Minerals resources, tax, and the prosperity of all Australians

A Policy Brief from the Minerals Council of Australia

June 2010

Minerals Council of Australia

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The Minerals Council of Australia (MCA) is the peak industry organisation representing Australia's exploration, mining and minerals processing industry in its contribution to sustainable development and society. 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 percent of Australia's annual minerals output and accounted for about 50 percent of Australia's exports in the year to June 2009.

The minerals industry recognises that its past success and future prosperity are dependent on a sound and expanding national economy, an educated and cohesive society and a sustainable natural environment. For this reason, the minerals sector supports public policy settings aimed at:

- Sustainable economic growth characterised by low inflation, low interest rates, fiscal prudence and a skilled and productive workforce;
- A sound, fair and stable society, where effort is encouraged and rewarded and a helping hand extended to those in need; and
- A sustainable natural environment, reflecting national consistency and balance in policy settings.

The MCA recognises that the future of the Australian minerals industry is inseparable from the global pursuit of sustainable development. Through the integration of economic progress, responsible social development and effective environmental management, the industry is committed to contributing to the sustained growth and prosperity of current and future generations.

This policy brief represents the policies and analysis of the Minerals Council of Australia (MCA). It has been prepared with the collective expertise of the MCA's Standing Committee on Taxation, the Secretariat and individual member companies.

Every effort has been made to ensure that the information is factual and correct. This brief will be continually updated through the course of the debate on the Government's proposed minerals Resource 'Super Profits' Tax as part of the industry's commitment to real and enduring taxation reform.

Introduction

Australia's minerals resources industry supports tax reform that is in the long-term national interest. Such reform is best achieved through broad and comprehensive consultation between Federal, State and Territory governments, industry and the community. This ensures that the design and implementation of tax changes are informed by an understanding of the industry's contribution to Australia's welfare as well as the commercial realities and wider economic ramifications of proposed changes.

When the Petroleum Resource Rent Tax (PRRT) was introduced, consultation began in 1983 with a series of discussion papers that addressed broad policy design issues. The tax was legislated in 1987 and took effect on 15 January 1988 after extensive consultation on the policy's fundamental design.

Regrettably, the Australian Government is not following this process in the development of its proposed Resource 'Super Profits' Tax (RSPT). The industry was not adequately nor constructively consulted during the 'Henry Review' into Australia's Future Taxation System. The limited engagement with the Minerals Council of Australia, related representative organisations and individual companies during the Henry Review and the Government's consideration of its recommendations was either perfunctory at best or deliberately exclusive at worst. The Government's announcement of its 'super tax' on 2 May 2010 limited consultation to transitional detail of the new tax system and 'identify[ing] any issues in the implementation of the RSPT that could undermine the Australian Government's policy intentions'.[1] This excludes any discussion of the fundamental design elements, their underlying justification and the real implications for investment and growth in Australia's minerals resources industry.

The MCA has consistently said there is a conceptual argument to reform the basis of determining minerals royalties payments from the existing revenue-based system to a profits-based system. A profits-based calculation has merits as it can more appropriately share risk and reward between government and mining companies, better reflecting the interdependency between these parties in converting natural resources into value for society.

However, the industry's support for reform was heavily qualified and conditional upon getting the design of any future regime correct. This will necessarily involve consultation with industry, particularly to ensure the practicality of proposed design features. Moreover, there can be no agreement on the appropriateness of any proposed tax reform without full consultation with all stakeholders, including industry and State and Territory Governments.

The industry's consideration of reform is based upon five sound policy principles that form the basis of genuine taxation reform:

- **Prospective:** Changes in taxation and royalties must not undermine the basis upon which long-run investment decisions have been made, nor compromise the principles of equity and efficiency.
- **Internationally competitive:** The overall taxation burden (resources, local, state and federal taxes and levies) should be internationally benchmarked and be competitive against other global investment destinations.
- **Differentiated:** Capital investment and financial return characteristics differ across resources commodities, starkly between oil and gas and minerals commodities, but also significantly between minerals commodities. Achieving a competitive taxation and royalty regime for different resources products requires different design and taxation/royalty rates specific to the characteristics of each product group.

- **Minerals resource-based:** Minerals resources taxation and royalties should be levied on the primary resource value only, and not on the value added in downstream transport, logistics and industrial processing and smelting.
- **Equitable and efficient:** Genuine reform of taxation and royalty arrangements should promote economic activity and improve the efficiency, simplicity and fairness of the system without compromising neutrality and while minimising the deadweight loss to the economy of taxation and royalty collection.

The Government's proposed super tax meets none of these fundamental reform principles. Alarmingly, the underlying premise of the super tax is flawed in its economic theory; the Government's justification of it is a gross misrepresentation of the industry's socio-economic contribution to Australia; and the modelling used to estimate its future impact is theoretical, unrealistic and highly selective.

The purpose of this Policy Brief is to bring clarity to the debate on the Government's proposed tax. It does this by contesting the misrepresentation of the industry's contribution to the welfare of all Australians; by challenging the simplistic application of economic theory to the commercial realities and investment decisions of the global minerals industry; and by underscoring the gravity of the risks to the prosperity of Australians today and tomorrow.

It is critical that the Australian Government and Australia's premier global industry—minerals resources—get this tax reform right. Failure to do so will leave a legacy that violates our commitment to sustainable development, compromising the ability of future generations to meet their needs. The risk is that the generation of tomorrow will be the generation of lost opportunities.

Mitchell H Hooke
Chief Executive Officer
Minerals Council of Australia

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Summary

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On 2 May 2010, the Australian Government announced its proposal for a new 40 percent Resource 'Super Profits' Tax on the Australian minerals resources sector. The minerals resources industry is supportive of tax reform founded on genuine consultation and sound and practical taxation reform policy principles. But the design of the proposed 'super tax' is fundamentally flawed. If implemented, it will put at risk future investment, growth and prosperity in the minerals industry—with consequences for the Australian economy and the welfare of all Australians. It will represent a missed opportunity for taxation reform in the national interest and levy real and tangible costs upon future generations of Australians.

Chapter 1: A robust minerals resources industry is vital to the prosperity of all Australians

1.1 The minerals resources industry is a key pillar of the Australian economy. The minerals resources industry accounted for more than 6 percent of Australia's economy in 2008-09. The industry directly employs 161,500 people—more than twice as many as a decade ago. Over the same time period, the industry has invested more than $125 billion in Australia. Benefits are widely shared through tax, the widespread ownership of shares and the goods and services the minerals resources industry buys from other Australian industries.

1.2 The minerals resources industry is a driver of, not a risk to, Australia's dynamic, diverse economy. Differences between industry growth rates are normal, and concerns that Australia has a 'two-speed' economy are misplaced. Over the last five years, differences in industry growth have been low by historical standards. A dynamic economy has enabled all Australian States and Territories to grow faster than the OECD average over the last two years.

1.3 The minerals resources industry is a major contributor to the Australian community through the broader economy and the communities in which it operates. Over the last decade, the industry returned 98 percent of its cash flows to the Australian community through taxes and investment—before considering dividends to Australian shareholders. The industry is the economic life-blood of many communities in remote and regional Australia, providing jobs and making a large contribution to infrastructure—building roads, airports, communications infrastructure, housing, hospitals, schools, day-care centres, sporting and other community facilities.

In the decade to 2008-09, the minerals resources industry's combined royalty and company tax payments amounted to about $80 billion, a fourfold increase over the time period. Over the last few years from 2006-07 to 2008-09, both company tax and royalty payments have doubled. In 2008-09, the industry represented 6 percent of GDP but accounted for an estimated 18 percent of company tax receipts. This is supported by some of the highest effective tax rates in the country. Externally verified figures show that Australia's two largest tax payers, BHP Billiton and Rio Tinto paid an effective tax rate of 42 percent over the last six years and an effective tax rate of 35 percent over the last decade, respectively.

Chapter 2: The prosperity from Australia's minerals resources needs to be earned

2.1 Australia faces fierce competition from other mineral-rich countries. Australia has only 15 percent of the world's iron ore, 13 percent of gold and copper and 6 percent of black coal. Since 2002, Australia's market share in key commodities such as coal, nickel, bauxite, copper, gold, and uranium has declined significantly.

2.2 Tax policy, fiscal stability and broader regulatory practices matter in the global contest for investment. The mining industry is capital-intensive with considerable and high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies, and long lead times to profitability. Its capital, people and technology are highly globally mobile. In this environment, tax has significant impact on the competitiveness of Australia's minerals resources industry and its attractiveness to global investors. As a result, maintaining a stable and competitive tax system is critical to attracting the investment that the industry needs to grow.

2.3 Other resource-rich countries have been penalised for uncompetitive, unpredictable and capricious tax changes. The experience of other countries highlights the adverse consequences that uncompetitive and destabilising tax changes have on investment and growth in the minerals resources industry.

Chapter 3: The Australian Government's justification for its super tax is flawed

3.1–3.2 The justification for the super tax misrepresents the socio-economic contribution of the minerals resources industry to the welfare of all Australians. In particular, the Government understates tax paid by the resources industry by excluding company tax and by relying on an unrepresentative survey of international tax rates that is contradicted by externally verified financial figures.

3.3–3.5 The supposed benefits of the super tax are based on theoretical assumptions that ignore commercial and economic realities and ramifications. The arguments for the tax wrongly assume that this tax is 'perfect'—that it will not distort investment decisions; that companies will be able to fund Government 'guarantees' at the Government long-term bond rate; that the tax's definition of 'super profits' captures only 'resource rents'; and that the current 'magnificent margins' buoyed by high prices will last beyond historical cycles. Instead, the proposed transition has already damaged Australia's reputation as a stable place to invest. Government modelling states that the super tax will increase output in the 'long run'—but Access Economics suggests that this 'long run' is 50 to 100 years away. And, while the Government suggests the super tax has not hurt share prices, further analysis of share markets shows otherwise.

In particular, the proposed transition that applies substantive tax changes to existing operations increases Australia's sovereign risk. It demonstrates the Government's preparedness to make substantial and unheralded changes to the tax system on existing operations—'effectively moving the goalposts' on past investments. The unprecedented nature of the Government's proposal—together with the lack of genuine industry consultation that preceded and followed the announcement—has introduced tangible uncertainty about what the Government will do next.

The Government's proposed transition puts in place a punitive transition for existing operations that hurts shareholders. In doing so, it creates a major wealth transfer from existing shareholders to the Government. This treatment of existing shareholders will give investors pause before committing additional funds to Australia.

Furthermore, mooted increases to State and Territory royalties show that the super tax has made Australia's tax system less stable. Leaving the current royalty system in place adds complexity to the tax system and leaves the door open for further tax increases.

Finally, the Government's broad definition of 'super profit' provides a basis for further tax increases in other Government industries. All Australian industries must generate returns above the long-term bond rate to survive. Establishing the precedent of taxing companies above this rate will give pause to investors considering long-term investments across the Australian economy.

3.6–3.9 The tax design is unprecedented, untested and risky. There is no economic rigour to the proposed super tax rate of 40 percent, notwithstanding that it will impose the highest rate of tax on any minerals industry in the world. While a 40 percent tax rate is comparable to some of the petroleum industry's global competitors, the same 40 percent tax rate applied across the minerals resources industry makes tax in Australia much higher than our international competitors. A 40 percent tax rate—regardless of the design of the tax—will make Australia's minerals resources industry uncompetitive.

While tax credits are designed in theory to reduce miners' cost of capital, in reality the value of these credits is highly uncertain. The industry does not want the Government to be a silent partner in a quasi-nationalisation of the industry. The risks on existing projects have already been taken, and the industry does not plan for future projects to fail. Furthermore, there is no confidence in the industry and capital markets that the Government's undertaking to cover 40 percent of losses is bankable in raising capital, nor is there any confidence that the undertakings will be honoured in a queue of competing creditors for taxpayers' funds. What is clear, however, is that by diminishing retained earnings by 40 percent, the Government severely restricts the industry's capacity to meet ongoing operational and capital reinvestment requirements.

While the super tax is meant to tax only 'super profits', in practice it is a tax on normal profits that penalises effort and expertise. The claims that the tax will help marginal projects are also highly questionable, especially in the short to medium-term.

Chapter 4: If implemented in its current form, the Government's proposed tax will put Australian prosperity at risk

4.1 Mismanagement of the minerals resources industry today will have a negative and long-lasting impact for generations. This is a particularly important time to maintain investment in Australia's minerals resources sector. Historically, periods of rapid industrialisation have stimulated investment in new resource basins and created long-term shifts in market share. Delays to investment in Australia now will have lasting negative impacts on Australia's market share and on the wealth created from Australian resources for decades.

4.2 The super tax will make Australia's minerals resources industry uncompetitive and delay investment. A combination of Access Economics and KPMG analysis suggests that the super tax will lead to significant delays to investment in Australia. Based on financial modelling of new second-quartile projects, KPMG finds that the super tax significantly reduces the value of Australia's iron ore, coal and bauxite projects, making them less attractive than projects in other countries. Based on this modelling, the super tax makes the value of Australia's copper, nickel and gold projects negative, and these projects will not be viable.

As a result, the super tax will reduce the attractiveness of Australian projects compared to others around the world. Companies and investors that typically rank projects based on risk and return will move Australian projects down their global list of investment options.

4.3 The consequences for the Australian economy will be significant. Delays to Australian projects over the next several decades will pose significant risks to Australia's minerals resources jobs, economic and productivity growth, and to household incomes and wealth.

