Chapter 5

Broader economic consequences of the flawed Mineral Resources Rent Tax and the expanded Petroleum Resources Rent Tax

Introduction

5.1 As detailed in Chapter 4, the flawed policy development process of the MRRT and expanded PRRT has lead to a distortionary, complex and unfair taxation regime to be imposed on one of the most important industries for Australia's economic prosperity into the future. Chapter 4 identified and examined the specific design concerns that stakeholders continue to have despite the work done by the PTG. The focus of that chapter was on the impact on the industry.

5.2 In addition to the specific design concerns raised by stakeholders and set out in Chapter 4, a number of broader concerns were raised. Those broader issues are outlined and examined in detail in this chapter. In particular, concerns were expressed about the lack of competitive neutrality of the proposed MRRT, the negative impact on Australia's international competitiveness and the sovereign risk implications impacting on investment in this important sector of the economy. Importantly, this chapter also examines some of the implications of the MRRT and expanded PRRT on the Commonwealth Budget.

Competitive advantage for the big three miners

5.3 As clearly set out in Chapter 3, the process employed by the government to develop the MRRT and the expanded PRRT was deeply flawed. Many contributors to this inquiry who are stakeholders in the mining tax debate were excluded from the discussions. These stakeholders view the government's decision to consult with the industry's three largest miners as providing those miners with a competitive advantage. This view is legitimate, as these three large miners were given exclusive access to both information and decision makers and were able to directly influence the design of the tax.

> The design of the tax is biased in favour of BHP and Rio in particular—given that they are our major competitors in the iron ore industry in a number of ways—in terms of both design and the combination of elements of the design.[1]

5.4 Documents released under freedom-of-information laws suggest it was BHP Billiton that drafted the terms of the peace deal with the Gillard government over the

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1 Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 21 – 22.

mining tax - ultimately costing taxpayers up to $60 billion.[2] Correspondence between the Office of the Treasurer and BHP Billiton provide an insight into the way in which the MRRT was settled between the government and the big three miners.

5.5 On Wednesday, 30 June 2010, Mr Gerard Bond of BHP Billiton sent by email to the then Treasurer's Chief of Staff, Mr Chris Barrett, and the Minister for Resources' then Chief of Staff, Ms Tracey Winters, a draft of the MRRT Heads of Agreement. The next day, 1 July, Mr Barrett provided the email to David Parker, who was at the time the Treasury Executive Director of the Revenue Group, along with another senior Treasury officer and Ms Winters:

> David,
>
> Please see the draft heads of agreement sent yesterday by BHP. We aim to sign this 5pm today with all three companies. Can your troops read it and ensure all the elements are OK? Please get back to me with any problems asap. Tracey, you might want to check it with DRET [Department of Resources, Energy and Tourism]
>
> I will send a separate email on the $50 million threshold, which is new, but helpful, I think.
>
> Regards,
>
> Chris[3]

5.6 On 1 July 2010, Mr Barrett sent an email to Mr Gerard Bond of BHP Billiton:

> Gerard,
>
> Final, clean version for your signature. Please let me know if any issues at your end.
>
> Regards,
>
> Chris[4]

5.7 The more junior stakeholders take the view that, the features of the proposed tax, negotiated exclusively, provide a competitive advantage to the well established three multi-national, multi-commodity and multi-project miners.

> The main points are around the application of the mining rights value versus the principles involved in historical cost; the low value they appear to be arguing should be placed on infrastructure, where they are likening it to a railroad in central Melbourne as opposed to high-risk infrastructure linking a port to a mine; the way ‘projects’ looks as if it is being defined

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2 Katherine Murphy, *BHP drafted mining tax truce, documents suggest,* The age.com.au, on 20 June 2011)

3 Email by Mr Chris Barrett, Chief of Staff, Office of the Treasurer, the Hon Wayne Swan MP. Email dated 1 July 2010 released under Freedom of Information: , (accessed 20 June 2011)

4 Email by Mr Chris Barrett, Chief of Staff, Office of the Treasurer, the Hon Wayne Swan MP. Email dated 1 July 2010 released under Freedom of Information: (accessed 20 June 2011)

> through the consultative panel; and the transferability rules. It is the combination of those particular factors that tends to favour companies with established mines and infrastructure and clusters of mines that help to de-risk that infrastructure in remote locations. The definitional aspects of 'projects' seem to be biased towards BHP and Rio. There is the issue of possible treatment of black-hole expenditure, which is particularly relevant for companies that are trying to develop but may not meet the definition of a project at this point in time...There is also the cost of compliance. The cost of compliance for this thing, per tonne, for the smaller players is going to be horrendous compared to the per-tonne cost of compliance for the larger companies.[5]

5.8 Andrew Forrest, Chief Executive of Fortescue Metals Group, explained recently that the particular changes to the starting base, to enable market valuation to be placed on projects, will provide a particular advantage to the large, well established miners with existing projects, at the expense of smaller ventures:

> If you don't have that large market value, like developers don't, then you start paying the tax immediately whereas the multinationals don't start to pay it for decades, if at all... If you have the balance sheet to fund a project, that's fine, you're OK... But if you don't have that balance sheet, then you're not going to be allowed to deduct interest before you pay this tax - that works directly against project financiers.[6]

5.9 This will make it more difficult for smaller emerging miners to develop as the ability for the large multinationals to claim a deduction for the market value of their projects will provide them with a tax shelter:

> Running the model based on the government's assumptions means a new miner with a $1 billion capital investment can deduct this value over the five-year transitional period, so the outcome is an MRRT bill of $185 million. Using this same model for an established miner with a $3 billion market value resource base, to depreciate that asset over an assumed eight-year life of the mine results in the miner paying no MRRT at all. Put simply, the new miner will pay $185 million in MRRT and the established miner will pay none.[7]

5.10 It is a travesty that smaller home-grown companies are penalised at the expense of multinationals.

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5 Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 21-22.

6 Mr Andrew Forrest, quoted in, Sue Lannin, Revised mining tax un-Australian: Forrest, *ABC News*, 13 June 2011, http://www.abc.net.au/news/stories/2011/06/13/3242507.htm (accessed, 14 June 2011).

7 Mr Stephen Pearce, Tax man digs a hole for emerging miners, *Australian Financial Review*, 22 June 2011, p. 63.

> There's never been a penalty like that against Australian companies in the history of our constitution... It shouldn't start now and, if it were to be adopted, it creates a very dangerous precedent.[8]

5.11 These smaller stakeholders also completely rejected the government's assertion that the deal struck, as set out in the Heads of Agreement, was a deal made with the mining industry:

> ...the agreement that was struck between the Prime Minister and the three companies was a deal done between the Prime Minister and those three companies. It was not a deal that was done with the industry. It provides a competitive advantage to those three companies to further strengthen their dominance.[9]

5.12 One of the concerns raised by these smaller miners is that the introduction of the proposed MRRT and expanded PRRT would impede their ability to innovate, particularly given the scrapping of the exploration rebate and the changes to the starting base calculations which favour larger, well established operations.

5.13 There are concerns that the preferential treatment of the signatories of the Heads of Agreement may in fact stunt the continued growth of Australia's mining sector, particularly junior miners who are generally the early innovators and risk takers. Such concern is particularly worrying, given the possible impact on the national economy.[10]

> CHAIR—So you are saying that we have an Australian success story like BHP, Rio and so on because of the risks taken in the past and the MRRT today will make it less likely for us to have similar success stories in the future because there is a disincentive to take on the sorts of risks which were taken on 30 or 40 years ago by BHP and Rio; is that right?
>
> Prof. Ergas—Yes, that is correct. It will also have the effect of distorting decisions and the allocation of resources between large established miners, such as BHP Billiton, Rio and Xstrata, and newer mining entities that do not have as wide a portfolio as the established miners have and as much scope to offset gains and losses within that portfolio.
>
> CHAIR—So what you are saying then—and I am not wanting to put words into your mouth, so correct me if I am wrong—is that those three big mining companies that had the privilege of sitting around the table with the Prime Minister, the Treasurer and the Minister for Resources and Energy are receiving more favourable treatment under the way the MRRT is

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8 Mr Andrew Forrest, quoted in, Sue Lannin, Revised mining tax un-Australian: Forrest, *ABC News*, 13 June 2011, http://www.abc.net.au/news/stories/2011/06/13/3242507.htm (accessed, 14 June 2011).

