



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

SELECT COMMITTEE ON FUEL AND ENERGY

Reference: Issues relating to the Fuel and Energy Industry

TUESDAY, 13 JULY 2010

CANBERRA

BY AUTHORITY OF THE SENATE

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SENATE SELECT COMMITTEE ON

FUEL AND ENERGY

Tuesday, 13 July 2010

Members: Senator Cormann (*Chair*), Senator Hutchins (*Deputy Chair*), Senators Bushby, Fifield, Ian Macdonald and McEwen

Senators in attendance: Senator Cormann, Senator Farrell, Senator Fifield, Senator Hutchins, Senator Ian Macdonald

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Bishop, Boswell, Boyce, Brandis, Carol Brown, Cameron, Cash, Colbeck, Jacinta Collins, Coonan, Crossin, Eggleston, Farrell, Feeney, Ferguson, Fielding, Fisher, Forshaw, Furner, Heffernan, Humphries, Hurley, Johnston, Joyce, Kroger, Lundy, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Pratt, Ronaldson, Ryan, Scullion, Stephens, Sterle, Troeth, Trood, Williams, Wortley and Xenophon

Terms of reference for the inquiry:

To inquire into and report on:

- a. the impact of higher petroleum, diesel and gas prices on:
 - i. families,
 - ii. small business,
 - iii. rural and regional Australia,
 - iv. grocery prices, and
 - v. key industries, including but not limited to tourism and transport;
- b. the role and activities of the Petrol Commissioner, including whether the Petrol Commissioner reduces the price of petroleum;
- c. the operation of the domestic petroleum, diesel and gas markets, including the fostering of maximum competition and provision of consumer information;
- d. the impact of an emissions trading scheme on the fuel and energy industry, including but not limited to:
 - i. prices,
 - ii. employment in the fuel and energy industries, and any related adverse impacts on regional centres reliant on these industries,
 - iii. domestic energy supply, and
 - iv. future investment in fuel and energy infrastructure;
- e. the existing set of state government regulatory powers as they relate to petroleum, diesel and gas products;
- f. taxation arrangements on petroleum, diesel and gas products including:
 - i. Commonwealth excise,
 - ii. the goods and services tax, and
 - iii. new state and federal taxes;
- g. the role of alternative fuels to petroleum and diesel, including but not limited to: LPG, LNG, CNG, gas to liquids, coal to liquids, electricity and bio-fuels such as, but not limited to, ethanol;
- h. the domestic oil/gas exploration and refinement industry, with particular reference to:
 - i. the impact of Commonwealth, state and local government regulations on this industry,
 - ii. increasing domestic oil/gas exploration and refinement activities, with a view to reducing Australia's reliance on imported oil,
 - iii. other tax incentives, and
 - iv. securing Australia's future domestic energy supply;
- i. the impact of higher petroleum, diesel and gas prices on public transport systems, including the adequacy of public transport infrastructure and record of public transport investment by state governments.
- j. any related matters

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Committee met at 8.31 am

CHAIR (Senator Cormann)—I declare open this public hearing of the Senate Select Committee on Fuel and Energy. The Senate has referred to the committee matters associated with fuel and energy including the price of fuel, regulation and taxation arrangements and alternative fuels. The committee is due to provide its final report to the Senate on 30 August 2010.

This is a public hearing and a Hansard transcript of the proceedings is being made. Before the committee starts taking evidence, I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. The committee prefers all evidence to be given in public, but under the Senate's resolutions witnesses have the right to request to be heard in private session. It is important that witnesses give the committee notice if they intend to ask to give evidence in camera. If a witness objects to answering a question the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may of course also be made at any other time.

I remind senators that the Senate has resolved that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given a reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. Departmental officers are also reminded that any claim that it would be contrary to the public interest to answer a question must be made by a minister and should be accompanied by a statement setting out the basis for the claim. I particularly draw the attention of officers to an order of the Senate of 13 May 2009 specifying the process by which a claim of public interest immunity should be raised.

Finally, on behalf of the committee I would like to thank all those who have made submissions and sent representatives here today for their cooperation in this inquiry.

[8.34 am]

ALTUS, Mr Mark, Director, Revenue and Intergovernmental Relations, Department of Treasury and Finance, Western Australia

BARNES, Mr Michael, Acting Under Treasurer, Department of Treasury and Finance, Western Australia

CHAIR—I welcome officials from the Western Australian Department of Treasury and Finance. I invite you to make a brief opening statement and then the committee will ask some questions.

Mr Barnes—Thank you. Firstly, thank you for the opportunity to appear before the committee today. The Western Australian Department of Treasury and Finance has a number of concerns in relation to the proposed minerals resource rent tax and expanded petroleum resource rent tax regime. Generally speaking, these concerns fall into three broad categories: first, the impact on the Western Australian resources industry and broader economy; second, the impact on the state government's sovereignty and autonomy over one of its most important revenue bases—that is, mining royalties; and, third, the need to clarify or confirm a number of key issues that remain outstanding or unresolved.

Turning first to the impact on the Western Australia resources industry and broader economy, I note by way of background that mining is Western Australia's largest industry, accounting for 24 per cent of gross state product in 2008-09. The Western Australian mining industry also makes an enormous contribution to the national economy, accounting for almost half of the nation's mining industry and over 30 per cent of the nation's total exports. Preliminary analysis by the WA Department of Treasury and Finance suggests that Western Australian projects will contribute around 60 to 65 per cent of the total MRRT revenue. In 2013-14 this equates to around \$3.9 billion of the Commonwealth Treasury's \$6.5 billion revenue estimate for that year coming from Western Australia. Even after the planned cut in the company tax rate to 29 per cent and a share of the proposed Regional Infrastructure Fund, we estimate that this package will see an overall net contribution from Western Australia of around \$3 billion in 2013-14. This is on top of Western Australia's already very substantial net fiscal subsidy to the Commonwealth, estimated at around \$11 billion in 2008-09. Our concern is that such a large redistribution of wealth from Western Australia may not be in the national interest and reduces incentives for the state to put in place growth-promoting policies and infrastructure.

Also in relation to the economic impact, it is of concern that there is no detailed analysis or modelling of the impact of the proposed MRRT and expanded PRRT regime, particularly by industry and/or region. In this regard we have a particular concern around the potential impact of the MRRT on the emerging magnetite iron ore industry in Western Australia's mid-west. We believe that magnetite iron ore should be excluded from the MRRT. Unlike the traditional hematite iron ore, magnetite ore requires extensive processing to convert it into a marketable product. While the Commonwealth's stated intention is to apply the MRRT taxing point as close to the point of extraction as possible so that only the value of the resource extracted is taxed, rather than the value added by processing, our view is that a better option is to exclude magnetite

ore from the scope of the MRRT. This would be simpler, provide certainty to an emerging industry, provide equity with respect to other minerals that incur high processing costs, like gold and nickel, and should have a negligible impact on the revenue yield, given that most of the value of magnetite comes from its processing, which is not intended to be captured by the MRRT anyway.

Turning next to the issue of the state's autonomy over mining and petroleum royalties, we view the Commonwealth's proposed mining tax regime as an unwelcome intrusion into an area of state government responsibility, undermining the state's autonomy and budget flexibility. While the proposed MRRT and expanded PRRT are currently envisaged to operate alongside state royalties, with a tax credit available for state royalty payments, we are concerned that over time there is a significant risk that states will effectively be crowded out of this revenue base, at least in respect of iron ore, coal and petroleum. The intentions of the Henry review committee were quite clear in this regard. Industry is also likely to bring pressure to bear on states to abolish their royalties so that companies need comply with only one regime, rather than two. Such an outcome would increase WA's reliance on Commonwealth grants and exacerbate the already high vertical fiscal imbalance between the Commonwealth and the states. A related issue is the extent to which the Commonwealth government will seek to cap the royalties that are creditable against liabilities under the MRRT and expanded PRRT. In our view, it is essential that states have full flexibility to alter their royalty regimes as appropriate to their specific circumstances.

Our third area of concern relates to the various unresolved or outstanding issues relating to the proposed MRRT and expanded PRRT package. These include implications for WA's revenue-sharing arrangement in relation to the North West Shelf project. While I note Ken Henry's comments from last week that the current arrangements should continue unchanged, we would like formal confirmation of this from the Commonwealth government.

Another outstanding issue is the operation of the proposed Regional Infrastructure Fund, including states' share of the funding and its treatment under the Commonwealth Grants Commission process. Finally, there is a need for clarity on the status of Commonwealth election commitments relating to a Western Australian infrastructure fund financed from Gorgon and/or Pluto project PRRT revenues and a flow through share scheme to encourage exploration activity.

CHAIR—Thank you very much, Mr Barnes. Is there any prospect that Western Australia would give up imposing royalties on the extraction of its resources?

Mr Barnes—I am speaking on behalf of the Department of Treasury and Finance and my strong view is that, under this government or under any future WA government, that would be an extremely remote prospect.

CHAIR—Do you publish information about mineral resource commodity prices, commodity price expectations and production volumes in your budget papers?

Mr Barnes—Yes, we do.

CHAIR—So it is your usual budget practice to publish those assumptions?

Mr Barnes—Yes, we publish the key parameters that underlie our revenue estimates, including our royalty estimates—parameters like the assumed Australian dollar to US dollar exchange rate and the assumed iron ore price. We also publish at an aggregated level our volume expectations.

CHAIR—You do that because your revenue projections are sensitive to these variables; is that right?

Mr Barnes—That is right. Our revenue projections are highly sensitive to those parameters. For example, each 1c movement in the Australian dollar to US dollar exchange rate impacts our full year royalty revenue by around \$47 million.

CHAIR—So anybody who would want to scrutinise your budget and your performance against budget would be able to assess whether any changes in fiscal outcome are due to changes in policy settings or due to changes in any of these variables, commodity prices, volumes et cetera?

Mr Barnes—Absolutely. I think our budget papers are very transparent in that regard. Indeed, we break down revenue movements by policy and parameter changes.

CHAIR—It would seem to me to be a very sensible budget practice to enable that sort of scrutiny to happen, but that is by the by. Are you aware of any significant improvements in the commodity price outlook for iron ore, or other resources for that matter, between 1 May and 1 July 2010?

Mr Barnes—I do have a table with me on iron ore spot prices. Our pricing assumptions for iron ore now are very closely linked to the spot market, given the recent change in pricing arrangements and the move away from the annual benchmark system for setting iron ore contract prices. The iron ore spot price has been quite volatile. For example, in January 2010 the spot price averaged US\$130 a tonne, in April 2010 the spot price averaged US\$177 a tonne and in June 2010 the spot price averaged US\$151 a tonne. To answer your specific question: between April and June the average spot price fell from US\$177 a tonne to US\$151 a tonne.

CHAIR—And it continued to fall until the beginning of July, didn't it?

Mr Barnes—I believe it is currently in the low 140s.

CHAIR—The information I have got is that in the period between the announcement of the superprofits tax and the announcement of the changed MRRT and the expanded PRRT arrangements iron ore spot prices in fact fell by about 30 per cent in US dollar terms, which of course is adjusted a bit for Australian dollars. How do you construct your commodity price forecasts?

Mr Barnes—With the recent move away from the benchmark contract arrangements for iron ore, we currently take the spot price in the quarter when we strike our revenue forecast and that spot price becomes our starting point. Then in a linear fashion we take that spot price down to around a long-run average of US\$75 a tonne by the end of the forward estimates period, which is a four-year period. That downward trajectory reflects our analysis of world demand and supply

and the expectation that world supply will increase over coming years and therefore put downward pressure on prices. We also check out forecast against private sector consensus forecasts to make sure that we are not too far off the mark from what the private sector is expecting.

CHAIR—So how often do you change those forecasts from a budget management point of view?

Mr Barnes—Formally twice a year; publicly twice a year in our budget and our mid-year review. Throughout the year we do internal updates for cabinet, probably five or six times a year.

CHAIR—Would you be able to provide us perhaps with the commodity prices and volumes that the WA treasury is assuming for the years 2012-13 and 2013-14?

Mr Barnes—Based on our budget time projections?

CHAIR—Yes.

Mr Barnes—Yes, I can do that.

CHAIR—Based on your budget time projections, yes; that is fine. Has the Commonwealth Treasury provided you with any analysis of the likely economic impacts of the minerals resource rent tax?

Mr Barnes—No, nothing over and above what is publicly available.

CHAIR—Has the Commonwealth Treasury provided you with any details on how it has calculated the revenue expected from the MRRT?

Mr Barnes—No.

CHAIR—Has the Commonwealth Treasury sought any advice from you in calculating those amounts for their own internal purposes?

Mr Barnes—No, I do not believe so.

CHAIR—So what information has the Australian government provided to you on how state royalty arrangements will interact with the application of the minerals resource rent tax?

Mr Barnes—Again, formally nothing over and above what is in the public arena already.

CHAIR—Do you know whether royalty credits under the minerals resource rent tax will be fixed at a particular level or point in time?

