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Mr John Hawkins
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Senate Standing Committee on Economics
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Dear Mr Hawkins

Inquiry into the *Uranium Royalty (Northern Territory) Bill 2008*

During the Senate Committee hearing on the *Uranium Royalty (Northern Territory) Bill 2008* conducted in Canberra on 8 April 2009, the Department undertook to provide further information on projections for future employment growth in the NT uranium industry. I would also like to take this opportunity to comment on some of the other issues raised during the inquiry.

Employment

The Senate Committee specifically enquired whether the Department had analysed the potential effect on employment in the Northern Territory arising from the Bill.

The modelling undertaken, and discussed in the explanatory memorandum, was conducted to provide broad indicative comparisons of the outcomes which the application of each of the three royalty types (profits, ad-valorem and hybrid) would yield for the uranium producer, government and Traditional Owners. The modelling was limited to direct financial outcomes through royalty and royalty equivalent payments, thus, the effect on employment in the Northern Territory arising from the development of particular deposits was not considered. However, the modelling showed that the mine life is likely to be shorter under an ad valorem royalty and that a profit based royalty regime was likely to provide investors with the greatest potential for a positive return over the life of a mine and thus was more likely to encourage investment in resource development, particularly for more marginal mining projects. Marginal mines can be an important source of employment and other benefits in regions where there are few other employment options. Hence the modelling (and broad economic theory) indicates that a profit based regime would provide greater output, employment and flow-on effects over the life of a mine.

Further to this, the April 2008 report "*Outlook for the Uranium Industry*" prepared by Deloitte Insight Economics for the Australian Uranium Association, notes that the expansion of Australia's uranium industry will result in both new investment and additional employment. Under the climate action scenario modelled in the report, it was estimated that the expansion of the uranium industry in the NT would create an additional 260 jobs relative to the base case from 2020.

Volatility of royalty and royalty equivalent payments

As discussed during the hearing, profit based royalties can be more volatile and consequently harder to forecast than ad valorem royalties as there is less predictability about revenue streams. However, RET notes that there are a number of issues which need to be taken account of and mechanisms for offsetting some of the volatility from profit-based royalty regimes which may alleviate the concerns of traditional owners:

- A profit based royalty regime is more economically efficient and will maximise investment in mining projects including encouraging the development of more marginally economic mining projects and avoiding the premature closure of mines. Hence in some instances, the comparison may be a stark choice between one of no mining development occurring at all under an economically less efficient ad valorem regime, and hence no royalty flows, compared with one where the efficient level of investment is made and royalty income is received but is more volatile. RET further notes that mining developments bring with them a broader range of economic and social benefits to the community by way of employment, infrastructure, taxation and services, and that a profits based regime provides greater scope for the community to access higher royalty returns when profitability is high.

- Secondly, section 46 of the *Aboriginal Land Rights (Northern Territory) Act 1967* (ALRA) provides for Traditional Owner groups to negotiate private payments directly with a mining company. The form and timing of private payments is not mandated so Traditional Owners can, for example, negotiate ad valorem payments for the purpose of offsetting lower profit based royalty payments during the early years of a mine's life or to smooth out royalty payments. The Uranium Royalty (Northern Territory) Bill 2008 deals only with the statutory royalty regime and therefore does not affect this right for Traditional Owners to negotiate private payments and any private payments would be made in addition to the statutory royalty (i.e. they are not deductible from the statutory royalty). I note that the Northern Land Council stated in its evidence that its practice is to insist on these types of arrangements in the agreements for which it is responsible.

  RET notes that, as the Traditional Owners have a veto over exploration and mining on their land, they are in a very strong position to negotiate the terms and conditions that they wish. Anecdotal evidence suggests that mining companies are prepared to negotiate private royalties with traditional owners and in the past these have covered ad valorem, profit based or hybrid systems.

  RET further notes that more recently best practice industry approaches to private agreements with Traditional Owners have involved the establishment of sustainability type funds which are independently governed and managed for the long term benefit of Traditional Owners and focused on ensuring indigenous communities benefit from their engagement with the uranium industry. In addition to its Code of Practice, the Australian Uranium Association has adopted high level principles for engagement with indigenous communities (developed through the Uranium Industry Framework)[1] and has recently announced the establishment of an Indigenous Dialogue Group to inform and shape the industry's contribution to indigenous economic development.