Chapter 5: Australia's tax reform should be based on five sound policy principles

The MCA has consistently said there is a conceptual argument to reform the basis of determining minerals royalties payments from the existing revenue-based system to a profits-based system. A profits-based calculation has merits as it can more appropriately share risk and reward between government and mining companies, better reflecting the interdependency between these parties in converting natural resources into value for society.

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5.4 Minerals resource-based: Minerals resources taxation and royalties should be levied on the primary resource value only, and not on the value added in downstream transport, logistics and industrial processing and smelting.

5.5 Equitable and efficient: Genuine reform of taxation and royalty arrangements should promote economic activity and improve the efficiency, simplicity and fairness of the system without compromising competitive neutrality, and while minimising the deadweight loss to the economy of taxation and royalty collection.

The rest of this Policy Brief provides detailed analysis to support each of the statements above.

Chapter 1

A robust minerals resources industry is vital to the prosperity of all Australians

1.1 The minerals resources industry is a key pillar of the Australian economy

The minerals resources industry contributes to the Australian economy in a number of ways:

- **Economic activity:** The minerals resources industry accounted for more than 6 percent of Australia's economy in 2008-09.[2]
- **Employment:** The minerals resources industry directly employs 161,500 people in Australia—more than twice as many as a decade ago.[3] Indirectly, the minerals resources industry supports hundreds of thousands of additional Australian jobs through the purchase of goods and services from other Australian industries.
- **Investment:** Over the last decade, the industry has invested more than $125 billion in Australia, much of which flowed to Australia's regional and rural communities.[4] Through this investment and direct contributions to communities—in economic development, community, health and environmental programs—the industry has led the growth and development of Australia's regional and rural communities.
- **Productivity:** In 2007-08, the average minerals resources job added about five times as much value to the economy as the average Australian job.[5]
- **Exports:** In 2008, minerals resources—Australia's largest export industry—accounted for about one in every two export dollars earned by Australia.[6]

The benefits of Australia's minerals resources industry are widely shared across the national economy, regional areas and communities in which it operates:

- **A large proportion of the income from the minerals resources industry flows to the Australian Government through tax revenues.** According to Treasury research, 'around one-third of additional national income attributable to the resources boom has gone to Commonwealth tax revenues'.[7] Treasury estimates that in 2007-08 this performance contributed an additional $25 billion to Australian Government tax revenues, more than the Federal budget surplus of $21 billion in 2007-08.[8] This strong budget position ensured the Federal Government had significant capacity to enact its fiscal stimulus program during the global financial crisis the following year. Furthermore, the industry has made a significant contribution to State Treasuries, with the Commonwealth Grants Commission noting in its latest report that the '[fiscal capacities] of Western Australia and Queensland have strengthened quite dramatically over recent years... principally from mining royalties'.[9]
- **Many Australians hold shares and superannuation in resources companies.** A substantial portion of Australian superannuation is held in shares, and minerals resources companies make up a large proportion of the Australian share market. As a result, Australian households hold a significant portion of their savings in minerals resources companies through direct ownership and superannuation funds.
- **Goods and services used in the resources industry are produced across Australia.** Resources companies purchase construction, transportation, technology and services from other Australian companies. And employees of resources companies spend much of their income on Australian goods and services. According to Treasury research, strong growth in minerals resources has increased demand for labour across Australia, 'reducing unemployment rates more quickly than would have occurred otherwise'.[10]

Overall, Access Economics calculates that about 36 percent of the improved terms of trade from the last cycle of rising commodity prices went to mining companies (much of this benefit then flowed back through the Australian economy through investment). The rest—64 percent of the total—'washed' through the economy and benefited all Australians through higher taxes and lower import prices, particularly for consumer goods.[11]

Over time, the benefits provided by Australia's minerals resources industry—higher productivity, job creation and benefits to household income and wealth—will become even more important as Australia addresses the challenge of an ageing population outlined in the Government's *Intergenerational Report*.[12] Growing the minerals resources industry will expand these benefits and position Australia to address its intergenerational challenges.

1.2 The minerals resources industry is a driver of, not a risk to, Australia's dynamic, diverse economy

The minerals resources industry is part of Australia's dynamic and diverse economy—with different industries driving growth over time.[13] A look at what has driven growth in Australia over the last three decades and Australia's recent performance across States suggests that concerns about a 'two-speed' economy driven by minerals resources are misplaced.

Chart 1 shows the fastest and slowest growing industries for each five-year period from 1980 to today. The relative performance of industries in the Australian economy is constantly changing—the industries in the top three and bottom three are different from one period to the next. And there is nothing unusual about differences in growth rates across industries. In fact, over the last five years, the differences in growth rates between industries have been low by historical standards.

Dynamism is fundamental to a healthy economy and has yielded Australia great results. Chart 2 shows that over the last two years all Australian States and Territories—not just Western Australia (WA) and Queensland—grew more quickly than other major developed economies, including the US, Europe and the UK. Indeed, Victoria recorded the largest percentage growth in full-time employment over the past 12 months, according to Australian Bureau of Statistics figures.[14]

Chart 1

The Australian economy is dynamic and diverse

Top three fast-growing and slow-growing industries in five-year periods since 1980[1]

	Top 3 growers	Bottom 3 growers	Difference between fastest and slowest grower Annual growth, percent
1980–85	▪ Mining ▪ Info. Media and telecom ▪ Admin. services	▪ Construction ▪ Manufacturing ▪ Wholesale trade	7.1%
1985–90	▪ Financial/insurance services ▪ Info. media and telecom ▪ Rental, hiring, real estate	▪ Public admin. and safety ▪ Retail trade ▪ Agriculture, forestry, fishing	9.1%
1990–95	▪ Info. media and telecom ▪ Admin. services ▪ Professional services	▪ Construction ▪ Manufacturing ▪ Agriculture, forestry, fishing	10.0%
1995–2000	▪ Professional, scientific and technical services ▪ Agriculture, forestry, fishing ▪ Admin. services	▪ Manufacturing ▪ Public admin. and safety ▪ Electricity, gas, water, waste services	6.8%
2000–05	▪ Construction ▪ Retail trade ▪ Healthcare and social assistance	▪ Education and training ▪ Manufacturing ▪ Electricity, gas, water, waste services	4.7%
2005–2009	▪ Arts and recreation ▪ Construction ▪ Financial/insurance services	▪ Rental, hiring, real estate ▪ Accommodation and food ▪ Manufacturing	5.6%

1 Growth in the real Gross Value Added (GVA) by industry.
Source: Australian Bureau of Statistics 5206.0 2010.

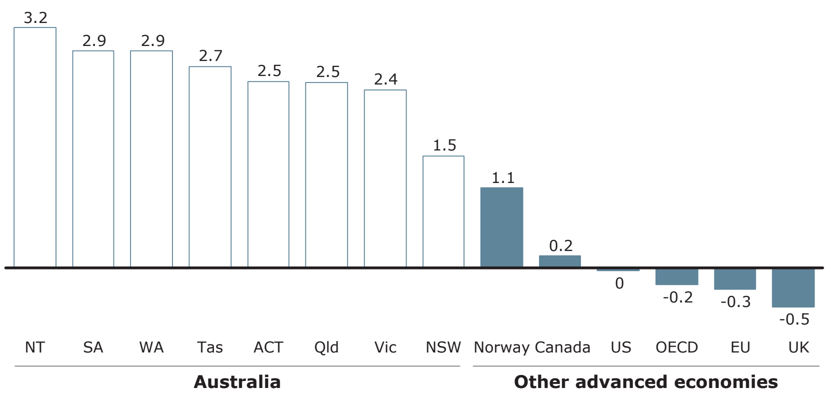
This dynamism, including differences in growth rates across industries, is a welcome result of three decades of economic reform. The result is that the Australian economy is better equipped to adjust to and benefit from rapid growth in its minerals resources industry—without dampening growth elsewhere. At the time of the 1970s resources boom, the Federal Government was in direct control of many arms of macro-economic policy, including the value of the exchange rate, the conduct of monetary policy and centralised wage-setting arrangements. Over the last few decades, the Government has enacted significant market-based reforms. In particular, the floating exchange rate has been a critical shock absorber that translates higher commodity prices into higher exchange rates—which benefit Australians through increasing purchasing power.[15]

Box 1 provides more explanation of why concerns about a 'two-speed economy' are misplaced.

Chart 2

Growth in all Australian states outperformed other developed economies

Annual real GSP/GDP growth from 2006–07 to 2008–09
Percent



Source: Australian Bureau of Statistics 5220.0 2010; OECD 'Quarterly National Accounts' 2010.

Box 1: Growth in Australia's minerals resources industry supports economic growth across the economy

Some commentators suggest that a slowing of investment in the resources sector is good for Australia because it will rebalance a 'two-speed economy' and avoid 'Dutch disease'. Deloitte research states that: 'Debate on the so-called Dutch disease also appears somewhat confused'. The Dutch disease hypothesis refers to the supposed adverse effects a resources 'boom' can have on a non-booming tradeable sector (usually manufacturing), typically through an appreciation of the real exchange rate. In industrialised economies, the focus has tended to be on the perceived negative consequences of de-industrialisation from the shift in labour from the lagging sector to the booming sector.[16]

For a number of reasons, concerns about the 'two-speed economy' and Dutch disease are ill-founded in the Australian context. Further, any policy measures to address such concerns would hurt Australia's most productive sectors and likely harm—more than help—the economy overall.

- **Reallocating resources from less productive industries towards productive industries is the key to increasing productivity, growth and national prosperity.** In 2007-08, minerals resources jobs were about five times as productive as the average Australian job.[17] Reducing investment in the resources sector shifts investment towards less productive industries, hurting Australia's productivity growth and prosperity.
- **The benefits of the minerals resources industry are widely shared across the Australian economy.** Treasury research points to three ways the industry benefits are shared across Australia—through higher tax revenues, the widespread ownership of shares and the goods and services the industry buys from other Australian industries.[18]
- **Concerns that mining may be hurting Australia's manufacturing industry are misplaced.** A study by the Australian Treasury found that over the period 2003-04 to 2006-07, income, investment and employment all rose strongly across the economy. In particular, the study found no neat match with the theory of Dutch disease when it came to the manufacturing sector. Manufacturing saw a modest acceleration in profits growth, and employment and investment outcomes were relatively better than in previous years.[19] Indeed, concerns that mining may be hurting manufacturing are misplaced. As the Productivity Commission's chair Gary Banks has noted: 'The... decline in manufacturing's share of GDP is mainly due to the expansion of services; not mining. Indeed the relative decline is in part a statistical artefact, with activities previously categorised as manufacturing now being contracted externally and classed as services'.[20]

- **Deloitte research provides further evidence that a mining boom will be beneficial—not harmful—to the Australian economy.** According to Deloitte, 'there is nothing in the Dutch disease story which says that the mining boom necessarily reduces wages, slows overall economic growth or reduces income. Indeed, the increase in minerals prices boosts the nation's overall income, increases growth and is likely to raise wages'.[21]

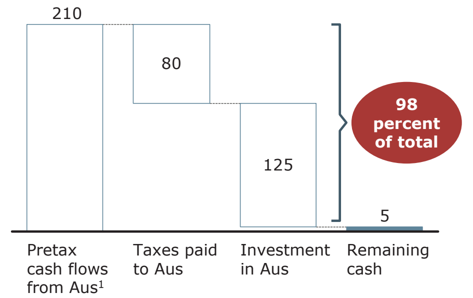
1.3 The minerals resources industry is a major contributor to the Australian community through the broader economy and the communities in which it operates

Chart 3 shows that over the last decade the sum of taxes paid and investment by resources companies in Australia was 98 percent of cash flows from Australian operations.[22] Resources companies have put into the Australian economy in tax and investment nearly all that they have earned from it—before counting dividends paid to Australian shareholders. The benefits of the resources industry have largely remained in Australia.

Chart 3

Taxes and investment sum to 98 percent of cash flows from Australia's minerals resources industry

Pretax cash flows, tax paid, and investment in Australia's minerals resources industry
1999-2000 to 2008-09, $ Billions



1 Pretax profit with depreciation expenses added back in to calculate cash flows

Source: Access Economics estimates for the Minerals Council of Australia 2010 sourced from Commonwealth and State Budget Papers, Australian Bureau of Statistics and Australian Tax Office; Australian Bureau of Statistics 8155.0 2010; Australian Bureau of Statistics 8415.0 2001.

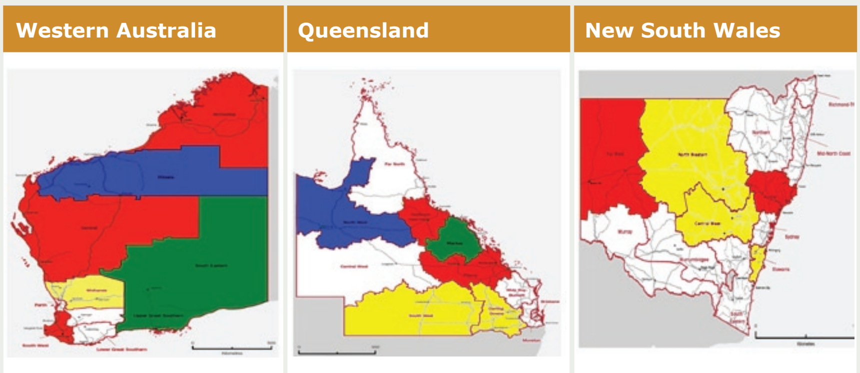
Australian taxes paid by minerals resources companies include both royalties and company tax. Externally verified figures from Australia's two largest minerals resources companies—BHP Billiton and Rio Tinto—show that both pay 35 percent of profits in tax or more. BHP Billiton states that its effective tax rate was 43 percent in 2008-09 and 42 percent in the six years from 2003-04 to 2008-09.[23] And Rio Tinto states that its effective tax rate averaged more than 35 percent over the last 10 years.[24]

Chart 4

The minerals resources industry creates a lot of jobs in Australia's rural and regional communities

Percentage of employment related to mining

21-30%
11-20%
5-10%
2-4%



Source: Concept Economics, 'The employment effects in the Australian minerals industry from the proposed carbon pollution reduction scheme in Australia', 21 May 2009.