Mr Barnes—That is one of the outstanding issues we would like clarity on. For example, the WA government recently removed a longstanding concessional iron ore royalty rate that dates back to around the 1960s in BHP and Rio Tinto state agreement acts. So that concessional rate

has recently been removed with effect from 1 July. So, firstly, we would like an assurance as to the removal of that concessional rate and the imposition of the normal Mining Act rate on those companies, that that will be fully creditable to those companies. The WA government has also publicly flagged its intention to move, at some stage in the future, from the iron ore fines royalty rate of 5.625 per cent to the lump rate on iron ore, which is 7.5 per cent. Again, we need clarity around whether that increase to the 7.5 per cent royalty rate would be creditable against the MRRT.

CHAIR—Has the Commonwealth Treasury approached you to set up a meeting to discuss these sorts of issues? This has been announced on 2 July and the previous tax arrangement had been announced on 2 May. I am surprised that there have not been more intensive levels of consultations by the federal government—the Commonwealth Treasury—with the WA state treasury. Western Australia is one of the main targets certainly as far as the iron ore aspect of the MRRT is concerned.

Mr Barnes—Yes. In fairness to my Commonwealth Treasury colleagues, they have been pretty busy in recent times. But we are still waiting to have that in-depth dialogue that we need to have.

CHAIR—Has the Commonwealth Treasury sought to organise a meeting? Is there a date set for a meeting with the Commonwealth Treasury for you to discuss these sort of issues formally?

Mr Barnes—Not as far as I am aware.

Mr Altus—There is a heads of treasuries meeting coming up on 6 August. That will be preceded by a meeting of treasury deputies about a week prior. We have not actually seen the agenda for those meetings as yet.

CHAIR—But that is a standard meeting that comes up in the normal course of events.

Mr Altus—That is right.

Mr Barnes—Yes, the Treasurers meetings happen normally every two or three months or so.

CHAIR—So there has been no contact from federal Treasury to WA Treasury in relation to the implications for Western Australia of state royalty arrangements under the MRRT? There has been no discussion at all with you on how the applications of the mineral resources rent tax might impact on Western Australia?

Mr Barnes—That is right.

Senator HUTCHINS—With Treasury?

Mr Barnes—Yes.

CHAIR—Has the Australian government discussed with you how the regional infrastructure fund might operate?

Mr Barnes—No, not yet. The only information we have is what is in the public arena.

CHAIR—Are you aware whether or not the design of the funding arrangements will be changed as a result of the change from the RSPT to the MRRT given the increased share of revenue expected to come from Western Australia?

Mr Barnes—We are working on the assumption that the arrangements are largely the same as the original announcement in relation to the regional infrastructure fund but, again, we are only operating on what is in the public arena.

CHAIR—So you are making these assumptions based on what you have been reading.

Mr Barnes—That is right.

CHAIR—What about the way this issue has been dealt with overall in terms of the level of consultation and interaction at a government or officer level? Is this usual practice or is this a bit different?

Mr Barnes—I am trying to recall a past example similar to this, but I cannot readily recall one.

CHAIR—How about when the GST was introduced?

Mr Barnes—There was extensive work, engagement and two-way consultation in the lead-up to the implementation of the GST. So, yes, that is a very different example.

CHAIR—Did the Australian Treasury contact you before the release of the superprofits tax?

Mr Barnes—Before the original public announcement the Commonwealth Treasury did give a very general heads-up of the direction that the recommendations were heading in, but at no stage prior to public release did we actually see the recommendations, nor—by definition, given that we did not see the recommendations—were we asked to comment or provide input on the recommendations.

CHAIR—The original proposal was for the resource superprofits tax to replace state royalties and that state royalties would be abolished. As far as you are aware, has anyone from the federal government at an official or government-to-government level discussed the prospect of abolishing state royalties with WA Treasury or the WA state government?

Mr Barnes—In the initial heads-up that I mentioned, that prospect was flagged as the direction that the Henry review committee was heading in.

CHAIR—What was your response to that?

Mr Barnes—We were not really given the opportunity to respond; it was more in the nature of a one-way communication that that was the direction the review was heading in.

CHAIR—What share of the Western Australian revenue comes from state royalties?

Mr Barnes—Including North West Shelf royalties it is about 18.6 per cent. That is our estimate for the current financial year 2010-11.

CHAIR—So it is a sizeable share of your annual budget. If the government wanted to essentially take over 18 per cent of your revenue base, you would expect them to at least have a conversation with you, wouldn't you?

Mr Barnes—Yes, it is a very sizeable share. That is of our total revenue base bearing in mind that about 40 per cent of our total revenue comes from Commonwealth grants, so the share of our own source revenue that comes from royalties is much higher than the 18.6 per cent that I mentioned. It is a very substantial revenue base for us. Normally, yes, you would expect more two-way, genuine consultation.

CHAIR—That two-way consultation still has not started to happen. You are hopeful that it might happen after your meeting on 6 August?

Mr Barnes—That is correct.

CHAIR—Wouldn't you expect it to happen sooner rather than later? You are in Canberra today; why wouldn't Ken Henry and others pick up the phone and sit down with you and give you some answers to all these questions?

Mr Barnes—You would probably have to ask Ken Henry that question. We have sent off a letter or two and emails to try to get clarity around some of these issues, but so far it has been to no avail.

CHAIR—How many letters and emails have you been sending to federal Treasury or the federal government?

Mr Barnes—I can recall two.

CHAIR—So you have been trying to have a meeting or discussion but so far that has not eventuated.

Mr Barnes—Yes—certainly not to the level of detail that we need.

CHAIR—Is there any truth to the rumours that federal Treasury officials contacted WA Treasury a day or two before the super profits tax was announced, to ask about the operation of WA state royalties?

Mr Barnes—I am not personally aware of that, I have to say. I do not know whether Mr Altus is.

Mr Altus—I am not either. It is possible that such communications occurred at the Under Treasurer, secretary level.

CHAIR—Has there ever been any request by federal Treasury for some WA Treasury officials to be seconded to federal Treasury to assist with these sorts of matters?

Mr Barnes—I believe that Ken Henry did raise that prospect with the WA Under Treasurer.

CHAIR—Because there seems to be a general lack of understanding on how royalties are operating. I am just asking you to explain it for the benefit of the public. One of the arguments that have been used by senior cabinet ministers at a federal level, and all of the government members and senators who run through the talking points around the super profits tax and its successor, is that state royalties are volumes based, taxes based on volumes, so they have supposedly not enabled the community to get their fair share of increasing commodity prices and only a profits based resource rent tax will enable the community to get a fair share of the increased value of those commodities, or so the argument goes. Would you care to comment (1) on the operation of state royalties in Western Australia, which I understand to be values based, and sensitive to price; and (2) on whether in fact a profits based resource rent tax is the only way to achieve a fair return to the community?

Mr Barnes—The vast majority of Western Australia's royalty regime is an ad valorem, or value based royalty system, not volume based; therefore our royalty revenue rises in line with increases in commodity prices and in line with increases in volumes. The chart I have in front of me shows that royalty revenue has increased substantially over the last four or five years, reflecting the increase in commodity prices that we have seen over that time. In 2004-05 our royalty revenue was less than \$1½ billion; in 2008-09 our royalty revenue was approaching \$3½ billion.

CHAIR—So there have been significant adjustments to your revenue as a result of the increase in commodity prices?

Mr Barnes—Absolutely.

CHAIR—You are reading from a document there. Is that something you might be able to share with the committee?

Mr Barnes—These are my internal notes. I would personally not have a problem with sharing them, but I would need to check with the WA government first.

CHAIR—If you would not mind, that would be great; the committee would certainly appreciate it. This is a briefing note about the impact of the minerals resource rent tax, is it?

Mr Barnes—Yes, it is.

CHAIR—Okay. If the government was inclined to share that with the committee, we would be most grateful. The Premier of Western Australia wrote to this committee about the expected share of revenue from the minerals resource rent tax that could come from Western Australia. He said that based on the information available it could justifiably be said to be between 60 and 65 per cent of \$10½ billion—that is, \$6.8 billion. That is quite a sizeable proportion to come out of Western Australia. Would you care to comment on that?

Mr Barnes—The 60 to 65 per cent is our preliminary analysis. It is based on the best available data that was to hand. That data was sourced from the Commonwealth Grants Commission. The Commonwealth Grants Commission would in turn have sourced that data

from each of the state treasuries. And it is the best data available for this purpose, because it is disaggregated by commodity and by state—and, obviously, we need that disaggregation to perform this analysis. I might ask Mr Altus to briefly outline how we arrived at the 60 to 65 per cent figure. It is a preliminary estimate, as I said, but we believe it is a robust estimate.

CHAIR—When you say ‘preliminary’ are you being conservative in your estimate or are you being ‘out there’ in your estimate?

Mr Barnes—Arguably we are conservative given that the very large LNG projects that are just under construction in WA, particularly the Gorgon project, will not actually start production until 2014-15, which is just outside the period we are talking about here. Yes, arguably we are conservative. This is one of the areas where we would be keen to open our analysis to scrutiny from the Commonwealth Treasury and other state treasuries.

CHAIR—If you get a chance to talk to them.

Mr Barnes—Yes. This is one of the areas where we need to get agreement on the methodology and get agreement on the data sources, so we will try to facilitate that.

CHAIR—It is strange that it takes a committee of the Senate to give WA treasury a hearing with federal Treasury. Maybe Mr Altus can go through the background to the 60 to 65 per cent share.

Mr Altus—Certainly. You will appreciate that there is no published data on profits, let alone resource rents, by commodity type and by state. Therefore, we have used, as Michael has indicated, value-of-production data as a proxy for profits or rents and we have used the value-of-production data that the Grants Commission has published in its working papers because that gives us the level of disaggregation by commodity type and by state that we need. The Grants Commission data is of course only historical data, so we have escalated it into 2012-13 and 2013-14 terms essentially using published data in states’ budget papers on their expected growth in royalties over that period after adjusting for any policy changes impacting on those royalty projections.

We focused primarily on iron ore and coal in this exercise on the basis that evidence that has been given to this committee by the Commonwealth Treasury suggests that the vast majority of the revenue under the new Commonwealth resources rent tax regime would be from those two commodities as opposed to coming from the petroleum projects onshore and the North West Shelf project that would fall within the scope of the expanded PRRT regime. Based purely on the value of production analysis that we have done, which focuses mainly on iron ore and coal, that suggests about a 50 per cent share or contribution by Western Australia, but we have then made some further adjustments to allow for the fact that proportionally the credits that would be allowed against MRRT liabilities for iron ore would be less than the credits that would be allowed for coal, reflecting the fact that ad valorem royalty rates for iron ore at around six per cent overall are less than the ad valorem royalty rates for coal, which are around eight per cent. Without going through the technical aspects of that adjustment, after you do that adjustment for the crediting of state royalties, that lifts Western Australia’s contribution to an estimated 60 per cent or so.

We have settled on an overall figure of 60 to 65 per cent after making a broadbrush allowance for the expanded petroleum resource rent tax and the likely contribution that Western Australia would make to that revenue stream. Our analysis indicates that Western Australia's contribution to the expanded PRRT revenues could be in the order of 80 to 85 or 88 per cent, which we have assumed would lift the overall average to between 60 and 65 after allowing for the evidence to this committee that the vast majority of the revenues from the overall Commonwealth resource rent tax regime will be from oil and coal. I should also say that we have a piece of paper which documents in step-by-step form exactly how we have done this calculation.

CHAIR—Could you share that piece of paper with us?

Mr Altus—We would be very happy to share that with you. As Michael has indicated, we would be very happy for it to be open to scrutiny, including from the Commonwealth Treasury, to let us know if there is any information or methodology issues that we might have overlooked or if there is a better way of doing it.

CHAIR—You have now put your methodology out there for scrutiny. You are prepared to table your document. Would you expect federal Treasury to do the same so you can swap notes in effect?

Mr Barnes—We would hope that this would be the start of that engagement process.

Senator HUTCHINS—Gentlemen, thank you very much for coming over today. I think the first body to appear before us was the Western Australian Department of Mines and Petroleum.

CHAIR—No, the WA treasury made a great contribution to the ETS debate, under the former Labor government incidentally.

Senator HUTCHINS—You might be able to clear this up for me. Treasury does not actually collect the revenue, does it, for the royalties? Is that collected by the Department of Mines and Petroleum?

Mr Barnes—That is right.

Senator HUTCHINS—If I am right, you have a big-picture approach to any revenue that is raised in the state of Western Australia?

Mr Altus—Treasury and Finance works very closely with the Department of Mines and Petroleum, both on revenue forecasting for state royalties and also on royalty policy issues. I might add—

Senator HUTCHINS—If one wanted to know the detail of how that revenue was collected, would one go to the Department of Mines and Petroleum to get that information rather than Treasury, or would it be in addition to that?