- The Aboriginals Benefit Account (ABA) was set up under the ALRA as an investment vehicle for which royalty equivalent payments are paid by the Commonwealth in respect to mining projects on Aboriginal land in the Northern Territory. In addition to distributing 30% of the royalty equivalent payments to, inter alia, Traditional Owners in the areas affected by mining, discretionary grants are paid for the benefit of Indigenous people in the broader Northern Territory community[2]. Of the $83.257 million collected in royalty equivalent payments to the ABA during 2007-08, $24.977 million was paid for the benefit of

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[1] The UIF Indigenous Engagement Working Group principles are available at: http://www.ret.gov.au/uif

[2] Appendix 10 of the Department of Families, Housing, Community Services and Indigenous Affairs 2007-08 Annual Report (available at http://www.fahcsia.gov.au/annualreport/2008/default.htm) describes the types and amounts of payments made from the ABA.

communities directly affected by mining operations and $20.311 million was paid in discretionary grants for the benefit of Aboriginal people living in the Northern Territory.

- The introduction of this new royalty regime for uranium in the NT will harmonise the royalty arrangements for uranium with that for other minerals. This will mean that for mining projects on Aboriginal land in the NT, the ABA will receive royalty equivalent payments which are derived from both uranium and non-uranium mining commodities. Each of these commodities will have their own individual commodity price cycles and different factors affecting the profitability of the firms mining these commodities, and hence the size and volatility of the royalty equivalent income streams flowing into the ABA will vary across commodities and projects. In addition to receiving royalty equivalent payments, the ABA also earns a revenue stream from interest on its investments ($12.253 million in 2007-08). These factors provide the potential for the flows into the ABA to be less volatile overall. Whilst this potential smoothing effect will not impact on the income flows to the individual Traditional Owner groups, it does have the potential to provide a smoothing effect on the discretionary grant payments paid for the benefit of Indigenous people more broadly in the NT.

- Finally, I note that profits based royalties have been levied in the Northern Territory since 1982 and that all stakeholders (industry, indigenous and government) have considerable experience with the operation of the regime and managing volatility of income streams. Indeed, over the period 2002-2006, some 64% of the royalty equivalents paid into the ABA were derived from mines in the NT which are already exposed to the existing profits based regime.

<u>Disincentive for elderly Traditional Owners</u>

On ALRA land, senior Traditional Owners have the final say on whether to allow exploration and mining on their land and this is on behalf of future generations of Traditional Owners. While the Traditional Owners may have less of a incentive to allow exploration and mining on their land if they consider they personally are not going to receive royalty revenue during the early years of a mine's operation when it may be unprofitable, benefits will still flow to the Traditional Owners and their families and to the community from jobs, infrastructure and other investment in the region, and from royalties when the mine becomes profitable. In addition, there is significantly greater potential under a profits based royalty regime for Indigenous communities to access higher royalty returns when profitability is high.

<u>Environment / rehabilitation issues</u>

In relation to clean up costs, RET considers that this is a very important issue but is however, quite separate from the royalty regime which is imposed. We note that the NT Government has established a comprehensive mine security policy (see http://www.nt.gov.au/d/Minerals_Energy/index.cfm?newscat1=&newscat2=&header=Rehabilitation%20Security) under its *Mining Management Act*. Miners are required to set aside a security which is calculated as per schedules for works under the mining lease in order to protect the community interest should a mining project fail to fulfil its obligations including to rehabilitate the land. Calculation of securities is based on the estimated actual cost of rehabilitation commensurate with the size, environmental risk and expected project life and is reviewed regularly. This ensures that 100% of the amount calculated for rehabilitation is paid by the company and held by the Northern Territory Government as a security bond. Separate arrangements have been established with the Commonwealth Government holding a rehabilitation bond for the costs of rehabilitating Ranger. These estimated costs are reviewed and subject to independent assessment annually.