The minerals resources industry contributed about $80 billion in royalties and company income taxation over the past decade. Over the last few years from 2006-07 to 2008-09, both company tax—which Treasury itself states operates as a 'quasi resource rent tax'—and royalty payments have doubled.[25] In 2008-09, the industry represented 6 percent of GDP but accounted for an estimated 18 percent of company tax receipts.[26] Furthermore, State budgets of the leading mining states show that these contributions are expected to grow significantly under the current system, notwithstanding that their royalties are production-based. The 2010-11 budgets of Western Australia, Queensland and NSW show that the State Treasuries expect royalties revenue to increase 48 percent, 67 percent and 86 percent, respectively.[27]

In addition to its contribution to tax and investment, the industry is the economic life-blood of many communities in remote and regional Australia. The industry directly accounts for roughly 30 percent of employment in the Pilbara region of WA and 20 percent in WA's South Eastern region. The sector is a major source of high-wage jobs in regions such as North West Queensland (21 percent of employment) and Mackay (12 percent of employment). Chart 4 highlights the importance of the minerals resources industry to regional employment in several States. Moreover, the industry makes a significant contribution to the physical and social infrastructure in regional and remote communities—building roads, airports, communications infrastructure, housing, hospitals, schools, day-care centres, sporting and other community facilities. Box 2 highlights these contributions to Australian communities, and notably Indigenous communities.

Box 2: The minerals resources industry builds local and Indigenous communities

The minerals resources industry plays a central role in supporting regional and Indigenous communities throughout Australia.

The industry is an economic catalyst in regional communities, bringing investment, employment and infrastructure and helping improve social services. Last year, the industry spent about $200 million on community development projects—seed funding and training for local business, health and wellbeing services, childcare centres and sporting and recreational facilities—as part of tens of billions in social and regional infrastructure, plant and equipment.[28] Furthermore, since 1967, minerals resources companies have built at least 35 new towns, 12 new ports, 25 airfields and over 2000 kilometres of rail line within Australia, as well as contributing to improved local infrastructure including roads, schools and community leisure and health facilities.[29]

More than 60 percent of minerals resources operations in Australia are located near Indigenous communities.[30] **The minerals resources industry is the largest private sector employer of Indigenous Australians.** At present, over 6 percent of minerals sector employees identify as Indigenous Australians. At specific sites, Indigenous workers account for over 20 percent of those directly employed or employed through contractors. For example, 26 percent of employees at the Argyle mine in the East Kimberley are Indigenous, with a target to reach 40 percent of the site workforce.[31]

Chapter 2

The prosperity from Australia's minerals resources needs to be earned

To capture the benefits of growth in demand for minerals resources, Australia needs to continue to invest in mines and infrastructure such as railways and ports. Minerals projects worth $120 billion are currently undergoing feasibility study or awaiting final investment decisions.[32]

Whether Australia secures this investment—and other future investment in the minerals resources industry—is not assured. Australia must compete with other countries to attract capital investment. A competitive and stable tax system is critical in the global contest for capital.

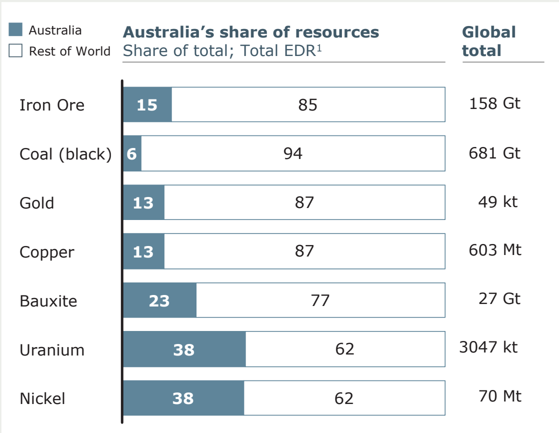
2.1 Australia faces fierce competition from other mineral-rich countries

Chart 5 shows that Australia's share of minerals resources is small compared to global resources. Consumers of resources such as China and India can look to other countries for their future supply.

The development of China and other emerging economies is fuelling strong growth in the global demand for resources. It is not just Australia that recognises the unique opportunity provided by this growth—other countries are seeking to rapidly develop their minerals resources. Chart 6 shows that, since the beginning of China's rapid growth a decade ago, Australia's global share of production of most minerals has stagnated or declined. Since 2002, Australia's market share in key commodities such as coal, nickel, bauxite, copper, gold and uranium has declined significantly. Only in iron ore has Australia's global share of production kept pace over this period.

Chart 5

There is no shortage of minerals resources in the world



1 Economic Demonstrated Resources (EDR) as of 2008. Gt = Gigatonnes, Mt = Megatonnes, kt = kilotonnes
Source: Geoscience, *Australia's Identified Mineral Resources*, 2009.

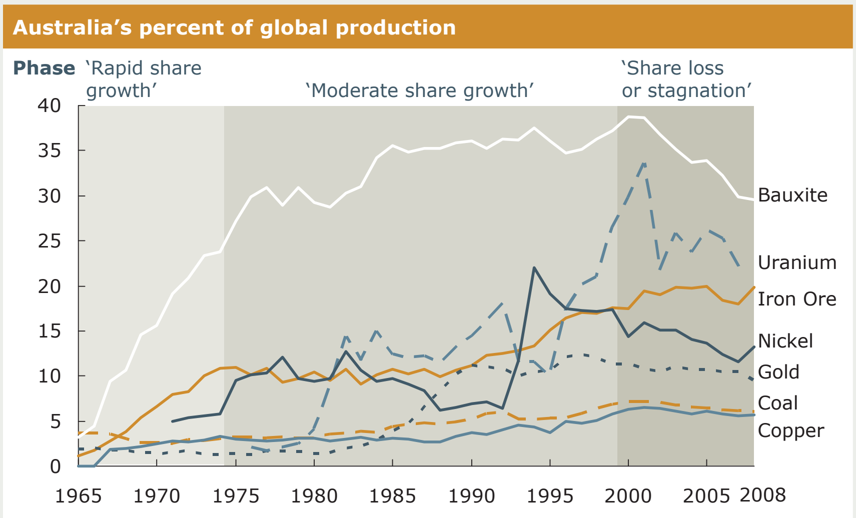
While Australia's share of iron ore production has grown marginally, even this market share is at risk. Australia faces fierce competition in the coming years from alternative iron ore producers—in particular, Brazil, Canada, India, and a number of African countries including South Africa, Guinea, Cameroon, and Senegal. The known high-grade iron ore resources (measured, indicated and inferred) remaining in Western Australia are in the order of one billion tonnes at 64 percent iron content (although the measure of total resources increases to 20 billion tonnes at 60 percent grade). In contrast, Companhia Vale do Rio Doce (Vale) in Brazil has immense resources of more than 17 billion tonnes at 66.5 percent iron in the Carajas region in the Amazon basin alone.[33] There are also substantial high-grade resources in West Africa, notably Guinea, Liberia and Sierra Leone, while India has substantial deposits of varying grades. Chart 7 shows that announced expanded capacity in iron ore is about three times expected demand growth through to 2015. There is no shortage of iron ore reserves around the world, nor of countries competing to supply it.

While other nations are playing economic catch-up or accelerating away, Australia is slipping behind. The 'canary in the coal mine' of new development is exploration activity—and Australia's exploration activity is declining as a share of the global total. Analysis by the Metals Economics Group shows that Australia's share of exploration for nonferrous metals was 12.5 percent in 2009, down from a high of almost 18 percent earlier in the decade. Australia's share of exploration is behind Latin America (26.5 percent of total), Canada (16 percent) and Africa (15 percent).[34]

Geoscience Australia notes 'there have been very few world-class discoveries in Australia in the past two decades and the inventory has been sustained largely through delineation of additional resources in known mineral fields... While Australia's resources stocks are healthy overall, the country's position as a premier minerals producer is dependent on continuing investment in exploration to locate high quality resources and to upgrade known deposits to make them competitive on the world market...Increasingly, multinational companies rank their individual mineral projects against investment returns from other projects worldwide and this has resulted in a number of recent mine closures in Australia.'[35]

Chart 6

Australia's share of global production grew until 2000 but has stagnated or declined in the last decade

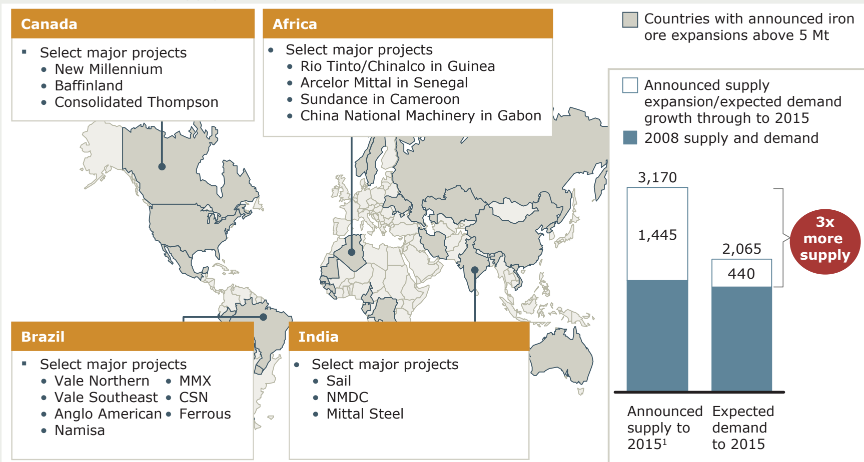


Source: ABARE 'Australian Commodities' 1965–2010; US Geological Survey Minerals Yearbook 1965–2010; British Geological Survey World Mineral Statistics 1960–2010.

Chart 7

Australia faces significant competition from other iron ore producers, especially from Brazil, Canada, Africa and India

Global announced supply[1], Million tonnes



1 Announced supply includes all expansion projects expected to start 2009 or later. Total tonnage of announced supply is included and is not adjusted for domestic iron ore demand and usage. Announced supply through to 2015 is based on company announcements

Source: Unctad; Company project announcements and annual reports; ABARE, 'Australian Commodities', 2010; Raw Materials Group 'Outlook for metals – a bright future?' 22 March 2010; Media articles.

2.2 Tax policy, fiscal stability and broader regulatory practices matter in the global contest for investment

The mining industry is capital-intensive with considerable and high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. Its capital, people and technology are highly globally mobile. In this environment, preserving Australia's position in the global minerals resources industry—and the prosperity that it brings all Australians—

will depend on maintaining strong incentives, not disincentives, to invest in exploration and capacity expansion. Policy settings, and in particular the tax system, matter in the global contest for investment:

- **Investors and companies invest less in countries with uncompetitive tax systems.** When assessing potential projects for investment, higher taxes represent lower returns for shareholders. As the World Bank notes, 'if the net effect of the overall tax system is too great (too high an effective tax rate), an investor may shift its focus to a lower taxing jurisdiction'.[36] Companies routinely rank projects around the world in order of the expected, stable returns—uncompetitive tax regimes move a country, or key projects, down the global investment list.
- **Investors and companies invest less in countries with unstable tax systems.** Investors in minerals resources commit substantial capital to long-life projects. For example, new and expansion projects in iron ore are multi-billion dollar investments—up to $6.4 billion.[37] These investments fund projects with at least 20 to 30 years of life and incur major expenditure before cash flows begin. Investors depend on stable policy settings—or binding foreign investment agreements with Governments—to recoup their investments and shy away from countries with unstable or uncertain tax systems.
- **Australian minerals resources companies depend on international investors to fund projects.** From 2001 to 2008, foreign direct investment has supported the expansion of the resources industry, with the level of foreign direct investment rising 15 percent per year to reach nearly $100 billion.[38] These investors—as well as Australian-based global resource companies—look carefully at project risks and returns and policy stability before making investments.[39]

For Australia, a stable and competitive tax system is critical to attract the investment needed to maintain its position in the global minerals resources industry. Focusing on the future of exploration spending in Australia, Metals Economics Group states: 'Looking earlier along the pipeline, Australia is in competition for exploration dollars primarily with Latin America (led by Peru and Chile), North America, and increasingly Africa. Based on this data, and recent activities in the market, those companies who can, may choose to explore where they see the best potential returns from successful finds'.[40]

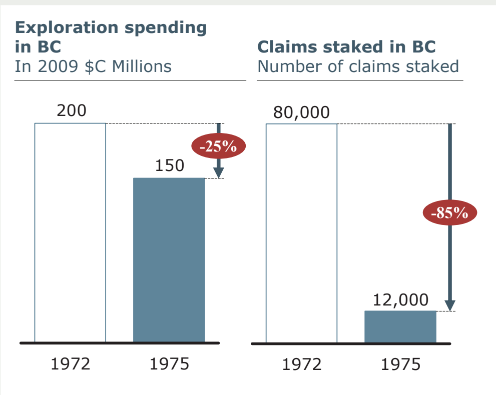
2.3 Other resource-rich countries have been penalised for uncompetitive, unpredictable and capricious tax changes