Mr Barnes—The Department of Mines and Petroleum is the collecting agency and the administrator, in the same way that the Australian Taxation Office is the collecting agency and the administrator of Commonwealth taxes. It depends on the type of question and the level of

detail, I guess. If you are seeking policy advice, my advice would be to go to the Department of Treasury and Finance in the first instance. If you are seeking advice on the mechanics of the collection of royalties and the administration of royalties, then you would go to the Department of Mines and Petroleum.

Senator HUTCHINS—I am not sure if you are in a position to answer for the department, but would the Commonwealth have approached them to talk about the detail of the royalties tax in Western Australia?

Mr Barnes—Personally, I am not aware of that happening.

Senator HUTCHINS—Would they be obliged to advise you if they did?

Mr Barnes—I do not think they would be obliged but I would expect that they would.

Senator HUTCHINS—But they are the ones who administer and they know the detail of the schemes that have been toing and froing between the Commonwealth and the state.

Mr Barnes—I do not know the extent of the toing and froing, but, yes, they known the detail—

Senator HUTCHINS—So you do not know whether they have or they have not?

Mr Barnes—I do not know.

CHAIR—Can you get that information for us on notice today?

Mr Barnes—I can try and find out—yes.

CHAIR—Thank you.

Senator HUTCHINS—So we may well have a situation where, because of your role, you may not be aware that there has been discussion between the Commonwealth and the department over the details of the tax. I am not saying that—

CHAIR—That is very tenuous.

Senator HUTCHINS—I have sat in here for a while and listened to some tenuous questions. I am asking you whether that may be the case. Am I right that you said that the state government is about to increase the royalties for iron ore fines—is that correct?

Mr Barnes—With effect from 1 July, it has increased the iron ore fines rate which was payable under the agreement acts in place with BHP and Rio at a concessional rate of 3.75 per cent. The government has removed that concession with effect from 1 July and the standard mining act fines rate of 5.625 per cent now applies.

Senator HUTCHINS—I am not sure of the date, but at some point, early this year or late last year, the Premier indicated that the government was considering a review of royalties tax. Is that part of that review?

Mr Barnes—That is right.

Senator HUTCHINS—Were there any other royalties affected by that review—do you know, Mr Barnes?

Mr Barnes—No, it was just iron ore and it was in relation to BHP and Rio state agreements and the concessional rate that was in place. The Premier has publicly flagged a two-step process. The move from 3.75 per cent to 5.625 per cent was the first step. The second step that is on the public record will be implemented at some point in the future, and that is to take the fines rate for all iron ore producers of 5.625 per cent to the lump iron ore rate of 7.5 per cent.

Senator HUTCHINS—My maths is not all that good, but that is about a 40 per cent increase, isn't it?

Mr Barnes—I will take your word for it, Senator.

Senator HUTCHINS—Those are all the questions I have.

CHAIR—Would it be usual for federal Treasury to not have any consultation or discussion with WA Treasury but to talk to other departments in Western Australia?

Mr Barnes—It would be unusual. They would typically come through us. We would expect that and we would do the same with them. It would be unusual if they had approached the Department of Mines and Petroleum directly, but I will seek to confirm that today.

CHAIR—I would have thought it to be highly unlikely. In terms of the methodology that you went through to assess the share of revenue expected to come from WA, have you only calculated the proportion of the MRRT/expanded PRRT that WA would be expected to pay or have you also separately estimated the absolute payments that WA will make under the MMRT from the ground up, so to speak?

Mr Altus—We have outlined to you the full extent of the calculations that we have performed so far.

CHAIR—Will the WA Treasury play a role in the policy transition group as far as you are aware?

Mr Barnes—To date and to the best of my knowledge we have not been invited to. But we would expect and hope that that would be the case.

CHAIR—But so far you have not been invited to participate.

Mr Barnes—That is right.

CHAIR—The WA state government would be a key stakeholder, given that there are issues around state royalty credits and other matters.

Mr Barnes—Absolutely.

CHAIR—Are you surprised that you have not been invited yet?

Mr Barnes—I guess that it is still relatively early days since the announcement of that group, so we hope that the invitation is in the mail.

CHAIR—It has been 11 days. The reason that I am asking is that public perception would be that the mining tax issue has been fixed and that everybody is moving on and there are no remaining issues. But by the sounds of it you are still very much in the dark as to the implications for the state of Western Australia.

Mr Barnes—Yes. As I outlined in my opening statement, there are a number of outstanding or unresolved issues that will remain of concern to us until we get some resolution of them.

CHAIR—Are the compliance costs of the minerals resource rent tax likely to be higher or lower than the compliance costs of the existing WA royalty regime?

Mr Barnes—We have not done that analysis. Until we see the detailed design of the MRRT, it is difficult to answer that question.

CHAIR—So you would not have a guesstimate? On the basis of what you know and what is in the public demand, would you have a perception as to whether it will be more complex or simpler to administer?

Mr Barnes—If I was to hazard a guess, I would guess that it would be more complicated, given that it tries to define the taxing point as close as possible to the point of extraction. Defining the mine gate, the costs that are incurred and the costs that are deductible against that mine gate value is not a straightforward exercise. So I expect that there will be significant compliance costs and I expect that they would in a general sense outweigh the compliance cost associated with the state's royalty regime, which is a relatively simple regime.

CHAIR—There has been obviously a change from the RSPT to the MRRT and the expanded PRRT arrangements in terms of the taxing point. As you mentioned in your comments earlier, it is now closer to the point of extraction. Does that impact, as far as you are aware, the constitutional status of that tax arrangement?

Mr Barnes—It certainly raises that question. It is an area that I am not really prepared to venture into, as I am an economist rather than a constitutional lawyer. But it raises that question.

CHAIR—It raises that question more so than for the superprofits tax arrangements?

Mr Barnes—I believe so. The closer that you get to the point of extraction, the more it starts looking like a royalty arrangement. A lot of it goes to that taxing point and the precise definition of that taxing point. That will determine the answer to some of those questions.

CHAIR—Would you expect that the federal government, in going through the process of negotiations, consultation and discussions with state governments, would seek legal advice separate from the advice that was obtained for the resource super profits tax?

Mr Barnes—I would expect so.

CHAIR—You recommended that this minerals resource rent tax should not proceed. Can you summarise the basis for your view that the MRRT should not proceed?

Mr Barnes—I guess it is because of some of those risks that I outlined in my opening statement. It is also as a result of the general principle of a concern that the Commonwealth is intruding in what is historically and, arguably, constitutionally a state responsibility not a Commonwealth responsibility and the implications of that for the current vertical fiscal imbalance between the Commonwealth and the states and the implications for the revenue autonomy and policy flexibility of the states. They are issues that we are very concerned about.

Our preference, therefore, is that the MRRT not proceed. If there is a view that the community is not receiving a fair return from resource companies, however a 'fair return' is defined—a very subjective thing to define—we would prefer that the Commonwealth and the states work together to design enhancements to the royalty regimes of the states to address that issue.

CHAIR—Thank you. In your opening statement you mentioned a pre-election commitment to establish a Western Australian infrastructure fund which was to be financed from tax revenues from the Pluto and Gorgon projects. From your point of view, where is that at?

Mr Barnes—The short answer is that we do not know. We have approached the Commonwealth both at the official and political level to try to seek clarity and get progress on the issue, including seeking to engage with the Commonwealth to establish a national partnership agreement to implement that election commitment, but, to date, we have had no engagement from the Commonwealth.

CHAIR—When was that commitment made?

Mr Barnes—Prior to the last federal election, so I guess that would have been—

CHAIR—Sometime in 2007?

Mr Barnes—I believe so.

CHAIR—And by 2010 you have not had any approach from the Commonwealth Treasury to work with you on setting that up?

Mr Barnes—No.

CHAIR—Yet they are promising the next infrastructure fund now.

Mr Barnes—Yes.

CHAIR—That does not give you much confidence that anything will be forthcoming very quickly after the money goes to Canberra.

Mr Barnes—No, it does not. One of the issues that remains unresolved is the interaction between the previously promised Western Australian infrastructure fund and the currently proposed regional infrastructure fund. What is the interaction between those two? There is a whole range of issues around those infrastructure funds: how they will operate; the basis of allocation to the states; and the Commonwealth Grants Commission treatment of payments from those funds, which is critical, particularly for a state like Western Australia. So all of those issues remain unresolved.

CHAIR—Thank you, Mr Barnes, for your evidence. I wish you luck in getting a meeting with Dr Henry and other Treasury officials. In my view, it is outrageous that those discussions between the Commonwealth and the great state of Western Australia have not happened yet. Perhaps you can leave us with your mobile phone number and we will pass it on to Dr Henry when he appears here at 10.15.

Mr Barnes—Thank you very much.

CHAIR—Before you leave, the committee this morning resolved that answers to any questions taken on notice be provided by 5 pm on Friday. I do not know to what extent you have taken questions on notice to which that might apply, but it would be appreciated if you could get back to us today on whether you would be able to share with us the document you were reading from earlier today.

Mr Barnes—Certainly.

[9.18 am]

MULLEN, Mr Noel Christopher, Deputy Chief Executive, Commercial and Corporate, Australian Petroleum Production and Exploration Association Ltd

ROBINSON, Ms Belinda Charlotte, Chief Executive, Australian Petroleum Production and Exploration Association Ltd

CHAIR—Welcome. I understand you have been given information about parliamentary privilege and the protection of witnesses in evidence. I invite you to make a brief opening statement, after which the committee will ask you questions.

Ms Robinson—We do not have an opening statement to make.

CHAIR—Okay. What has been your level of involvement as the Australian Petroleum Production and Exploration Association with the Gillard government in terms of negotiating the announced changes to the petroleum resource rent tax before they were announced on 2 July 2010?

Ms Robinson—Of course, before 2 July, most of the consultations had been done as part of the Rudd government. Is that what you mean?

CHAIR—No. The period I am interested in is that from the changing of the Prime Minister, which was on a Thursday morning, to the announcement on 2 July of the revised scheme. I am interested in what negotiations you were involved in with the Gillard government before the revised MRRT and expanded PRRT arrangements were announced.

Ms Robinson—APPEA was not involved in any negotiations in the lead up to the 2 July announcement, but I understand a number of our member companies had been engaged more up until that period and after that period. APPEA itself was not engaged in any further negotiations.

CHAIR—Is that a surprise? You are a senior industry body in the resources industry.

Ms Robinson—It was consistent with the process. The process in general had a strong focus on negotiating with individual companies. That said, a series of Treasury panel discussions had been held around the country and we had certainly participated in those in the early days.

CHAIR—Under the Rudd government?

Ms Robinson—Under the Rudd government. In most of the negotiations the emphasis was on a company-by-company basis.

CHAIR—Are all three companies that were involved in direct negotiations—BHP, Rio and Xstrata—members of yours?

Ms Robinson—BHP Billiton is a member of ours.

CHAIR—So that is it—BHP Billiton?

Ms Robinson—Yes.

CHAIR—What is your level of involvement in the policy transition group?

Ms Robinson—All we are aware of at the moment is the announcement to establish the policy transition group. We certainly are not aware of any further announcement around how that group will be structured or how it will involve individual companies or industry associations. We have had a preliminary discussion with the Department of Resources, Energy and Tourism and put forward some preliminary views around structure, for example. But, other than that, I am not aware that there have been any further developments on the establishment of that group.

CHAIR—Is that surprising?

Ms Robinson—No, I do not think so. It was only announced on 2 July and I understand Don Argus has been out of the country and presumably the government would want to settle detail of structure and so on with him. We are not particularly concerned about that. We are anticipating some further information about that in due course.

CHAIR—Yes, but, given the level of public concern about the resource superprofits tax and all of the developments since then—there is a public perception now that the whole issue has been fixed and it is done and dusted—the policy transition group is fairly critical if it were to proceed in terms of some massive details, isn't it?

Ms Robinson—I think it will play a very critical role. Certainly when it came to the announcement in relation to the petroleum sector the detail was very limited and there was much less detail around the petroleum resource rent tax proposal for oil and gas than there was around the minerals resource rent tax for the minerals sector.

CHAIR—Why is that?

Ms Robinson—You can only speculate as to why but I think possibly one of the reasons is that this industry is familiar with the PRRT—

CHAIR—On an offshore basis.

Ms Robinson—on an offshore basis, so perhaps there was not quite the imperative to settle the issue at the level of detail that was required for the miners, who of course are completely unfamiliar with something like an RRT.

CHAIR—Do you agree with that?

Ms Robinson—I guess my view on that is that it is better to have a considered process that carefully looks at all of the issues than perhaps rush into detail and then have to wind some of that back. We are not necessarily uncomfortable that there is a lot of work still to be done, but there is a lot of work still to be done. I think there were three dot points in relation to the oil and

gas PRRT announcement, which means there is a considerable amount of fat that needs to be developed as part of that policy transition group.

CHAIR—There is quite a bit of detail out there. What is your assessment of the impact of the MRRT expanded PRRT arrangement on your industry, particularly the small and middle tier end of your industry?