9 Mr David Flanagan, Managing Director Atlas Iron, *Committee Hansard*, 8 November 2010, p. 5.

10 Mr Morgan Ball, CFO and Company Secretary, BC Iron Ltd, *Committee Hansard*, 8 November 2010, p. 6.

> designed than those competitors and potential future competitors who were excluded from the process when this tax was negotiated behind closed doors.
>
> Prof. Ergas—Yes, I think that is a reasonable summary of the situation. Essentially we have a tax that is in many respects a highly distorting tax but it is especially highly distorting in respect of those who were not included in its negotiation... .I do not believe it is competitively neutral. It is distorting the decisions that will be taken by the major established miners and will have significant distorting effects in that respect; but it is also distorting in terms of the allocation of resources between those established miners and potential, and at this point unknown, future challenges.[11]

Sovereign risk

5.14 As it is expected that demand for commodities from China and India will remain strong into the future,[12] Australia as a destination for foreign investment will increasingly compete with other suppliers of coal and iron ore. There is a concern amongst miners that the surprise announcement of the MRRT and extended PRRT has damaged Australia's reputation as a stable environment for such investment.

> The MRRT… continues to severely damage Australia`s sovereign risk and reputation as a safe place in which to invest.[13]
>
> [The MRRT] …is a direct transfer from shareholders to the government and also reinforces fears about sovereign risk.[14]

5.15 Perceptions of increased sovereign risk because of the proposed MRRT and PRRT, will see Australia face increased competition from lesser developed countries that have large, untapped reserves of mineral resources:

> The "Pilbara's of Africa" are a real danger to the people of Australia, because if they get their iron ore going at the level of the Pilbara then all those jobs, all those earnings and all those taxes will be enjoyed by other countries and not by Australia.[15]

5.16 Academics also share the concern that there could be a global response to the proposed changes to Australia's mineral taxation regime that reduces Australia's competitiveness as a supplier of resources:

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11 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Henry Ergas, *Committee Hansard*, 30 March 2011, p. 6.

12 Dr David Gruen, Executive Director Macroeconomic Group Australian Treasury, 'The Resources Boom and Structural Change in the Australian Economy', *2011 Economic and Political Overview Committee for Economic Development of Australia*, 24 February 2011.

13 Association of Mining and Exploration Companies, *Submission 3*, p 1.

14 Institute of Public Affairs, *Submission 15*, p 7.

15 Mr Andrew Forrest, CEO, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 19.

> The MRRT will make investing in Australian coal and iron ore projects less attractive than those overseas and less attractive than investing resources not subject to tax, and it will penalise high-risk projects, that is, compared to situations without such a tax. Moreover, the MRRT falls less heavily on mature projects that are included in a portfolio of Australian mining assets. It falls less heavily on those that have high market values and less heavily on miners who have ready access to overseas alternatives. And the three mining companies that negotiated the MRRT with the Gillard government have these exact characteristics.[16]

5.17 The Australia Institute, however, does not accept this argument and suggest that the concept of sovereign risk has been misconstrued by the mining industry:

> 'Sovereign risk' is a concept that the miners have re-introduced into the debate. It used to refer to the risk of nationalisation or expropriation in some third-world countries in the past. Nowadays, it seems to refer to just any tax increase that affects a mining company. For example, it was used in the context of the proposed emissions trading scheme. There is, of course, the 'risk' that any democratic country will change tax rates, environmental laws, industrial relations legislation, land rights and a host of other circumstances. But in a democracy, questions about spending and taxing are always subject to debate and change.[17]

5.18 Given the differing views held on what could be considered a first order issue for future economic growth in the sector, the matter of sovereign risk was raised with Treasury. Treasury officials advised that the matter is multifaceted:

> ...taxation arrangements are one consideration but only one consideration among many. And if taxation was the extent of sovereign risk that was of concern to a mining venture, it would be of a lesser order of magnitude in risk terms than many other forms of sovereign risk that one could find around the world in places that are well endowed with mineral resources... it is very difficult to make an assessment of the extent to which concerns about sovereign risk actually affect individual investment decisions.[18]

5.19 The Treasury view of taxation and sovereign risk differs from that of many professional economists. For example, Professor Fane wrote, in reference to the government's original RSPT proposal, that:

> The resource rent tax 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. 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

16 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 3.

17 Australia Institute, *Submission 14*, p 7.

18 Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 42.

> nationalisation, without compensation, of 40 per cent 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. Such a policy would only be non-distorting if the government could offer a cast-iron guarantee that it would never be repeated. 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.[19]

5.20 Treasury's view also contrasts with the reality of the experiences of industry participants. An illustration is the experience of Fortescue Metals Group Ltd who explained to the committee that, in recent capital raising negotiations, which occurred after the announcement of the MRRT and expanded PRRT, over 400 individual institutions raised concerns about sovereign risk:

> We had contact with 426 different institutions in our recent capital raising. Each one of them expressed their concern about the unnecessary, unpredictable and discriminatory basis of Australia’s purported taxation regime as considered under the MRRT. I say to you at the outset that this harms Australia. The very discussion harms Australia.[20]

5.21 It is clear that issues of sovereign risk affect the three multinational signatories to the Heads of Agreement to a lesser extent than they do local junior miners within the sector who do not share the same ability to spread their risk across different jurisdictions. This is the view of Fortescue Metals Group Ltd who observed that BHP Billiton, Rio Tinto and Xstrata all have investments in countries that are ultimately competing with Australia for market share.[21]

5.22 Indeed, Xstrata confirmed that this was the case and that, in considering investment, stability in 'fiscal type issues like tax and royalties' does play a part in the decision making process:

> Like any other business there is a finite amount of capital available for investment and so prospective projects from around the world are ranked and prioritised. In this context Australian projects must compete for investment capital with other projects in different geographies...

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19 G Fane, 'Reputation of Nation on the Line', *The Australian*, 31 May. 2010

20 Mr Andrew Forrest, Chief Executive Officer, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 18.

21 Mr Andrew Forrest, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 26.

> ...when we look at investing in countries around the world—and we have investments in 19 countries, some in Africa, some in South America, obviously here in Australia, New Caledonia and so forth—we look at the level of stability that we expect to get in terms of fiscal type issues, like tax and royalties and so forth, and we understand what changes have happened historically, the nature of the decisions the governments have made and whether or not we should be concerned about big changes in the future in those sorts of policies. Then we make investment decisions on our perception of risk.[22]

A flawed foundation – pure resource rents do not exist

5.23 The committee considers that of the design concerns raised during the inquiry process, the most notable is a concern held by many academic economists that although the concept of pure economic rents works in theory on the presumption that such taxes have no effect on investment behaviour, in practice, they are bound to fail.

5.24 Professor Pincus, a Visiting Professor of Economics at the University of Adelaide, explained why, in his view, pure rent taxes cannot exist, in reality:

> ...it is not feasible to tax mining in a neutral way such that the industry is unchanged except that the owners obtain less profit. If such a neutral tax did exist then it would be a tax on pure rents, and on pure rents only. Although the concept of a frictionless machine is very useful in theory, in practice no such machine exists; similarly, the concept of a tax on pure rent is useful in theory but in practice no such tax can exist. The definition of pure rent is, 'A payment made to the owners of a productive input which is in excess of that which is necessary to bring the productive input into being.' Nature put minerals in the ground and put them there with no payment. Thus, by definition, any payment for ownership rights over those minerals in the ground is pure rent. So, in theory, any tax on those pure rents, even a 100 per cent tax, will not alter the amount that is in the ground. In contrast, almost nothing else would come into existence in a market economy unless somebody is paid for the effort, the knowledge and the risk necessary to bring things into being. If a tax reduces those rewards then the tax will discourage production of all those other things.[23]

5.25 Professor Pincus explained that the gap between economic theory and practice can be attributed to information asymmetry and that reliance on generalised assumptions results in the failure of the economic theory when it is applied to real life situations:

> So there is a gap between economic theory and practice, and that gap arises because mining companies have information about their activities that is not

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22 Mr Peter Freyberg, Chief Executive Officer, Xstrata Coal, *Committee Hansard*, 13 December 2010, pp. 17, 30.

