MINERALS COUNCIL OF AUSTRALIA

SUBMISSION TO THE SENATE ECONOMICS LEGISLATION COMMITTEE

Mineral Resource Rent Tax Amendment (Protecting Revenue) Bill 2012

2 NOVEMBER 2012

EXECUTIVE SUMMARY

The Minerals Council of Australia (MCA) welcomes the opportunity to comment on the Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012 (the Bill). The Bill is designed to restrict the full crediting of State and Territory royalties under the Minerals Resource Rent Tax (MRRT) to those in place as at 1 July 2011.

Full crediting of royalties is a key feature of the MRRT's design, one that ensures double taxation is avoided and that delivers a measure of stability and predictability to the overall tax burden on coal and iron ore projects, albeit at the upper end of globally competitive tax rates. The MCA recommends that the Senate Economics Legislation Committee reject both the Bill and the premises on which it is based.

Economic and commercial context

Coal and iron ore are Australia's two largest export industries which together accounted for more than one third of Australia's total export earnings in 2011-12. Combined they employ more than 80,000 Australians directly and hundreds of thousands more indirectly, with the vast bulk of employees in regional and remote Australia.

The growth of these industries has yielded significant economic gains to Australians over the last decade. These benefits have been distributed widely throughout the Australian community through a range of channels, including via expanded demand for labour and intermediate inputs (especially services), higher investment and increased revenues to governments.

Even before the introduction of the MRRT, coal and iron ore were among the highest taxed industries in Australia based on the two main fiscal instruments used to collect mineral resource revenues – State and Territory royalties and Commonwealth company income tax. Due overwhelmingly to higher contributions from these industries, revenue to Australian Governments from the minerals industry has risen more than four-fold since the start of the last decade with a cumulative total from royalties and company tax alone exceeding $124 billion since 2001-02. The industry tax take ratio (calculated as company income tax and royalties over taxable income before royalties) has remained high and stable over this period, averaging 41.6%.

Business conditions in the coal and iron ore industries have deteriorated markedly over the last 12 to 18 months. By October 2012, monthly average thermal coal and coking coal prices were down 36% and 55% respectively from highs reached in 2011, while iron ore prices were down 41%. The continued high Australian dollar has also impacted heavily on industry revenues as part of a larger structural deterioration in Australia's cost competitiveness that has developed over recent years.

This more difficult operating environment (most acute in the coal industry) has seen the closure of some relatively high-cost operations, job losses and the scaling back of investment plans. It is now widely recognised – including by official forecasters – that there are no more "easy gains" for Australia from high prices for coal and iron ore. Looking ahead, further gains from the development of Australia's coal and iron ore resources will rely overwhelmingly on expanded export volumes, rigorous cost control and higher productivity.

The Minerals Resource Rent Tax and royalty crediting

Coal and iron ore projects are highly capital-intensive with considerable high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. A competitive and stable taxation regime is vital to Australia's reputation as a competitive supplier and attractive location for investment in these industries.

The MRRT adds a third mechanism to taxing resource profits or "rents" derived from the extraction of coal and iron ore in addition to State and Territory royalties and Commonwealth company income tax. Royalties provide a "hard floor", the baseline above which MRRT becomes payable. The royalties that entities pay on iron ore and coal are credited against the MRRT liability of a project to ensure – as noted in the Explanatory Memorandum of the MRRT legislation – "that the royalties and the MRRT do not double tax the mining profit".

The MRRT is a profits tax on top of another profits tax (i.e. company income tax). It is designed to provide an additional return to the Australian community during periods of abnormally high industry profitability. The Government-appointed Policy Transition Group (PTG) described the MRRT as providing the Australian community with an additional return "at the peak of the resources cycle", recognising that the minerals tax take, like the minerals profit cycle, is volatile. The Government has recognised repeatedly that the MRRT will be volatile (as commodity prices, exchange rates, investment plans and other variables change) and that this is intrinsic to how resource rent taxes are designed to work.

The December 2010 PTG report recommended that the Government legislate full crediting of all current and future State and Territory royalties "so as to provide certainty about the overall tax impost on the coal and iron ore mining industries". Benchmarking of our minerals taxation regime nonetheless puts Australia at the upper boundary of globally competitive tax rates – above nations such as Canada, Brazil and China for iron ore and above the likes of South Africa, Canada and China for coal. Incidentally, none of these nations has additional imposts in the form of a Carbon Tax or emissions trading scheme.

The PTG report stated further that the MRRT should not be used as a mechanism to enable States and Territories to increase royalties on MRRT taxable commodities. Thus it recommended that "the Australian, State and Territory Governments put in place arrangements to ensure that State and Territory governments do not have an incentive to increase royalties on coal and iron ore". In line with this recommendation, the minerals industry supports constructive dialogue between Commonwealth and State and Territory governments in support of stable and internationally-competitive taxation and royalty arrangements.

The Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012: Flawed premises

The Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012 runs directly counter to the policy objectives of limiting the overall tax burden on coal and iron ore mining industries and providing greater taxpayer certainty. It should therefore be rejected. The Bill if enacted would:

- Impose higher tax burdens on coal and iron ore projects in Australia, threatening jobs and investment in an already difficult economic environment
- Overturn any residual claims Australia has to maintaining stable and internationally-competitive taxation arrangements in the minerals industry
- Undermine any prospect of Commonwealth-State fiscal cooperation aimed at ensuring efficient and equitable minerals resource taxation arrangements across the Federation.

The minerals industry considers that the Bill rests on a series of flawed premises:

1. That the mining industry is not paying its way (notwithstanding the massive growth in the revenue contribution from the minerals industry over the last decade)
2. That our taxation system is an island and Australia will remain an attractive destination for investment in coal and iron ore irrespective of policy actions
3. That the volatility of MRRT revenues in response to changing market conditions is a design flaw, rather than an essential design feature
4. That intergovernmental conflict over minerals resource taxation (with taxpayers caught in the middle) provides a basis for good governance in the interests of the Australian people.

The Bill would overturn the Australian Government's July 2010 agreement on the MRRT and its March 2011 decision to accept all recommendations of the PTG. The MCA recommends that the Senate Economics Legislation reject both the Bill and the premises on which it is based.

CHAPTER 1: INTRODUCTION

The Minerals Council of Australia (MCA) is the peak national body representing Australia's exploration, mining and minerals processing industry. It represents the minerals industry both nationally and internationally in its contribution to sustainable economic and social development.