Ms Robinson—Noel is in fact speaking to us from Perth, because we are in the process of travelling around the country, meeting with all of our members to tease out what the issues are and what the specific impacts are so that we can get a better handle on understanding the answer to your question. Certainly, there are a number of issues that will need to be further developed, particularly around transitional arrangements. You mentioned small to medium sized companies, and we would like to see the inclusion of a threshold below which the scheme may not apply. That could be some sort of an opt-in threshold, but it is quite possible that a number of small to medium sized companies will not in fact pay the PRRT. The increased compliance burden that will be put on these companies will probably not be worth it simply to satisfy the desire to have the whole sector covered.

Mr Mullen—There are two elements of this small to mid-caps perspective that we are focusing on at present. One is that the PRRT regime has largely been born out of the offshore industry and the way that it is structured. I guess it is stating the obvious to say that the nature of onshore operations is a little different. We will need to go through the PRRT legislation carefully to ensure that retrofitting the onshore industry into the act is done seamlessly and does not create a situation where there is confusion. From a second perspective we are trying to assess what the impact will be from a compliance perspective on the small to mid-cap companies. Generally speaking, the larger corporate are operating under the PRRT regime, so we need to carefully consider what the financial implications may be for these small to mid-cap companies in terms of normal compliance.

CHAIR—So at this stage you do not know?

Mr Mullen—At this stage, because some of the details are a little unclear it is making it a little bit difficult for us to make those judgments. As Belinda mentioned, we are having to consider the processes by which these issues can be worked through with the government and the various policy agencies we see as being critical to try to get that seamless transition.

CHAIR—But if you do not know what the impact will be on that part of your industry, presumably the government does not know, either?

Mr Mullen—That is quite possibly the case but, in a sense, it is an implication of the way that the legislation is currently structured. It is pretty much designed around single offshore projects. There are some options for combining projects together. The onshore industry has developed in a very different manner. Many smaller companies are involved onshore. There is significant diversity where permits are located which can transition into a single project. Those are the sorts of things we are trying to grapple with at present. We would need them to be resolved through some legislative reform.

Ms Robinson—But as a general comment across the board the impact will be greater, not less, given the way the new scheme will work—that is, it will be superimposed on the royalties based regime. The tax certainly will not go down for anyone but it may mean that, for some companies, depending on the profitability of those projects, they may not pay additional PRRT, or the level of PRRT they pay will be less than the tax paid on very profitable projects. Currently, the oil and gas industry pays about the same in tax as it earns in net profit, so that is about a 50 per cent tax rate across the board. That will not go down; it will go up. But how it plays out will require a project by project analysis.

CHAIR—It sounds to me as though the administration of all of this onshore will be particularly complex. As you say, the PRRT offshore is the only tax beyond the usual company tax and so on that applies, whereas onshore you will continue to have state and territory royalties as well as credit arrangements. There seem to be much more compliance and administrative burdens involved. Is that a fair comment?

Ms Robinson—That is definitely one of the key concerns of the small to mid-cap companies. There has been a process of reform in Australia aimed at cutting red tape. We are looking at imposing a PRRT on top of a royalties based regime on primarily those companies that are least capable financially of being able to administer these processes. They do not have teams of people to maintain compliance, maintain records and administer these programs. I think from conversations we have so far had with our members, small to mid-cap compliance is definitely one of the key issues, particularly in the context that a number of their projects may not end up paying PRRT because of the size of the project and the profitability of them. They will certainly be keeping two sets of books, maintaining two sets of records for a tax that they may not pay.

CHAIR—Has the government asked you to provide any details about the financial impact or any financial modelling with regard to the types of projects that your industry invests in?

Ms Robinson—Not APPEA, no.

CHAIR—They are essentially dealing directly with individual companies?

Ms Robinson—That is right.

CHAIR—And, as far as you are aware, they are dealing with all those individual companies?

Ms Robinson—My understanding is that it has been a selection of companies. Again, one concern of the small- to mid-cap companies is a sense that they have not perhaps been as involved in the negotiations as some other companies and therefore are not as convinced that the issues associated with them have been as well understood as they would have liked. From our perspective we are making those views known. We are looking forward, through the Policy Transition Group, to ensure that that sort of process is not repeated and that the concerns of the small- to mid-cap companies are taken into account in that process and are appropriately addressed.

CHAIR—Have you done any analysis of the average tax rate your members who are affected by the expanded PRRT would pay?

Ms Robinson—I would refer to my previous comments in relation to that.

CHAIR—You do not yet know?

Ms Robinson—We do not yet know, but it will not be less than 50 per cent. We certainly know that.

CHAIR—It will be more than 50 per cent?

Ms Robinson—It will be more than 50 per cent, assuming that there will be an increase in the tax rate associated with the new regime.

CHAIR—Is that internationally competitive?

Ms Robinson—Noel, I will let you answer that.

Mr Mullen—Can I answer that in two ways. I guess the decision to retain the existing royalty and crude oil excise regime effectively places the floor underneath—not the viability per se but the profitability and the average tax rates. I think it is fair to say that there will be no projects paying any less than what their current liabilities are. Whether that average tax rate is increased will then depend on whether the PRRT trips into individual projects. In terms of international competitiveness I think the general consensus is that the PRRT regime places Australia well. It is one of the more competitive regimes.

CHAIR—That is the PRRT in the absence of a royalty regime applying at the same time?

Mr Mullen—That is right.

CHAIR—If you can qualify—when you say it places us well, it is the offshore part of it?

Mr Mullen—That is correct. With respect to the offshore PRRT regime, the general commentary from consultants and from those people who observe different fiscal regimes it is seen as being one that is globally competitive. It places Australia in a position where we can attract the sort of capital that is necessary to commercialise the discoveries. I think it will now be a question of onshore with a combination of the existing royalty and excise regimes and, overlaying that, the PRRT. As to where that places us I guess, to some extent, the jury is still out and, to a large extent, we are awaiting an analysis that would come through from groups such as Wood Mackenzie as to whether it places us in a better place.

CHAIR—So the best case scenario is that things stay the same and the worst case scenario is where they become significantly worse and then there is a range in between? The range in terms of impact is from status quo to significantly worse off. Is that right?

Mr Mullen—The status quo scenario does not take into account how the regime ends up being administered.

CHAIR—That is compliance costs—

Mr Mullen—Yes. There will obviously be compliance costs. That will be very important.

CHAIR—So what you are telling us is that, essentially, the range is from definitely worse off to potentially significantly worse off?

Mr Mullen—I think the range is from marginally worse off, if you factor in the compliance arrangements, to a possible outcome where there is an increased fiscal burden. The ultimate impact of that fiscal burden will be determined by the finalisation of a number of the settings. There is obviously a lot of discussion around transitional issues in terms of existing projects moving into the PRRT regime onshore. Until those sorts of issues are resolved, it is a little bit hard to be definitive about what the impacts will be, but it is certainly easy to say that the best possible outcome would effectively be no change.

CHAIR—How does the announced package affect the incentives to explore for new sources of petroleum?

Mr Mullen—One of the aspects of the PRRT is that there is a provision that allows for the wider deductibility of exploration expenditure. Clearly, entities that have a PRRT liability from one project are able to offset their exploration expenditures in other areas. We assume that from 1 July 2012 that will mean that any exploration that is undertaken in oil and gas operations in Australia will be transferable against the PRRT liable projects. That clearly provides stimulus for projects that have PRRT liabilities in other areas. One of the critical mechanisms inside the PRRT regime is the uplift provisions for exploration. They clearly recognise that exploration is a far riskier endeavour and therefore the uplift rate is higher than what we would call the general project cost uplift rate. That provides another incentive. But it is fair to say that the incentive is largely around the fact that companies that currently do have PRRT liabilities are able to offset their costs against those projects.

CHAIR—Ms Robinson, do you want to say something about how the announced package affects the incentives to explore for new sources of petroleum?

Ms Robinson—One of the concerns that this industry has had for many, many years is around the ability of the smaller midcaps to raise funding, to raise capital, to support their exploration programs. Before I go on, it is very important to understand the role that the smaller midcaps play in petroleum exploration in Australia. Once upon a time, of course, Woodside was a very small company; Santos was a small company; Origin was a small company; Beach Petroleum was a small company.

CHAIR—All small companies want to become big companies.

Ms Robinson—All small companies certainly want to become big companies, but the ability to become a big company is the ability to grow and is dependent to some extent on the ability to raise capital to support exploration. They also are the companies that can go or are willing to go to places that the big companies are not able to commercially justify. They are the ones who can go into the nooks and crannies of some of the basins to where it is commercially viable for them to do something but not for others. In other words, they play a very, very important and somewhat unacknowledged role in the integrated nature of Australia's oil and gas industry.

Because they tend not to pay PRRT, up until now they have not been able to pass through the deductions that might be associated with exploration against a PRRT because they do not have a PRRT liability and possibly are unlikely to do so even under the new regime. From an investment point of view, that makes it difficult for them to attract capital, so this industry has very long argued for what was called a flow-through share scheme, which was in fact incorporated into the government's election platform in the 2007 election. That has since been replaced, post Henry tax review, by a resource exploration rebate, which we also warmly welcomed. It certainly was not the flow-through share scheme. Some members preferred it; some members preferred the flow-through share scheme, but it is certainly true to say that it retained the notion of the need and the acknowledgement of the need to provide an incentive for the small cap to midcap players to continue to explore in Australia. That was acknowledged. Under the new package now, we have been quite disturbed to see that that has been dropped. The government have gone on to say that they would like the new policy transition group to explore, so to speak, other incentives for exploration.

CHAIR—In a process to be finalised in the fullness of time, which has not even started yet and which you do not even know whether you are going to be a party to.

Ms Robinson—We are optimistic that it will have a look at this issue. It is a very real issue. We would very much like—and I think it is in Australia's best interests—to have Australia's small and midcap players exploring for our oil rather than going overseas and exploring for somebody else's, particularly in the context of Australia now producing around 50 per cent of what it consumes, with a deficit of around \$16 billion in liquids, in oil, compared with only 10 years ago, when we had a net surplus in oil and we were producing around 108 per cent of what we were consuming. These are issues of national interest, and certainly exploration incentives for the small to midcap companies are an important vehicle for being able to address them.

CHAIR—When did you first find out that the resource exploration rebate had been scrapped by the government?

Ms Robinson—With the announcement on 2 July.

CHAIR—So you did not know before the announcement on 2 July?

Ms Robinson—No.

CHAIR—Did the government at any time consult with you or any of your impacted members on the effects of removing this rebate?

Ms Robinson—No, but we had raised on a number of occasions through our conversations the importance of retaining exploration incentives. We had seen some reporting, for example, in the newspapers that this was being considered for withdrawal, and we were concerned about that. As you might expect, we drew those concerns to the attention of the negotiators.

CHAIR—Not with much effect, by the looks of it. Would you have expected them to at least have a conversation with you before you had to find out about it in the newspapers or in the announcement put out by the government?

Ms Robinson—We would have liked to have been consulted. Whether or not that would ultimately make any difference we can only speculate.

CHAIR—There is one thing I am interested in. Under the resource super profits tax, the crude oil excise was supposed to be scrapped, and Dr Henry last week told us that it would now remain under the MRRT expanded PRRT arrangements. What proportion of your 50 per cent tax rate is made up by the crude oil excise?

Ms Robinson—Noel, can I refer that to you?

Mr Mullen—Yes. The actual separation of crude oil excise payments to the government, to the best of my knowledge, is not recorded separately in budget papers, but our understanding is that the crude oil excise is largely confined to one or two projects in Australia. It would probably have a significant impact in the overall incidence in terms of tax paid for those projects, but for the vast majority of onshore oil projects—and bearing in mind that crude oil production excise applies to oil and condensate production—we would expect that most of the projects are not incurring a crude oil excise liability. But, as I say, for those projects that are, it applies basically on a volumetric basis and it would be quite significant.

CHAIR—It would be quite significant, did you say?

Mr Mullen—Significant in terms of the amount of revenue that is raised, or the amount of tax that is paid.

CHAIR—So the fact that under the RSPT it was to be scrapped and under the MRRT expanded PRRT deal it is not being scrapped would help the government to minimise the fiscal impact of the new deal?

Mr Mullen—It would certainly underpin the resource tax collections from the petroleum industry.

CHAIR—Interesting. Has the government provided any explanation to you of why small miners under the \$50 million profit threshold have been made exempt but small oil and gas producers are not exempt?

Ms Robinson—No, they have not, but we have not had those conversations with the government as yet and we would expect that they might be issues to be raised and discussed under the policy transition group.

CHAIR—The thing is, though, that Julia Gillard might be in her Comcar on her way to Yarralumla as we speak, calling an election. Certainly, the only reason there is some leverage to force the government into discussions about the ins and outs of this is that the government is facing an election. Once the election is out of the way, are you confident that you will be able to have sensible conversations about these sorts of things, given that you are still not having any of these conversations on this side of the election?