The importance of the tax system to investment decisions makes the consequences of uncompetitive and destabilising tax changes particularly severe. The following examples highlight the significant and enduring consequences of uncompetitive tax rates and uncertainty around tax changes:

- **Copper in British Columbia, Canada.** In 1974, British Columbia imposed a 5 percent ad valorem royalty and an additional 1.5 percent royalty on mineral smelting and refining.[41] The adverse consequences of these tax changes were severe and immediate. Chart 8 illustrates that exploration expenditure fell 25 percent from 1972 to 1975, and new claims (a leading indicator of capital investment) fell 85 percent from 80,000 in 1972 to 12,000 in 1975. Following these impacts, a newly elected government repealed the royalty in 1976.[42] British Columbia's share of the global copper market stabilised through the early 1990s.[43]

Chart 8

Tax changes in British Columbia decreased exploration in the early 1970s



Economic analysis has shown that if the goal is to increase tax revenues for government and to maintain output and employment… industries that face prices set in competitive world markets are a poor choice for increased taxation

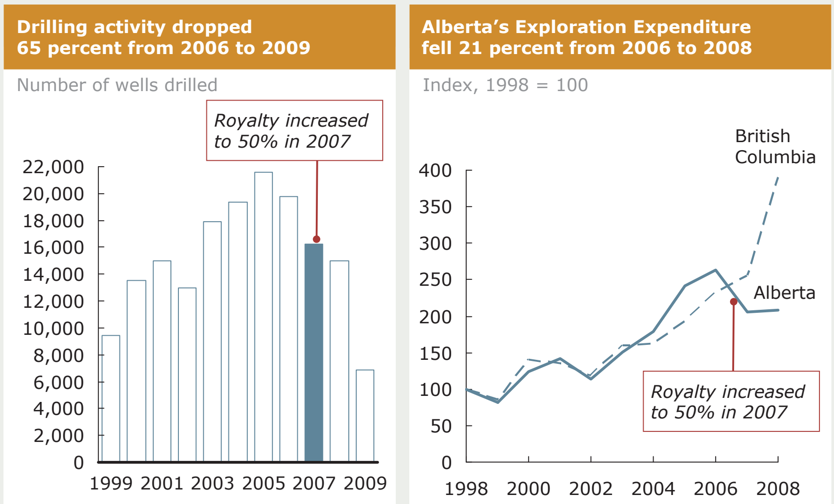
DeYoung 1977

Source: John H DeYoung, 'Effect of tax laws on mineral exploration in Canada', Resources Policy 1977; Natural Resources Canada, 'Mineral Exploration Spending in BC 1970–2009' from BC Business Council, 'Prospects for Mining in BC', September 2009.

- **Minerals tax changes in Papua New Guinea.** From 1996 to 2000, the PNG Government raised the royalty rate from 1.25 percent to 2 percent and imposed a new 4 percent levy on mining income.[44] Furthermore, leases were subject to agreements that the State could take a 30 percent share in the project for a price based on a project's exploration costs, not its market value. From 1998 to 2002, Papua New Guinea's share of global exploration capital fell 75 percent.[45] Following a series of tax reforms earlier this decade, resources investment activity in Papua New Guinea has resumed.
- **Minerals policy in South Africa.** In 2003, South Africa began a complex and fundamental mining policy reform process. The new policies were to apply to projects in which large, long-term, and irrevocable investments had already been made. The uncertainty surrounding these changes led investors to conclude that investment in South Africa carried 'political risk', or sovereign risk.[46] As a share of total investment in South Africa, investment in minerals resources fell from 11 percent in 2003 to 6 percent in 2005.[47]
- **Oil and gas taxation in Alberta, Canada.** In 2007, the Government in Alberta, Canada's largest oil and gas producing province, introduced a new royalty rate of 50 percent to replace the existing tiered royalty of 30 to 35 percent on oil and gas.[48] Chart 9 shows that, as a result, exploration expenditure in Alberta fell by 21 percent from 2006 to 2008 (compared to a 67 percent rise in British Columbia) and the number of wells drilled fell by 65 percent from 2006 to 2008. According to an Alberta Government report, 'the hard truth is that Alberta has lost competitive ground'.[49] Since then, the Government has changed its policy to a maximum royalty rate of 40 percent, with a minimum rate of zero.[50]

Chart 9

Alberta's drilling activity and exploration expenditure has slumped since royalties were increased



Source: Canadian Association of Petroleum Producers Statistical Handbook, 2009.

- **Windfall profits taxation in Zambia.** In 2008, Zambia, Africa's largest copper producer,[51] increased its company tax from 25 to 30 percent and royalties from 0.6 to 3 percent. It also introduced a 25 percent tax on copper and cobalt profits above a certain price threshold. According to Zambian Mines Minister Maxwell Mwale: 'In 2008, when we imposed windfall tax, we saw a decline in minerals exploration and we don't want that to happen—we need to attract investors'.[52] Zambia has since dropped the windfall tax.

These international examples highlight that tax rates and regulations—and uncertainty around changes to potential tax arrangements—influence the willingness of global companies and investors to commit additional capital into exploration and development. The lessons are clear: increases in taxes on mining projects are likely to affect international competitiveness and investor confidence. Uncompetitive and uncertain tax systems—regardless of the design of the tax system itself—could lead to an enduring increase in Australia's sovereign risk and to a fall in Australia's competitiveness—to the detriment of the quality of life of all Australians and particularly of future generations.

Chapter 3

The Australian Government's justification for its super tax is flawed

The minerals resources industry supports tax reform. However, the Government has based the case for its 'super tax' on several misleading claims—and has based its design on theory that is at odds with commercial reality and business practicalities. The Government's key claims are addressed in this chapter, so Australians can judge the merits of the proposed super tax on the facts.

The justification for the super tax misrepresents the socio-economic contribution of the minerals resources industry to the welfare of all Australians

3.1 The Government understates taxes paid by the resources industry—the industry makes a far greater tax contribution than the Government suggests.

3.2 The Government makes a misleading comparison with the PRRT—in particular, unlike the super tax, it did not apply to existing projects when introduced.

The supposed benefits of the super tax are based on theoretical assumptions that ignore commercial and economic realities and ramifications

3.3 The Government claims the super tax will not increase sovereign risk. Markets, economic analysts and commentators disagree—they say the proposed super tax has already damaged Australia's reputation as a stable place to invest.

3.4 The Government claims the super tax will increase investment in minerals resources, and hence production and income. This is simply wrong and it will take 50 to 100 years for Australia to recover from the negative impacts of the super tax on investment.

3.5 The Government protests the super tax has not hurt share prices—careful analysis of the market shows otherwise.

The tax design is unprecedented, untested and risky

3.6 The super tax's 40 percent rate has been chosen without economic rigour and will make Australia's minerals resources industry internationally uncompetitive, burdening it with a much higher tax rate than competitors.

3.7 The Government claims the super tax will reduce miners' cost of capital through tax credits—but, in practice, the value of these credits is highly uncertain and not valued by the industry or capital markets.

3.8 The Government says the super tax only taxes super profits—in fact, it taxes normal profits and penalises effort and expertise.

3.9 The Government says the super tax will help 'marginal' projects—but in Australia today, viable new projects will be seriously, if not terminally, hurt by the super tax.

3.1 The Government understates taxes paid by the resources industry—the industry makes a far greater tax contribution than the Government suggests

The Government has repeatedly understated the level of tax that the industry pays.

The Government's '1 in 3; 1 in 7' claim is misleading—it excludes company tax and inflates mining profits.

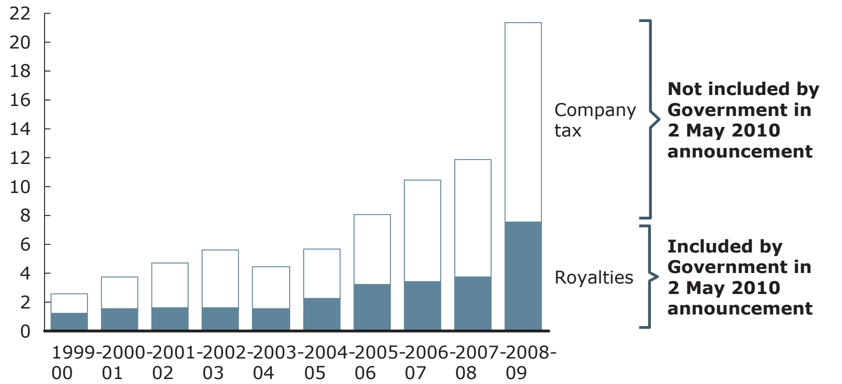
The Government claims that 'at the beginning of the 2000s, or around that date, something like one in three dollars in mining profit was returned to the Australian people. Now it's more like one in seven'.[53] This claim has been repeated in Government advertising.

These estimates exclude company tax, which represents more than half of the tax that minerals resources companies pay. Chart 10 shows that minerals resources companies paid $21 billion in tax in 2008-09—more than $13 billion in company tax and more than $7 billion in royalties.

Chart 10

The Government has significantly understated the total tax bill of the minerals resources industry

Total company tax and royalties paid from minerals resources
Australian $ Billions



Source: Access Economics estimates for the Minerals Council of Australia 2010 sourced from Commonwealth and State Budget Papers, Australian Bureau of Statistics and Australian Tax Office.

Even the Government's use of royalties figures is misleading. First, the claims fail to recognise that the Government's selected benchmark marks a time when the industry was barely recovering the cost of its investment capital. Commenting on the Government's 'one in three' to 'one in seven' comparison, David Uren, Economics Correspondent at *The Australian*, points out that 'the change in the past decade depends on the starting point'. A decade ago, 'resource prices were at record lows so, of course, the share of mining income paid in royalties was very high'.

Second, the claims use an uncommon and inflated definition of profit. According to David Uren: 'the other, more manipulative part of the comparison is the very definition of the mining sector's profit'. The figures used by the Government 'subtract[s] total expenses, interest deductions, and royalties and add[s] an allowance for the mining sector's capital, using the long-term bond rate'. David Uren calls this a 'measure of profit beyond the calculation of most observers of the mining industry' and states that: 'if a simpler definition of profit were used, such as the Australian Bureau of Statistics measure of pre-tax profit, there would have been little change in royalties or company tax paid as a share of profit over the past decade'.[54]

In contrast to the Government's 'one in seven' claim, externally verified figures show that Australia's two largest resources companies—BHP Billiton and Rio Tinto—both pay more than one in three dollars of profit in tax. BHP Billiton paid about one in 2.5 dollars of profit in tax in 2008-09 and over the last six years.[55] And, over the last decade, Rio Tinto has paid more than one in three dollars of profit in tax.[56]

The Government claims the mining industry pays 13–17 percent company tax, but this is contradicted by verified financial data.

Based on a draft paper from the University of North Carolina, the Government claims that 'in Australia, wholly-domestic mining companies paid an effective tax rate of only 17 percent and multinational mining companies paid an effective tax rate of only 13 percent'.[57]

But the report's own authors have urged caution in using their figures, stating that 'the paper is a draft form and likely will undergo additional revision before publication in a peer-reviewed journal. Moreover, the paper's usefulness in formulating policy for one sector in one country should not be overstated'. The authors subsequently revised the paper to exclude the 13 percent and 17 percent figures, leaving the

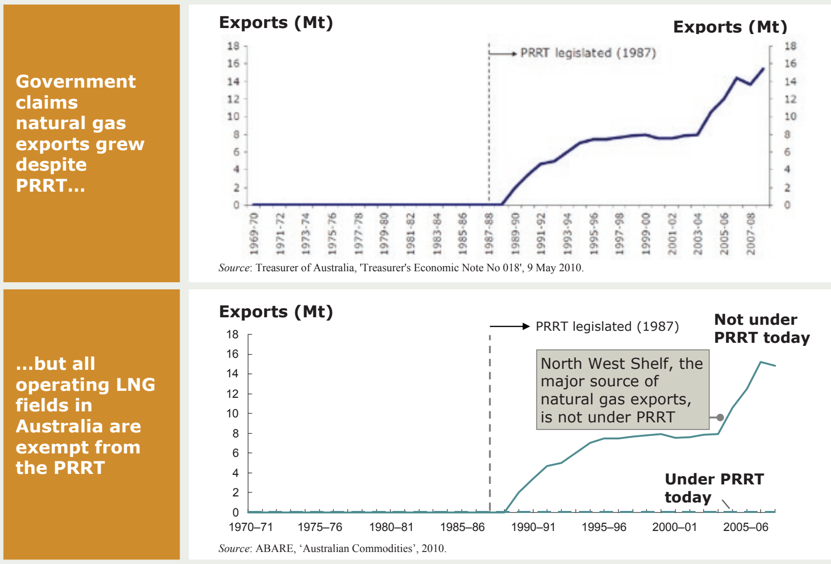
Government with no source for its claims.[58]

As discussed above, externally verified figures from Australia's two largest resources companies—BHP Billiton and Rio Tinto—show tax rates higher than 35 percent for both companies.[59]

3.2 The Government makes a misleading comparison with the Petroleum Resource Rent Tax—in particular, unlike the super tax, it did not apply to existing projects when introduced

Chart 11

Growth in Australia's LNG exports has been driven by projects that are exempt from the PRRT



The Government claims Australia's offshore petroleum industry has 'flourish[ed]' under the Petroleum Resource Rent Tax (PRRT).[60]

The Government's evidence linking the introduction of the PRRT to strong growth in Australia's petroleum industry is misleading. The top of Chart 11 shows a chart produced by the Government in the Treasurer's Economic Note on 9 May 2010. The Note defends the Government's new tax by citing the strong performance of Australia's LNG industry following the introduction of the PRRT. The bottom of Chart 11 shows the true picture—the LNG projects that experienced growth, such as the North West Shelf, are not subject to the PRRT.