23 Professor Jonathan Pincus, Visiting Professor of Economics, University of Adelaide, *Committee Hansard*, 30 March 2011, p. 1.

> available to government. Thus, a taxing authority cannot, with perfect accuracy, divide mining profits into two piles: that which is due to the value of minerals in the ground; and that which is due to the efforts, talents and risk taking of the owners, the workers and the suppliers. A tax will inevitably fall on some revenues that are not pure rents. The abandoned super profits tax is not a knife you can take to a magic pudding, which is the mining industry, cut out a slice and leave the pudding no smaller.[24]

5.26 The view that achieving economic rents in the resource sector requires investment by both public and private enterprise, and that there must therefore be some incentive for private investment to be undertaken, was a common observation made by economists who appeared before the committee:

> Essentially, the Henry review is saying: 'Virtually all of this resource rent is available for capture if government wants to, it could all be taken by government, and we'll set a rate that's a bit lower.' But in fact there are these opposing drivers for resource rents: there is clearly a strong government role for both the investment reason and the capital reason, which suggests that the resource rents or the amount of capture by government should be well above zero; and there is also a very strong private interest in there, which means that any tax on resource rents or any royalties should be well below 100 per cent. The resource super profits tax and the minerals resource rent tax are both in the middle somewhere—it is just that the Henry review did not explain why it is in the middle. The Henry review just came up with a number, but there was really no justification there for it. That is the first key problem—that we need a lot more rigorous analysis.[25]

5.27 Professor Rolfe, a Professor in Regional Development Economics from Central Queensland University, went as far as suggesting that the Henry Tax Review had been simplistic in its approach and had not adequately accounted for the role of both public and private investment in generating resource rents.[26] In his opinion:

> The Henry review downplays the important role that property rights and private investment have, as well as public investment, in creating resource rents. This is where there is a difference between text book economics and the real world. In textbook economics it assumes that we have a resource out there, and because of its physical location and the fact that you cannot shift it, it can earn these super profits. It takes that as a given and then looks to the ways of allocating those super profits, or rents as we call them. The problem is that both public investment and private investment over time create those rents.[27]

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24 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 1.

25 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 44.

26 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 44.

27 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 43.

Revenue, spending and structural deficit under the MRRT and PRRT

5.28 The revenue projections surrounding the RSPT, MRRT and expanded PRRT have been the focus of much scrutiny since the first announcement of resource rent tax reform. This section of this chapter explores the revenue and spending implications of the MRRT and the PRRT and, in doing so, exposes the structural deficit that is associated with its fiscally irresponsible combination of volatile and reducing tax revenues and the increasing cost of associated budget measures. That cost of associated budget measures per annum progressively increases beyond Treasury's revenue projections for the MRRT.

Revenue under the RPST, MRRT and the PRRT

5.29 Commentators have pointed out that historically, revenues from resource rent taxes in Australia have been notoriously difficult to predict with a great deal of accuracy. For example:

> Using Treasury’s own Budget forecasts of revenue for the Petroleum Resource Rent Tax (PRRT) over the past 10 years, versus actual revenue collected from that tax during each of those years, it is apparent that Treasury’s revenue forecasts have been out by as much as 86 per cent in a single year.
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> In 1997-98, the difference was 6.71 per cent, in 1998-99 it was -56.35 per cent; 1999-00: 64.44 per cent; 2000-01: 85.86 per cent; 2001-02: -4.83 per cent; 2002-03: 12.63 per cent; 2003-04: -8.75 per cent; 2004-05: 32.64 per cent; 2005-06: 42 per cent; 2006-07: -35.98 per cent; 2007-08: -5-51 per cent; 2008-09: -28.12 per cent. Check for yourself.
>
> No wonder Ms Gillard wants the nation to look forward, looking at Treasury’s history of preparing economic advice based on its forecasting of commodity prices shows that it is hopeless.
>
> Ms Gillard and Mr Swan want the nation to believe they are presenting hard economic data to justify their claims to economic responsibility but the figures they present are as firm as a dissolving blancmange.[28]

5.30 The government has never acknowledged the following basic fact: that other things being equal, a tax which produces a revenue stream which is highly volatile (or more precisely, highly correlated with overall economic activity) should have a lower value attached to it than a tax which produces the same revenue on average, but is less volatile.

5.31 In other words, the risk or uncertainty attached to resource rent tax revenues is an important component of their value to the Australian community. As Ergas, Pincus and Harrison (2010) wrote:

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28 P, Akerman, 'Gillard is Smoke and Mirrors Surpluses', *The Daily Telegraph*, 15 July, 2010,

> Public discussion of, including government commentary on, the RSPT and now the MRRT has focussed on the "rivers of gold" that it is claimed these taxes will yield. However, these claims embody fiscal illusion. When valued appropriately, the transfer of wealth from the miners to the taxpayers is less, possibly far less than is suggested by Treasury estimates of tax collections...
>
> ...In short, far from yielding "rivers of gold," such taxes yield highly risky returns, which taxpayers would rationally discount substantially in arriving at an estimate of the social value of the income stream. However, the promise of such "rivers," unaccompanied as it is (not least in AFTS) by any qualification as to the risk being placed on taxpayers, encourages fiscal illusion, that is, an underestimate of the social cost of funding spending commitments. This seems to make it more likely that such taxes will serve to increase low value public spending, compounding the inefficiencies involved in raising the revenue.[29]

5.32 When the RSPT was announced in the 2010-11 Commonwealth Budget, the government forecast that it would raise $12 billion over the forward estimates period.[30] The $12 billion is the summation of the first two years operation of the MRRT, that is, from 2012-13 to 2013-14, as set out in the first line of the table below.

Table 5.1: Revenue from the MRRT 2012-13 and 2013-14[31]

Stronger, fairer, simpler tax reform — resource super profits tax

Revenue ($m)	2009-10	2010-11	2011-12	2012-13	2013-14
Australian Taxation Office	-	-	-	3,000.0	9,000.0
Related expense ($m)					
Australian Taxation Office	*-*	*7.7*	*23.9*	*32.2*	*27.3*
Related capital ($m)					
Australian Taxation Office	*-*	*-*	*9.8*	*5.6*	*-*

5.33 Following the revision of the proposed RSPT to the MRRT and expanded PRRT, the government updated its revenue forecasts. Initial projections suggested that revenue to be collected from the much narrower MRRT (which would apply only to coal and iron ore and at an effective rate of 22.5 per cent rather than 40 per cent) and the expanded PRRT, was not significantly less than that for the RSPT and over the forward estimates period (over its first two years of operation) would raise $10.5 billion.[32] The MRRT and expanded PRRT would raise only $1.5 billion less than the RSPT.

29 Ergas, H. Harrison, M. and Pincus, J. (2010), *Some Economics of Mining Taxation*, Economic Papers, 29(4): 369-383, pp 380, 382.

30 Department of the Treasury, *Federal Budget 2010-11*, *Budget Paper No.2*, p. 45.

31 Department of the Treasury, *Federal Budget 2010-11*, *Budget Paper No. 2*, p. 45.

32 Department of the Treasury, (accessed 6 May 2011).

5.34 The lack of significant difference between the revenue estimates over the forward estimates under a universal RSPT and its much narrower replacement, the MRRT, was questioned at the time. It was in fact an issue raised by the previous Senate Select Committee on Fuel and Energy. Evidence given by Treasury to that committee explained that the difference in the revenue forecasts was the result of changes to the assumptions (in particular significant increases in undisclosed commodity price assumptions) on which the estimates were based and the smaller scale of the MRRT's application.