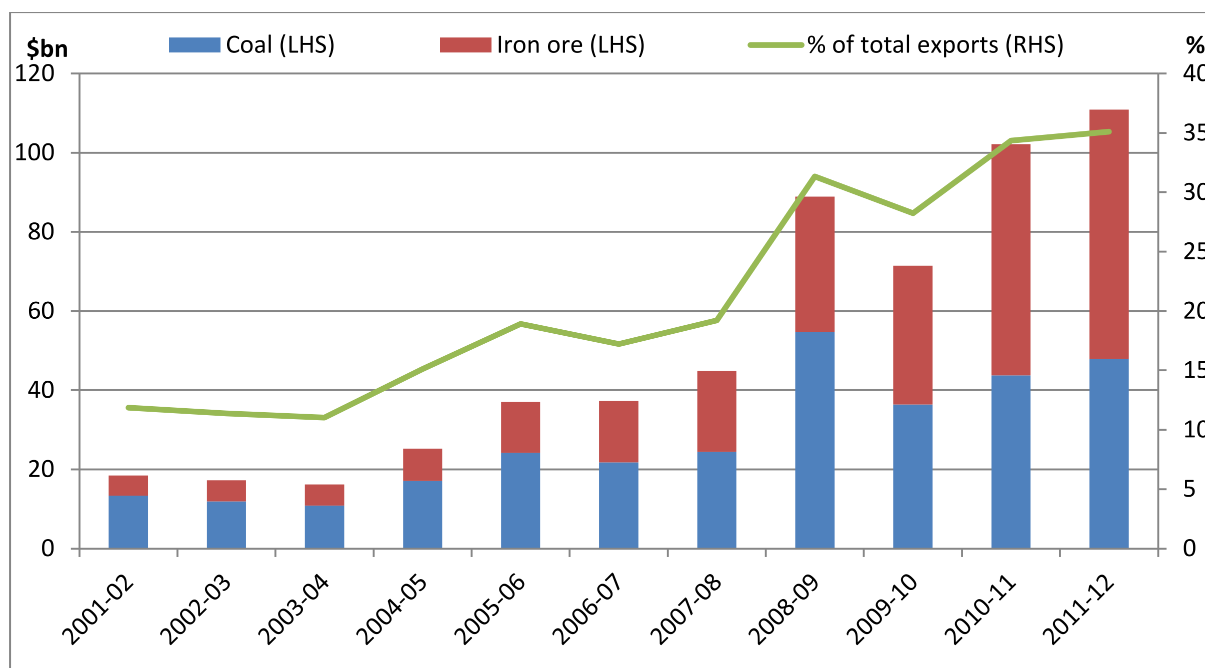
The MCA's strategic objective is to advocate public policy and operational practice for a world-class industry that is safe, profitable, innovative, environmentally and socially responsible and attuned to its communities' needs and expectations. MCA member companies produce more than 85% of the nation's annual minerals output and account for an even higher share of export volumes.

1.1 Economic and commercial context

The mining and minerals processing industry is Australia's principal export earner and most globalised industry. It has been a major driver of growth, investment and higher living standards in Australia over the last decade. In recent years, the industry has accounted for around 7% of GDP directly (significantly more when account is taken of mineral resource-related economic activity), upwards of 20% of national investment and more than 50% of Australia's exports of goods and services.

In 2011-12, Australia's mineral resources earned $164 billion in export revenue, 52% of Australia's total export revenue. The two mineral commodities covered by the MRRT – iron ore ($63.0 billion) and coal ($47.9 billion) – together accounted for 35% of Australia's total export income in 2011-12, up from around 10% in 2001-02. They are Australia's two largest export industries by a significant margin.

Figure 1: Australia's coal and iron ore exports



Source: BREE

The growth of these industries has yielded significant economic gains to Australians. Increased coal and iron exports over the last decade have directly increased the buying power of consumers and industries. Driven largely by higher terms of trade for mineral commodities, average weekly real household incomes in Australia have climbed almost 40% over the period from 2002-03 to 2011-12. [i]

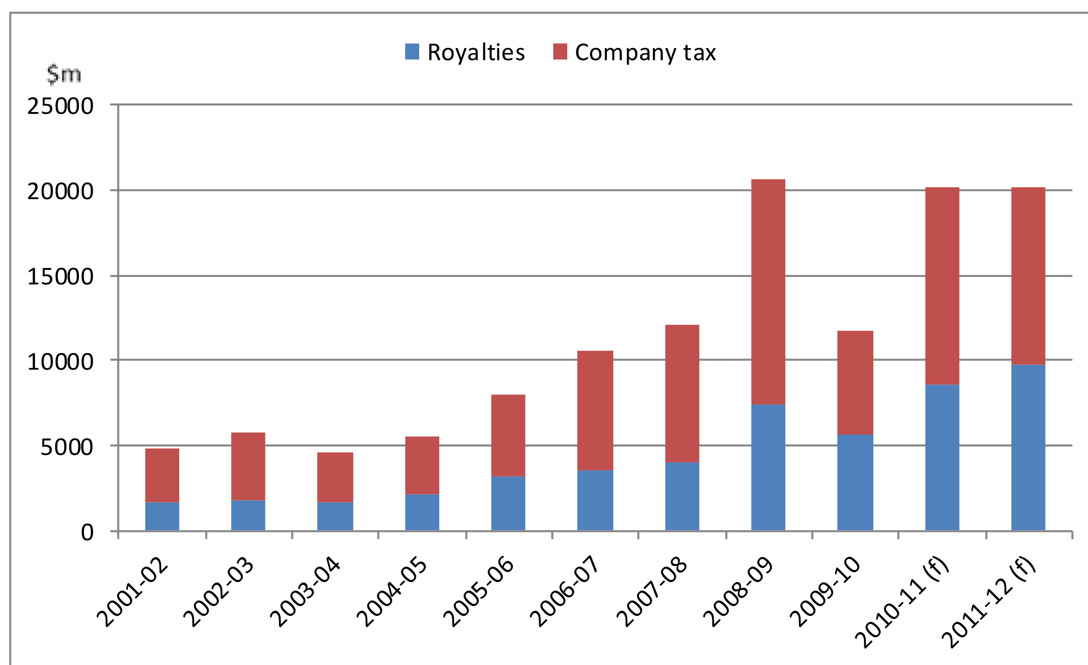
Growth in mining activity – largely from a rebound in coal and iron ore exports – helped to cushion Australia's economy from recession in the wake of the Global Financial Crisis. Mining was the only industrial sector to expand in Australia during the December 2008 quarter when the rest of the economy contracted and most countries slid into recession.[ii]

Treasury analysis has shown that corresponding with the "mining boom" there has been a narrowing in the dispersion of regional unemployment rates – with a smaller proportion of regions experiencing high unemployment. Compared with the late 1990s when fewer than 15% of local regions had unemployment rates of less than 5%, by September 2010 the figure had risen to around half.[iii]

Reserve Bank of Australia research has outlined the various channels by which the benefits of mining sector growth have been distributed throughout the economy. Activity within the mining industry has spilled over into domestic activity through its demand for labour, intermediate inputs (especially services) and investment, the boost to Australian incomes through the ownership of mining equities and revenues to governments.[iv]

Even before the introduction of the MRRT, coal and iron ore were among the highest taxed industries in Australia based on the two main fiscal instruments used to collect mineral resource revenues – State and Territory royalties and Commonwealth company income tax. Due overwhelmingly to higher contributions from these industries, revenue to Australian Governments from the minerals industry has risen more than four-fold since the start of the last decade. The total minerals industry tax take from these instruments over the period from 2001-02 to 2011-12 has been more than $124 billion.