In more than two decades, Australia has not exported a single tonne of LNG under the PRRT. (The Gorgon project was recently approved—more than twenty years after the PRRT was introduced.[61]) And, in fact, oil production subject to PRRT has fallen significantly—not risen—since the introduction of the PRRT in the late 1980s.

Comparisons with the PRRT are misleading because the super tax is far more onerous, because it both increases sovereign risk—unlike the super tax, the PRRT did not apply to existing projects—and decreases international competitiveness. Unlike the petroleum industry, the super tax will impose the highest taxes of minerals anywhere in the world—by a significant margin.

Chart 12 highlights a number of differences between the super tax and the PRRT. In particular, the PRRT was not applied to existing operations when introduced, providing exemptions to the North West Shelf and Bass Strait.[62] While the North West Shelf is still exempt, the PRRT was extended to the Bass Strait in 1990-91.[63] Because the PRRT was introduced gradually, companies were able to anticipate and factor the PRRT into their decisions. Instead, the new super tax will immediately apply to existing operations with a punitive transition arrangement.

Petroleum and gas company Woodside, the operator of the North West Shelf Venture and a company seeking to develop new fields such as Pluto and the Browse Basin, highlights the negative effects of the super tax compared to existing tax systems. Chief Executive Officer Don Voelte states that Australia's low sovereign risk is under severe threat due to the super tax: 'If this Government starts to be seen as willy-nilly changing tax any time they want to, this will be viewed very negatively by the investing world for Australia.'[64] He draws on the example of Pluto, Woodside's new LNG development under the PRRT, stating: 'We re-looked at the project using the new super-profits tax and we will tell you right now that management would not have been able to take that project to the board of directors...We would not try under the new taxes. Pluto would still be in the ground.'[65]

Furthermore, countries consistently apply a higher tax rate to petroleum projects than they do to minerals projects. As a result, tax rates that may be competitive in petroleum are not competitive in minerals resources. This is discussed in Chapter 4, but it highlights why neither the super tax nor the PRRT is appropriate for Australia's minerals resources industry.

Chart 12

The super tax compares unfavourably to the PRRT

	PRRT	Super tax *(compared to PRRT)*
Application to existing projects	▪ When introduced, applied only to new stand-alone projects (i.e. known at time of investment)	▪ Applies to existing projects (i.e. not known at time of investment)
Rate	▪ 40 percent (internationally competitive for oil)	▪ 40 percent (not competitive for minerals)
Return permitted to investors before taxing 'super profit'	▪ Government long-term bond rate plus a minimum of five percent	▪ Government long-term bond rate
Depreciation schedule for capex	▪ Capex 100 percent deductible in year spent	▪ Capex deductible over time, not immediately
Royalties	▪ PRRT replaced original crude excise and royalties	▪ Existing and currently scheduled state royalties must still be paid, but are refundable against super tax ▪ No restriction on imposition of unscheduled or new royalties, which will add to the tax burden
Transfer and recognition of losses and expenditure	▪ Only exploration costs are transferrable ▪ Companies do not receive refunds if losses remain at end of project life	▪ Group companies can transfer losses including exploration ▪ Where not transferrable, companies receive partial refunds for losses remaining at end of project life (tax loss multiplied by 40 percent)

3.3 The Government claims the super tax will not increase sovereign risk. Markets, economic analysts and commentators disagree—they say the proposed super tax has already damaged Australia's reputation as a stable place to invest

Treasury Secretary Dr Ken Henry has stated directly: 'I do not understand why there should be any perceived increase in sovereign risk at all'.[66] The reason, though, is simple. The economic reality is that the Government cannot make such a substantial change to the taxation regime, particularly the rules pertaining to existing investments, without creating significant concern among investors that Government may seek to do so again. This impact could extend well beyond the minerals resources industry. Box 3 demonstrates that the proposal of the super tax has already damaged Australia's reputation as a stable place for investment.

There are several reasons why the Government's proposal—in particular the proposed transition that applies substantive tax changes to existing operations—increases Australia's sovereign risk:

- **It demonstrates the Government's preparedness to make substantial and unheralded changes to the tax system on existing operations**—'effectively moving the goalposts' on past investments.[67] The unprecedented nature of the Government's proposal—together with the lack of genuine industry consultation that preceded and followed the announcement—has introduced tangible uncertainty about what the Government will do next. According to David Murray, Chairman of Australia's Future Fund: 'Companies generally... understand that the general rate of company tax can move over time, but it's the specially structured designer taxes that give rise to additional sovereign risk'.[68]
- **It puts in place a punitive transition for existing operations that hurts shareholders.** As discussed below, the Government's proposed transition creates a major wealth transfer from existing shareholders to the Government. This treatment of existing shareholders will give investors pause before committing additional funds to Australia.
- **Mooted increases to State and Territory royalties show that the super tax has made Australia's tax system less stable.** Leaving the current royalty system in place adds complexity to the tax system and leaves the door open for further tax increases. For example, the Northern Territory has announced an increase in profit-based tax from 18 to 20 percent.[69] Any such tax increase could create a higher total tax burden. Regardless, the tax system will become increasingly complex and uncoordinated.

Box 3: The announcement of the super tax has increased sovereign risk

- According to *The Australian*, 'Macquarie Bank advised clients Australia was **'now seen as being a high sovereign risk destination to invest'** and there was a 'significant risk of major capital flight out of Australia''.[70]
- As reported in the *Sydney Morning Herald*, a survey by Radar Group of Australian institutional investors with assets over $125 billion revealed that '**71 percent of respondents feel increasingly nervous about regulatory or sovereign risk in Australia** as a result of the 40 percent tax on profits'. The survey 'found that all institutional investors interviewed believed the tax would have an impact on investment, with most believing the tax could escalate Australia's level of sovereign risk'.[71]
- According to David Murray, Chairman of Australia's Future Fund, **'there are several significant flaws. My view is that the tax has to be changed or abandoned.'** In particular, 'if we can't achieve a design that does not penalise existing projects—that's a **sovereign risk issue**—and a design that does not discriminate between recurrent spending and long-term intergenerational wealth creation; if those things can't be done, the tax should be abandoned'.[72]
- Moody's has compared Australia's super tax to large windfall tax increases enacted in Zambia in 2008. According to Moody's analyst Matthew Moore, 'the experience of Zambia provides a cautionary tale. Its introduction of a similar (to the Rudd government's proposed tax) windfall tax on minerals likewise upset foreign mining firms and was blamed for a reduction in mining exploration'. Zambia has since repealed many of its tax increases.[73]
- Faisal Al Suwaidi, CEO of Qatargas, stated: 'A really important point for us is trust and confidence. In Qatar, once we agree things they don't get changed. We do not go and do funny things and go and ruin the market for ourselves. These [Australian tax] changes come from people who have not been involved in this energy business for long enough'.[74]

- **The Government's broad definition of 'super profit' provides a basis for further tax increases in other Government industries.** All Australian industries must generate returns above the long-term bond rate to survive. Establishing the precedent of taxing companies above this rate will give pause to investors considering long-term investments across the Australian economy.

This increase in sovereign risk will make it more difficult for all industries in Australia—not solely the minerals resources industry—to attract the investment needed for growth.

In fact, the increase in sovereign risk casts doubt on whether the super tax itself will work. The super tax depends on 'guaranteed' tax credits from the Government to compensate companies for failed projects. The Government's argument cites long-standing economic research by Professors George Fane and Ben Smith that the appropriate carry forward interest rate on the tax credits is the government bond rate.[75]

Professor Fane has recently noted that the resource rent tax misleadingly looks like the answer to a Treasurer's prayer: a non-distorting tax that allows the community to share equitably in the value of resources that rightfully belong to the community. However, he notes that: 'Unfortunately, it is a chimera. Applied to existing successful projects with no compensation for past investment, it would be equivalent (economically, if not legally) to the nationalisation, without compensation, of 40 percent of the equity in the relevant projects. Unless the government proposes to search out all those who have invested in failed projects and refund them 40c per dollar of losses, plus accumulated interest since 1901, or whenever, then a rent tax applied to existing successful projects, with past investment carried forward at the government bond rate, is equivalent to the nationalisation with less than full compensation of part of the equity in the relevant projects'.[76]

The Government's proposed transition shows how existing tax arrangements are anything but 'guaranteed'. According to Professor Fane: 'But in the context of a rent tax applied to existing as well as new projects, the 'cast-iron guarantees' that the tax rate will never be raised and that tax credits on future projects will be honoured are a joke: it is like being offered a guarantee from someone who has stolen your wallet that they will never steal from you again'.[77]

In seeking higher short-term tax revenues through a punitive transition arrangement, the Government has made any true reform far less likely to succeed.

3.4 The Government claims the super tax will increase investment in minerals resources, and hence production and income. This is simply wrong and it will take 50 to 100 years for Australia to recover from the negative impacts of the super tax on investment

The Government claims that modelling shows the super tax will increase investment in Australia's minerals resources sector. The Treasury Secretary has stated that: 'It is the strong and clearly stated view of Treasury that the Resource Super Profit Tax will grow the mining sector and the economy. The tax was constructed on that basis, and the modelling released with the tax package clearly demonstrates it.'[78] But the Government's modelling is based on theoretical assumptions that do not capture the reality of the commercial operations and investment decision-making of the industry:

- **The modelling assumes that the super tax does not distort investment because it is a 'perfect' tax.** The super tax is based on the idea of economic 'rents' or 'super profits'. Theoretically, taxes on these 'rents' or 'super profits' do not distort investment decisions. Based on this theory, Government modelling just assumes that the tax does not affect investment decisions: 'the RSPT only taxes the economic rents earned from immobile factors, in this case minerals reserves. If only these rents are taxed, then the investment decisions of mining companies will not be distorted.'[79]

  But analysis by Chris Richardson of Access Economics contests the Government's assumption that the super tax taxes only 'super profits' and not normal profits. He states: '...you can't observe resource rents, and the RSPT's super profits are just a mechanical proxy formula to estimate them. The RSPT assumes all profits above a threshold—the government bond yield—are no longer normal profits but are super profits.' He concludes that: 'Most importantly, the RSPT's formula will show that more super profits are created when miners work harder or smarter. That makes the RSPT a tax on effort and entrepreneurial expertise as well as a tax on mineral resource rents. The upshot is that miners are being taxed on some of their normal profit as well as on any super profit.'

  As Chris Richardson points out, 'no real-world tax is perfect'. But the Government's modelling 'assumes that the RSPT is the perfect tax, causing no harm. Its result... will therefore presumably hold regardless of the RSPT rate: that is, at 99 percent just as much as 40 percent. That should start you wondering'.[80]

- **The modelling assumes 'perfect' capital markets.** The Government has argued that—because of the Government 'guarantee'—companies should be able to finance 40 percent of their projects at the long-term Government bond rate. In fact, this will require mining companies to fundamentally change their approach to funding projects. As discussed further below, both industry and capital markets see no practical value in this guarantee, calling into question the Government's fundamental assumptions about the tax's impact on cost of capital and investment decisions.

- **The modelling ignores the effects of competition from projects in other countries.** The model assumes that 'an industry can access as much capital as it needs so long as it can achieve the after-tax real rate of return required by international investors'.[81] The reality is that Australian projects compete for limited investment with projects in other countries. Increasing tax on returns in Australia—even if those returns remain positive—will make Australian projects less attractive than projects in other countries, delaying investment in Australia.

  Thomas Neubig, a partner with Ernst & Young in the United States, says the presumption that mining investment is completely immobile is flawed: 'We do not believe that critical assumption is realistic for the 21st-century global mining industry'.[82]

- **The modelling focuses on the long-run and ignores the short-term and medium-term.** The Government's modelling states that the super tax will increase investment and income in the 'long run', but does not specify when the 'long run' takes effect. Access Economics estimates that the 'long run' is 50 to 100 years into the future.[83] Government modelling ignores the damage that the super tax will cause to Australia's investment and economic growth in the meantime.