> ...The $12 billion figure for the RSPT was, if you like, a whole system costing—that is, it took the RSPT gross revenue, netted off royalty refunds, accounted for the deductibility of RSPT payments in corporate income tax. So in the number there was the corporate income tax effect. It also took into account the effect of changed company tax payments at the personal level, so it was a full system costing. The same full system costing has been done for the MRRT—that is, netting off royalties to the extent that MRRT payments are in excess of royalties, otherwise creditable, taking account of the effect under company tax and also under personal tax. The whole system, the nature of the costing, is unchanged in that sense, but embedded in that are a number of ups and downs by taking into account the interactions between the profits based tax and the corporate income tax and at the shareholder level.
>
> So the differences in the costing come about for two reasons: one we have already explored, which is the change in commodity prices that have occurred since budget time, and the other effect that is relevant is the smaller scope of the MRRT compared to the RSPT in particular. In fact the MRRT applies only to coal and iron ore and the RSPT was to apply to the whole sector.[33]

5.35 This, however, did not explain why a uniform resource rent tax such as the RSPT would only raise $1.5 billion more than a narrow MRRT and expanded PRRT over the forward estimates period. The committee sought to understand how the base assumptions had changed and repeatedly requested that information from the Treasury.

> CHAIR—...Revenue estimates from the mining tax keep bouncing around quite a bit, based on changes in underlying assumptions. Are you now in a position to release those assumptions?
>
> Dr Henry—The government released a Mid-Year Economic and Fiscal Outlook recently which contained our most up-to-date forecasts for revenue from the mining resource rent tax. The Mid-Year Economic and Fiscal Outlook indicated the assumptions upon which those most recent estimates were based. As I am sure the committee would be aware, the revenue estimates are sensitive to movements in both commodity prices and exchange rates... That [recent] movement in the exchange rate has had a

33 Mr David Parker, Department of the Treasury, Senate Select Committee on Fuel and Energy, *Committee Hansard*, 5 July 2010, p. 14.

> significant impact on a number of heads of revenue, but the mining resource rent tax revenue is one of those. The Mid-Year Economic and Fiscal Outlook explains how that occurs and sets out the assumptions with respect to the exchange rate, anyway, and commodity prices upon which the MRRT revenue forecast has been based.[34]

5.36 The Treasurer never volunteered the reasons for the small fiscal impact over the forward estimates of the significant change in scope of the newly proposed resource rent tax. The Treasurer again had to be forced to – eventually – make the concession that the reason was significant increases in commodity price assumptions in particular. As detailed in Chapter 3, the government's unwillingness to release assumptions and modelling has exacerbated uncertainty around the taxes' potential operation. Continued requests for the government to release the modelling assumptions were denied by the Treasurer on the grounds that the information was supposedly commercial-in-confidence and its release would be a breach of that confidence.[35] This is in contrast to the actions of both the governments of Western Australia and Queensland which publish their commodity price, production volume and exchange rate assumptions in their budget papers.

Revenue, Mid-year Economic and Fiscal Outlook: more volatility

5.37 Despite a reluctance to release the assumptions on which the revenue projections have been based, the government has repeatedly acknowledged the severe volatility of the revenue that is forecast to be generated by the proposed MRRT and expanded PRRT. In the 2010-11 Mid Year Economic and Fiscal Outlook the government stated:

> The potential for a renewed deterioration in the major advanced economies and transmission of weakness to the developing world presents considerable risks to the domestic economic outlook...risks surrounding the global economy have heightened in recent months. Were the global economy to falter, it is likely that Australia would be affected through both financial and trade channels, including through lower prices for our key commodity exports. Australia's terms of trade and income growth are heavily influenced by the prices of several key non-rural commodities that are currently trading around record levels and which are highly sensitive to demand from the Asian region... the continuing uncertainty around the growth prospects for many of the world's major economies...is a potential source of volatility for budget estimates.[36]

34 Senator Mathias Cormann, Chair Senate Select Committee on the Scrutiny of New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 2.

35 Treasury Portfolio, answer to question on notice, 20-21 October 2010 (received 2 February 2011).

36 Department of the Treasury, *Mid Year Economic and Fiscal Outlook, 2010-11*, pp 9, 11, 23.

5.38 The 2010-11 Mid Year Economic and Fiscal Outlook (MYEFO) showed that the revenue projections from the proposed MRRT and expanded PRRT had been revised down. The volatile nature of the factors underpinning the MRRT and the expanded PRRT revenue were beginning to be demonstrated:

Table 5.2: Revenue volatility of the MRRT[37]

Stronger, fairer, simpler — improved resource taxation arrangements

Revenue ($m)

	2009-10	2010-11	2011-12	2012-13	2013-14
Australian Taxation Office	-	-	-	-1,000.0	-6,500.0

5.39 These revised revenue forecasts were explained as having been revised down as a result of 'significant volatility':

> As the global supply of iron ore and coal increases, the medium-term outlook is for Australia's terms of trade to decline. However, the rapid pace of economic development in emerging Asia... underpins expectations that the medium term decline will be gradual, notwithstanding the potential for significant volatility over shorter time horizons.[38]

Revenue - Commonwealth Budget 2011-12: more volatility

5.40 More recently in its 2011-12 Federal Budget, the government acknowledged that the MRRT and expanded PRRT are:

> ...a highly variable source of revenue as they are heavily influenced by commodity prices and exchange rate levels.[39]

5.41 The budget went on to explain that in 2012-13:

> ...revenue from resource rent taxes is expected to grow by 295 per cent ($6.0 billion) largely reflecting the MRRT commencing in 2012-13.
>
> In the projection years, revenue from resource rent taxes is expected to grow by 9.6 per cent in 2013-14, but decline by 17.6 per cent in 2014-15. These changes largely reflect changes in forecast commodity prices and anticipated production trends.[40]

5.42 Although the budget did not identify specific revenue projections over the forward estimates period, it did acknowledge that an increase in the global supply of commodities such as coal and iron ore (presumably from the 'Pilbara's of Africa'):

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37 Source: Department of the Treasury, *Mid-Year Economic and Fiscal Outlook 2010-11*, p. 226.

38 Department of the Treasury, *Mid Year Economic and Fiscal Outlook, 2010-11*, p. 3.

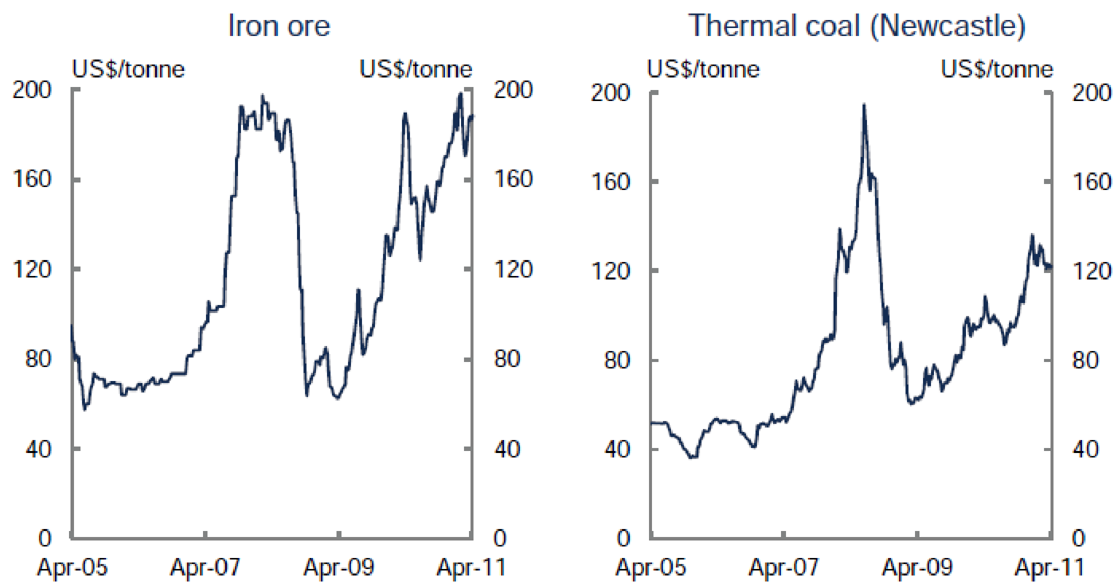
39 Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 5: Revenue*, p. 5-29.

40 Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 5: Revenue*, p. 5-29.

> ...is expected to weigh on commodity prices over the next two years, with further gradual commodity price declines projected over the medium term. The terms of trade are forecast to fall ¼ of a per cent in 2011-12 and 3 per cent in 2012-13, largely reflecting a modest fall in non-rural commodity prices.[41]

5.43 Chart 5.1 below illustrates the volatility associated with commodity prices.

Chart 5.1: Volatility of commodity prices[42]



Source: Bloomberg and Global Coal.

