ANDEV Australians for Northern Development and Economic Vision

Friday, 22 October 2010

By email: newtaxes@aph.gov.au

Senator Mathias Cormann
Chair
Senate Scrutiny of New Taxes Committee

Dear Senator Cormann,

Please find attached a submission (Part A) with respect to the MRRT which you kindly suggested we present.

The submission is in two parts, the first in relation to thermal coal and the second part, to be forwarded shortly, will be in relation to iron ore,.

Part A, primarily aims to demonstrate that the proposed MRRT on the thermal coal industry and any other additional taxes e.g. ETS or a Carbon Tax, will not only impact the thermal coal industry but importantly power costs for businesses and homes throughout Australia, and:

- Thermal coal is not exclusive to Australia, but exists in many countries. Australia needs to maintain its competitiveness to supply thermal coal markets. Australia is already competing against low cost Indonesia and will be competing additionally against low cost Mongolia.

- Australia is not the only supplier of thermal coal, yet we are one of the most environmentally responsible, least polluting suppliers.

  Increasing investment in thermal coal supply in low cost countries will over time replace Australian thermal coal if we don't act to reduce our costs and remain competitive. Hence more polluting coals from lower cost countries will replace Australia's environmentally preferred coals. (Graphs follow)

- Increased taxes on thermal coal will increase directly (or indirectly via subsidies) power generating costs in Australia, as approximately 80% or more of Australia's power is generated by thermal coal. All or nearly all Australian households would be affected by this if any additional tax applied to thermal coal, and further be impacted by the increased costs of all goods and services requiring power usage. This could close businesses, send them off shore, impact the Australian economy much more so than the MRRT on other commodities.

- Similar costs apply for mining, infrastructure and transporting metallurgical and thermal coal however metallurgical coal is sold for over double the price per tonne than thermal coal. Further, historic price rises have occurred for both copper and gold, yet neither needs to bear the extra MRRT cost.

- It is relevant and significant to note that the recent September 2010 ABARE forecast shows significant improvement in Australian commodity revenues (please see attached) and this means that the forecast budget deficit will be reduced, hence the budget can return to surplus earlier than planned and the opportunity exists to lessen the MRRT (and exempt thermal coal) .

- There is considerable concern and exposure that the current Government has done a deal with multinational companies which have advantages for existing producers, but disadvantage new producers, (e.g. in relation to infrastructure and finance costs) and hence the MRRT is not yet adequately addressing the future of Australia.

- Australia needs policies that encourage economic growth and the protection of living standards, particularly given the increasing age of our population and increasing revenue needed to accommodate our increasing elderly population, (and other needs). Any additional tax on thermal coal would have significant effect on the cost of power (and potentially the adequate supply of power), and goods and services that required power, and would have more impact on Australia's economy and living standards than the MRRT on magnetite.

- Given the foregoing we need in Australia, a pro-active policy to encourage investment in our thermal coal industry, policies that enable Australia to maintain competitiveness in markets overseas and policies that maintain ongoing revenue from Australia's thermal coal and related industries. The recent independent Fraser Institute report in 2010 is just one report that shows Australia's position is declining as a country in comparison to other countries which are more attractive to investment.

It is critical to remember the Australia is not the only country that has thermal coal endeavouring to reach markets, and hence Australia must remain competitive, or we will see less revenue from thermal coal exports, and coals more polluting than Australia's, being increasingly used.