Figure 2: Revenues from the minerals industry have grown markedly

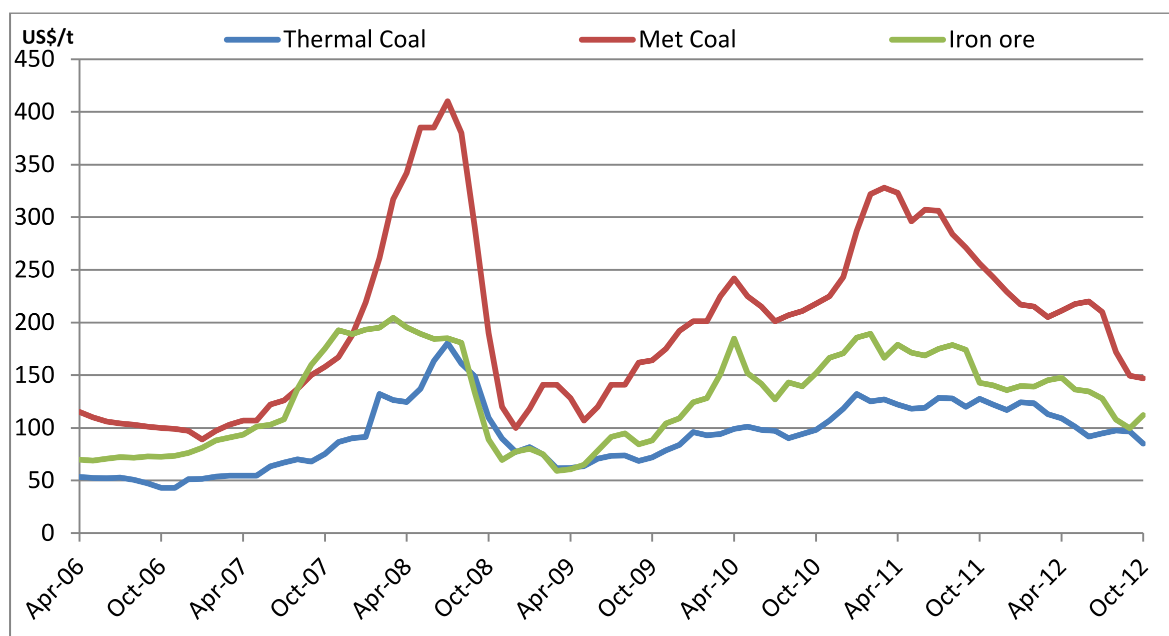


Source: ABS, State Budget Papers, BREE, Deloitte Access Economics estimates

The gains derived by the community from Australia's comparative advantage in coal and iron ore are significant and enduring. At the same time, business conditions in these industries have deteriorated markedly over the last 12 to 18 months underscoring the cyclical nature of the mining industry and the volatility of commodity prices.

Weaker global economic conditions (including in emerging Asian economies such as China) have seen prices for coal and iron ore decline sharply. By October 2012, monthly average thermal coal and coking coal prices were 36% and 55% respectively from highs reached in 2011, while iron ore prices were down roughly 41%.

Figure 3: Bulk commodity prices



Source: ANZ

The continued high Australian dollar has also impacted heavily on industry revenues given the sharp reductions in US dollar prices. While typically Australia's exchange rate has closely tracked changes in the spot iron ore prices, this relationship appears to have altered over the course of 2012.

Added to these cyclical factors there has been a marked structural deterioration in Australia's cost competitiveness over recent years. A major report for the MCA by Port Jackson Partners released in September 2012 details the competitive challenge confronting Australia's minerals industry and the degree to which future investment is now at risk.[v]

The research shows that large market share gains over earlier decades have been replaced by stagnation or share losses in key mineral commodities. Rising operating and capital costs mean that Australian projects have become less attractive just as new, strong rivals have begun emerging. Within highly competitive markets for thermal coal and coking coal, more than half of Australia's mines have operating costs above global averages. Even in iron ore, Australia has lost its operating cost advantage for all but established Pilbara projects.

New projects are also less competitive with capital costs in Australia considerably higher than the rest of the world. Only five years ago, Australia could build coal and iron ore projects as cheaply as our competitors. Now, Australian iron ore projects are 30% more expensive than the global average, while thermal coal capital costs are 66% above the global average.

A more difficult operating environment has resulted in both project delays and cancellations and the closure of some relatively high-cost mines in the coal industry. Australian Bureau of Statistics figures suggest the coal industry has shed more than 14,000 jobs since May 2012. There is now heightened uncertainty about the future minerals investment pipeline, with coal and iron projects worth more than $90 billion remaining uncommitted according to the Bureau of Resource and Energy Economics (BREE).[vi] Analysis by ANZ estimates that $40 billion of coal projects are risk of not proceeding due to a sharper than expected slowdown in China, weaker commodity prices, high domestic labour and construction costs and the persistently high Australian dollar.[vii]

It is now widely recognised – including by official forecasters – that there are no more "easy gains" for Australia from high prices for coal and iron ore.[viii] Future gains will rely overwhelmingly on expanded export volumes, rigorous cost control and higher productivity. In this context, the policy imperative of stable and internationally competitive tax and royalty arrangements takes on even greater importance.

1.2 The Minerals Resource Rent Tax and royalty crediting

Coal and iron ore projects are highly capital-intensive with considerable high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. A competitive and stable taxation regime is vital to Australia's reputation as a competitive minerals supplier and an attractive location for minerals investment.

Through the 2010 tax debate – and in its aftermath – the extent of the minerals industry's preparedness to engage in meaningful consultation for reform of mineral royalty taxation arrangements became obscured. The principles that formed the basis of industry advocacy were as follows:

- **Internationally competitive**: the overall tax burden on the industry should be competitive with tax burdens in other countries;
- **Prospective**: tax changes should not undermine the basis upon which past investments have been made (i.e. no retrospective application);
- **Differentiated**: reforms should recognise that capital investment and financial return characteristics differ across resources commodities such that different minerals can sustain different tax burdens;
- **Resource-based**: a resource-based tax should be limited to the value of the resource (not reach into the value added from infrastructure and other activities such as processing and smelting); and
- **Equitable and efficient**: Reform of taxation and royalty arrangements should promote economic activity and improve the efficiency, simplicity and fairness of the tax system without compromising competitive neutrality.

The foundation agreement for the MRRT was reached based on the design principles outlined above for the development of an internationally-competitive minerals resource tax regime (albeit at the upper boundary of global tax rates) that also provides the Australian community with an appropriate return from accessing Australia's finite mineral resources during periods of abnormally high profitability.

The MRRT is a profits-based tax on cash flows from extracting coal and iron ore in Australia. It is designed to tax only the rents or profits attributable to the value of the resource.

The MRRT applies in conjunction with State and Territory royalties and Commonwealth company income tax. Hence from 1 July 2012 returns to the community arising from the extraction and use of Australia's coal and iron ore resources are to be collected through three mechanisms: State and Territory royalties, Commonwealth company income tax and the MRRT.

Under the MRRT, State and Territory royalty payments remain and the liability to pay them exists regardless of the MRRT. Royalties are the baseline – the "hard floor" above which MRRT becomes payable. The royalties that entities pay on iron ore and coal are credited against the MRRT liability of a project to ensure – as noted in the Explanatory Memorandum of the MRRT legislation – "that the royalties and the MRRT do not double tax the mining profit".[ix] Royalties paid on projects in respect of MRRT assessable receipts will be neither transferable nor refundable under the MRRT.

Royalties are generally applied on the basis of volume or value without regard to the profitability of a mining operation. Hence while royalties recover a portion of resource rents when mining profits are high, they will also tax mining operations where no economic rent is present.