5.44 The view that revenues sourced from the mining sector are highly speculative as they are based on highly volatile commodity prices, and therefore that forecasts made often turn out to be inaccurate and require revision is a view held by more than just the Department of the Treasury.

> The revenues from taxes such as the RSPT or the MRRT are usually overstated because these revenues are risky. The failure to take account of the risky character of those revenue streams could lead to fiscal illusion and make it more likely that unwise public spending commitments will be made. The background is that the government is planning to spend the forecast revenues—they are in the forward estimates. Without the mining tax revenues the government will have to cut its spending if it is to meet its announced fiscal targets. The Treasury has made various forecasts of the expected revenues from the proposed mining tax; some of them tens of

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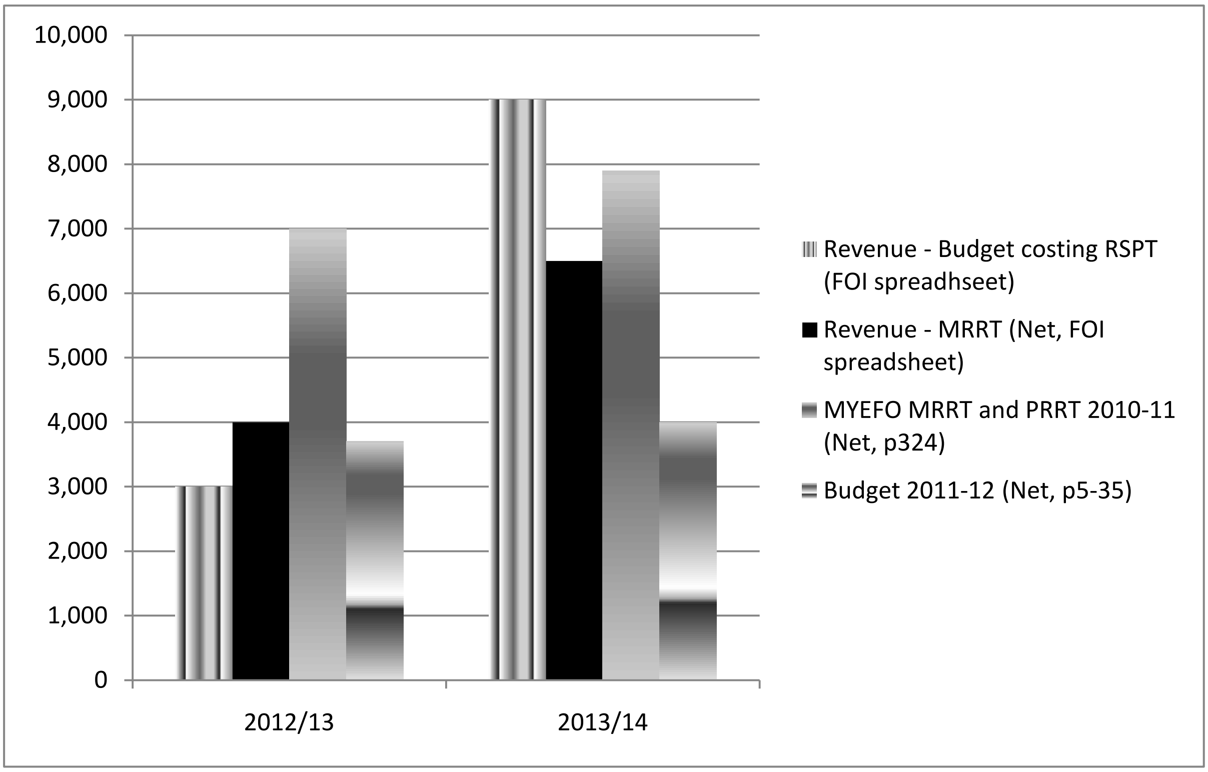
41 Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 2: Economic Outlook*, p. 2-28.

42 Source: Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 2: Economic Outlook*, p. 2-28.

billions of dollars larger than others. To note this is not to criticise Treasury forecasters; nobody can accurately and consistently predict the future.[43]

5.45 The history of the volatility is set out below. It covers the Treasury Freedom of Information costing for the RSPT, the net revenue for the MRRT in the Freedom of Information release by Treasury, as well as the 2010-11 Mid Year Economic Forecast and Outlook and the Commonwealth Budget. The Net figure used below 'represents the net impact on receipts across several different revenue heads. This includes offsetting reductions in company tax, crude oil excise and interactions with other taxes'.

Chart 5.2: RSPT and MRRT Revenue ($billions)[44]



Revenue raised from the MRRT

5.46 Table 5.3 below provides a summary of the Treasury projections of MRRT revenue at the time the government signed the MRRT Heads of Agreement.

Table 5.3: Revenue breakdown from MRRT[45]

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43 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 3.

44 Department of the Treasury, *Mid-Year Economic and Fiscal Outlook 2010-11*, p.283; Department of the Treasury, *Budget Strategy and Outlook – Budget Paper No.1 2011-12*, p. 5-35.

Year / Total	Iron Ore ($m)	Coal ($m)	TOTAL MRRT ($m)
2012-13	3,500	500	4,000
2013-14	5,000	1,500	6,500
2014-15	4,500	2,000	6,500
2015-16	3,500	2,000	5,500
2016-17	2,000	2,000	4,000
2017-18	1,500	1,500	3,000
2018-19	1,500	1,500	3,000
2019-2020	1,500	1,500	3,000
2020-21	2,000	1,000	3,000
Total	**25,000**	**13,500**	**38,500**

Costs of measures associated with the MRRT and expanded PRRT

5.47 Despite repeated requests for information about the projected fiscal impact of the various budget measures associated with the MRRT and expanded PRRT, at the time of printing, the government had refused to provide it. However, information contained in recent Commonwealth Budgets has enabled a construction of the cost to the Budget of measures associated with the MRRT and expanded PRRT. Those costs related principally to the cost of foregone taxation revenue as a result of the proposed increase of compulsory super contributions from 9 to 12 percent, the foregone revenue associated with a reduction in the company tax rate and spending over ten years through the regional infrastructure fund.

45 Source: Treasury Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011).

Cost of the phased increase of compulsory super contributions from 9% to 12%

5.48 The increase in the superannuation guarantee was announced as part of the original RSPT measures and was carried over into the MRRT and expanded PRRT initiatives. The superannuation guarantee rate will rise from 9 per cent to 12 per cent in 2019-20. The measure starts in 2013-14. Table 5.4 below provides an overview of the measures.[46]

Table 5.4: Cost of the increase in the compulsory superannuation levy[47]

Year / Total	Rate of the compulsory Superannuation Guarantee (%)	Revenue foregone ($ millions)
2013-14	9.25	240[48]
2014-15	9.5	520
2015-16	10.0	1,136
2016-17	10.5	1,752
2017-18	11.0	2,368
2018-19	11.5	2,984
2019-20	12.0	3,600[49]
2020-21	12.0	4,200[50]
Total		**16,800.0**

Company taxation rates

5.49 The cost to revenue of funding a reduction in the company income tax rate has been projected using the limited information available to the committee. The committee has sought to obtain more accurate information through Senate processes however, such information has not been forthcoming.

46 Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 18 April 2011.

47 Parliament of Australia, Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 18 April 2011.

48 Department of the Treasury, *Budget 2010-11, Budget Measures, Budget Paper No.2*, p.42.

49 Department of the Treasury, *Budget 2010-11, Budget Measures, Budget Paper No.2*, p.42.

50 Estimate.

5.50 Table 5.5 below provides an overview of the projected cost of the reduction in company taxation rates:

Table 5.5: Revenue foregone as a result of the cut to company tax

Year / Total	Cost of revenue forgone as a result of the reduction it the company tax rate ($ millions)
2010-11	
2011-12	0
2012-13	400.0
2013-14[51]	1,450.0
2014-15[52]	1,493.5
2015-16[53]	1,533.8
2016-17	1,575.2
2017-18	1,617.8
2018-19	1,661.4
2019-20	1,706.3
2020-21	1,752.4
Total	**13,191.0**

51 For 2011-12 – 2013-14, please refer to Budget - 2010 - p.39; Budget - 2010 - p.43; MEYFO - Appendix A, Part 2 - policy decisions taken between the 2010-11 Budget and the 2010 PEFO; Economic Statement 2010 - p. 24.