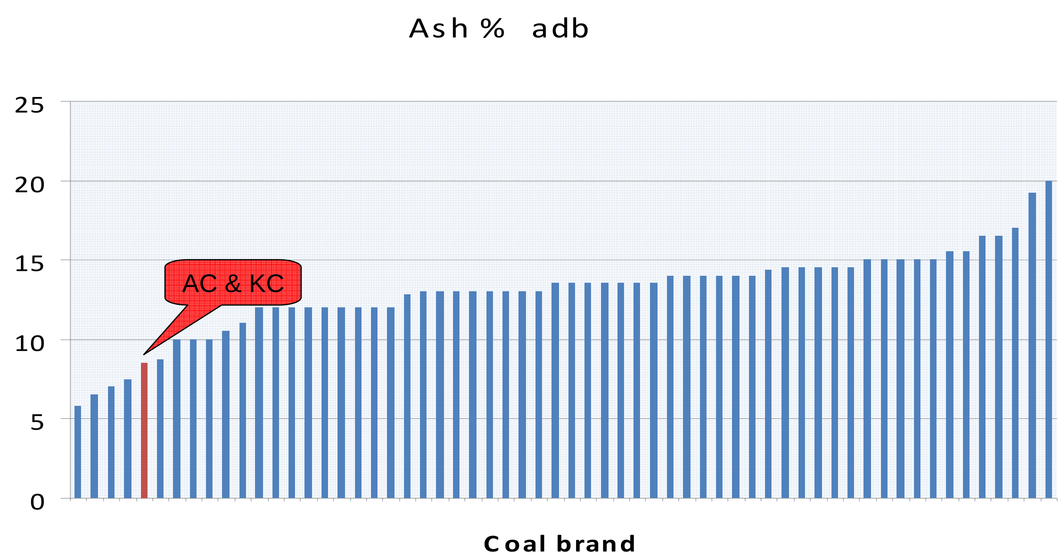
1. Coal is the most abundant fossil fuel in the world, leaving ample opportunity for competition from less costly countries. Global recoverable reserves were estimated at 844 billion tonnes in 2005 and located in 68 countries according to International Energy Statistics (IES) which are produced by the U.S. Energy Information Administration. Coal is produced in huge volumes in many countries for both domestic consumption and for export. According to IES, coal (in all of its forms) was produced in 67 countries in 2008 and exported by 60 countries of which 25 exported more than 1 million tonnes with total exports then at 986 million tonnes. In the same year 104 countries imported coal of which 48 imported more than 1 million tonnes with total imports then at 964 million tonnes.

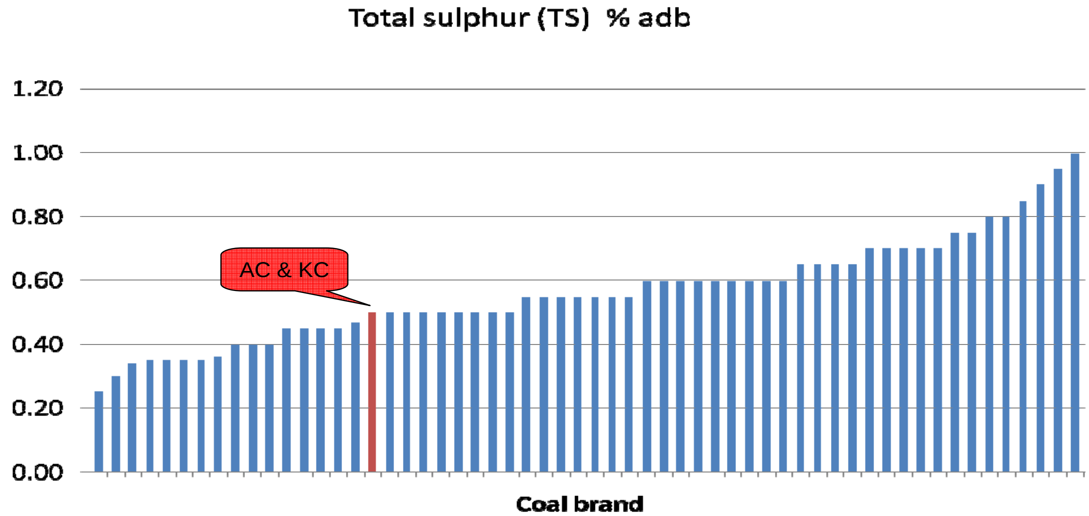
2. There are large deposits in Australia of thermal coal known to be low in ash, sulphur and gas and with comparatively superior burning efficiency thereby minimizing CO_2 emissions. There is an ongoing, increasing demand for at least another generation of coal fired power stations to use thermal coal (given its relatively lower cost) and it is therefore sensible to utilise the deposits particularly when many Australian thermal coals are more clean (with lower, ash, sulphur and gas) than coals in China for instance.