Company income tax – like the MRRT – taxes mining profits proportional to industry profitability, though it applies to the normal return on investment as well as to rents. Income tax is designed to tax an entity's annual profit, but is not specific to a type of profit (as is the case under the MRRT). Whereas under income tax, State mining royalties are viewed as costs that reduce profits and are deductible, under the MRRT they are viewed as another way of taxing the resource, and so are credited against the liability for MRRT to avoid double taxation.

As the former Head of Treasury's Revenue Group noted at the 2009 MCA Tax Conference, "the application of the company tax to the resources sector has acted as a *de facto* resource rent tax".[x] The MRRT is therefore a profits tax on top of a profits tax – in effect, a "top-up" tax on highly profitable projects.

Under the MRRT, highly profitable coal and iron ore projects with an MRRT liability should face an effective tax rate (ETR) of not more than 46%, noting that other key features of the MRRT (such as the starting base allowances) will also affect ETRs over the life of a project.[xi] Based on benchmarking of our minerals taxation regime, this puts Australia at the upper boundary of globally competitive tax rates – above nations such as Canada, Brazil and China for iron ore and above the likes of South Africa, Canada and China for coal. Incidentally, none of these nations has additional imposts in the form of a Carbon Tax or emissions trading scheme.

The Government-appointed Policy Transition Group (PTG) described the MRRT as providing the Australian community with an additional return "at the peak of the resources cycle", recognising that the minerals tax take, like the minerals profit cycle, is volatile.[xii]

The Government has always recognised that the MRRT will be volatile (as commodity prices, exchange rates, investment plans and other variables change) and that this is intrinsic to how resource rent taxes are designed to work. The volatility of the MRRT is not a design flaw; it is a deliberate design feature, one which was highlighted by the Government, including in the Second Reading Speech at the time of legislation was introduced into the Parliament. As the Assistant Treasurer stated in his speech on the MRRT Bill in November 2011:

> *We will see volatility in MRRT revenue, particularly as prices and investment plans change, but that is good for the nation and for the industry.*[xiii]

Full crediting of all royalties is a critical feature of the MRRT designed to avoid double taxation and to provide taxpayers with a measure of stability and predictability regarding the overall tax burden on coal and iron ore projects, albeit at the upper boundary of globally competitive tax rates. In making recommendations on the MRRT, the PTG cast the policy challenge as finding a balance whereby:

1. Australia maintains an internationally competitive fiscal regime for minerals taxation
2. The legitimate needs of States and Territories, including a relatively stable revenue stream, are met
3. The application of royalties (which represent a direct cost to industry irrespective of capacity to pay) do not unnecessarily damage the relevant industries and prevent optimal resource extraction
4. Australians as a whole are able to capture an appropriate return from the profits of industry at the peak of the resources cycle.

The PTG report when on to state that:

> *Recognising this objective, as well as the importance of preserving Australia's international competitiveness, the PTG recommends that there be full crediting of all current and future State and Territory royalties under the MRRT so as to provide certainty about the overall tax impost on the coal and iron ore mining industries. Equally, the MRRT should not be used as a mechanism to enable States and Territories to increase inefficient royalties on MRRT taxable commodities. Accordingly, the PTG also recommends that State and Territory Governments put in place arrangements to ensure that State and Territory governments do not have an incentive to increase royalties on coal and iron ore. This would limit their negative impacts, while allowing the Australian Government's taxation regime to maximise the return to the community during the highpoint of the resources cycle, so achieving the balanced outcome described above.*[xiv]

The minerals industry supports genuine dialogue between Commonwealth and State and Territory governments aimed at limiting the overall tax burden on coal and iron ore mining industries and providing greater taxpayer certainty. Such dialogue must take place on a platform of mutual trust and be based on a recognition that ensuring stable and internationally-competitive resource taxation arrangements is a shared responsibility within the Australian Federation.

CHAPTER 2: THE MINERALS RESOURCE RENT TAX AMENDMENT (PROTECTING REVENUE) BILL 2012: FLAWED PREMISES

The Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012 is designed to restrict the full crediting of State and Territory royalties under the MRRT to those in place as at 1 July 2011. As noted above, full crediting of royalties is a key feature of the MRRT's design, one that ensures double taxation is avoided and that delivers a measure of stability and predictability to the overall tax burden on affected projects, albeit at the upper end of globally competitive tax rates. The Bill if enacted would:

- Impose higher tax burdens on coal and iron ore projects in Australia, threatening jobs and investment in an already difficult economic environment
- Overturn any residual claims Australia has to maintaining stable and internationally-competitive taxation arrangements in the minerals industry
- Undermine any prospect of Commonwealth-State fiscal cooperation aimed at ensuring efficient and equitable minerals resource taxation arrangements across the Federation.

The minerals industry considers that the Bill rests on a series of flawed premises:

1. That the mining industry is not paying its way (notwithstanding the massive growth in the revenue contribution from the minerals industry over the last decade)
2. That our taxation system is an island and Australia will remain an attractive destination for investment in coal and iron ore irrespective of policy actions
3. That the volatility of MRRT revenues in response to changing market conditions is a problem; a design flaw, rather than an essential design feature
4. That intergovernmental conflict over minerals resource taxation (with taxpayers caught in the middle) provides a basis for good governance in the interests of the Australian people.

The Bill would overturn the Australian Government's July 2010 agreement on the MRRT and its March 2011 decision to accept all recommendations of the PTG. The MCA recommends that the Senate Economics Legislation reject both the Bill and the premises on which it is based.

2.1 Flawed Premise #1: The mining industry is not paying its way

The Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012 embodies the mistaken view that the minerals resources industry is not already making a large contribution to government revenues in Australia, one that has grown markedly over the last decade. The minerals sector is among the highest taxed industries in Australia, even before the introduction from 1 July 2012 of two new taxes – the MRRT and the Carbon Tax.

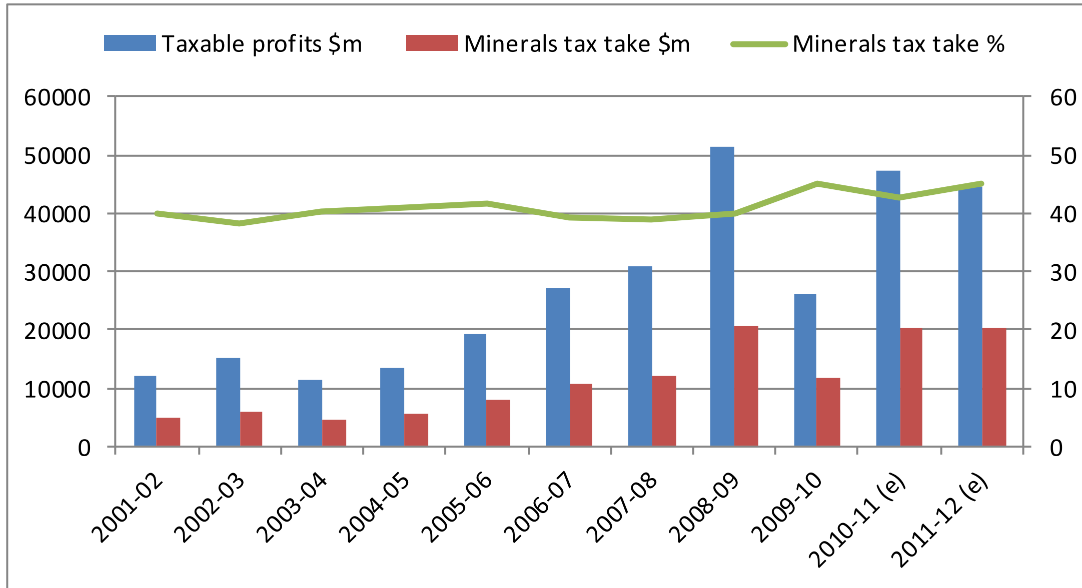
Minerals resources companies have been Australia's highest company income taxpayers in recent years. The industry's indirect tax contribution is also significant. Higher average wages in the industry have resulted in higher average tax rates, higher average tax payments per person and higher tax collections by the Commonwealth. Returns to the Australian community also come via payroll tax, fringe benefits tax, GST and other indirect taxes, charges and levies.

