</table>

[2] If we subtract the mining contribution to GDP (instead of economic rent), real GDP is Rs. 1,598.53 billion.

Transaction narrative	**Revenue from mining**	**1.27%**	Mineral sold Capital receipt : cash **Change in net worth : loss**	38.08% 1.76% **36.32%**
Reported Revenue Deficit / NOB		2.46%	**True Revenue Deficit / NOB**	41.47%
Non-mineral revenue deficit (NOB – mineral receipts)		3.73%		

Governments usually target a balanced budget or a small deficit. The *reported revenue deficit (NOB) in Goa was 2.46% of GDP*, already a little high. In the present accounting framework, increasing mining would increase revenues, lowering the deficit.

The "non-mineral deficit" is an additional measure provided by the IMF. As its name indicates, this metric effectively treats mineral receipts as capital receipts by excluding them from government revenues. *Goa's non-mineral revenue deficit was 3.73% of GDP*. This is already unsustainable. Observe that increasing or reducing mining has no impact on the non-mineral deficit.

However, accounting for the losses in capital as expenses, *the true revenue deficit (NOB) is an astonishing 41.47% of GDP*. It is unlikely that any democracy has reported such large revenue deficits in normal times. Note that additional mining worsens the true revenue deficit.

The current revenue accounting for mineral receipts is incentivising the consumption of mineral wealth across the world. This is unsustainable.

A recent example

The Tax Cuts and Jobs Act of 2017 has become law in the U.S.[3] One provision opens the wetlands of the Arctic National Wildlife Refuge for oil drilling.[4] The U.S. federal government estimates it will receive $1 billion in revenues over the next 10 years.[5] The Alaska government will receive an equal amount of revenues, helping bridge its yawning deficit. The Alaska Native Corporations would also benefit from their holdings of land within the Refuge.

The oil deposits in the Refuge are valuable assets, held by the government under a public trust on behalf of the people. The oil, the Refuge, and the way of life it sustains are a shared inheritance, a common birthright.

Once the Refuge is opened up to oil extraction, then the oil will be sold. The owners receive compensation, in this case an estimated $1 billion for the federal government. This $1 billion isn't revenue or a tax. It is merely the consideration received in exchange for the oil, an asset. The government is converting mineral wealth into financial wealth by selling

[3] https://www.vox.com/2017/11/9/16620290/senate-republican-tax-plan-orrin-hatch-mitch-mcconnell
[4] http://www.audubon.org/news/report-arctic-refuge-facing-its-biggest-threat-yet
[5] https://www.audubon.org/sites/default/files/arctic_refuge_scroll_final.pdf

oil. Consuming this financial wealth depletes the government's wealth.

This is an economic error. Since the $1 billion is labeled as revenue, it is more likely to be consumed. The nation would then be poorer by ruining its wetland, endangering the Porcupine caribou herd and the way of life of the Gwich'in indigenous people.

Government accounting worldwide wrongly treats royalty and other mineral receipts (where the government owns the mineral) as "revenue".

Politicians love selling off national assets like oil and minerals because it gives them "revenue" without raising taxes, i.e., easy money. The politicians choose how to spend the money, and whether to save anything (most often, without any consultation with the people they serve or consideration of future generations). The current U.S. tax bill cuts tax rates. In other countries, it may be to buy arms to stay in power, or to buy support through contracts to cronies. Selling the family jewels to consume the proceeds becomes a national project.

The consequences aren't pretty. The Refuge is being opened up to drilling because of the "revenue" that will be received by the federal government, the Alaska government and the indigenous peoples. How would ordinary citizens view this project if they understood it in terms of consuming the family jewels?

Conclusion

The IPSAS should urgently issue a standard to correct this representational error in the accounting, statistical and disclosure standards for minerals. Given the $27 trillion of public funds involved, the wealth mismanagement incentive for politicians is possibly the single largest issue facing resource-rich states and nations.

Natural wealth mismanagement is much more than an accounting issue. Properly speaking, it is an ethical and moral issue. However, the misleading accounting affects whether we can as human beings change our current mindset for a better and more just way of handling these assets. It is also directly connected to the persistent extreme poverty and growing inequality the world has experienced in the past half century. Lives are at stake.

Yours faithfully,

(Dr. Claude Alvares)
Director

Encl: 1. Mitigating the Resource Curse by improving Government Accounting

2. Response to FAQs