Australia should be seeking to benefit from export of its lower polluting thermal coals whilst demand continues and as new coal fired power stations are being built now. Development of these less polluting thermal coal deposits should be encouraged not hindered by the introduction of a MRRT and potentially other taxes.

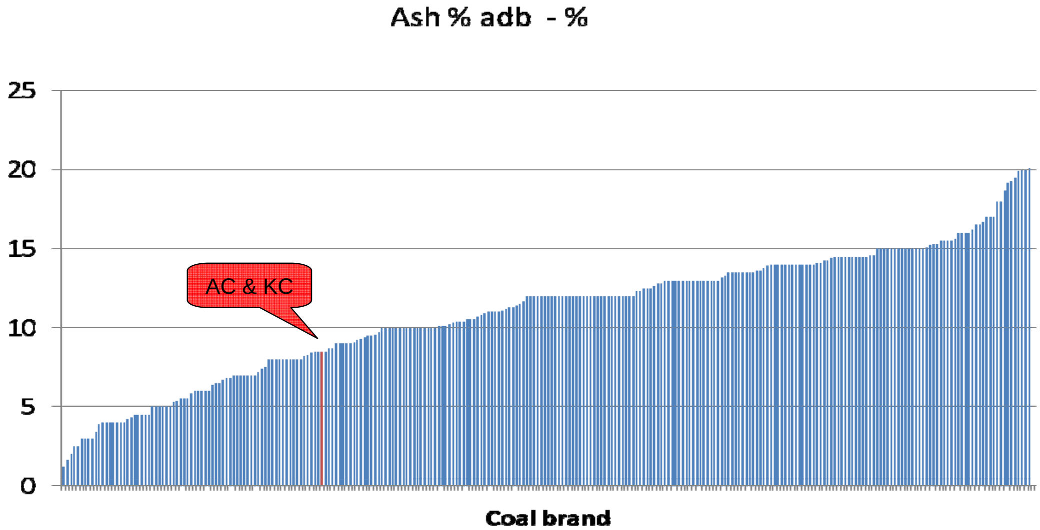
For instance there are new mines planned in the Galilee Basin set to be the largest thermal coal mines in Australia with comparatively low ash, sulphur and gas, as the following tables show:

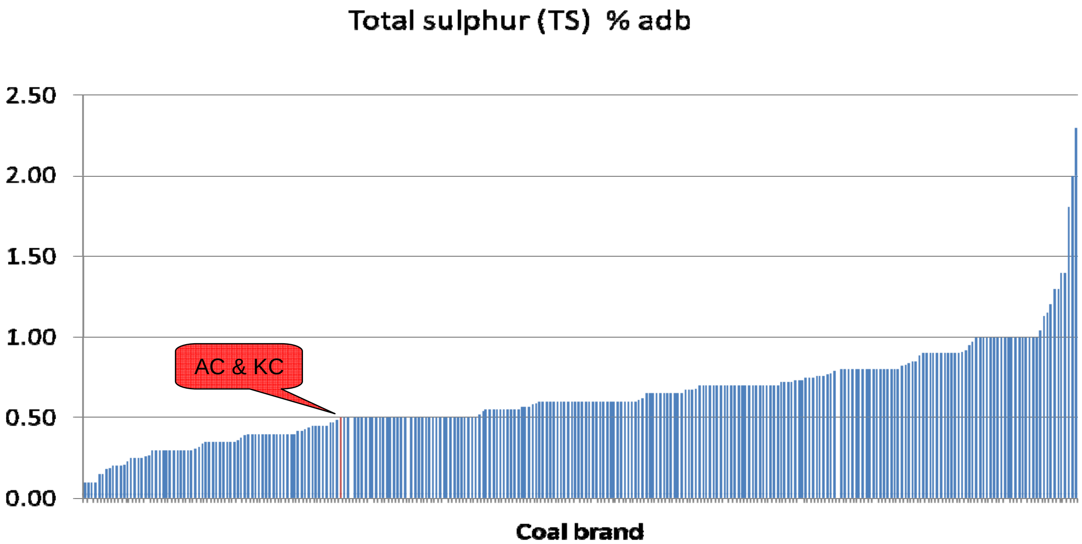
Galilee Basin (AC and KC) Quality Coal Comparison – Australian Coals