Transfer pricing issues

The issue of transfer pricing is a serious one which governments have incentive to ensure does not occur and is a potential issue for both the ad valorem and profits based royalty regimes. As the NT Treasury said in its evidence, where there is any query about the price being paid for the uranium in the royalty return, the onus is on the company and not the government to prove the price is valid. Further, the spot and long term price for uranium are both available publicly, see for instance the websites of UxC Consulting (http://www.uxc.com/) and the World Nuclear Association (http://www.world-nuclear.org/info/inf22.html) which publish uranium price statistics and volumes for worldwide sales.

All uranium producers in Australia are required to hold a uranium export permission issued by the Minister for Resources, Energy and Tourism. A condition of all export permissions is that copies of all uranium contracts must be submitted to the Department of Resources, Energy and Tourism (RET) and companies are required to provide details of all exports and prices obtained for material. RET publishes an annual uranium price achieved for all Australian exports. For instance, in 2008 the average Australian price achieved was A$35.17 per pound. Australian prices compare favourably with average Canadian prices achieved. I note that the average annual price achieved for Australian uranium has been increasing over time, up from A$18.78/lb in 2003 to A$27.71/lb in 2006. This reflects the end of long term contracts signed by Australian producers when the world uranium price was very low. We expect to see a continuing increase in the average prices achieved for Australian uranium exports in the future as new long term contracts are signed at higher prices.

On this basis, RET has a very good understanding of the actual prices that Australian uranium is sold for and, as part of the administrative arrangements being established to support the Bill, will liaise closely with the NT Treasury on what are appropriate benchmark prices for uranium with which to compare royalty returns. Thus in the case of uranium, governments are in a much stronger position to identify and resolve any issues of transfer pricing or circumstance where a company seeks to keep the price artificially low for royalty purposes, than is the case for most other commodities. RET further notes that were the NT Government to be concerned that transfer pricing was occurring, the *Minerals Royalty Act* incorporates the power for the NT Government to issue a default or amended assessment of the royalty payable.

Ad valorem versus profit based royalty regime

Economic theory indicates that profit royalties are more efficient than ad valorem or volume based arrangements. There are several publicly available reports which reflect this, including the following.

The consultation paper for the Henry Tax Review (see http://taxreview.treasury.gov.au/Content/Content.aspx?doc=html/pubs_reports.htm) noted that: "*The recent cycle in resource prices, sustained increases followed by sharp decreases, serves to highlight the relative efficiency of the various revenue arrangements. The extended period of profitability in the mining sector resulted in an increase in revenues from company income tax and specific resource taxes, royalties and excises levied on mining, oil and gas resources (accounting for the major part of resource related revenues). However, the rate of increase does not appear to have been proportional to the growth in the operating profits of the mining sector.*

The relatively slow growth in government revenues is partially explained by the prevalence of ad valorem royalties. Ad valorem royalty revenues do not vary in proportion with profits. A corollary is that, in a period of lower operating profits for the mining sector, total government revenues fall by less than operating profits. Indeed, a particular project may be in a loss making position but still be required to pay royalties. Royalty arrangements can therefore discourage higher risk projects. They can also impede the efficient development of otherwise marginally profitable reserves. Resource rent taxes such as Australia's PRRT are designed to overcome these issues."

The 2007 ABARE report *Mineral Resource Taxation in Australia – an Economic Assessment of Policy Options* (see www.abare.gov.au) noted that: "*Provided there exists a range of low profit and high profit resource projects, output based royalties (ie ad valorem) tend to overtax low profit projects and to undertax high profit projects. The government tax take will be too high for low profit projects with some becoming uneconomic as a consequence (and the government tax take reduced to zero for these projects), and too low for high profit projects*."

Finally, a study on mining royalties for the World Bank in 2006 found that: "*Where a nation has a strong desire to attract investors, consideration should be given to either forgoing a royalty and relying on the general tax system, or recognizing the investors' strong preference for being taxed on their ability to pay. A nation seeking to differentiate itself from other nations that it competes with for mineral sector investment may find a royalty based on income or profits to be an investment incentive. Although profit-based royalty schemes are inherently more difficult to implement than other royalty schemes, governments that are capable of effectively administering an income tax are positioned to manage a profit or income based royalty.*" (Mining Royalties - A Global Study of Their Impact on Investor, Government and Civil Society, World Bank, 2006 =- see http://publications.worldbank.org/ecommerce/catalog/product?item_id=5345313)

Yours sincerely

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17 April 2009