52 Projection from 2014-15 increased at Budget 2011 forecast economic growth rate of 3.0%.

53 Projection from 2015-16 increased at the Inter-generational report (40 year average) of economic growth rate of 2.70%.

Regional Infrastructure Fund and Regional Development Australia Fund

5.51 The table below provides an overview of infrastructure spending measures associated with the MRRT and expanded PRRT.

Table 5.6: Cost of the Regional Infrastructure Fund

Year / Total	**Cost of regional infrastructure spending ($ millions)**
2010-11	12.0
2011-12	42.4
2012-13	704.3
2013-14	866.8
2014-15[54]	665.5
2015-16[55]	618.0
2016-17	618.0
2017-18	618.0
2018-19	618.0
2019-20	618.0
2020-21	618.0
Total	**6,000.0**

The structural deficit

5.52 The previous sections of this report highlighted the volatility associated with the MRRT and the expanded PRRT. Since the announcement of the RSPT there has been considerable volatility in the factors, such as exchange rates and commodity prices, that underpin the revenue stream. As outlined above, the spending and revenue commitments represent a substantial outlay of funds.

54 For figures covering 2010 to 2015, please refer to 2011-12 *Budget Papers, Australia's Federal Relations, Budget Paper No.3,* 2011-12, p. 74 -75 – 10 May 2011

55 For expenditure over the period, 2015-16 to 2019-2020 please note that it comes from the difference between $6.0 billion, which is the total infrastructure spending committed against the MRRT and the amount spent as 2014-15 (the last year of the Budget forecast) which is $2.3 billion. The figure of $2.3 billion is then divided by the remaining years of forecast MRRT outlays to 2020/21, which is 6 years. This gives an average of $618 million.

5.53 The table below provides a comparison of the outlays and revenue associated with the MRRT:

Table 5.7: Structural deficit under the MRRT

Year / Total	Revenue raised from the MRRT ($ millions)[56]	Combined cost of measures associated with the MRRT ($ millions)
2010-11		12.0
2011-12		42.4
2012-13	4,000.0	1,104.3
2013-14	6,500.0	2,556.8
2014-15[57]	6,500.0	2,678.5
2015-16[58]	5,500.0	3,288.0
2016-17	4,000.0	3,945.4
2017-18	3,000.0	4,604.0
2018-19	3,000.0	5,263.6
2019-2020	3,000.0	5,924.3
2020-21	3,000.0	6,570.6
Total	**38,500.0**	**35,989.9***

*final total may not add exactly due to rounding various sources

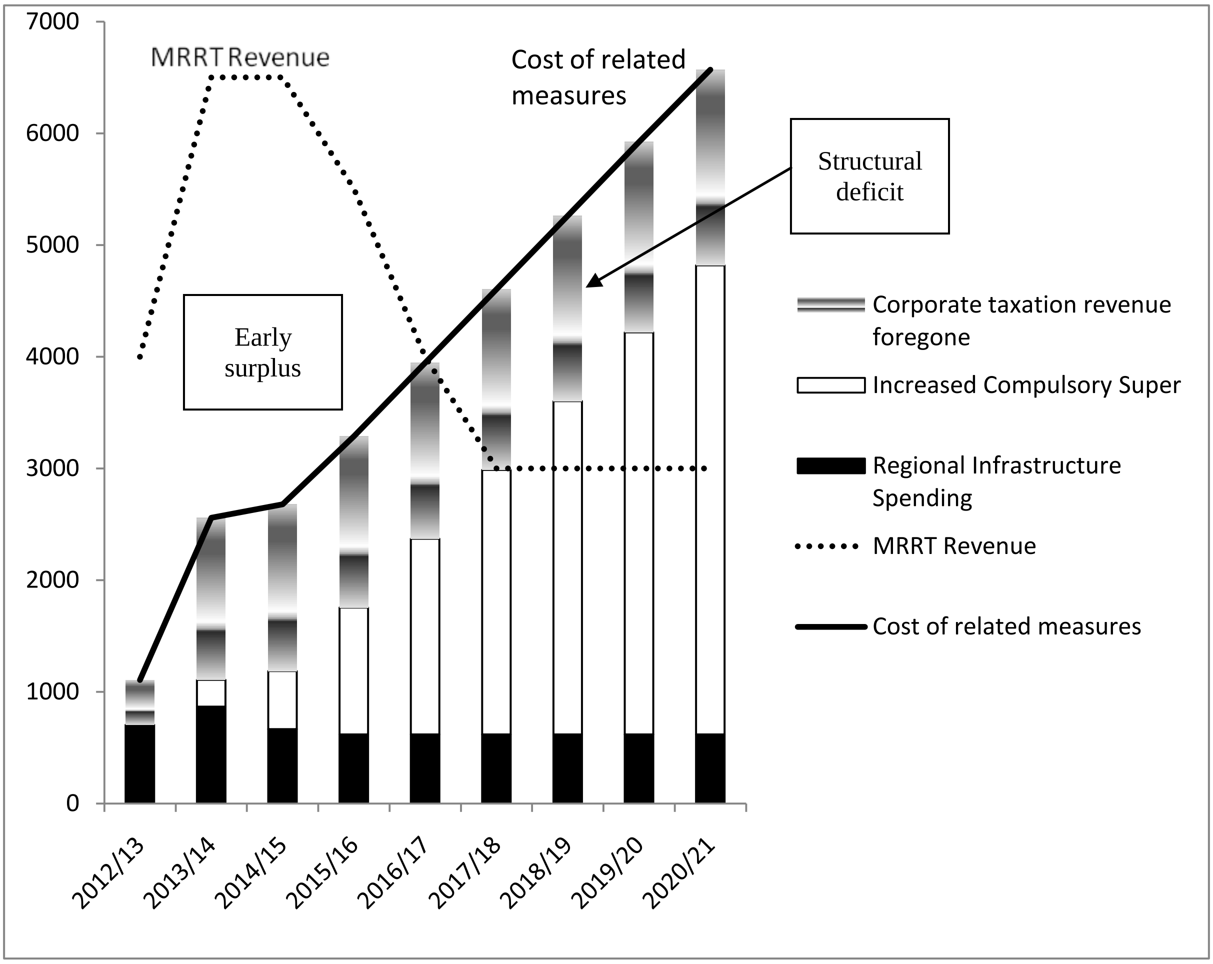
5.54 The chart below overlays the revenue and associated spending and revenue foregone from the MRRT. It is clear from the graph that there is a structural deficit associated with the fiscally irresponsible combination of taxing and spending from the flawed MRRT.

56 Source: Treasury Freedom of Information release: (accessed 20 June 2011).

57 For figures covering 2010 to 2015, please refer to *Budget Papers 2011-12, Australia's Federal Relations, Budget Paper No.3,* 2011-12, pp. 74 -75.

58 For expenditure over the period, 2015-16 to 2019-2020 please note that it comes from the difference between $6.0 billion, which is the total infrastructure spending committed against the MRRT and the amount spent as 2014-15 (the last year of the Budget forecast) which is $2.3 billion. The figure of $2.3 billion is then divided by the remaining years of forecast MRRT outlays to 2020/21, which is 6 years. This gives an average of $618 million.

Chart 5.3: Structural deficit under the MRRT ($ billions)



5.55 This chart demonstrates how the mining tax and related budget measures were designed in such a way to ensure it helped create the illusion of an early surplus, with the increasing cost of related budget measures concentrated in the period beyond the forward estimates.

5.56 It is important to note that, since the Treasury modelling of the mining tax deal with the big three miners, revenue estimates for the MRRT have been downgraded in the budget, principally as a result of Australia's strong exchange rate. The MRRT is now expected to raise $3.7 billion in 2012-13 instead of 4 billion, $4 billion in 2013-14 instead of $6.5 billion and $3.4 billion in 2014-15 instead of $6.5 billion.[59]

5.57 It is also important to note that the above projections have not been able to explicitly account for the cost of other measures announced as part of the government's mining tax proposal. Other changes include instant write-off and simplified depreciation for small business, the refund of superannuation contributions for low income earners and the $50,000 concessional cap for super balances under

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59 Department of the Treasury, *Budget 2011-12, Budget Paper 1*, p. 9-17.