Galilee Basin (AC and KC) Quality Coal Comparison – World Coals





We are however concerned that potential future cost imposts of a MRRT (and on top of this potentially an ETS or a tax on carbon) will make investment in such mining developments uncompetitive in our already high cost country, when compared with Asian and other competitors with much lower wage rates and hence much lower cost.

3. Potential changes in royalty and taxation quantities and regimes, with the further risk of an ETS, environmental and other policies, have already diminished Australia's place as an investment option. As noted from the recent independent Fraser Institute Report, (commissioned just prior to the dropping of the RSPT) recently published:

Thursday, 12 August 2010
THE move to increase mining taxes is having an unsettling effect on mining company confidence across the globe, according to Canadian think tank the Fraser Institute, which said overnight Australian states are losing their attractiveness as mining destinations due to the federal government's recent tax grabs.

Chief among these are Australian states, most of which dropped significantly on the Fraser Institutes' Policy Potential Index which assesses how mineral endowments and public policy factors such as taxation and regulation affect exploration investment.

In a statement accompanying the release of the report, the Fraser Institute said international mining executives were looking less favorably on these formerly mining-friendly jurisdictions that are moving to increase taxes on the industry.

Australia is chief among these, according to the report, with the federal government's proposed resources super-profits tax having a significant impact on Australia's standing among global mining executives.

The 2009/10 index saw South Australia drop to 15th place overall from 10th, and Western Australia fell to 28th from 19th, the Northern Territory dropped to 30th from 14th, Queensland declined to 33rd from 24th, and New South Wales plummeted to 38th overall from 20th, according to the Fraser Institute.

Fifty-one jurisdictions were included in the mid-year report. The average rank of the Australian states fell to 31st place, from 18th in the 2009-2010 index.

The attempted tax grab impacted on Australia's reputation globally, and risked defining the country's attitude to the industry for overseas executives, according to the report, with more survey respondents saying they were worried about Australia's future taxes than agreeing they were familiar with local mining issues.

The two other areas in the world that saw their standing drop – Quebec and Nevada – also looked at introducing new mining taxes in the survey period.

Report author Fred McMahon said uncertainty over future tax regimes was the driving factor in the drop in the standing of Australian states in the survey.

*Overall, the top 10 jurisdictions in the mid-year survey were Alberta, Finland, Quebec, Yukon, Saskatchewan, Chile, Newfoundland and Labrador, Botswana, Alaska and Nevada. (**Please note, Australia and our States are not even in the top 10 indeed all these countries rank above Australia, as indeed 30 countries now rank above the average of Australian States**)*

Further, the AAP released the following on 5 August 2010:

Mongolia may kill Aussie coal: Friedland

5-August-10 by AAP

Mongolia's lower-tax coal sector could rob global market share from Australia, Canadian billionaire mining executive Robert Friedland says.

Mr Friedland, who chairs the Toronto stock exchange-listed miner Ivanhoe Mines Ltd and its 90 per cent owned Ivanhoe Australia, said "Mongolia could kill Australian coal" because its mining tax was lower than in Australia.