Total revenue from the two primary sources of returns from the minerals industry – Commonwealth company income tax and State royalties – has increased more than four-fold since the start of the last decade. Over the period from 2001-02 to 2011-12, the total industry tax take from royalties and company exceeded $124 billion (estimates for 2010-11 and 2011-12 by Deloitte Access Economics).

Based solely on official data, Deloitte Access Economics calculate the average tax ratio of the minerals industry the period from 2001-02 to 2009-10 (the last year for which official data is available) at 40.5%. Incorporating estimates for 2010-11 and 2011-12, the average ratio since 2001-02 is 41.6%, with the percentage tax over taxable income before royalties moving higher in recent years.

Thus, as shown in Figure 5, the industry tax ratio has been high and relatively stable over the last decade as industry profitability has fluctuated with changing economic conditions. Contrary to claims made during the 2010 tax debate, the industry tax ratio has actually risen in recent years, hitting a decade high of 45.2% in 2009-10 (the last year of available official data).

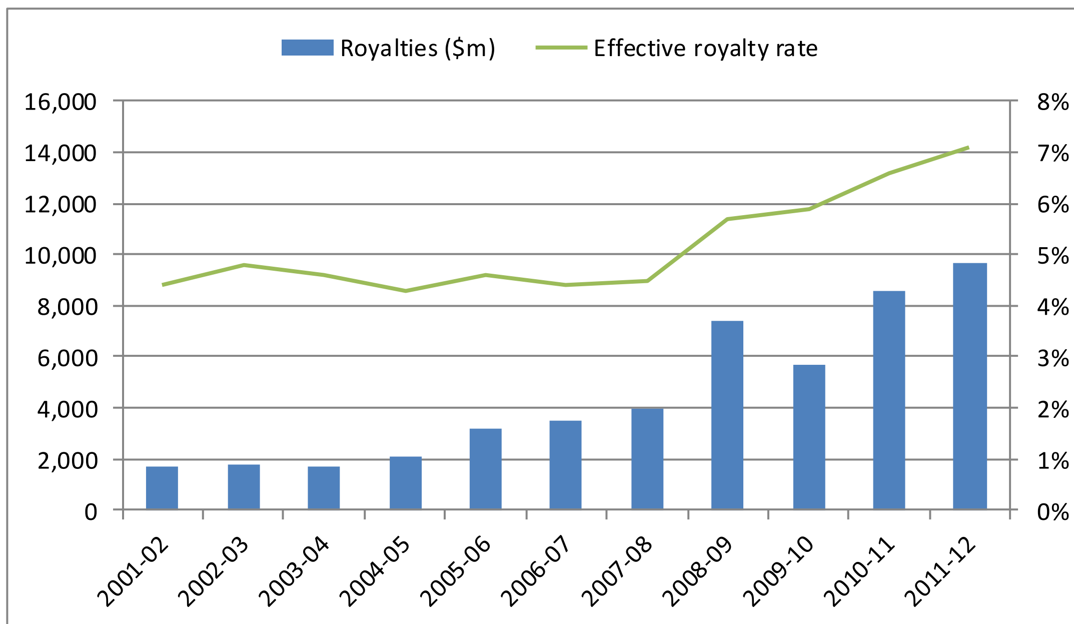
Figure 4: The minerals industry tax take ratio has remained high and stable



Source: Source: ABS, State Budget Papers, BREE, Deloitte Access Economics estimates

The general stability in the minerals industry tax ratio is no surprise. On the one hand company tax is a steady share of profit. On the other hand royalties – typically levies on production volumes or values – have seen their rates rise across the period over which the mining of minerals in Australia has been more profitable. This has meant that the largest part of the minerals industry tax take already moves with profit, and the other part has tended to move with profits over time.

Figure 5: Royalties – Australian minerals industry (1999-00 to 2011-12)



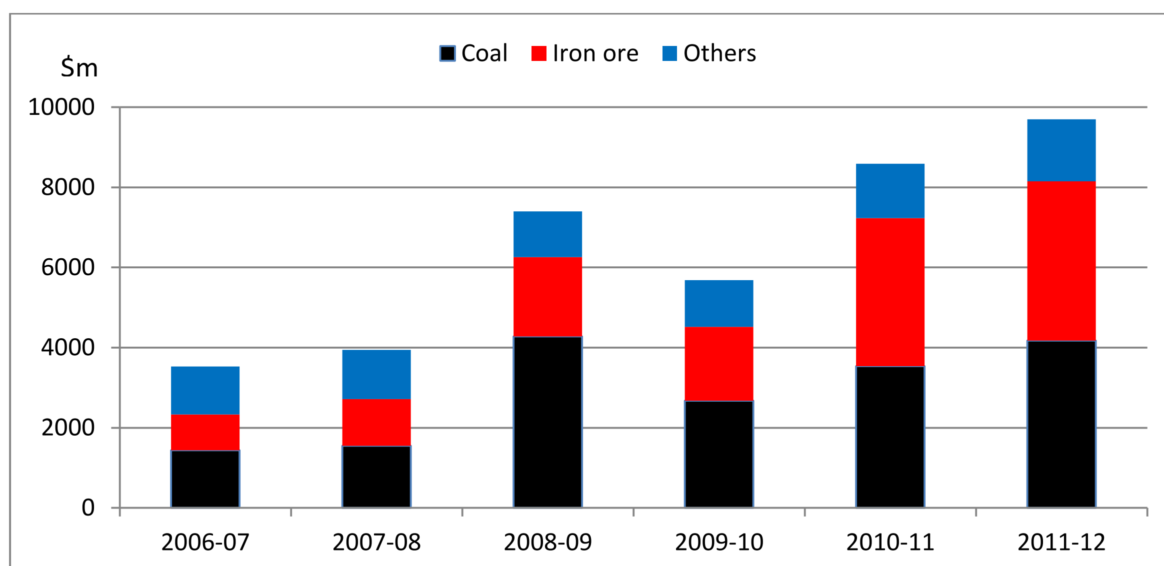
Source: ABS, State Budget Papers, BREE, Deloitte Access Economics estimates

In reality, the overwhelmingly majority of royalties are based on the *value* of mineral production – not volume. While varying from State to State, relatively high royalty rates have applied to export coal and lump iron ore. Moreover, States have responded to rising profitability by lifting royalty rates since 2006-07. States have lifted royalty rates, and the composition of minerals mined has shifted towards those with higher royalties, to such an extent that royalties have lifted faster than profits over recent years, increasing the effective royalty rate.