$500,000. All of these were announced as part of the government’s response to the Henry Tax Review. In that announcement, these three initiatives were costed at $2.645 billion in 2013-14.[60]

5.58 Adding these additional commitments means that the MRRT and expanded PRRT combined with the related budget measures are projected to become even more of a burden on the budget beyond the forward estimates. All other things being equal, this would create a significant structural deficit over the medium to long term.

5.59 Indeed, the year in which the MRRT and expanded PRRT would raise the most revenue would be in its first year of operation (2012-13), before many of the related budget measures begin to take effect. It seems like a convenient coincidence for the government that this year corresponds with the year in which they seek to return the budget to surplus. The government’s mining tax would therefore, appear to be more to do with returning the budget to surplus in one year at the cost of creating a permanent structural budget deficit for the longer term.

5.60 Economists who appeared before the committee commented on the importance of what is done with revenues gained as a result of the proposed resource rent tax arrangements and were critical of the government's intention to spend them. They are of the view that such spending would result in future deficits:

> Prof. Pincus—...the intention to spend the revenue and rely upon its coming is a bad idea. Let me make an analogy: state governments found themselves with huge inflows of stamp duties during the property boom. Once that boom stopped, they said, ‘Oh, we’re short of money!’ That is an inappropriate allocation of expenditures over a period of years. Do not spend so much in the good years and do not collapse the expenditure so much in the bad years. So the proposition we are making is that it is inappropriate to plan to spend the best estimate that the Treasury has made. The best estimate that Treasury makes for a whole lot of other taxes, fine, but for the—
>
> CHAIR—So the risk is that you essentially set yourself up for a structural deficit because your spending is in line with revenue expected at times when commodity prices and revenues are high, and then when the revenues drop you have a gap.[61]

A way forward

5.61 To address this concern of future deficits, some economists suggested that proceeds from any such tax arrangements may be better invested in longer term capital assets rather than being used by government in the recurrent revenue and expenditure mix:

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60 Australian Government 2010, *The Resource Super Profits Tax: A Fair Return to the Nation*, p. 16.

61 Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 12.

> A major problem with the Henry review in this area, and the subsequent justification of the resource tax, is that it does not put enough focus on capital. Clearly, an argument is that the resource tax is appropriate to minerals because it is relying on extractive industries. But the real economic argument, the sustainability argument, is that as we deplete natural capital it should be replaced with other forms of capital. The idea is that your total capital stock does not fall. So, clearly, you do not want proceeds out of extractive resources to go into consumption because that is running down your capital base. That is the Nauru example. So there should be a stronger sustainability framework and there should be much more clearly a very transparent system for saying that reductions in natural capital will be replaced by other forms of capital.[62]

5.62 The Organisation of Economic Cooperation and Development (OECD) has noted the risks of not acting prudently with the funds of the MRRT and the PRRT. They particularly note the risk of linking future public spending decisions to fluctuating tax revenues:

> If resource revenues are spent as they come in, which occurred to some extent in the boom of the 2000s, fiscal policy risks being pro-cyclical. *To avoid such risks, public spending decisions should be disconnected from the fluctuations in tax revenues caused by commodity price movements. While Australia's circumstances differ in important respect from other commodity producing countries, the authorities should nevertheless consider creating a reserve fund endowed with all resource tax revenues to assist in shielding the budget and the real economy from the effects of revenue volatility*.[63] (Emphasis in original)

Consequences for the broader economy

5.63 The implementation of the proposed tax will have consequences for the broader economy. In a recent report, the World Bank observed that:

> [f]rom a macroeconomic perspective, the optimal level [of taxation] is one that maximises the net present value of the social benefits flowing from the mineral sector, including government tax receipts, over the long term. This implies a balance, because if taxation is too high, investment and the tax base will decrease as investors shift their focus to other alternatives, and if taxation is too low, the nation will lose revenue useful to serve the public welfare.[64]

5.64 In making this observation, the World Bank noted that governments, when determining the optimal level of taxation, can look to empirical evidence of investor

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62 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 43.

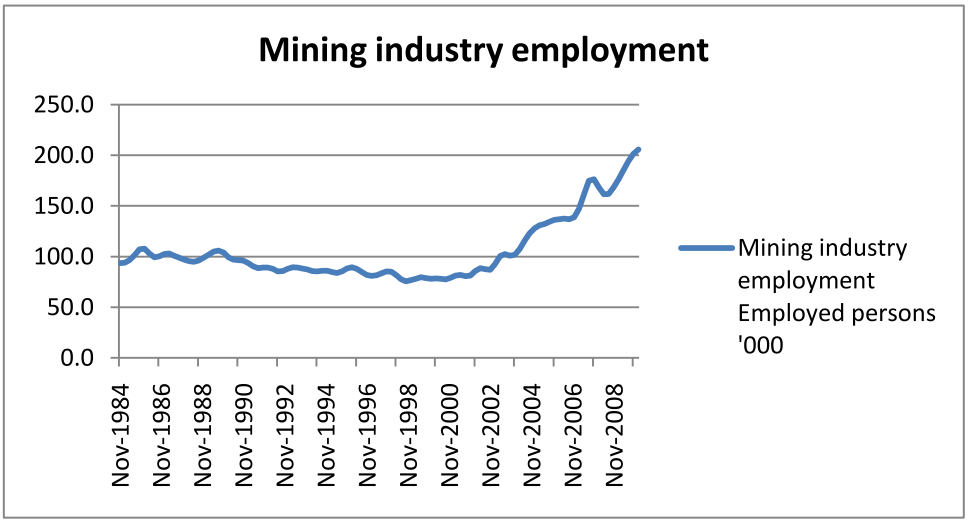
63 Organisation of Economic Cooperation and Development, *OECD Economic Surveys: Australia: November 2010*, p. 9.

64 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 266.

perceptions and behaviour.[65] In the Australian context this requires that consideration be given to how job losses in the mining industry would translate across other industries.[66]

5.65 Data released by the Australian Bureau of Statistics identifies that as at February 2011, the Australian mining industry employed 205,800 persons, an increase from 76,900 just 10 years ago.[67]

Chart 5.4: Mining Industry employment[68]



5.66 Bearing in mind that the mining industry in Australia has a multiplier effect of three, any job lost in a mine as a result of decisions to move investment to other jurisdictions, could translate into the loss of another three jobs in the community, for example in industries such as retail, health provision, education and property.[69]

5.67 The mining industry relies heavily on investment. If the proposed change to Australia's resource rent taxation regime does result in a change in investment behaviour and investment is driven offshore there will be negative consequences for employment.

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65 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 266.

66 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 223.

67 Australian Bureau of Statistics, *6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, Feb 2011*, 17 March 2011.

68 Source: Australian Bureau of Statistics: 6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, Feb 2011, 17 March 2011.

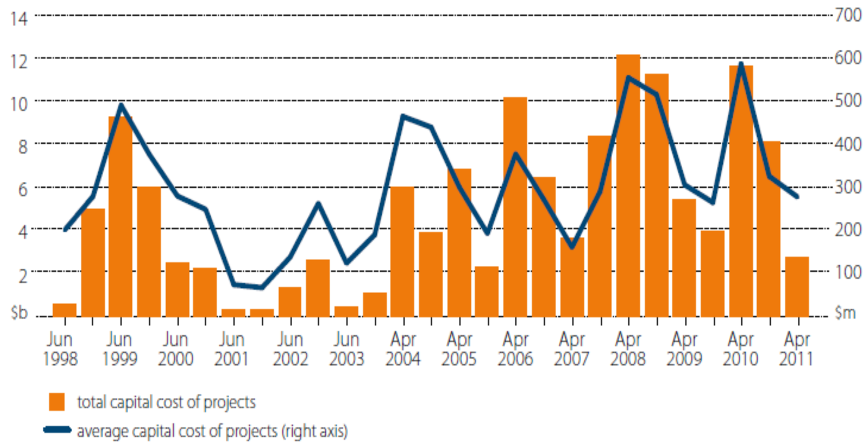
69 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 223.