- **The modelling presupposes margins will remain high.** While margins have been high in recent years, it is premature to presume that, as supply catches up to demand, the prices that have buoyed those margins will continue in line with recent trends.[84]

3.5 The Government protests the super tax has not hurt share prices—careful analysis of the market shows otherwise

Many factors influence share and currency prices. The announcement of the super tax coincided with heightened fears of a default by the Greek Government, general concerns about the Euro-zone, and a sharp drop in the Australian dollar. Hence, the Government claims that observations that the stock market is falling because of the new tax are 'wrong, wrong, wrong, against all the factual data'.[85]

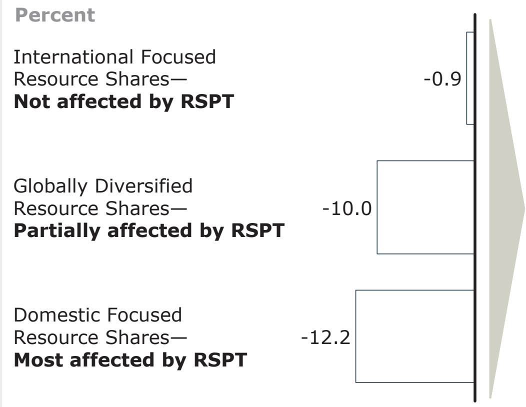
The super tax has lowered the share prices of Australian-focused minerals resources companies

Careful analysis can isolate the impacts of the super tax from other factors. To do so, Gresham Advisory Partners compares changes in the share prices of three types of mining companies listed in Australia: those with internationally focused operations (which are not subject to the super tax); those with domestically focused operations (which are subject to the super tax) and those with globally diversified operations that pay the super tax on their Australian operations.[86] The impact, summarised in Chart 13, is clear—the value of companies subject to the super tax declined by 10–12 percent in the month after the Government's announcement, while the value of companies not subject to the super tax fell by less than 1 percent.

Chart 13

The Government's super tax has already hit share prices of ASX listed resources companies

Average return between 30 April 2010 and 31 May 2010[1]
Top 150 ASX-listed resources companies (excluding oil & gas) by market capitalisation



*"The results are consistent with industry views that **the new tax** will increase the cost of capital for domestically-focused miners, **increasing the relative attractions of offshore projects**"*

Gresham Advisory Partners

1 The RSPT was announced on 2 May 2010

Source: Gresham Advisory Partners, 'ASX Resources – Group 150', May 2010.

The Government's proposed transition represents a major transfer of wealth from existing shareholders

The reality is that Government cannot increase the amount of tax a company pays, and leave less income for shareholders, without affecting the share price. In particular, the Government's proposed transition for existing operations represents a major transfer of wealth from shareholders to the Government that will negatively impact share prices. In a speech to the Australian Business Economists the Treasury Secretary Dr Ken Henry said that under the proposed super tax 'the government is, effectively, a silent partner in the investment, sharing in costs, risks and returns'.[87]

What price is the Government paying for this share? It is a Government-mandated price—not a price set by the market. It is a price—the accounting book value of existing operations—that is much lower than true market value of the assets. This is different to the tax system's typical treatment of transition issues, which values assets at market value—not book value. Instead, this is similar to the Government buying your house today for less than it cost to build twenty years ago—while completely ignoring interest paid on the mortgage or changes in market prices. In effect, the Government is taking much more than a 40 percent share.

Furthermore, applying the new tax to existing operations violates the principle of 'sharing in costs, risks and returns' on which the super tax is based. This is because the new tax applies to existing operations—by definition, successful mining projects—but does not recognise the 'costs' and 'risks' of failed operations that have been shut down. In effect, the Government takes a large share of the rewards without any of the risk-sharing that justifies doing so. This is why Ross Garnaut and Anthony Clunies Ross state that the Brown tax—the theoretical tax that is the basis for the super tax—is 'inappropriate for retrospective treatment since its special feature is subsidisation of outlays as they occur'.[88] In other words, the 'special feature' of risk-sharing can only be used by future projects, making their application to existing operations 'inappropriate'.

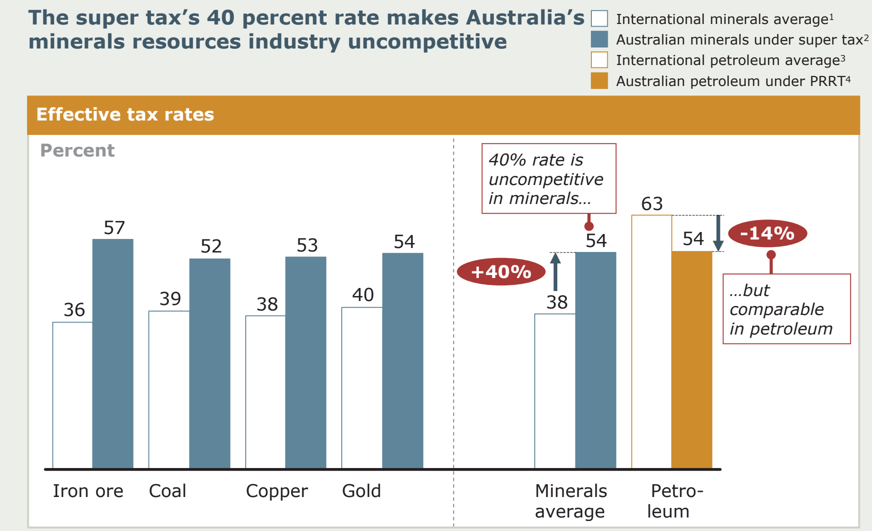
3.6 The super tax's 40 percent rate has been chosen without economic rigour and will make Australia's minerals resources industry internationally uncompetitive

The super tax applies the same 40 percent rate to Australia's minerals resources industry that is in place in Australia's offshore petroleum industry under the PRRT. The Government has said of the super tax that 'we've got the rate right'.[89]

But applying the same tax rate to petroleum and to minerals suggests that the Government has not thought through the implications of its tax. KPMG states that: 'Internationally, the tax treatment of oil and gas typically differs from the tax treatment of minerals resources. International practice is that petroleum is almost invariably taxed at higher rates than minerals resources'.[90] Chart 14 shows that, while a 40 percent tax rate is comparable to some of the Australian petroleum industry's global competitors, KPMG analysis of the same 40 percent tax rate applied across Australia's minerals resources industry makes it uncompetitive—with a tax rate 40 percent *higher* than the international average for minerals.

Chart 14

The super tax's 40 percent rate makes Australia's minerals resources industry uncompetitive



1 Unweighted average of competitors analysed in KPMG report
2 Includes impact of Government's proposed reduction of corporate income tax rate to 28%
3 Unweighted average of 101 major oil-producing jurisdictions per Wood MacKenzie at US$60 per barrel
4 Average of Enfield and Stybarrow projects per Wood MacKenzie at US$60 per barrel
Source: Analysis based on KPMG, 'Potential financial impacts of the Resource Super Profits Tax on new mining projects in Australia', 1 June 2010; Wood Mackenzie.

A 40 percent tax rate—either under a PRRT or super tax system—will make Australia's minerals resources industry uncompetitive. Chapter 4 describes how this leads to a shift in investment away from Australia into competing countries.

3.7 The Government claims the super tax will reduce miners' cost of capital through tax credits—but, in practice, the value of these credits is highly uncertain and not valued by the industry or capital markets

The Government emphasises the super tax's provision of 'guaranteed' tax credits, which are designed to provide tax refunds to minerals resources companies if projects fail. In theory, this 'reduces the rate of return that a mining project needs to generate for it to be a viable investment'.[91] This assumes that minerals resources companies are able to fund these tax credits at the Government's long-term bond rate.

But the Government has provided little evidence to support this theoretical claim. Instead, the Fortescue Metals Group announced that it has put $17.5 billion in projects on hold because the 'guarantee' is 'considered of no lending value by project financiers'.[92] Xstrata has placed on hold $586 million of a potential total investment of $6.4 billion in Queensland, stating that the proposed super tax 'has created significant uncertainty for the future of mining investment into Australia'.[93] Western Australian-based Cape Lambert Resources has cancelled $200 million development.[94] And Michael Kiernan, Chairman of Swan Gold has warned that the increased tax on companies 'will make it virtually impossible for small companies... to get funding locally'.[95]

KPMG concludes that, for a range of reasons including risk and pricing issues, funding tax credits at the Government bond rate is impractical over the short to medium-term: 'The capital and debt markets will be unable to price funding at the LTBR [long term bond rate] due to risk and pricing issues. The key issues include sovereign risk, security risk, transaction costs, repayment profile uncertainties and the uncertainty of the value of the tax credit throughout the term of the debt funding'. As a result, 'the Government will need to actively intervene and become the purchaser of the debt at the LTBR'.

Furthermore, as discussed above, investors assign little value to the Government 'guarantee' because of uncertainty about whether the Government will actually make good on 'guaranteed' credits. Investors concerned about sovereign risk in Australia recognise that the 'guarantee' is governed by tax legislation that Government can change at any time. There is no contract, enforceable by a court of law, which gives investors any confidence that the rules are fixed.

KPMG concludes that the reduction in returns to Australian mining projects under the super tax will likely result in Australian mining projects moving 'down the list' of international projects. And that it is 'unlikely in the short to medium term that new entrants will fill all of the void left by large project deferrals or reallocations to projects offshore'. As a result, the 'impact on the mining sector from the introduction of the RSPT at 40 percent means that it will take a long time for the sector to recover'.[96]

3.8 The Government says the super tax only taxes super profits—in fact, it taxes normal profits and penalises effort and expertise

The Government's announcement states that the super tax is a tax on returns generated only after shareholders receive a 'normal return'. It considers such returns as 'super profits'.[97]

But, as stated above, Chris Richardson from Access Economics points out that: 'Super profits are just a mechanical proxy formula… The RSPT merely assumes all profits above a threshold—the bond yield—are no longer normal profits but super profits'.[98]

If true, almost all industries generate 'super profits'. The Minister for Finance and Deregulation recently described returns of 6 to 7 percent as 'modest'—not 'super'—and 'a little bit over the current bond rate but certainly not in the zone that would trigger… ordinary commercial investment'.[99] Chris Richardson states that 'if you believe that this RSPT proxy is perfect at identifying resource rents, you would also have to believe that Australia's banks and breweries have been doing a lot of mining'.[100]

Furthermore, the Government's use of the word 'super' conveys a misleading impression about minerals resources profits, which, in fact, are not 'super' at all. Between 1973 and 2009, the total return to shareholders in Australian minerals resources has been 14.7 percent per year, compared to the total return to shareholders in all Australian sectors of 13.6 percent per year.[101] Returns in Australia's minerals resources sector are only slightly higher even after the industry's strong performance over the last several years.

According to Chris Richardson, 'the upshot is that miners are being taxed on some of their normal profit as well as on any super profit. And that's a problem', particularly when the result is a tax on 'effort and entrepreneurial expertise as well as a tax on mineral resource rents'.[102]

3.9 The Government says the super tax will help marginal projects—but in Australia today, viable new projects will be seriously, if not terminally, hurt by the super tax

The Government claims the super tax will aid smaller miners because 'less profitable projects—including those marginal projects where there is some uncertainty as to whether they will go ahead—will actually be better off under the new arrangements'.[103]

In theory, a profit-based tax such as the super tax will tax projects that are truly marginal less than the current royalty system. This means that, in the very long run, projects that are truly marginal—just above the hurdle rate, or required rate of return for investors—may be more likely to go ahead under a profit-based tax than under the current royalty system.

However, in the short and medium-term, the super tax will only hurt—not help—minerals resources projects. Australian projects compete against projects in other countries for investment—a high tax rate that reduces the value of Australian projects will make them less attractive than alternatives. Because of this competition—and investors' demands for projects with strong valuations given the risks of investment in mining—projects that are truly marginal are not under consideration for investment anyway. JP Morgan finds that the super tax is only superior to royalties *below* a company's hurdle rate, or the required rate of return for investors.[104]

Furthermore, the super tax will be particularly harmful to minerals resources companies that have relied on debt financing. This is because interest expenses—which are deductible from company tax—are not deductible from super tax payments. This can lead to effective tax rates even higher than the statutory rate of 57 percent.

The claims that marginal mines at end of life would benefit from the tax are also highly questionable. In theory, marginal production of an existing mine may be more attractive under the super tax than the royalty system, if no additional investment is required for such production. But in reality, mines at end of life require additional incremental investments to continue to produce, and the super tax will make such investments less attractive. As a result, the super tax will likely shorten—rather than extend—the life of existing mines by diminishing the incentives to make the investments necessary to keep them running.

In summary, the Government has justified the case for its super tax on misleading claims and designed a theoretical tax that will not work in the commercial world of long life, long lead-time large capital assets. This poorly designed tax poses significant risk to the prosperity of Australians for generations to come.

Chapter 4

If implemented in its current form, the Government's proposed tax will put Australian prosperity at risk

The MCA has commissioned reports from Access Economics and KPMG to understand the impact of the 'super tax' on the minerals resources industry and the Australian economy. The combined analysis suggests that the super tax will delay investment in Australia's minerals resources industry. Delay will come at exactly the wrong time—when margins are buoyed by very high prices that cannot last indefinitely. Australians are in danger of 'missing the boat', with real opportunity costs to the Australian economy for generations.

4.1 Mismanagement of the resources industry today will have a negative and long-lasting impact for generations

This is a particularly important time to maintain investment in Australia's minerals resources industry. Failure to do so will have lasting impacts on Australia's global market share of resources production and the wealth created from Australian resources.

The global supply of minerals is shaped by periods of rapid industrialisation that drive demand for minerals above the market's short-term capacity to supply. Chart 15 highlights major post-war industrialisations—driven by the post-war reconstruction of Europe, the industrialisation of Japan, and the industrialisation of China and other emerging economies over the last decade.

During these periods of rapid demand growth, the mismatch between demand and supply causes temporary increases in prices and profits. This stimulates new investment to develop resource deposits into operating mines. As supply rises to match demand, entirely new resource basins are opened up as mining companies invest in ports, railways and roads to transport mineral deposits to market. The opening of new resource basins causes long-term shifts in global market share.