Ivanhoe Mines' 79 per cent-owned coal company South Gobi Energy Resources is the largest coal producer in Mongolia in terms of export sales.

The tax on mining profits in Mongolia was 25 per cent compared to Australia's proposed 30 per cent mining tax, Mr Friedland said.

Mongolia had a clear advantage in that it neighboured its Chinese customers.

"They're closer to China than your lucky island," Mr Friedland told the Diggers and Dealers mining conference in Kalgoorlie.

The Hon Stephen Smith then Foreign Minister highlighted that 300 Australian firms had now invested very substantially in West Africa. With coal, Australian firms are now investing offshore for our coal markets e.g. in Indonesia, where several have recently invested. Companies recently reported include:

- Kangaroo Resources Ltd
- Pan Asia Corp
- Overseas & General Ltd and
- Indo Mines

The below media excerpt from the Tex Report states further

Australian Enterprises Actively Join Coal Business In Indonesia

-Coal mine developments in Australia getting difficult due rising costs-
Independent mining companies in Australia have come to actively participate in coal businesses in Indonesia in these days. Australia, mining companies have come to embark on coal mine developments in Indonesia where coal mines developments can be managed by smaller amount of investments. The participations by Australian mining companies one after another as if in competition should be attributed to the fact that it has become difficult for independent mining companies to develop coal mines in Australia due to

soaring costs for necessary equipment and facilities as well as for work force. In contrast, in Indonesia coal mines developments can be promoted with small amount of investments.

The article specifically mentions Australian coal companies now investing this year in Indonesia instead, and continues: - "*Since export prices of metallurgical coal and thermal coal remain at high level, from now number of independent mining coal companies of Australia entering coal operations in Indonesia seems very likely to increase*."

Recent Australian industry comments provided by "Austcoal Consulting in July 2010 at the AME Mining Conference" stated

"MINEC analysis of mining cost escalation for three listed coal companies – Coal & Allied, Gloucester Coal and Macarthur Coal – showed that average FOB cash costs more than doubled from:

$A45/saleable tonne in June 2003
to
$A95/saleable tonne in June 2009"

This in itself detracts from international investment, the additional application of taxes e.g. MRRT will only further exacerbate the issue. High commodity prices will not maintain indefinitely but unfortunately the cost to mine our commodities will not reduce e.g. labour costs are not forecast to go down, and any such wage increases also impacts on all services and items that require labour increasing Australia's costs.

Australia must ensure it prepares for increased competition from low cost countries that if unaddressed will significantly steal further investment away from investing in thermal coal in Australia and diminish Australia's market share, therefore we need to urgently create and implement policies that enable the environmentally cleaner, low ash, low sulphur Queensland thermal coals to be able to be cost competitive and exported. The immediate public advice of elimination of MRRT on thermal coals (particularly thermal coals from new projects given the additional expenses to start new projects and the need to achieve substantial bank finance) would help this important process. Also the immediate advice that if ETS or other carbon tax is implemented, it will not apply to thermal coals that are exported and/or new thermal coal projects.

4. The elimination of MRRT on thermal coal is additionally important for Australia as additional taxes (such as the MRRT) on thermal coal affects the price of power and anything, including services, requiring power on-used in Australia.

For instance, if the price of thermal coal was higher due to the addition of the MRRT (and/or ETS or similar), the effect of this higher cost would be passed on to electricity wholesale and retail consumers through domestic power generation. This in turn means increasing costs for all items or services which require electricity. Electricity consumers include for example, mum and dad and family consumers, the suburban rail system in south east Queensland and Melbourne, the electrified narrow gauge coal network currently managed by Queensland Rail, Perth's new northern electrified line and light rail systems which are growing in popularity, and the electricity consumption of various public buildings, and many companies. Any federal or state government power exercised such as price capping or subsidy to protect the retail consumer will be at a cost that will need to be recouped in some form. The government would likely recoup such deficit through some other form of taxation. Given that Australia currently obtains 80% of its power through the usage of thermal coal, the cost increase for electricity and all items and services that use coal powered electricity would be increased if either MRRT or any additional taxes e.g. a carbon tax were imposed on thermal coal.