5.68 In its *Major development projects –April 2011 listing*, the Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences identified that:

> The value of completed [mineral and energy] projects is the lowest since October 2005...Both in terms of total capital cost and average capital cost, the number of completed projects was lower than the previous listing and below the average (in 2010-11 dollars) for the previous eight years.[70]

5.69 Clearly, as identified by ABARES-BRS, investment in mineral and energy projects has declined since the announcement of a mining tax.

Chart 5.5: Completed projects, June 1998 to April 2011, total and average capital costs[71] (2010-11 dollars)



5.70 In fact, the World Development Report of 2005, when considering what constitutes a good investment climate suggested that:

> A good climate focuses on, among other things, minimising costs caused by taxation and policy uncertainty.[72]

5.71 The government would do well to keep this in mind and heed the advice of the World Bank that investors:

> ...take taxation into consideration when deciding where to invest.[73]

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70 Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences, *Minerals and energy, Major development projects – April 2011 listing*, 26 May 2011, p. 5.

71 Source: Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences, Minerals and Energy, *Major development projects – April 2011 listing*, 26 May 2011, p. 5.

72 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 215.

73 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 216.

5.72 A survey of mining companies that ranks the most important investment considerations, identified four tax related criteria in the top 20 issues that they take into account when determining investment.

Table 5.8: Mining company ranking of investment decision criteria (out of 60 possible criteria)[74]

Importance Ranking		
Exploration stage	*Mining stage*	*Investment decision criteria*
1	n.a.	Geological potential for target mineral
n.a.	**3**	**Measure of profitability**
2	1	Security of tenure
3	2	Ability to repatriate profits
4	9	Consistency and constancy of mineral policies
5	7	Company has management control
6	11	Mineral ownership
7	6	Realistic foreign exchange regulations
8	4	Stability of exploration and mining terms
9	**5**	**Ability to predetermine tax liability**
10	8	Ability to predetermine environmental obligations
11	**10**	**Stability of fiscal regime**
12	12	Ability to raise external financing
13	16	Long-term national stability
14	17	Established mineral titles system
15	n.a.	Ability to apply geologic assessment techniques
16	**13**	**Method and level of tax levies**
17	15	Import-export policies
18	18	Majority equity ownership held by company
19	21	Right to transfer ownership
20	20	Internal (armed) conflicts
21	14	Permitted external accounts
22	19	Modern mineral legislation

Source: Otto 1992a.
Note: n.a. = not applicable.

5.73 As illustrated, the idea that the isolated application of a rent tax to certain sectors of the mining industry will not affect investment behaviour or have flow on consequences for the broader economy is fundamentally flawed.

Committee comment

Committee comment – 'Big three miners'

5.74 The committee is greatly concerned that the government has negotiated the design of a new tax exclusively and in secret with just three taxpayers, excluding their competitors and all other stakeholders from that process. The committee is particularly troubled by this approach given it has led to a tax design which is manifestly not

74 Source: Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 216.

competitively neutral. It will make it harder for the small and mid-tier mining companies to compete with the big three who were given a seat at the table. That is a highly inappropriate precedent for the development of taxation policy and should not be allowed to stand. For this reason alone the Parliament should reject the government's proposed MRRT and expanded PRRT. The policy outcomes of this flawed process and the impact of this new tax design on competitive dynamics in this capital intensive industry, which by its nature, already favours larger more established miners are highly inappropriate and improper.

5.75 The committee understands that the three big mining companies were put in a very difficult position by the government. They were invited to attend a meeting and quite understandably accepted that invitation in the circumstances. Companies have a responsibility to act in the best interest of their shareholders, and they did. However, the Australian government is expected to act in the public interest and they did not.

5.76 The committee considers that it is incongruous that a government which claims to value innovation and research and development would design a tax that would hamper the capacity of smaller emerging miners to innovate, and therefore survive, in an increasingly competitive industry.

5.77 As identified in Chapter 4, the committee takes the view that the proposed taxes are not genuine 'root and branch' reform but are a simplistic and lazy approach to taxation reform resulting in an ad hoc tax grab which will, in reality, worsen the distortions in the taxation of Australian resources.

Committee comment – Sovereign risk

5.78 Despite Treasury's assertions that it is very difficult to make an assessment of the extent to which concerns about sovereign risk affect individual investment decisions,[75] the committee regards the experience of industry participants since the announcement of this proposed tax as more credible. In view of the miners' experiences, as put to our inquiry, the committee is concerned that the implementation of the MRRT and expanded PRRT will have a detrimental effect on future investment in Australia, and not only in the mining industry.

5.79 The committee acknowledges that it is the right of governments internationally to determine their tax policy settings and from time to time review and adjust those settings. However, the committee considers that major reform in any area of policy should be preceded by a period of open and transparent consultation and engagement. This did not occur prior to the announcement of the RSPT, MRRT or expanded PRRT. The committee is of the view that the government's flawed and secretive approach in these circumstances has done unnecessary damage to Australia's reputation as a stable destination for foreign investment. A change in tax policy

75 Dr Ken Henry, *Committee Hansard*, 22 November 2010, p. 42.

settings after a period of open, transparent and inclusive consultation would not have exposed Australia to the same damage to its international reputation.

Committee comment – resources rent taxes

5.80 The fact that the foundation of the design of the MRRT and expanded PRRT relies on contested economic theory raises serious concerns.

5.81 The committee acknowledges the evidence it received, that in reality pure economic rents do not exist and as a result, is concerned by the government's view that the application of a super profits (rent) tax to the mining industry would not have any effect on the behaviour of mining companies and other stakeholders. The committee's concerns are compounded in light of the role the sector played in helping Australia avoid economic meltdown as a result of the global financial crisis.

> A tax will inevitably fall on some revenues that are not pure rents. The abandoned super profits tax [RSPT] is not a knife you can take to a magic pudding, which is the mining industry, cut out a slice and leave the pudding no smaller. Neither is the new MRRT.[76]

5.82 The committee acknowledges that resources in the ground are the property of the people in each State. Importantly, those companies who take risks to develop those resources, investing time, money, resources, and effort, in an activity which ultimately leads to public benefits, have the right to be rewarded for their efforts. It is appropriate that the risk-reward equation recognises the significant risks involved today for those trying to set up the big successful mining companies of tomorrow.

5.83 The committee takes the view that the government needs to stop viewing the mining industry as a 'magic pudding' that can solve all its financial woes and give due regard to the importance of this sector of the economy to our economic prosperity moving forward.

Committee comment – structural deficit matters

5.84 One of the intentions of the RSPT as announced in the 2010-11 Budget was to ensure that the community received a fair return for its mineral resource wealth. That tax, based on the design put forward by the Henry Tax review, was intended to ensure efficiency and effectiveness and also to reduce complexity within the tax system. The committee takes the view that this has not been delivered through the proposed MRRT and expanded PRRT.

5.85 The proposed resource rent tax arrangements in no way achieve the aims of the Henry Tax Review. Rather than to simplify our tax system it makes it more complex, rather than fairer it makes it less fair and, rather than removing distortions, it increases them compared to the status quo.

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76 Professor Jonathan Pincus, *Committee Hansard,* 30 March 2011, p. 1.

5.86 The tax as it stands would undoubtedly have adverse consequences for jobs in the important mining industry as well as across the broader community given the multiplier effect of jobs in the mining industry.

5.87 The committee considers that what has been proposed is not reform. Rather, it is a simple and lazy grab for cash designed to create the illusion of an early surplus. Furthermore, the committee considers that targeting one specific industry experiencing a boom is short sighted. To then tie spending commitments to revenue projections based on the assumption that commodity prices, which are inherently volatile, will remain high is fraught with risk and would worsen the current structural deficit.

5.88 The committee is strongly of the view that the proposed resource rent taxes should be scrapped and not proceed. However, if the Parliament decided to support the MRRT and expanded PRRT, the revenues raised should be used exclusively to pay off debt and, once debt is paid off, to be invested in a sovereign wealth fund like the Future Fund and used for building capital.

Recommendation 7

5.89 The committee recommends that, if contrary to its principal recommendation the Parliament is of a mind to pass these flawed resource rent tax arrangements, the Parliament amend the legislation to ensure revenues raised, which are subject to high volatility and likely to reduce over time, are used to increase the net financial worth of the Australian Government either through the payback of debt or investment in assets through the Future Fund.