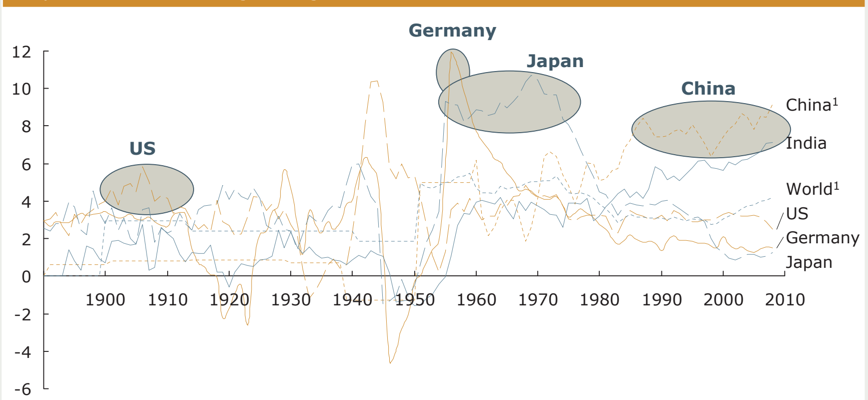
Japan's industrialisation in the 1960s and 1970s was critical to the development of Australia's resources industry. During its post-war industrialisation, Japan built major steel and shipping industries. To secure its supply of raw materials, Japan invested in countries like Australia, Brazil

Chart 15

Historically, periods of industrialisation have driven rapid growth in demand for minerals resources

Denotes major industrialisation or recovery

Real GDP growth,
10-year historical moving average, Percent



1 Data for China and World interpolated where data unavailable before 1950

Source: A. Maddison, 'Historical Growth Statistics', Groningen Growth & Development Centre, University of Groningen, 2010; OECD, 'OECD.Stat' 2010; IMF, 'World Economic Outlook Database', 2010.

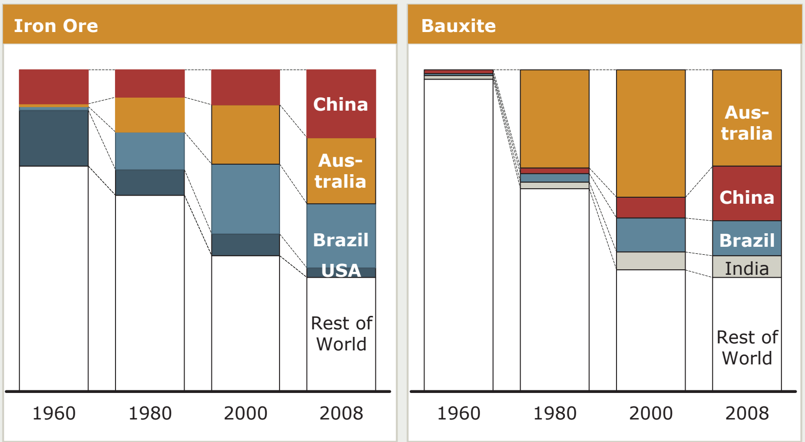
and Canada.[105] These investments supported the creation of two of Australia's most important resource basins: the Pilbara (iron ore) and the Bowen Basin (coal).

The creation of new resource basins can significantly change a country's share of global production. Once new ports, railways, roads—even new towns—are in place, operations typically last for decades and incremental production increases can be made at lower costs. Chart 16 shows how Australia and Brazil became major producers of iron ore and bauxite (used to make aluminium) during Japan's industrialisation—dramatically increasing market share from 1960 to 1980. Once major resource basins had been established in Australia and Brazil, their market shares continued to grow over the next two decades through to 2000—until, once again, the industrialisation of a major economy (in this case China) began to drive shifts in market share that are ongoing today.

Chart 16

The period of Japan's industrialisation from 1960 to 1980 saw rapid shifts in market share, similar to today

Market share of global production by country ranked by 2008 position



Source: US Geological Survey Minerals Yearbook, 1960-2010; UNCTAD Iron Ore 2000, 2008.

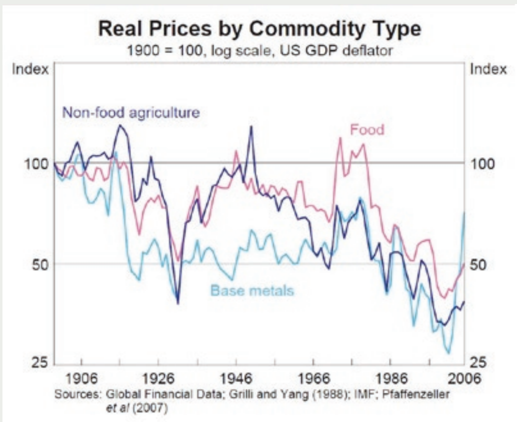
Like Japan in the 1960s and 1970s, China is investing in resource projects to secure its minerals supplies. Similarly, private companies have a strong business case to invest now to take advantage of Chinese demand. Australia has been a beneficiary of these investments, but so have other countries. Chinalco (a major Chinese resources company) and Rio Tinto recently announced a joint venture to develop the multibillion dollar Simandou iron ore project in Guinea, West Africa.[106]

The opportunities provided by strong demand growth and high prices make this an important time for Australia to maintain investment in its minerals resources. Australia has already experienced falling market share across most commodities. Any further delays to investments will have lasting impacts on Australia's future market share of global production and the wealth created from Australian resources because:

- **These delays will only hasten the development of alternative resource basins in other countries.** Chart 16 shows that China's development has begun to create shifts in market share similar to the 1960 to 1980 period—for example, Australia's share of global bauxite production has fallen over the last decade and China's share of iron ore doubled over the same period. Further delays to investment in Australia will provide opportunities for other countries and lead to lower market share for the Australian minerals industry for decades to come.
- **Delays will reduce the benefits Australia receives from today's temporarily high prices.** For a time, high prices and profits driven by growth in China and India are providing Australians with strong returns from their minerals resources. But these high prices are temporary. Chart 17 shows that

Chart 17

Commodity prices have declined over the long term, though they have increased recently



Source: Reserve Bank of Australia, 'The Recent Rise in Commodity Prices: A Long-Run Perspective', 2007.

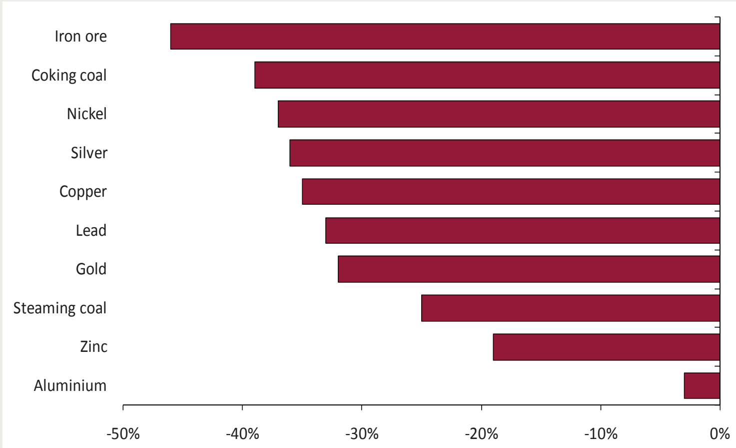
commodity prices, including the prices of base metals, have declined over the last century, though with considerable volatility. According to the Reserve Bank of Australia: 'After rising in the 1950s in the context of strong world demand for steel—for which iron ore is primarily used—real iron ore prices declined for the next five decades' until the recent price rise.[107] While the prices of minerals resources have risen significantly in the last decade, this is the exception—not the rule.

Nor is this temporary price increase expected to last. Chart 18 shows Consensus estimates of long-term minerals resources prices compared to today. Across the board, prices are expected to fall significantly.

As a result, delays to investment in Australian minerals resources will reduce the benefit that Australians receive from their resources for decades.

Chart 18

Consensus forecasts see long-run price falls across minerals



Source: Access Economics, 'The impact of the RSPT', Presentation to Minerals Week, 2 June 2010.

4.2 The super tax will make Australia's minerals resources industry uncompetitive and delay investment

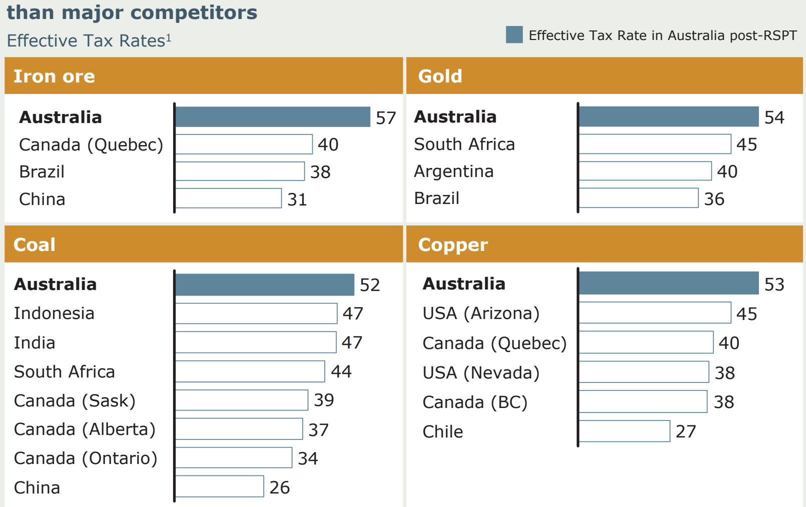
If implemented in its current form, the super tax will delay investment in Australia's minerals resources and lead to generations of lost opportunities.

A combination of analysis by KPMG and Access Economics suggests that the super tax will slow greenfield investment in Australia by reducing the return to Australian projects. Output will only recover in the 'long run'—once Australian mines have returned to their initial relative position on the global cost curve in 50 to 100 years.[108] This is a high risk strategy because over that time-frame entire industries can come and go (along with demand for the minerals resources they require).

Comments in Box 4 highlight the genuine fears about delays to Australian projects caused by the super tax—and the eagerness of other countries anticipating more investment at Australia's expense.

Chart 19

The super tax will make Australia's tax rates on minerals higher than major competitors



1 US and Canada effective tax rates are conservative as they do not include depletion and processing allowances applied between mine mouth and mine gate

Source: KPMG, 'Potential financial impacts of the Resource Super Profits Tax on new mining projects in Australia', 1 June 2010.

A closer look at the super tax's impact on individual minerals illustrates why these delays to Australian projects are real. What follows traces the impact of the super tax through the Australian minerals resources industry, showing how the increase in tax rates leads to lower project values that will shift investment overseas.

The super tax raises the effective tax rates in Australia's minerals resources industry to the highest in the world. Chart 19 shows effective tax rates for Australian second-quartile greenfield mines under the super tax compared to effective tax rates in competitor countries. The super tax makes Australia's tax rate in iron ore, gold, coal and copper between 52 and 57 percent, much higher than major competitors.

Box 5 on page 34 explains why applying the same model as the PRRT to Australia's minerals resources industry would also be uncompetitive and lead to similar impacts on investment.

These high effective tax rates significantly reduce the cash flows from Australian mines. Chart 20 shows that the super tax significantly reduces cash flows from a typical Australian iron ore mine—while leaving the investment required unchanged.

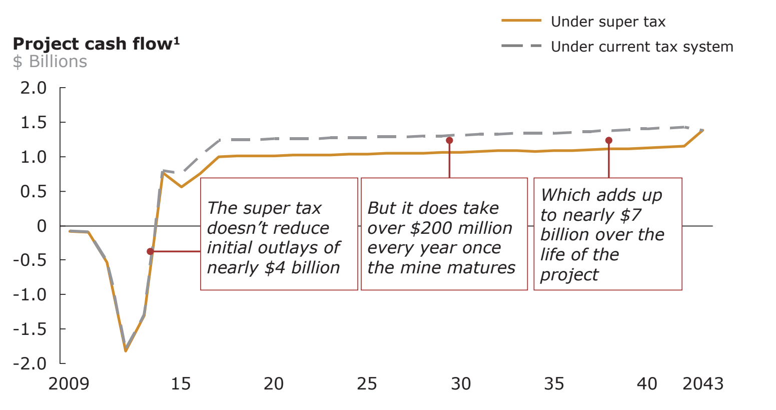
The result is that the super tax has a major negative impact on project values. Chart 21 shows KPMG estimates of the super tax's impact on the value of a second-quartile greenfield Australian mining operation compared to the current royalty system.[109] This has different implications for different minerals:

- **The super tax makes the value of copper, nickel and gold projects negative—these projects would not be economically viable under the tax.** This puts at risk up to $38 billion of announced projects in Australia's copper, nickel, and gold industries in the project pipeline.[110]
- The super tax significantly

Chart 20

Cash flows are much lower under the super tax than the current system

Cash flows for second-quartile greenfield Australian iron ore mine over project life

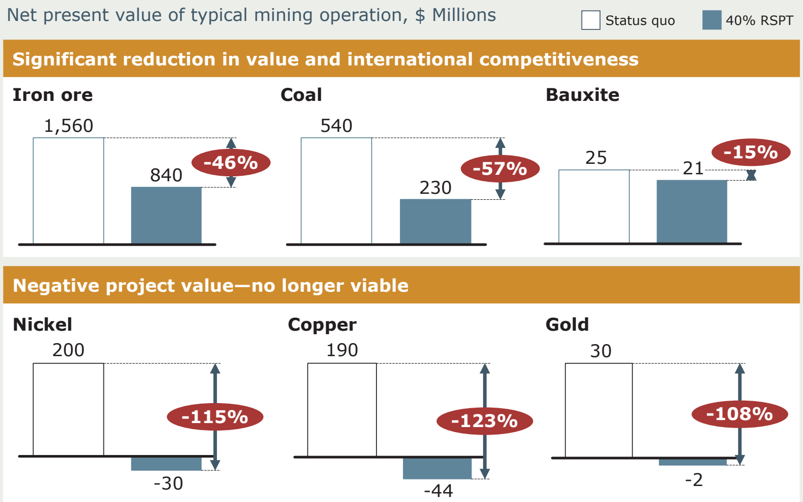


1 Net cash flow available for equity, assuming 10% debt funding
Source: Analysis based on KPMG model of second-quartile greenfield Australian iron ore mine prepared for Minerals Council of Australia.