We believe that should exceptions, waivers/exclusions or other special arrangements be applied to magnetite for the MRRT, then such exceptions, waivers etc should at least also apply to thermal coal which has a far more important impact on Australian costs than magnetite, which is primarily for export.

In terms of relativity, the current price at which thermal coal is sold is $94 per tonne as quoted on the global coal platform for the week ending July 30th 2010 whilst a typical Queensland hard coking coal is sold for up to $225 per tonne yet similar costs are involved for mining and transporting the coal, rendering metallurgical coal with far greater profit margins.

To again use the Galilee Basin as an example, it faces the same if not greater mining and transport infrastructure costs, including construction of a 495 km standard gauge railway from the Galilee Basin to the port of Abbot Point, which will need to be funded by private enterprise. This is well over $6 billion of investment that will enable a new Basin to be developed that will otherwise remain dormant, producing no revenue, no tax or jobs.

This demonstrates that thermal coal although absent from recent media (in part as both the NSW and QLD Labour State Premiers do not speak out unlike the Liberal State Premier of WA who actively defends his state’s mining projects) provides clearly greater justification for being excluded from the proposed MRRT, than WA’s magnetite.

The Australian coal (and iron ore) industries, will be made less profitable should any new additional tax be applied, and will have increased costs due to any new additional tax, leaving less funding available for investment. Political decision makers cannot continue to rely on Australia being able to compete on world markets against lower cost commodities from other low cost countries in the near term, if taxes and hence cost go up, and hence should factor in less, not growing, ongoing revenue. We need to encourage revenue from our thermal coal projects.

Australia will increasingly compete against countries with much lower labour costs such as Indonesia, African countries, Mongolia and elsewhere. The cost differential particularly impacts lower priced and lower margin thermal coal, far more than the higher priced and higher margin metallurgical coal (or iron ore). Various iron ore companies are asking for exemptions from the MRRT on particular ores which are lower in iron content and are hence lower priced. If an exception were to be made for magnetite, (which should only be considered in the instance of on sale to steel mills based in Australia), then such an exception should at least be applied to thermal coal, particularly as higher electricity prices would affect more Australians and Australian businesses. This submission is not however requesting that magnetite ores be given any exemption from MRRT. There are vast quantities of other non magnetite ores available in Australia before magnetite ores need to be processed to earn revenue, such processing causing far greater pollution than the abundantly available higher grade ores.

5. 2010 Federal Intergenerational report finds:

- Life expectancy will continue to rise; and,
- The aging population will increase putting stress on Government services (hence increasing revenue will be required).

Those of us now working and heading to retirement age will be making up part of this aging population requiring increased services.

Do we really want our elderly citizens, many on fixed incomes, to face increased costs for power, limiting their ability to use cooling in summer, heating in winter, lights , dishwashers, dryers, usage of electrical gadgets, alarm systems, refrigeration etc, due to higher costs of electricity and potentially inadequate availability of electricity!

Do we really want to limit a very valuable source of revenue for Australia from the thermal coal industry given the increasing needs of this aging population, their pensions, their health requirements, expenses for senior citizens' homes etc?

For those of us not yet in the aging population segment, and not planning to rely on old age pensions or public health etc in future, increasing thermal coal and power costs, will still impact our lives and standards of living if the MRRT is imposed on thermal coal, potentially causing inadequacy of power generation and/or increase of all items and services affected by power generation.

It is too often forgotten that revenue needs to be earnt before spending can occur, be this on defence, police, roads, health services etc, and debts due to over spending can be repaid, hence if we choose policies that curtail the thermal coal industry, this potentially large revenue source will be reduced and less revenue will be available for Australia and its future.