Ms Robinson—We can only go on the basis of what has been reported and what we have been told—that is, this process will be a genuine and open consultative process. We have had

preliminary conversations with the department, which has reinforced the point that it will be encouraging all issues to be put before the group and that these issues will be given fair and well-consulted consideration. To answer your question, we are optimistic and we expect that what has been committed to will be delivered. There is no reason for us to suspect otherwise.

CHAIR—Except past performance. So far there has not been that much quality consultation, engagement or negotiation. What makes you think that will change after the election is out of the way?

Ms Robinson—The negotiations have been quite comprehensive. Our concern has not necessarily been around consultation broadly. It has been specifically around the level of consultation and the level to which the interests of the small- to mid-cap players have been taken into account. One of the things that we will be pushing for very vigorously through this new process is to ensure that it is a genuine whole-of-industry consultative program and that those issues will be addressed where commitments have been made to address them through that program. We are going into this process very constructively and taking the government on its word.

CHAIR—The government has not explained to you yet why small miners have the \$50 million threshold but small oil and gas producers have not. What is your view as to why they have done that?

Ms Robinson—Part of the answer to that is possibly in the first question that you asked and the answer that we gave around the level of detail that perhaps was needed. There was a greater imperative to provide a much greater level of detail in relation to the MRRT.

CHAIR—Are you expecting that \$50 million threshold will apply to your smaller and medium sized members?

Ms Robinson—Applying a glass half full approach, the fact that it has not been explicitly addressed should mean that there is a very strong case to be made that exactly the same acknowledgement of the issues associated with the small miners should be extended to the oil and gas industry. We will be continuing to make that point very strongly. We can see no reason as to why there should not be a threshold applied to the small oil and gas companies. No-one has indicated to us as to whether it is ruled in or ruled out, or on what basis.

CHAIR—It is 13 July today, 11 days since the announcement. I would have thought this was a pretty easy clarification for government to make—if indeed they want to make that clarification. If it was meant to apply to smaller oil and gas producers as well as to the smaller miners, given the concerns that I have seen you express publicly, surely somebody in government would have picked up the phone and reassured you, ‘Ms Robinson, everything is going to be okay. It is only the lack of detail provided in relation to the expanded PRRT, compared to the MRRT, which means that information was not out there publicly, but of course your small oil and gas producers will have the same arrangements in place as the small miners.’ The fact that has not happened leads me to the conclusion that it is not intended to happen.

Ms Robinson—That is a question I cannot answer. It is a question only the government can answer. It will be an issue that we will continue to draw to the attention of the government through this process and directly.

CHAIR—Do your smaller oil and gas producers face different risks relative to larger oil and gas producers in terms of being able to access the value of PRRT tax credits?

Ms Robinson—Noel, can I refer that to you?

Mr Mullen—Yes. As I mentioned before, one of the design features of the PRRT regime is the ability to transfer exploration expenditure from project to project depending on the profitability of individual projects. Clearly, that has the potential to provide a greater benefit to larger companies, as opposed to small companies. The one design feature which is fundamentally different between the MRRT and the PRRT regimes is that, under the MRRT system, there is full transferability of all costs between projects—and that clearly advantages the MRRT regime compared with the PRRT. I guess the underlying difference for large and small companies is that many small companies can often be single-project companies.

CHAIR—So they do not have the capacity to transfer losses between projects to the same extent?

Mr Mullen—Exactly. That will always be a limitation or a design concern with any system that has an inherent feature the transferability—the way that impacts on companies that are single-project companies. To some extent that has shaped some of our recommendations over the last 10 years or so in terms of the concerns around some of the uplift rates that can apply to some types of projects. Where you do not have that ability to transfer, they are inherently riskier under the PRRT regime, particularly gas versus oil. So there is a whole load of issues that come into the mix there.

CHAIR—So is it fair to say that you think the uplift factors should vary to reflect the different levels of risks?

Mr Mullen—The issue that has often been pursued by the industry is the fact that the PRRT regime in its original construct was primarily designed around offshore oil projects which have a certain risk profile attached to them. The nature of the offshore industry has fundamentally changed over the last 20 years since the regime was introduced. The jury is still out in terms of whether the carry-forward provisions for gas projects are appropriate or whether they reflect appropriately the risks associated with those sorts of projects. But as a general contention, though, the nature of this sort of regime in terms of its operation for small companies will always tend to slightly disadvantage them relative to large companies because they do not have the suite of projects available.

CHAIR—So, if large companies enter into a deal around tax design, that does not necessarily mean that that same design will be as beneficial or as fair and reasonable for those smaller companies, does it?

Mr Mullen—That is quite possibly the case. The comment that was made before about the success of this measure, to a large extent will be dependent on whether the small to mid-size

companies in the industry are able to operate within the regime on a seamless basis. We have raised a number of concerns about the administration of PRRT. Clearly, it has some design features which are attractive in terms of it being profits based. For that to really translate into an effective outcome will mean that it has to operate on a seamless and smooth basis for all companies in the industry, not just large companies.

CHAIR—How do you understand the existing assets will come into the PRRT base? Will they be valued on a market basis? How will that market valuation be done if that is the case?

Mr Mullen—The government in its announcement has indicated that companies transitioning into the PRRT will be able to use the market value or written down book value. That is the nature of the announcement or the full breadth of the announcement thus far. That is an issue that we will be raising at an early stage with the policy transition group. There is really not a lot more detail around it than that.

CHAIR—So you are not aware of whether the government is going to use the same commodity price forecast for valuing assets as it has used in its budget to forecast its own revenues?

Mr Mullen—We are not aware of that.

CHAIR—So you have not had any discussions with the Australian government around any of this?

Mr Mullen—Not as yet, but I think it is fair to say that it is one of the early priority issues that as an industry we will be focusing on.

CHAIR—Ms Robinson is hopeful that the \$50 million threshold will apply to smaller and medium size companies in the oil and gas sector as well. Are you aware of whether any tax will apply to anything above the \$50 million or to the \$50 million plus? Do you understand the question?

Mr Mullen—I think at this stage, until the transitional details are finalised, particularly for existing projects, it really is too early to make those judgments. The recognition of the use of market value as the appropriate basis for transitioning projects is appropriate and is supported by the industry. We are obviously acutely aware of the fact that many of these projects will continue to pay royalties. They have historically paid significant levels of resource taxation. We do not see it in any way as being unfair to bring in projects at the appropriate market value.

Ms Robinson—Could I clarify one point. Senator, you mentioned in the lead-up to that question that we would be arguing to have the \$50 million threshold applied to oil and gas projects. I am not sure that we would specifically argue for the same threshold that has been announced for the MRRT. What we would be suggesting is that it might make sense to acknowledge the need for a threshold—that could be a production threshold, for example—to acknowledge the need to streamline and remove the compliance burden for projects that may not in effect pay PRRT.

CHAIR—That is a good point. I have asked a question about financial impact, and what you were essentially saying is that you are currently doing the work and do not know yet. In terms of the overall share, are you aware of any estimate as to how much of that \$10.5 billion in the years 2012 to 2014 is expected to come from the expanded PRRT component of the package?

Mr Mullen—No. From our industry's perspective, clearly much of the growth that will take place in the next decade will be associated with the coal seam gas projects in Queensland. They are not so much over the horizon, but we are probably talking about payment profiles which would be outside the forward estimates period. We can assume that the other large project, which is not covered by the PRRT regime, would probably be the North West Shelf project, and they will continue to pay royalties and excise. It is certainly our assumption that not a large component of the additional revenue would come from the oil and gas industry.

CHAIR—Listening to your explanation, it sounds to me as though it is highly unlikely that any of the \$10.5 billion for the 2012 to 2014 period would come from the expanded PRRT component of the deal.

Mr Mullen—Assuming that the design features are structured in a manner that we consider to be fair, equitable and appropriate, I think that is a fair statement, primarily because significant revenues are already generated from the PRRT regime, which will not change.

CHAIR—Offshore. What we are looking at is the expanded PRRT arrangements as they would apply to the North West Shelf and the onshore arrangements. That is not expected to kick in before the end of the forward estimates, is it?

Mr Mullen—That is probably a fair assumption.

CHAIR—The Australian tax office recently released a number of draft rulings into aspects of the PRRT regime. Could you talk us through APPEA's views on those rulings and whether there are any implications for the negotiations that will need to take place over the next little while to give effect to the government's PRRT and MRRT announcement?

Mr Mullen—Rulings were issued a number of weeks ago and follow on from the release of some discussion papers in late 2009. In a way, the release of the rulings is symbolic in terms of some of the challenges that will confront both the PRRT and the MRRT negotiations. They are quite lengthy rulings, for those people who have read them. They go into considerable detail in terms of trying to establish the basis for ascertaining deductibility and the nature of deductibility and record-keeping requirements. From APPEA's perspective, we have concerns with the level of detail that is now being imposed on claimants or companies that are operating under the PRRT regime. At the present time they are generally large companies. We are obviously talking about the transitioning of quite a few onshore companies—in fact, essentially hundreds of onshore companies—into a system which will create considerable uncertainty in terms of the requirements, both going forward and historically, and in terms of substantiating deductions.

We really see a critical role of the policy transition group to almost look at this ruling as a reason why there is a need to provide a simpler approach for entities to be able to comply with their requirements under the regime. Clearly, the industry has concerns with a number of elements of the ruling, one of which is the retrospective impact. From an industry association's

perspective we have been seeking clarification on quite a few elements of the operation of the RRT for more than a decade, and to be confronted with very detailed interpretative provisions that will be applied retrospectively, in some cases up to 20 to 25 years, after the start of the regime, is clearly of concern. As I have mentioned, this is clearly a priority for us in terms of the policy transition group—to get that right balance between the integrity of entities operating under the regime and providing taxpayers with the certainty and fairness to operate under a genuinely economic tax.

CHAIR—We might have to leave it there. Thank you so much, Ms Robinson and Mr Mullen, for your assistance to the committee.

Senator IAN MACDONALD—Senator Cormann?

CHAIR—I am sorry, Senator Macdonald?

Senator IAN MACDONALD—I am driving between Moura and Biloela, having been to Blackwater, Emerald and Capella, which is why I am not with you, but I have been listening in on the phone. Could I just ask you whether you could ask Dr Henry something on the record? A lot of people have been raising with me that the announcement of the new MRRT indicated that it related to coal and iron ore. People I have been talking to out here are saying they cannot find that anywhere, that there is nothing written about it. They are also telling me that they are currently still going through the 5,000 pages of the RSPT, which they think is relevant to this. They have asked for further detail; they have been told it will not be available—until 30 August, I think they said, and then only to people who are registered and can show a business number—so they are trying to work out what they are doing. They have also told me they are spending a small fortune on accountants and lawyers, trying to work out whether they are in, whether they are out, how it affects them, what they should be doing, how they should be dealing with staff et cetera. Particularly, a couple of quarries out here have specifically raised this with me. They are quite concerned. I am wondering, in case I drop out and do not get an opportunity to question Dr Henry or the department, whether you could raise some of those issues and try and get some clarification for these constituents out in the Bowen Basin coalfields area.

CHAIR—Yes, excellent; we will.

Proceedings suspended from 10.03 am to 10.13 am

BARTLEY, Mr Scott William, Principal Adviser, Resource Tax Unit, Business Tax Division, Department of the Treasury

DAVIS, Mr Graeme, Manager, Business Tax Division, Department of the Treasury

HENRY, Dr Ken, Secretary, Department of the Treasury

McCULLOUGH, Mr Paul, General Manager, Business Tax Division, Department of the Treasury

CHAIR—I welcome Dr Henry and officers from the Department of the Treasury. I understand you have been given information on parliamentary privilege, the protection of witnesses' evidence and public interest immunity claims. We have read your submissions.

Dr Henry, thank you for making yourself available to the committee again today. Recalling you here today was not our preferred option; however, the government on 2 May sought to impose a massive new tax on the mining industry, which is an important industry for Australia. After that event they negotiated a deal on the design of that tax in private. Changes were made to the assumptions underlying the revenue projections in relation to commodity prices, production volumes and presumably a whole range of other variables.

Of course, we have asked questions in relation to these questions, answers to which we think are in the public interest given the impact of the tax, the changes to it since and the assumptions that have been changed on the budget, on the economy, on jobs, on investment in the mining industry and, of course, also on states like Western Australia and Queensland in particular. In that context, of course, we are rather suspicious as to why the government would not be volunteering information on many of these questions, because of course not doing so raises suspicions as to whether the government, in fact, has something to hide. So we are very grateful for your attendance this morning. We are hopeful that we are going to get some answers to the questions that we explored with you last week. As you might be aware, I wrote to the Prime Minister yesterday asking her to facilitate you being able to answer some of those questions that we have been pursuing in the public interest. With those few opening remarks, Dr Henry, I invite you to make a brief opening statement, and then the committee will ask you some questions.

Dr Henry—Thank you. I do not have any opening statement prepared.

CHAIR—Let us get straight into it, then. Are you now in a position to provide answers to all the questions you took on notice last Monday?