Chart 21

KPMG estimates that the super tax will have a significant impact on project values, with some projects becoming economically unviable

Net present value of typical mining operation, $ Millions



Source: KPMG, 'Potential financial impacts of the Resource Super Profits Tax on new mining projects in Australia', 1 June 2010.

Box 4: Australia is at risk of losing investment to other countries because of the super tax

- **Canadian MP Brad Trost** told the ABC that 'we see an **opportunity to have some money come north**' after this '**blunder by the Australian Government**'.[111] Shortly afterwards, Rio Tinto announced that it planned to spend $449m to restart its Canadian iron ore expansion program, with Iron Ore Chief Executive Sam Walsh highlighting the '**attractiveness of investing in Canada**'.[112]
- Reflecting on his country's experience with its resource rent tax—which it abolished as part of a tax reform process in 2003—**Greg Anderson, Executive Director of the PNG Chamber of Mines and Petroleum**, states: **'I'm delighted the Australian government is driving companies offshore, because we are going to pick some of them up...** [PNG's resource rent tax] was a complex tax, which looked very bad on paper because no one could understand it overseas. So the government at last got rid of it, simplified tax and made it internationally competitive.'[113]
- Minerals resources companies of all sizes involved in both exploration and production have consistently come out against the Government's super tax. Simon Bennison, CEO of The Association of Mining and Exploration Companies, states, 'It is clear from the overwhelming response of financial commentators and experts, including Moody's, that **this tax will be a massive hit for future investment in the Australian mining industry**. AMEC has been inundated with responses from its members confirming this to be the case'. For example, **'drill rigs are now idle and the crews have been stood down and placed on the dole queue'**.[114]
- BHP Billiton CEO Marius Kloppers warned that Australia was in danger of 'tarnishing' its reputation as the 'gold standard' of investment destinations for mining companies. According to Kloppers, **'... it would be extremely unlikely to think that we can approve a major investment while this uncertainty hangs over us...'** Addressing BHP Billiton's metallurgical coal assets in the Bowen Basin in Queensland and Indonesia, he added that 'if this tax passes in unmitigated form, what would happen is you would decrease the attractiveness of the Bowen Basin relative to Indonesia'.[115]
- According to Rio Tinto CEO Tom Albanese, if previously in place, the super tax would have significantly reduced investment in the Pilbara to date. According to Albanese, 'if the super tax had been in place, I think you can be assured that **the Pilbara business would have been a lot smaller business now than it actually is today.** The Government's claim that it would have gotten $35 billion of extra taxes over the past decade if this tax had been in place 10 years ago ignores that inconvenient reality.'[116]
- AngloGold Ashanti CEO Mark Cutifani has warned that projects such as the proposed Tropicana development in WA were facing increased competition for investment from deposits in other countries, such as Guinea. 'While we are still committed [to Tropicana], what should be a twenty year development that our industry so desperately needs, has slipped back down the project priority list.'[117]

reduces the value of Australia's iron ore, coal, and bauxite projects by 46, 57, and 15 percent, respectively.

Investors will choose projects with the most attractive risk-return profiles. By reducing the value of Australian projects and increasing Australia's sovereign risk, **the super tax will likely make a number of Australian projects less attractive than alternatives in other countries.** Some Australian projects that would have proceeded under the current tax system will be delayed as investors choose to invest elsewhere. These delayed projects will only proceed when they become attractive compared to alternatives.

Deferral of Australian minerals resources projects has already begun. Chart 22 shows that, since the Government announced the super tax, several industry leaders have announced delays to projects that have already had real consequences for Australian jobs and investment.

4.3 The consequences for the Australian economy will be significant

These delays—at exactly the wrong time—will present real risks to the Australian economy. The super tax threatens Australia's prosperity in several ways:

- **The super tax will hurt jobs in Australia's minerals resources industry.** Less investment and production in Australia's minerals resources industry will provide fewer job opportunities for Australians. The super tax will also hurt jobs in industries that provide goods and services to the minerals resources industry, such as construction.

Chart 22

Mining projects were cancelled or placed on hold following the RSPT announcement

	Economic Impact	Project Issue
Fortescue Metals Group[1]	▪ **On hold:** A$17.2 billion investment ▪ **On hold:** 22,500 construction and 10,000 ongoing jobs	▪ Fortescue delayed two of three expansion projects, citing the "uncertainty" and RSPT "cash impost ... on future business revenues" ▪ Additionally, the 40% "tax guarantee" is considered to have "no lending value" by financiers
Xstrata[2]	▪ **On hold:** A$586 million investment in Queensland ▪ **On hold:** 3,250 new jobs	▪ "The two projects involve significant risks and total capital investment of over A$6.4 billion." ▪ "RSPT has created significant uncertainty for the future of mining investment into Australia"
Cape Lambert Resources Ltd[3]	▪ **Cancelled:** A$200 million development project	▪ Cape Lambert decided to invest money in a project in Sierra Leone instead.

1 FMG ASX Release, 'Implications of the Proposed Resource Super Profit Tax', 19 May 2010 (US$15 billion converted at exchange rate on 19 May 2001 of 1:1.14531; www.oanda.com).
2 Xstrata media release, 'Suspension of expenditure on A$6b Wandoan Coal and A$600m Ernest Henry underground copper projects in Queensland', 3 June 2010.
3 Cape Lambert Resources ASX announcement 'Response to ASX Query', 5 May 2010; Tony Sage, Cape Lambert Executive Chair in ABC News Lateline Business, 5 May 2010.

- **The super tax will hurt Australia's GDP and productivity.** The super tax will have significant flow-on effects for the rest of the economy. Minerals resources companies will purchase fewer goods and services from Australian companies. And fewer job opportunities will reduce household spending on goods and services made in Australia.

  To the extent that investment and jobs shift to other sectors in the Australian economy, Australia's productivity will suffer. As Chart 23 shows, the minerals resources industry is Australia's most productive sector. Reallocating investment and employment away to other industries will impede Australia's productivity growth, at a time when productivity growth is critical to address the challenge of Australia's ageing population.

- **The super tax will reduce household income and wealth.** Household income will fall along with job opportunities. Australians who lose jobs due to the super tax but find employment elsewhere will be less productive and, as a result, take home lower wages and salaries.

  The super tax will lower share prices of Australia's minerals resources companies by under-compensating shareholders for the transition of existing operations. As a result, household wealth invested in minerals resources companies directly or through superannuation will be reduced by the super tax.

- **The super tax will hurt Australian exports.** Slowing investment and growth in minerals resources will hurt Australia's largest export industry and lead to a significant fall in Australian exports.

- **The super tax poses risks to Government tax revenues.** Lower investment and output in the minerals resources sector will erode the revenue base for company and other taxes. Similarly, other industries that depend on the minerals resources industry will not grow as quickly and will pay less company tax as a result. Less employment and lower salaries will lead to less personal income tax, payroll taxes, and GST revenues. After considering these effects, the super tax increases tax revenues in the short term, but with a risk to long-term revenues that are crucial to maintaining a healthy budget as Australia's population ages.

The net result is that, in its current form, the super tax is not in Australia's national interest—or that of individual Australian households. The poor design of the super tax puts at risk the growth, jobs, and wealth that the minerals resources industry promises to create for Australians. And it does so to raise more short-term tax revenues, while at the same time putting long-term revenues at risk. As Ian Smith, CEO of Newcrest Mining and Chairman of the Minerals Council of Australia, states:

‘The impact on the industry may not be felt from day one of this tax proposal, or even year one. It will be felt hardest 10 and 20 years into the future. This is really a tax on our grandchildren. Without a profound policy shift, there is a real risk that one of Australia’s most important industries will be damaged and the prosperity that flows to every Australian will be diminished’.[118]

Box 5: Why the PRRT is not the answer for Australia’s minerals resources industry

Some commentators have suggested that replacing the super tax with the Petroleum Resource Rent Tax would allay concerns around the Government’s tax proposals. The Government has also alluded to potential changes to the uplift rate, but not the 40 percent tax rate.

But a 40 percent tax rate—under the PRRT or super tax model—is not appropriate for the taxation of minerals. Chart 14 shows that petroleum is taxed at a much higher rate than minerals around the world. The 40 percent tax rate that is competitive in the global petroleum industry is uncompetitive in the global minerals resources industry. Similarly to the super tax, applying the PRRT model to Australia’s minerals resources industry would hurt project values and shift investment away from Australia to competitor countries. Furthermore, applying similar transition arrangements to a PRRT model would raise the same sovereign risk issues and under-compensate shareholders for transition.

Replacing the tax credits offered by the super tax with a higher uplift rate does not alter the significant negative impact that an uncompetitive tax rate will have on investment in Australia’s minerals resources industry and on the Australian economy.

Chapter 5

Australia's tax reform should be based on five sound policy principles

The minerals resources industry supports genuine tax reform. Unfortunately, the Government's super tax—flawed in concept, design and application—does not meet the mark for genuine reform. As such, it represents a tax grab rather than reform. Australia's prosperity depends on adopting a tax system for minerals resources that respects five sound policy principles.

5.1 Prospective: Changes in taxation and royalties must not undermine the basis upon which long-run investment decisions have been made, nor compromise the principles of equity and efficiency. Applying changes only to prospective investments achieves this objective; applying changes to past investments does not.

- Confidence in the stability of the tax system applying to long-life, large capital investments is a key consideration for investors deciding where to invest.
- The Australian minerals resources sector faces fierce international competition for the investment needed to grow Australia's minerals resources and the jobs, wealth, and tax revenues that it creates.
- Preserving the value of existing operations is critical to continuing to attract the investment needed to grow Australia's minerals resources industry and support Australian prosperity.

5.2 Internationally competitive: The overall taxation burden (resources, local, state and federal taxes and levies) should be internationally benchmarked and be competitive against other global investment destinations, recognising the mobility of capital (financial, human and technological) and that Australian companies compete for direct investment in a strongly globally integrated industry.

- Australian projects compete with attractive and feasible projects in other countries for investment.
- Tax rates have a major impact on the relative attractiveness of Australian projects.
- Competitive tax rates ensure that Australian projects remain financially attractive to investors.

5.3 Differentiated: Capital investment and financial return characteristics differ across resources commodities, starkly between oil and gas and minerals commodities, but also significantly between minerals commodities. Achieving a competitive taxation and royalty regime for different resources products requires different designs and taxation/royalty rates specific to the characteristics of each resources product group.

- Different commodities have different economics, different investment profiles and varying risks. Petroleum is more profitable than minerals, and some minerals, such as iron ore, are more profitable than others, such as nickel. As a result, different minerals can sustain different tax rates.
- Different tax burdens are internationally competitive in each mineral. For example, oil faces higher tax burdens than minerals across the globe. As a result, a 40 percent tax rate is globally comparable in Australia's oil industry but not in minerals.

5.4 Minerals resource-based: Minerals resources taxation and royalties should be levied on the primary resource value only, and not on the value added in downstream transport logistics and industrial processing and smelting.

- A resource tax aims to tax the value of the minerals resource and should not unintentionally tax infrastructure, downstream processing, manufacturing and transport, all of which are already taxed via Australia's company tax system.

- It is important that Australia encourages growth in minerals resource-sector infrastructure such as railways and ports. Australia currently faces severe infrastructure bottlenecks that inhibit growth in the minerals resources industry and its associated benefits.

5.5 Equitable and efficient: Genuine reform of taxation and royalty arrangements should promote economic activity and improve the efficiency, simplicity and fairness of the system without compromising competitive neutrality, and in minimising the deadweight loss to the economy of taxation and royalty collection.

- Tax should be designed to promote economic activity and improve the efficiency, simplicity and fairness of the system.
- Tax should aim to minimise any impact on investment decisions.

As one of Australia's most globalised industries, the minerals sector has an abiding interest in ensuring that tax reform maintains and enhances Australia as an internationally competitive investment destination and enhances economic performance. The Minerals Council of Australia has published this Policy Brief to better inform public policy making and to bring much-needed factual clarity to the debate on the Government's proposed Resource 'Super Profits' Tax. The minerals resources industry supports genuine tax reform and contends that a profits-based tax is conceptually beneficial, if designed well. The industry has repeatedly affirmed that it is ready to engage in constructive discussion on genuine tax reform. But the proposed Resource 'Super Profits' Tax has a flawed design. This is a product of the Government's failure to consult with industry and State and Territory Governments, as well as its lack of understanding of the real commercial and economy-wide ramifications of the proposal. The importance of the minerals resources industry—and the long-term consequences of investment flowing to mining projects in other countries—are such that Australia cannot afford to get this wrong.

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