6. There are considerable concerns and expense that the MRRT is currently designed so that there is no tax deductibility in relation to the MRRT for new infrastructure, and concerns regarding lack of deductibility for new finance expense.

To quote Andrew Forrest in the Kalgoorlie Miner of 1 October (and similar in other publications):

> "*"The tax suits only those players who already have their own infrastructure and who have always denied third party access" he said*
> *"The three big mining companies deliberately designed this tax with no tax deductibility for infrastructure."*
> *According to Mr Forrest, without infrastructure access or investment there will be no new mines.*

> *"These three big miners know this and they are trying to shut the door to new entrants." he said."*

In relation to thermal coal it is critical that new thermal coal projects are not prevented from being developed where they need to build infrastructure, so particularly critical new thermal coal projects do not attract the MRRT and that this is announced asap. For other new projects, it is very important that the MRRT does not make it any more difficult to build new infrastructure, or raise money for new projects.

7. If the loss of additional revenue from the thermal coal industry or future thermal coal industry via the MRRT poses difficulties for the government, one possible option could be to consider the advice of the IMF. The Washington-based IMF, in a report on the Australian economy, said the mining tax should be broadened beyond coal and iron ore to other commodities to help reduce inflationary pressure, and many have pointed to the injustice of just targeting iron ore and coal, particularly when other commodities such as copper and gold have enjoyed and are forecast to continue enjoying meteoric price rises. Since the MRRT agreement gold and copper prices have continued to escalate. Perhaps a super tax could be considered for gold and copper for new projects in the instances where gold and copper prices exceed the prices as at the date of the MRRT?

   With the recent September 2010 significant improvement in ABARE forecasts for Australian commodity revenues (please see attached) this means that the forecast budget deficit will be reduced, hence the budget can return to surplus earlier than planned and the opportunity exists to exclude thermal coal from the MRRT.

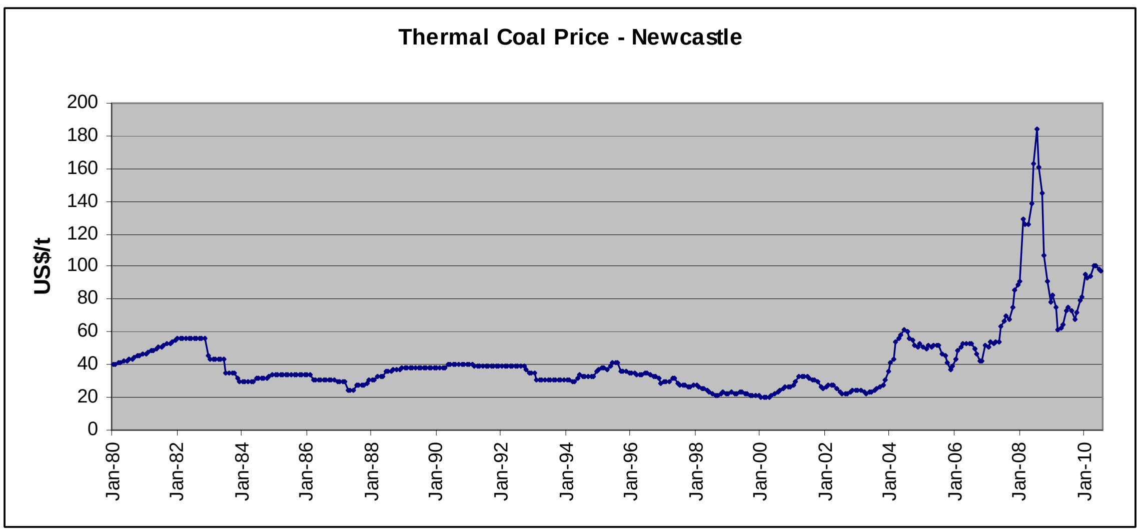
   Further taxes could also be achieved through further significant increases in taxation on cigarettes and alcohol, plus additional taxes on drug and alcohol related illegal activities. These products are well known to cause great drains on Australian revenue.