Dr Henry—I have, as you know, provided the committee with responses to all of the questions taken on notice. In respect of a number of those questions, having referred the questions to the Treasurer for his consideration, I gave a response to the effect that that sort of information is not generally provided. I presume your question is whether at this point I am able to provide such information, notwithstanding that it is not general practice for such information to be provided. I would, of course, wish to take that question on notice and refer it to the Treasurer for his consideration, since I would want to inquire of the Treasurer whether he wishes

to reconsider whether the committee should be provided with additional information. However, that is essentially by way of background, because I am able to say to the committee that it is my understanding that the Treasurer will shortly be putting more information into the public domain, some of which information goes very much to the questions that I took on notice at the last committee hearing.

CHAIR—So, if the Treasurer is going to provide the information in any event, why would you not be at liberty to provide it to the committee this morning?

Dr Henry—Of course I am very happy to ask the Treasurer whether he would be comfortable with me publishing the information today in this committee or whether he would prefer himself to publish the information shortly.

CHAIR—We gave you notice yesterday that we would be seeking these answers again today. Maybe we should have a short interruption so you can check with the Treasurer whether he would be comfortable with you answering the questions of this committee here. You have the information, presumably.

Dr Henry—As it happens, no, I do not have the information in front of me. Indeed, it is my understanding that the information which is to be published has not yet been finalised.

CHAIR—Okay. Let us go through them in turn: the changes in assumptions around commodity price forecasts and the change between the budget and the announcement on 2 July. Do they still have to be finalised or does Treasury have that information?

Dr Henry—Certainly Treasury has information about the changing commodity prices between 2 May and 2 July that underpin the forecast revenue for the MRRT. We have that information.

CHAIR—So who has made a decision that you are not allowed to share that with the committee?

Dr Henry—It is the Treasurer's decision whether that information is provided to the committee and in what form it is provided to the committee. In respect of these questions I think you will find that I will continue to seek the Treasurer's guidance on the matter of what information he wishes to be provided to the committee.

CHAIR—Last week we asked you questions on where the \$10½ billion of revenue is expected to come from for the period 2012-14—where it is coming from geographically and where it is expected to come from by resource. When you took those questions on notice, indications either from you or Mr David Parker at the time were that, 'This is not going to be very difficult to get hold of and we will take it on notice.' Specifically in relation to the geographic sourcing of the revenue, essentially he said, 'I will have to do a bit of work but it would not be too hard to identify that.'

Dr Henry—I am sorry, Senator, that is not my recollection. I would have to consult the *Hansard* record.

CHAIR—The *Hansard* record will show that is what David Parker in fact said. I think you, Dr Henry, and I agreed that you would have to do the work, given the government's commitments for the infrastructure fund to be proportionate to the revenue raised in individual jurisdictions.

Dr Henry—Yes.

CHAIR—Can I just understand more clearly. When you assessed those questions on notice, you would have been in a position to answer those questions except that the Treasurer came to the view that that information should not be provided to the committee in that form.

Dr Henry—No, not in respect of geographic impact and impact by commodity. I stand to be corrected here but I do not believe that work has been done. I do not believe that we have that work sitting in the department in a form in which it could be made available to this committee or indeed to anybody else. That is work which has yet to be done.

CHAIR—Okay, but clearly in relation to the changes in commodity price forecasts, in terms of the changes in assumptions around production volumes and so on, you would have had to do that work before the government was able to go out and announce the deal on 2 July.

Dr Henry—That is correct.

CHAIR—So that information would have been available to you and you would have been able to provide that information. Who made the decision for that information not to be provided in answers to questions on notice by this committee?

Dr Henry—As I have already indicated, it is for the Treasurer to decide whether that information is provided to the committee and in what form.

CHAIR—So the Treasurer decided that you are not able to answer our questions in relation to—

Dr Henry—Let me put it this way: as you know, at the last hearing I undertook to seek the Treasurer's advice in respect of how those questions should be answered. The answers that have been provided to the committee incorporate the Treasurer's advice.

CHAIR—Do you know when the Treasurer is expected to release this information?

Dr Henry—No, I don't. I honestly do not, but I understand that it is imminent. That is to say, I understand that it is within a matter of days.

CHAIR—Will it include information about the assumptions about commodity prices and volumes under the RSPT and the MRRT?

Dr Henry—As I said, it is my understanding that the publication, if you like, has not been finalised. The form of the release of the information has not been finalised.

CHAIR—I propose we have a short interruption of the committee to enable you to inquire with the Treasurer's office as to whether he is indeed comfortable with you providing the information that we think should be provided in the public interest to this committee today. The committee will adjourn until 10.30, and hopefully by then—

Senator HUTCHINS—So we can watch Julia Gillard at 10.25.

CHAIR—You can do so if you want.

Proceedings suspended from 10.24 am to 10.29 am

CHAIR—Dr Henry, has the Treasurer given you any indication as to whether he is happy for you to provide this information to the committee in the public interest?

Dr Henry—I have taken the opportunity of the break to consult with the Treasurer's staff. I have not spoken directly with the Treasurer myself but I have spoken with his staff and I can report that it is the Treasurer's intention to publish the information imminently. I can confirm that the information, the publication if you like, is still in draft form, it has not yet been finalised. I can also report that, as I indicated earlier, the Treasurer would be publishing the information.

CHAIR—The information that we have been seeking?

Dr Henry—Some of the information that you have been seeking.

CHAIR—Which bits?

Dr Henry—In particular, information that would allow the reader to determine how much of the net revenue impact of the 2 July announcement is due to parameter variations, including commodity prices, and how much is due to policy decision. That is one of the issues which you will recall we spent some time on at the last committee hearing. In fact, you referred to it again this morning. So the Treasurer intends imminently to put that information into the public domain.

CHAIR—Why are you not in a position to do so now? What is the public interest to delay the release of that?

Dr Henry—I am not suggesting there is any public interest to be served by denying the committee the information. I am certainly not relying myself on any public interest claim and never have. I should not say I never will but I cannot imagine a circumstance in which I would.

CHAIR—What is 'imminent'? When you say the release is imminent—

Dr Henry—As I indicated earlier, I do not know when this information will be published.

Senator FIFIELD—Dr Henry, can you indicate whether what the Treasurer will release will be information specifically about these tax changes or will those parameter changes which you are talking about, the information in relation to those, be released as part of a broader economic statement or part of a broader update of government parameters and forecasts?

Dr Henry—That I do not know either.

CHAIR—Who makes these decisions?

Dr Henry—The Treasurer does. Let me put it this way. In a budget or midyear economic and fiscal outlook the Treasurer and the Finance Minister take responsibility for the content of the document. With respect to the publication we are talking about right now, which is, as I have already said, in a draft form and it has not been finalised, I do not know whether that will be a joint publication between the Treasurer and the Finance Minister or whether it will be authorised by the Treasurer alone. I suspect the former but I do not know that. That would be the most usual.

Senator FIFIELD—So you suspect it would be by the Treasurer alone.

Dr Henry—No, the former, that it would be a joint statement, but I do not know that for a fact.

Senator FIFIELD—But it could be a broader statement, a broader update of parameters and forecasts.

Dr Henry—As I said, the publication is still in draft form, it has not been finalised, and unless and until it is I am a bit wary of misleading the committee on the content—

Senator FIFIELD—It could be a pre-election PEFO or something.

Dr Henry—Well, it could not be a PEFO.

Senator FIFIELD—By definition it could not be a PEFO but it could be something that looks like a PEFO.

Dr Henry—I do not want to run the risk of misleading the committee about the content of the document, about its nature. Since it is still in draft form, I would prefer not to speculate on the nature of the document.

CHAIR—Are you in a position today to tell us what your commodity price assumptions are and what your assumptions are around production volumes at the basis of the assessment of the fiscal impact of the MRRT expanded PRRT?

Dr Henry—No, I am not and, as I did on the last occasion that we met, I would refer that question to the Treasurer for his consideration.

CHAIR—Are you aware that the Western Australian government publish this sort of information as a matter of course in their budget papers? Given that the revenue in that state is sensitive to changes in commodity prices and production volumes, and given that under this tax the revenue of the Commonwealth will be sensitive to changes in commodity prices and production values if this tax were to get up—but you have budgeted for it—would it not be prudent practice for this sort of detail to be included as a matter of course, as part of usual budget practice?

Dr Henry—It is in the Commonwealth budget as well. I am not sure whether it is to the same level of detail as the Western Australian government publishes. I would have to compare the two documents.

CHAIR—You just said that the Commonwealth does it as part of the usual budget practice.

Dr Henry—Yes.

CHAIR—The government, in their answer, said that the government does not provide this level of detail as part of usual budget practice. Yet you told me just now that the Commonwealth does provide it in the budget papers.

Dr Henry—The Commonwealth budget papers contain a good deal of information on commodity prices, and so too, for that matter, have recent midyear economic and fiscal outlooks contained quite a lot of information on commodity prices, including by commodity and not just an aggregate. In particular, the budget papers, in those parts of the budget that deal with revenue, include information on prices and volumes. As I said, it is maybe not to the same degree as the Western Australian government budget, but I am not sure about that.

CHAIR—Your budget papers, the May budget papers, between pages 2 and 5 of Budget Paper No. 1, indicate that the government expected commodity prices to moderate somewhat in 2011-12. Do you stand by that statement in your budget papers?

Dr Henry—Sorry, which paper was this?

CHAIR—This is a quote from Budget Paper No. 1, pages 2 to 5.

Dr Henry—Which year?

CHAIR—This year, the 2010-11 budget papers. Budget Paper No. 1 says:

Commodity prices are expected to moderate somewhat in 2011-12 ...

Do you stand by that statement?

Dr Henry—Clearly, since the budget, people—well, everybody really—have been revising up their commodity price forecasts over the 2010-11 and 2011-12 period. Of course, it depends on the commodity. Not all commodity prices, as we discussed last time, are actually increasing at all and certainly not all are increasing at the same rate. But, as a general proposition, commodity prices over the forecast period have strengthened relative to budget.

CHAIR—So what are the actual mineral price and volume assumptions used in the MRRT impact calculations, given that you consider them to have strengthened since the budget?

Dr Henry—As I have already indicated, that is a question that I will refer to the Treasurer.

CHAIR—As a matter of course, do you check your estimates against commercial estimates or estimates made by state governments?

Dr Henry—As a general proposition, yes. That is to say, not all. I would not want to suggest that it was all.

CHAIR—You are not prepared to give us information about your commodity price assumptions and your volume assumptions. I am not blaming you for it, because I understand the position you are in. However, I do think it is entirely unsatisfactory, given the impact of the change and given that it was negotiated in private. The way the government has set out to mask the fiscal impacts of policy changes versus changes in assumptions I think is entirely inappropriate. For Senate committees like this one it is our job to get the sort of detail that we have been asking you for. I am really sorry about the position the government has put you in, quite frankly. But, given that you are not able to give us the information itself, can you talk us through your methodology a bit more. Last week you indicated to us that the ABARE data, the ABARE long-term minerals price and volumes forecast, was one of the inputs that you considered. Is that correct?

Dr Henry—That is correct.

CHAIR—And you presumably used that data for the May budget, when you were assessing the RSPT proposals?

Dr Henry—My colleague has just confirmed that those data are an input and I think I indicated that last time we met, that we consider those data along with other data.

CHAIR—Sure. Over what period do the ABARE long-term minerals price and volume forecast go which you considered for the purposes of the budget?

Dr Henry—I do not know, I am sorry; I would have to take that question on notice.

CHAIR—Does somebody here know? I would like to minimise the number of questions you take on notice, for understandable reasons.

Dr Henry—I understand, but I can assure you that with respect to that question I can get you an answer to that question very quickly.

CHAIR—Even though you might not know the specific period, they are long-term forecasts which will go up to a decade with obviously reducing accuracy moving forward—that is fair to say, isn't it? Long-term: it is not just over the next 12 months; it is over an extended period of time, isn't it?

Senator HUTCHINS—Can I just ask a question?

CHAIR—Hang on, can we just get the answer?

Dr Henry—Senator, perhaps I should know the answer to that question, but I do not. I would like to check it; I would not like to mislead the committee.

CHAIR—Before I pass over for a short question from Senator Hutchins, the revised MRRT, did that rely on ABARE long-term forecasts as one of its inputs which were not yet made public? Or did it rely on short-term data?

Dr Henry—The earlier forecasts did not rely on ABARE forecasts and projections, and neither did the 2 July numbers rely on ABARE forecasts and projections. ABARE data are important inputs, but they are only inputs into our work. We do not rely on them.

CHAIR—So you also look at short-term data, spot prices and all of that?

Dr Henry—Yes, of course, and as I indicated last time we have liaison directly with market analysts and we have liaison directly with the companies themselves. And of course during the past couple of months there has been, as you know, quite extensive, unusually extensive and intensive, liaison with affected companies.