Total royalty payments to State and Territory Governments have risen sharply since 2006-07, due overwhelmingly to growth in coal and iron ore royalties. Coal royalty payments have risen at an average annual rate of 24%, while iron ore royalties have risen at an average annual rate of 35% between 2006-07 and 2011-12.

Notwithstanding the uneven distribution of resources across the States (with the bulk of royalty revenues flowing to Western Australia, Queensland and New South Wales), the system of Horizontal Fiscal Equalisation means that all States (including those without large mining industries) have benefited from industry growth – even though there is debate over the desirable extent of redistribution and over some aspects of current arrangements.

Figure 6: Mineral royalties by commodity (2006-07 to 2011-12)

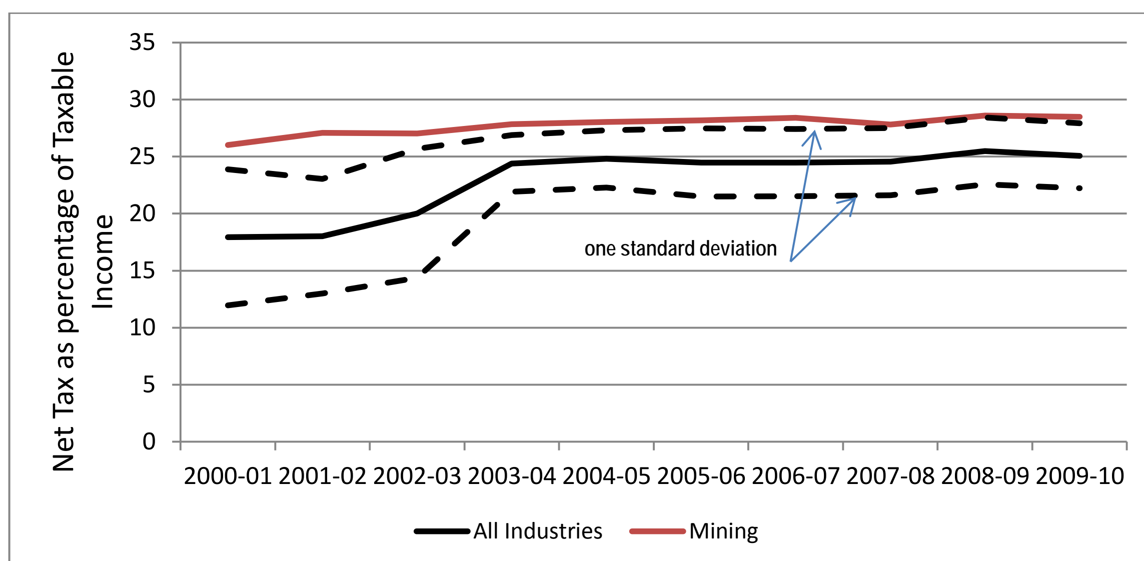


Source: ABS, State Budget Papers, Deloitte Access Economics estimates.

Data for net company tax from the Australian Taxation Office (ATO) confirm that mining (including oil and gas) is among the highest taxed industries in Australia. After refunds and credits, the net corporate tax rate on mining has been consistently above the average of total industries.

Professor Sinclair Davidson of RMIT has shown that over the decade to 2009-10 (the last year of official data), the average effective company tax rate for mining (net corporate tax as a percentage of taxable income) has remained above the average of all industries, plus one standard deviation.[xv]

Figure 7: Average effective net company tax rates for all industries and mining



Source: ATO Taxation Statistics (various issues). Calculations by Davidson (2012).

2.2 Flawed Premise #2: Our tax system is an island

Policy settings – particularly the taxation system – are crucial to attracting the investment needed to develop Australia's minerals resources. Securing the benefits of Australia's comparative advantage in mineral resources requires stable and globally competitive tax arrangements that encourage investment.

The second flawed premise of the Bill is that Australia can continually raise taxes on its most globalised industry and not impact negatively on investment, jobs and economy-wide growth. It reflects a similar mindset to that which underpinned the deeply flawed Resource Super Profits Tax; namely, that our taxation system is an island and Australia will be a preferred destination for minerals investment irrespective of policy actions.

As the (outgoing) Chairman of the Productivity Commission, Mr Gary Banks, has observed:

> *No country's taxation system is an island. Relative expected returns across resource-prospective countries will be the main determinant of international investment and thus domestic activity in the long term.*[xvi]

Mining is highly capital-intensive and characterised by considerable and high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. Capital is highly mobile and is rationed and allocated strategically. Companies make multi-decade investment decisions based on risk-weighted, after-tax returns. It is common for mining companies to rank mining taxation regimes across the world and project-specific reassessments of a country's fiscal regime are always undertaken when evaluating potential investment opportunities.

This sensitivity can be attributed to the particular (and often unique) characteristics of minerals resource projects. These characteristics include:

- The exploration phases preceding start-up and production are lengthy and costly, and there is no income during these phases
- The development of a mine is very capital intensive and requires specialist equipment and skills
- A mining project typically has a long life and therefore may be subjected to changes in the political regime or domestic circumstances
- Prices take larger cyclical swings than in most other economic sectors

- The scale of operations can be very large, with high replacement and incremental investment to maintain production
- Mining activities generally get more costly as a project matures because the resource becomes less accessible
- Mine closure and reclamation incur large costs after income has ceased.

Higher effective tax rates – the impact of this Bill – distort production and investment decisions and push Australian projects up the global cost curve, leaving firms better off pursuing offshore options instead. As the Minister for Resources and Energy Martin Ferguson has pointed out repeatedly:

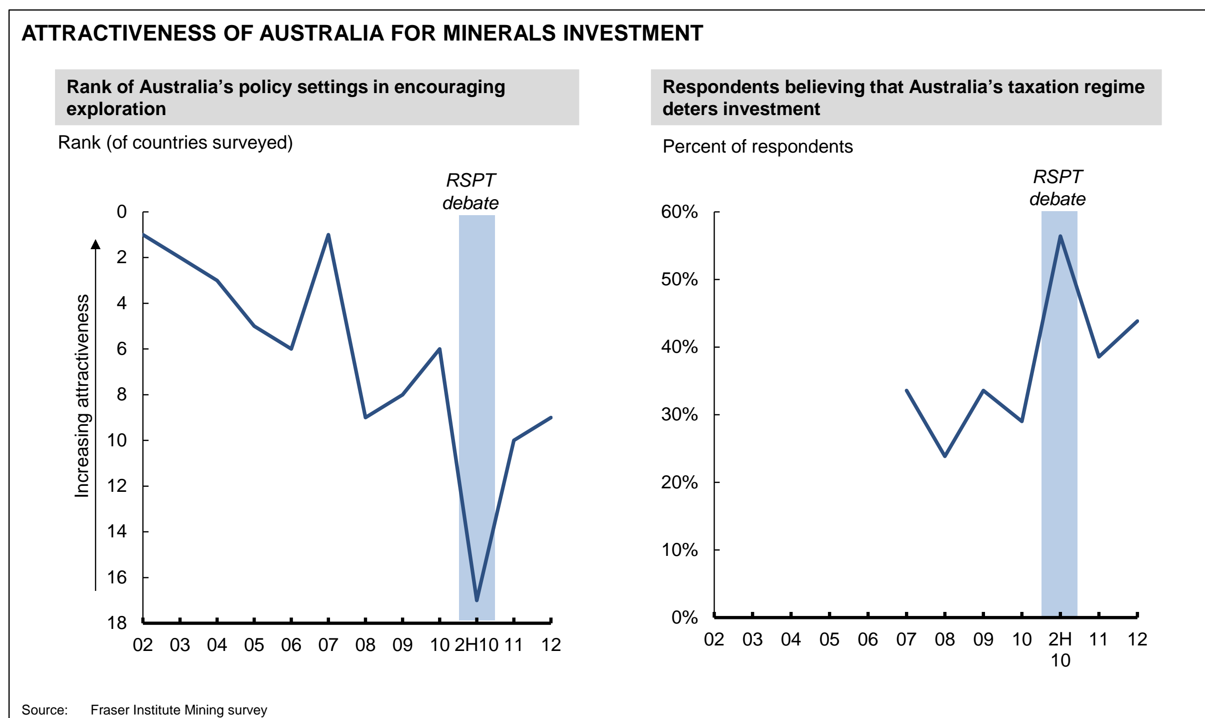
> *We cannot underestimate the importance of sound government policy in attracting investment and facilitating economic growth. Investment capital is footloose, and Australia is competing globally to attract this capital and investment.*[xvii]

Coal is mined commercially in more than 50 countries, with Australia accounting for less than 9% of global black coal production and just 6% of the world's black coal Economic Demonstrated Resources (EDR). Australia faces increased competition for market share from existing exporters (including Indonesia, Colombia and North America) and from emerging exporters (including Mongolia and Mozambique).

In iron ore, strong competition will come from Brazil, Canada, India and a number of African countries in the years ahead. High grade iron ore resources remaining in Western Australia are eclipsed by those in the Carajas region in Brazil and there are substantial high-grade resources in other countries. Brazil, Guinea in West Africa and India combined have more than enough resources to take all of the future growth in demand.

Confidence in fiscal stability is paramount if Australia is to grow (or even maintain) its market share in industries characterised by long time horizons and long-lived assets. Australia's reputation as a stable and attractive minerals investment destination has deteriorated over recent years. This can be seen most clearly in the ranking of Australia in the wake of the RSPT proposal, based on the annual survey of mining companies conducted by the Fraser Institute in Canada.

Figure 8:



Prior to the RSPT debate, investors consistently ranked Australian mining policies as amongst the most attractive in the world. The RSPT debate, however, put Australia's reputation at risk. Australia's policy attractiveness fell from 6th to 17th among mining peers, below Zambia, Ghana, and Peru.

Although ultimately settled, the RSPT debate left a legacy in terms of policy uncertainty and sovereign risk perception. As reported in the Fraser Institute's 2011-12 Survey of Mining Companies, Australian States and Territories now rank down in the middle of the pack based on tax regime attractiveness to investment – between 30th and 61st of the 93 nations and provinces examined.[xviii] Further increases in the overall tax burden on Australia's minerals industry would make Australian projects less attractive than alternatives in other countries. Far from guaranteeing future growth and investment in Australia, the outcome would be less growth, less investment and (ultimately) less taxation revenue.

2.3 Flawed Premise #3: Volatility of MRRT revenue is a problem

The Bill if enacted would impose additional imposts on the minerals industry regardless of underlying economic conditions. With its stated motivation to "protect revenue" irrespective of changes in business conditions and industry profitability, the Bill contradicts fundamentally the key feature of resource rent taxation, namely to align the resource charge with profitability.

The reality is that collections under the MRRT can be expected to be both volatile (jumping around from year to year) and variable (providing surprises relative to what was forecast). This is principally because the MRRT's tax base is highly dependent on commodity prices and exchange rates – themselves both volatile and variable.

The Government has recognised on a number of occasions that resource tax revenues are highly volatile and that this is intrinsic to how such taxes are designed to work. As noted earlier, this is not a design flaw – it is an essential design feature where the objective is to minimise distortion to investment and production decisions. As the Treasurer pointed out on 25 October 2012:

> *The design of a resource rent tax is such that it delivers the revenue when profits are high and in the case of commodities where prices are high and of course when they go down, it doesn't necessarily deliver the same amount of money. … we've had a real crash in commodity prices which has not only affected the resource rent taxes but it's affected company tax as well.*[xix]

The Finance Minister made the same point on 30 October 2012, stating:

> *There are obviously swings and roundabouts in MRRT revenue, a profit based tax, so by design it will collect more when profits are high and less when profits are low.*[xx]

Treasury officials have repeatedly emphasised the high level sensitivity of MRRT revenue to the exchange rate and to assumptions about commodity prices. On 24 February 2011, the former Treasury Secretary, Dr Ken Henry, told the Senate Economics Legislation Committee that:

> *As we all know, these particular revenue estimates, and, indeed, of course, the actual revenue eventually collected, is highly dependent upon the exchange rate and commodity prices for individual commodities – iron ore and coal. It is a matter of fact on the historical record that the exchange rate, particularly the Australian dollar-US dollar exchange rate – and that is the one that matters most with these revenue estimates, as you know – and also the world prices of iron ore and coal have been amongst the most volatile parameters that economic forecasters or revenue forecasters would confront. That is something that is very well understood.*[xxi]

Similarly, research by the Australian Parliamentary Library has noted that:

> *The revenue derived from the MRRT will be heavily dependent upon (Australian dollar) commodity prices. In particular, movements in exchange rates and world prices for iron ore and coal will be fundamental in determining the revenue raised by the MRRT. The revenue flows will be highly*

procyclical. That is, MRRT revenues will vary significantly with nominal GDP growth. In addition, the design features of the tax in terms of how mining profits and losses are defined and deductibility of certain types of expenditures mean that there will be significant lags in MRRT collections in the event of significant rises or falls in commodity prices. This is similar to the way in which company tax revenues fluctuate with nominal GDP growth. In short, significant volatility will be a feature of the tax.[xxii]

Other commentators have made the same point, highlighting the high level of sensitivity to China's commodity demand in particular and that this would have been equally been the case with the RSPT. Thus, for example, Chris Richardson of Deloitte Access Economics has observed that:

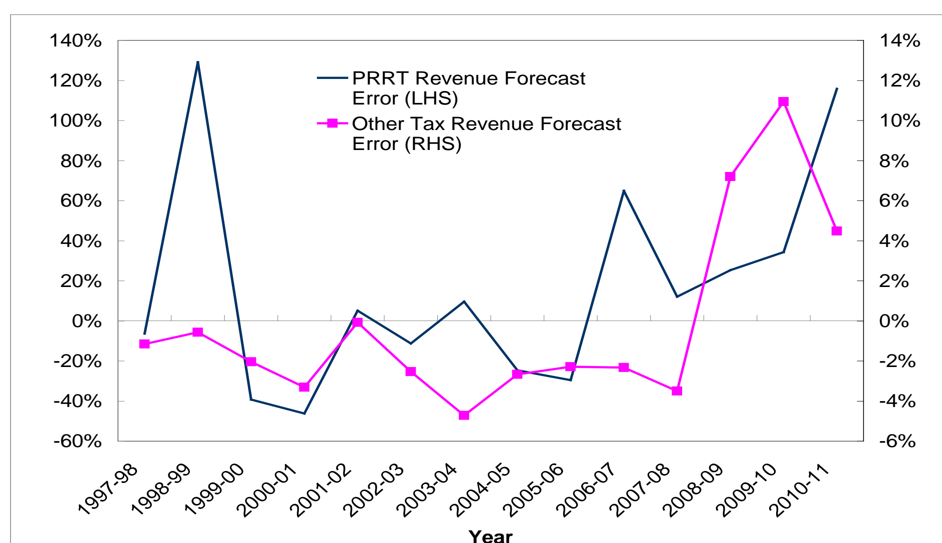
It [the MRRT] was always – if you like – designed to be a volatile tax, a turbo-charged tax cutting in and cutting out. Whether you look at the original version of the tax [the RSPT] as proposed or the current version both of them were always going to be very vulnerable to China.[xxiii]

The experience of the Petroleum Resource Rent Tax (PRRT) underlines both the inherent volatility and variability of resource rent taxes. The PRRT is similar to the MRRT in many respects; in particular, both taxes are targeted at similar bases (i.e. economic rents). Analysis of the PRRT by Dr Alex Robson of Griffith University has shown it to be a highly volatile source of revenue and one that is difficult to predict.[xxiv]

Using various statistical measures of volatility, Dr Robson found that PRRT revenue in some instances has been three orders of magnitude larger than volatility of aggregate Commonwealth revenues. This is due principally to the relative volatility of the tax base and the degree to which individual components of the tax base – prices, exchange rates, volumes and costs in global oil and gas markets – are themselves volatile.

Secondly, examining the predictability of PRRT revenue based on the forecasting record of Australian governments since 1997-98, Dr Robson found that forecasts of PRRT revenue have generally been very inaccurate, with the Australian Government tending to overestimate PRRT revenue by relatively large dollar amounts. Forecast errors of plus or minus 40% of actual revenue are the norm, with errors of more than 100% not uncommon. A comparison with other sources of tax revenue is also instructive, showing the percentage errors in PRRT forecasts are many orders of magnitude larger than the forecast errors of all other tax revenue.

Figure 9: PRRT and Total Tax Revenue Percentage Forecast Errors, 1997-98 to 2010-11



Source: Budget Papers, various years; author (Robson) calculations

Both the volatility and unpredictability of PRRT revenues are due to uncertainty regarding resource prices, exchange rates, aggregate production volumes and aggregate allowable costs under the PRRT. The same will be true for the MRRT.

2.4 Flawed Premise #5: Taxpayers should bear the risk of intergovernmental conflict over minerals resource taxation

The Bill (as exemplified by the comments made in support of it) is a thinly disguised attack both on the mining industry and on State and Territory Governments. It would guarantee systemic intergovernmental conflict over mineral resources at the expenses of industry and the wider community.

Within Australia's federal structure, taxation of the resources industry is a shared responsibility across Commonwealth and State/Territory Governments. A degree fiscal cooperation is therefore essential to ensure equitable and efficient resource taxation arrangements.

Responsibility for Australia's onshore mining industry has largely rested with the States, including responsibility for the charging arrangements through which the industry pays for the use of the community's non-renewable resources. States and Territories collect royalties in return for granting the right to private businesses to exploit mineral resources within their jurisdictions. At the same time, the Commonwealth has a well-established position in the field of taxation, including in relation to companies.

This Bill as drafted would impose higher effective tax rates on coal and iron ore projects that have been the subject of increased royalties since July 2011. It would also take Australia further away from the sort of Commonwealth-State cooperation needed to ensure effective and efficient governance in the interests of all Australians.

The Bill is motivated by a desire to elevate a small set of policy objectives at the expense of others. As noted earlier, the Government-appointed PTG recognised the multiple policy objectives that arise in relation to minerals resource taxation and highlighted that the responsibility for maintaining the integrity and competitiveness of Australia's resource taxation regime is shared across the Federation. Ultimately, there is only one avenue by which a durable framework for stable and internationally-competitive taxation and royalty arrangements can be implemented and that is via constructive dialogue between stakeholders (including industry) and agreement between Commonwealth and State and Territory Governments.

By contrast, this Bill adopts a narrow, economically destructive and confrontational approach to resource taxation.

Firstly, it takes no account of the need for internationally-competitive tax and royalty arrangements leaving companies exposed to higher effective tax rates based on royalty increases since July 2011. Since July 2011, governments in the major resource states of Western Australia, New South Wales and Queensland have moved to increase royalties.

- In its 2011-12 Budget, the Western Australian Government announced a two-stage increase in the royalty rate on iron ore fines: from 5.625% to 6.5% on 1 July 2012, and to 7.5% from 1 July 2013. This will result in the royalty rate for iron ore 'fines' being the same as for iron ore 'lump'.

- In its 2011-12 Budget, the New South Wales Government announced its intention to increase coal royalties to raise an estimated $944 million by 2014-15 ($235 million in 2012-13, $244 million in 2013-14 and $465 million in 2014-15). The increased royalty is designed to address the negative impact on NSW of the Carbon Tax. While the Government has linked the measure to the MRRT and stated that the tax burden on mining companies will not alter, it remains unclear how this will be achieved. The supplementary royalty rate to achieve the 2012-13 revenue target will be set by regulation on or before 15 December 2012.

- In its 2012-13 Budget, the Queensland Government announced that from 1 October 2012 royalties would increase from 10% to 12.5% for every tonne of coal sold between $100 and $150 per tonne, plus an additional tier of 15% on coal sold above $150 per tonne.

Contrary to widely held views, it is important to recognise that there is not a dollar-for-dollar trade-off in the interaction between Commonwealth MRRT and State royalties. In the absence of entities having an MRRT liability, royalty increases are a direct additional cost to coal and iron ore producers. Hence, if a project is not paying MRRT in a particular year, a State increasing its royalty rate will receive revenue at the expense (at least initially) of the project's profitability, rather than at the expense of the Commonwealth.[xxv]

In not taking account of this fact, the Bill threatens investment and jobs in the coal and iron ore industries in what is already challenging economic environment based on movements in key parameters. It especially threatens new projects that are, in many cases, already marginal investments.

Secondly, the Bill consciously adopts a Commonwealth-centric view of rights and responsibilities in the Australian Federation. In the process, not only are industry concerns discarded; so are the legitimate interests of State and Territory Governments given their important constitutional rights and responsibilities. Hence, for example, the Bill takes no account of:

- The historical role of States and Territories in charging for the right to mine under their soils
- The economic, social and environmental objectives of State and Territory Governments
- The particular spending needs (for example, in relation to economic and social infrastructure) that come with supporting minerals resource development.

The minerals industry considers that to the extent current royalty crediting arrangements under the MRRT provide an incentive for States to increase royalties, the only way this can be resolved is via constructive dialogue involving all stakeholders (including industry) and, ultimately, via an intergovernmental agreement that takes full account of the need for stable and internationally-competitive taxation and royalty arrangements.

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