8. To date the debate on taxation or "super profits" taxation or "resource rent" taxation, has focused very much on market activity in the recent past and short term production future, and on the myth that these growing markets will still be available to Australia on an ongoing basis. They won't be if Australia's costs continue to go up and Australia becomes uncompetitive. It is acknowledged that since 2004 there has been a step change in the market for most commodities corresponding to the emergence of China as a voracious consumer of raw materials. In Australia's case the neglect of infrastructure investment, the slowness of government approvals and the resultant slowed development of new sources of supply contributed to a short term period of boost in commodity prices.

   We say "short term" as the market is not content with paying higher prices and is very actively pursuing the development of cheaper alternatives, especially in low cost countries such as Indonesia, Africa and Mongolia. Many unthinking pundits subscribe to the "super cycle" concept and foresee a long period of sustained growth for Australia, but they completely ignore the reality, a reality readily available to them through history, that to continue to be able to supply in any cycle, you must remain competitive. They should be able to remember what has happened to economies throughout the developed world, such as USA, Europe and Australia, who used to manufacture goods, however given that they are now no longer competitive in comparison to cheaper Asian and Indian countries especially, their own manufacturing industries have closed. We ask the Committee to be alert to this when considering our request to recommend dropping the MRRT on the lower priced thermal coal.

The mining boom could be relatively short and in the case of thermal coal the information herein should clearly show that much care needs to be taken to keep the thermal coal industry competitive and able to continue contributing important revenue for Australia, plus the importance of Australia's thermal coal industry which supplies some approximately 80% of Australia's power generating requirements.

Prices are dictated by the world market as are many, but not all costs. Prior to 2004 the thermal coal seaborne market was driven by cost minimization. The industry was fragmented and the market was regularly oversupplied resulting in the price being locked between US$20/t and US$40/t for most of the past 24 years (as indicated on the below graph) despite the existence of a substantial market. What profits were made were generated only by suppliers at the competitive end of the cost curve.



Source : globalCOAL and IMF

The poor state of the industry was exacerbated by the rapid introduction and expansion of Indonesian export tonnage, which continues to this day, and remains an ongoing major lower cost, competitor to Australia. As previously mentioned Australian companies are taking advantage of this right now, investing in Indonesia instead of Australia.

This was the age of "profitless prosperity" and many countries such as communist style countries, produced for State requirements, not for profits.

The above mentioned "super cycle", if it persists, will provide a step change in prices for commodities but will do so in an environment where there are abundant reserves in countries outside Australia ready to substitute for high cost Australian supply, and markets which are currently "ours", turning to other less high cost sources, such as depicted in the AAP report re Mongolia and in Indonesia.

So it is true to say that there will be increased market volumes but we will see more increased volumes supplied from countries that are cost competitive.

The highly regarded and independent International Fraser Institute in Toronto has noted that:

"*While nations globally are striving to simplify their tax codes, Australia seems intent on adding complexity to its resource taxes: the RSPT is out; the MRRT is in, and the petroleum resources rent tax (PRRT) is expanded.*"

And

"*The problem with assessing Australia's return to competitiveness is that the dust is suspended in mid-air, instead of settling. The mineral resources rent tax (MRRT) numbers don't add up, details are uncertain, complexity has increased, and the whole episode creates new risks for Australian miners.*"

And concludes that in regard to the MRRT:

"*Complexity and uncertainty have produced a deadweight competitiveness loss.*"

We have put forward this information in the hope that you and the Senate Scrutiny of New Taxes Committee will give needed consideration to the thermal coal industry in Australia and its key issues, and recommend exempting thermal coal from the MRRT.

Part B (for iron ore) will be submitted shortly.
Best regards

Greg Anderson, Jan Ford, Chris Codrington and Hans Mende
ANDEV Executive, on behalf of the
Membership of ANDEV

Att.