CHAIR—Yes, ‘unusual and intensive’ indeed! You talk about short-term data and spot prices. Isn’t it true that spot prices for iron ore, for example, have gone down in the period 2 May 2010 to 2 July 2010 by about 30 per cent in US dollars according to the steel index?

Dr Henry—I do not have the number with me.

CHAIR—I am happy to share my data with you. It is open and transparent on this side of the table, Dr Henry. You would be aware though that the general direction of the spot prices for iron ore has been down in the relevant period between May and—

Dr Henry—Yes.

CHAIR—You are. So how does that coincide with this revision of increased commodity prices which is being used by the government to come up with a conclusion that revenue will increase as a result?

Dr Henry—One has to make a judgement about the commodity prices in the relevant period. The relevant period for purposes of the revenue from this tax is not this year, obviously. In fact in the 2 May statement it records positive revenue in the last two years of the forward estimates, but not in this year and not in the next year. So what is important here are judgements about commodity prices not this year—well I would not want to suggest that is unimportant, obviously it is not unimportant, but what is rather more important is where commodity prices are likely to go over the last two years of the forward estimates period.

CHAIR—You are, of course, spot-on in that last part of your answer. However, we have not been able to find any evidence in the market whatsoever of improvements in the commodity price outlook that might have happened between 1 May and 1 July 2010. On what data are you basing your assessment that, in the final two years of the forward estimates period, commodity prices are likely to increase significantly?

Dr Henry—A mix of forecasts internally generated and information supplied by the companies themselves.

CHAIR—So the companies themselves have said to you that they expect significant increases in commodity prices in the last two years of the forward estimates period.

Dr Henry—I think so. Certainly generally that is correct. The only reason I am hesitating is because your question relates to both of those years. I think it is the case that in both of those years the companies indicated higher commodity prices than we had been thinking previously.

CHAIR—Can you share the data with us? Have those companies released that data publicly? Have they advised the market of expectations of significantly higher—

Dr Henry—I do not know whether and to what extent the companies have published that information. I would have to take that on notice. As to whether the information can be shared with the committee, again that is a question I would wish to refer to the Treasurer.

CHAIR—When you value mining assets for the purposes of the MRRT, will the government use the same commodity price forecasts as it has used to calculate the expected revenue from the MRRT?

Dr Henry—By the time it takes as legislated and implemented, and then by the time we get to the practical matter of the valuation of starting cost base, spot prices would have moved but also expectations of future commodity prices will have moved. So one cannot say that definitely the same commodity prices would be used. We are talking about assessments that will be made some years hence.

CHAIR—In fact they could well be lower than what you have now put into your model for the MRRT expanded PRRT deal.

Dr Henry—As we discussed last time, commodity prices tend to be relatively volatile. They go up and down. For the past several years commodity prices have generally been elevated relative to trend. As you know, we expect that will continue for quite some time. We think that we are in a period of elevated commodity prices relative to long-run history. But it would be courageous at least to pretend that commodity prices at some stage over the forecast period will not fall somewhat. They might. They might go up to even higher levels.

CHAIR—You have just mentioned that expectations are that increases in commodity prices will continue. To the extent that you expected that, those expected increases would have been part of your assumptions in the budget released only 2½ months ago.

Dr Henry—That is true.

CHAIR—The question really is whether anything happened between 1 or 2 May and 2 July which can give you cause to significantly change your commodity price forecasts. What is the event that happened, other than information from the companies? Is there anything else, other than information provided directly to you by the companies?

Dr Henry—As I indicated, I will have to take on notice the first part of that question. As I have already indicated, in revising our commodity price forecasts we did some work internally, which did lead to upward revisions in our commodity price forecasts. We relied on publicly

available information and we spoke to the companies. As I understand it, in discussions with the companies there was a further but relatively modest upward revision to the forecast we had already come to. I do not have with me the price decomposition of those two upward revisions to commodity prices and will have to take on notice that question.

CHAIR—I might just make you aware that the committee this morning resolved that answers to questions on notice will fall due at 5 pm on Friday.

Dr Henry—As always, Senator, I will do my best.

CHAIR—I know you will, Dr Henry. I want to go back to the budget delivered early in May. The government stated then that ‘the medium-term projections assume that the terms of trade will fall over the medium term as supply increases’.

Dr Henry—Yes.

CHAIR—Does this remain the view of the government—you have just said yes—and the Treasury? If so, what implication does this have for the MRRT expanded PRRT revenue, particularly beyond the forward estimates?

Dr Henry—As indicated in your question, that is a projection rather than a forecast. It is a projection that is conservative. Perhaps I should say it is a prudent projection to underpin prudent medium-term fiscal assessments. We do not have any particular information that would allow us to forecast commodity prices out over that time horizon. You are, after all, talking about perhaps a 10-year time horizon. You would be aware that, starting back in 2003, which is when we first began making medium-term projections of commodity prices and publishing them, we have consistently been caught off guard by movements in commodity prices and have found ourselves having to make forecasts in the near term which are considerably above projections for those corresponding ones made only a few years before but—

CHAIR—But you know what, Dr Henry? At least in that circumstance everybody can assess the reasons for any changes in budget outcomes compared to budget. Everybody can see whether they are related to changes in commodity prices beyond expectations or whether they are related to changes in policy settings. The problem we have here is that the government has changed at the same time both the policy settings and the underlying assumptions on things like commodity prices and production volumes without separating clearly one from the other. I believe that this was for a political purpose on behalf of the government and I do not think it is very good practice. That is really the reason why we are having this conversation.

Dr Henry—All I can say in response to that, Senator, is, as I have already indicated, the Treasurer will make that information available—

CHAIR—In the fullness of time?

Dr Henry—Imminently, as I understand it.

CHAIR—On a question of process methodology, how many mineral commodities have you reviewed in changing your assumptions around commodity prices and production volumes?

Dr Henry—Quite a lot.

CHAIR—Did you review all of them and make adjustments to all of them?

Dr Henry—All of the major ones.

CHAIR—So the fiscal impact of the MRRT expanded PRRT deal includes changed commodity price assumptions for—

Dr Henry—Let us say for gold.

CHAIR—Gold?

Dr Henry—Yes, which is not in the scope of the MRRT.

CHAIR—So it is not just in relation to the groups of minerals that are subject to the MRRT?

Dr Henry—No.

CHAIR—So you might actually have changed hundreds of assumptions across your budget in the context of assessing the fiscal impact of the MRRT expanded PRRT deal?

Dr Henry—Quite possibly.

CHAIR—Will you be able to provide us on notice—I know that you will have to check with the Treasurer, but I consider this information to be in the public interest—a table with all of the changes in assumptions about all of the variables that have led to the fiscal outcome of a \$10½ billion revenue projection for the 2012-14 budget forward estimates period? If the Treasurer is listening, he might want to consider making that part of his announcement. We would be very grateful.

Dr Henry—I will certainly take it on notice and consult with the Treasurer.

CHAIR—If you had not changed your assumptions on commodity prices and volumes, what would have been the net fiscal impact of the MRRT expanded PRRT deal then?

Dr Henry—As I have indicated previously, I think you have asked that question previously.

CHAIR—No, the question I asked previously was how much you would have raised under the RSPT if you changed all of your assumptions equally. My question now is a bit different.

Dr Henry—It is a different question; you are quite right. But I provide the same answer.

CHAIR—Okay. It is a question of process, then. When you became aware of the deal that had been negotiated, its parameters and everything else, did you initially model the fiscal impact on the assumptions in the budget, commodity price volumes and everything else or did you immediately review all of your assumptions before making that assessment?

Dr Henry—I think I indicated the last time we met that we were revising our commodity price forecasts at the same time.

CHAIR—It was coincidence; one did not lead to the other.

Dr Henry—It was coincidence.

CHAIR—A very convenient coincidence, as I might have mentioned at the time. A number of analysts have made public their assessments—you talked about your consultations with analysts—that little or no material MRRT will be paid by miners or by oil and gas producers in the budget out years. Are all of these industry analysts wrong?

Dr Henry—Other industry analysts have said quite different things. There is some dispute, I have noticed—in media reporting, anyway—about comments that people have allegedly made. I was reading this morning in one of our newspapers that another analyst was contradicting the views that an analyst had reported yesterday about comments made by a BHP executive, for example. There is a lot of discussion out there. There are a lot of people prepared to make statements of the sort that you have just made.

CHAIR—But the thing is that the reason people have to resort to these sorts of things is that the government so far has refused to release relevant information. In the absence of the data being made available by the government, all sorts of people will make all sorts of assumptions and come to all sorts of conclusions.

Dr Henry—That is a contestable proposition you have just made, and we will have an opportunity to test it. I hope you are right but, frankly, I doubt it.

CHAIR—You doubt what?

Dr Henry—I doubt that the Treasurer's publication that I referred to earlier will silence all the critics.

CHAIR—I was not suggesting that it would silence all the critics, but it would, hopefully, contribute to a more informed public debate to the extent that you are concerned that the current debate might not be as informed as it should be.

Dr Henry—We agree on that.

CHAIR—I thought we might. You specifically mentioned BHP. The *Australian Financial Review* yesterday quoted a Bank of America Merrill Lynch analyst as saying it is unlikely there would be much impact on BHP's revenue for the first 25 years. You would have read that. Is this correct?

Dr Henry—I did read that. I read the same newspaper—this is what I was referring to earlier—reporting this morning the view of another analyst who claims to have been at the same meeting at which the BHP executive spoke and who gave a rather different version of the BHP executive's remarks.

CHAIR—It is also reported today, of course, that BHP Chief Executive Officer Marius Kloppers has confirmed that his company will suffer ‘little impact during the first five years of Labor’s new mining tax’. Where is the money coming from?

Dr Henry—That would be a good question if one were to take at face value all of the comments that you have reported thus far but I can assure you that in consultations with the companies, and those companies are BHP, Rio and Xstrata, the companies at very senior level assured us that they would be paying very substantial amounts of tax under the MRRT.

CHAIR—Assured you or assured the government?

Dr Henry—Well, assured the government and, as I indicated last time, we were provided with information which we then quality assured ourselves so we could provide some level of assurance to the government that those claims had veracity.

CHAIR—So have you in Treasury modelled individual companies’ MRRT obligations in arriving at your aggregate number of \$10½ billion?

Dr Henry—I do not believe we have.

CHAIR—So you have essentially taken the companies’ word for it?

Dr Henry—Certainly not, and that is inconsistent with what I said in response to the earlier question. We have undertaken what I would describe as quality assurance or due diligence. We have not simply taken the companies’ word for anything.

CHAIR—So I guess it leads us back to the question: how do you get to your \$10½ billion forecast?

Dr Henry—As I indicated, I understand that the Treasurer will be providing further information on that question shortly.

CHAIR—We had Western Australian treasury here this morning. They tell us that they expect between 60 and 65 per cent of the revenue to come from Western Australia. I refer you also here to the quote by Mr Parker on page 15 of the *Hansard* transcript from last week’s hearing where he said that it ‘would not be a difficult piece of analysis’ to identify how much of the \$10½ billion would come from Western Australia, Queensland or other states. Are Western Australian treasury right when they tell us that around \$6.8 billion of revenue from the MRRT would come from Western Australia?

Dr Henry—I do not know and I would have to take that question on notice.

CHAIR—Please do. I table the Western Australian treasury methodology and their assumptions—for your purpose—because the Western Australian treasury and the Western Australian government are being entirely transparent and they are very keen for this information to be scrutinised by yourselves. In fact, this morning WA treasury officials explained to us that they have not had an opportunity yet to talk to anyone in the federal government about the way the MRRT and the expanded PRRT arrangements are going to work out for them and a whole range of associated issues. I did offer to provide you with the acting undertreasurer’s mobile

number, but I think he is making separate arrangements. But if you can please on notice review the conclusions of the Western Australian treasury, particularly where they come to the conclusion that nearly \$7 billion conservatively—out of \$10½ billion—would come out of Western Australia and tell me whether you agree and if you do not agree why and on what basis you come to a different view. Is that something you can take on notice?

Dr Henry—I can. I am curious to know—I guess I can find out for myself—whether the Western Australia treasury has indicated where the \$7 billion is going to come from.

CHAIR—I am not going to go through all of the evidence but I invite you to review their evidence this morning. They certainly talked us in some detail through their methodology and how they have assessed it using Commonwealth Grants Commission data and data from individual states and territories. I am really interested in your view. If WA treasury is correct and if 65 per cent of revenue from one single new tax on mining were to come from one state like Western Australia, that would seem a rather unfair national tax, wouldn't it?

Dr Henry—You are asking me to express an opinion on policy.

CHAIR—Is there any limit to how much tax can be raised in one single tax measure—how much can be imposed on one individual state? Is there a taxation fairness principle which says that taxes should be imposed on a fair and equitable basis across the country and not be targeted at one specific state?

Dr Henry—Well, yes. This raises some very interesting issues and we could discuss them for a considerable period of time; certainly, I could expound on them for hours. But—

CHAIR—Give us your five-minute version, Dr Henry.

Dr Henry—Okay. There are provisions in the Constitution that prevent the Commonwealth from legislating in the taxation area in a way that would discriminate amongst the states or parts of states. Since this tax is constitutional—

CHAIR—We do not know that.

Dr Henry—This tax is clearly does not discriminate as between the states or parts of states; it does not offend that constitutional limitation. But, secondly—and perhaps more importantly—in the federation there is a well entrenched principle of horizontal fiscal equalisation which is administered by the Commonwealth Grants Commission, or at least they provide advice to the Commonwealth government on how the process of horizontal fiscal equalisation should be administered. And it is horizontal fiscal equalisation which determines the way in which net revenue, from any new tax, actually, is distributed amongst the states. Thus, for example, if the Western Australian government were to double all of its mineral royalties tomorrow, which it could well do, it would find that most of that revenue would end up in the budgets of the other states and territories. In fact, very little of that revenue, once the Commonwealth Grants Commission had done its work, would remain with the Western Australian budget.

CHAIR—So what you are saying is: the Western Australian government would be much better off if you were to raise all of the money centrally in Canberra and then hand it out to the individual states according to—

Dr Henry—No, no—I am certainly not wanting to suggest that. All I want to suggest and emphasise—and this is a very important point, not well understood—is that it is the process of horizontal fiscal equalisation that determines the net revenue flows and the net impact on state budgets of taxation decisions taken not just at the Commonwealth level but by any of the individual states or any of the individual territories.

CHAIR—A positive way of putting that is that increased royalty revenues in Western Australia from an increase in the value of mineral resources flow through as fiscal benefits to all of the states and territories through the Commonwealth grants process.

Dr Henry—That is correct.

CHAIR—So, if that is the case, why do we have a need for this, supposedly to ensure a fair return for the whole of the Australian community from the resources mined in Western Australia?

Dr Henry—That goes to the question of the level of the royalties levied by, let us say, the Western Australian government or the Queensland government or whatever state jurisdiction. And in the public debate since 2 May, a lot has been made of the fact that over the past several years the proportion of mining profits that have been returned to the community through minerals taxation has declined, and declined quite substantially. So it goes to a judgment, really, as to whether state governments are securing sufficient, adequate, fair return for the community from what is presently accruing to the mining companies from the exploitation of these community owned resources.

Senator HUTCHINS—Dr Henry, is it standard practice for Treasury to provide geographical breakdown of tax measures?

Dr Henry—No, it is not.

Senator HUTCHINS—Did you do that for the previous government as well? Did you have geographical breakdowns of tax measures under the previous government?

Dr Henry—That is a long period of time you are asking me to cast back over. I do not recall any case. I do not know; can you recall any case, Mr McCullough?

Mr McCullough—It certainly was not standard practice.

Dr Henry—It certainly was not standard practice, and I don't recall any case.

Senator FIFIELD—But certainly, with some tax measures, they would be broken down by state?

Dr Henry—Certainly, obviously, the GST—and for a very good reason. The GST revenue had to be broken down by state.

CHAIR—And I would have thought that—given the commitment of the then Prime Minister, Kevin Rudd, that the infrastructure fund, of \$5.6 billion or something over 10 years, was to be allocated to individual states according to the share of revenue generated in those states—that would make that sort of modelling pretty imperative, wouldn't it?

Dr Henry—We discussed this a week ago, and Mr Parker indicated, as I recall, that we would probably be doing that work in order to—

CHAIR—He indicated that it would not be a difficult piece of analysis to do. He took the question on notice and we were not provided with the answer. I am still at a loss to understand why it is not in the public interest for this committee to get that information.

Dr Henry—I have not suggested that it is not in the public interest.

CHAIR—Except that you have refused to provide the answer, presumably based on a direction from the Treasurer, which is what we have gone through before.

Dr Henry—All I have done, as is usual practice, is refer such questions to the Treasurer.

CHAIR—So it was his decision to say that the government does not provide this level of detail, in line with usual budget practice.

Dr Henry—As I said earlier, the answers that I have provided to the committee incorporate the counsel that I have received from the Treasurer.

CHAIR—You are of course aware that the only reason you can refuse to answer a question asked by a senator or by a committee is if you have the capacity to rely on a proper public interest ground to refuse providing a particular piece of information.

Dr Henry—I am not relying on any such—

CHAIR—You are not answering the question.

Dr Henry—With respect, I am answering the question.

CHAIR—With respect, Dr Henry, very specifically, the question that was put on notice last week was about how much of the revenue from the MRRR and the expanded PRRT arrangement will come from Western Australia or other states. You took it on notice. Your response was a non-answer. I am not just paraphrasing. What you said is that the government does not provide this level of detail, consistent with usual budget practice. You would have seen the advice from the Clerk of the Senate in relation to this. She concurs that this is a non-answer. The question then arises: what are the public interest reasons for you not sharing that information and for the government not sharing that information?

Dr Henry—I am not—

Senator HUTCHINS—A point of order, Chair. I asked Dr Henry whether or not it was standard practice to provide a geographical breakdown for tax, and he said no. You do not like the answer; I know that. But that is the answer. I have some more questions that I want to ask.

CHAIR—Senator Hutchins, I will point out that the government committed to providing a share to the individual states consistent with the share of revenue generated.

Senator FIFIELD—On that point of order, to be fair to officers at the table, the answer was not really that they did not provide information on a geographical basis but that they do so where it is appropriate. That would be fair to say. This is an instance in which it would be appropriate to do so.

Senator HUTCHINS—Dr Henry, during the consultation process during the change from the RSPT to the MRRT, a number of organisations were consulted. Would that be correct? These would have included government departments and industry bodies, correct?

Dr Henry—That is correct.

Senator HUTCHINS—As is fairly clear from the publicity, a number of industry bodies that were involved and some that were involved did not like the outcome. What government departments were involved in the process? Does that include state government departments? We had the Western Australian Treasury say this morning that they were not involved in the discussions, and yet from what I understand—

Dr Henry—Let me start with the 2 May announcement. With the announcement on 2 May, a consultative panel was established. That consultative panel consulted very widely, including with state government departments.

Senator HUTCHINS—So was the Western Australian Treasury consulted or was the consultation with the Western Australian Department of Mines and Petroleum?

Dr Henry—I am pretty sure that it was the Western Australian Treasury.

CHAIR—They explained it as a one-way communication, though. It was not so much consultation as—

Senator HUTCHINS—Mr Chairman, you will get your chance again. Would there have been any other government departments, like the Queensland Treasury? Let us go back to Western Australia. As I understand it, the collection of the royalties in Western Australia is not done by Treasury; it is done by the Department of Mines and Petroleum. They actually administer the tax. Would it be more appropriate for, say, your body, the consultative committee, to speak to them in addition to Treasury?

Dr Henry—It may be. I do not know. I was not a member of that panel and I simply cannot recall. I do not know whether anyone else can. No. I am sorry, Senator. I would have to take that on notice.

Senator HUTCHINS—Could you take that on notice, Dr Henry.

Dr Henry—Yes, certainly.

Senator HUTCHINS—It would be interesting to see how many of the state bureaucracies—not just, say, the cover letter of Western Australian government or New South Wales government but whether or not their variety of government departments—were involved in the discussions. If you could take that on notice it would be appreciated. Also, for how long did the discussion between the companies and the consultative group go? Was that just as the chair characterised it—a one-way street? Was there extensive discussion with the companies?

Dr Henry—The fact is that it depended upon the company. There was an open invitation for all affected companies to consult with the panel. They were encouraged to consult openly to share information with the panel. Some companies chose to do that. Other companies took weeks even to get to the point of picking up the phone and, when they did meet with the panel, refused to provide any relevant information. I do not wish to name companies, but they know who they are. Some of the consultation therefore was of value and some of the consultation was, frankly, rather pointless. But it varied very much company by company.

Senator HUTCHINS—For how long a period did that go?

Dr Henry—The best part of two months, really.

CHAIR—That was under former Prime Minister Rudd, was it?

Dr Henry—Yes.

CHAIR—The period which was characterised by senior cabinet members as not having experienced adequate consultation.

Senator HUTCHINS—So there was two months of discussion. Some companies decided to participate and some did not.

Dr Henry—That is correct.

Senator HUTCHINS—And you are loath to name the ones that did not, but they know who they are. I suppose they are squealing the loudest. I do not have any more questions at this stage but I have some more for later.

CHAIR—Before I move on to other things, Senator Macdonald, who is in Northern Queensland meeting with constituents at the moment, asked me to raise this. There seems to be a level of concern amongst some of the mining companies covering resources which have, on the face of it, been excluded that they could still become subject to the MRRT expanded PRRT arrangements on the basis that they have been excluded only in a press release. There has not been any official documentation to confirm that all of the smaller mining companies that have previously expressed concerns are in fact properly excluded from the scope of the MRRT. Can you confirm that for us on the record and help us allay those concerns?

Dr Henry—I can certainly confirm that that is the government's intention. As you know, Senator, since you yourself have an important role to play in this, it is for the parliament to determine ultimately how the legislation is framed. But it is certainly the government's intention.

CHAIR—Until it changes its intention.

Dr Henry—It is the government's intention.

CHAIR—In consultations with the state government, clearly the state government would be a key stakeholder in all of this. Did you provide them with any analysis on the likely economic impacts of the minerals resource rent tax on Western Australia?

Dr Henry—Certainly I did not. I do not believe anybody in my department did so.

CHAIR—Have you shared with WA Treasury how Commonwealth Treasury calculated the revenue expected from the minerals resource rent tax?

Dr Henry—I do not believe so, Senator. I stand to be corrected, but I do not believe so.

CHAIR—Have you provided any information to the state government in Western Australia or, indeed, other state governments on how state royalty arrangements will interact with the application of the minerals resource rent tax?

Dr Henry—The 2 July statement makes pretty clear the form of that interaction.

CHAIR—Except it does not seem to be so clear to the officers of WA treasury—who, I am sure, are as professional and expert as Treasury officials at a Commonwealth level. Other than the information that you provided to our committee last week—which was that in a general sense arrangements will not change from the RSPT to the MRRT arrangements—there has not, as I understand it, been any formal confirmation of that through any of the official channels.

Dr Henry—That is probably right, but I am sure that, over the next two years, before the tax starts operation, there will be plenty of opportunity for that sort of consultation and for that sort of detail to be settled.

CHAIR—Over the next two years, I guess. Some people are of the view that the only reason the federal government has had any discussions with anyone is that it is facing an imminent election. After the election I guess some of that dynamic will change again. Are you giving an absolute guarantee on behalf of the government that state governments will be properly consulted after the election?

Dr Henry—It is not for me to speak on behalf of the government.

CHAIR—Will state governments—in particular those in the states that are significantly impacted—be represented on the policy panel?

Dr Henry—I am sorry, Senator; which panel?

CHAIR—The policy transition panel which is going to be chaired by Don Argus. Will state governments, who are, after all, significantly impacted by all of this, be represented in this policy transition group?

Dr Henry—I do not know. The membership of that panel, as I understand it, has not yet been finalised. I am not able to indicate to the committee this morning what the composition of that panel might be.

CHAIR—The government wants us to believe that all of these mining tax related issues have now been fixed, but it seems to me like there are still a lot of outstanding questions and outstanding issues that have not been resolved. Will that be resolved in the next few days or will we have to wait and trust that everything will be okay after the election?

Dr Henry—I am not sure which matters you are referring to, Senator. Perhaps you could give me a list.

CHAIR—Like the matters that I have just asked about. For example, who is going to be involved in the policy transition arrangements? What is going to be the impact on jobs and the economy? What is going to be the share of revenue that is going to come out of Western Australia, Queensland and other states? There is a whole range of outstanding matters, I would have thought.

Dr Henry—But these are not matters inherently of policy design—that is, matters that, for example, go to the crafting of the legislation or to the impact on taxpayers of that legislation or at least the compliance impact on taxpayers of that legislation. I think there is a fair degree of clarity around those design parameters.

CHAIR—Whose idea was the 25 per cent extraction allowance?

Dr Henry—I indicated last time that officials were not party to the face-to-face discussions that occurred between the government and the mining executives.

CHAIR—Does that mean that you do not know?

Dr Henry—Well, I cannot be sure. I have a view, but I cannot be sure.

CHAIR—So we do not know whether it was an idea that came from the government or whether it was an idea that came from the companies themselves?

Dr Henry—I think it was an idea that came from the companies, but I cannot be sure.

CHAIR—But it was certainly not an idea that came from Treasury?

Dr Henry—I can confirm that it was not an idea that came from Treasury.

CHAIR—Who came up with the 25 per cent figure?

Dr Henry—Again, I do not know.

CHAIR—So you do not know how that was determined?

Dr Henry—No, I do not.

CHAIR—Do you know what the effect on the budget is going to be of the 25 per cent extraction allowance?

Dr Henry—I am not sure that it is possible to answer that question. But I do not, no.

CHAIR—Perhaps you could take it on notice and see whether you can answer what the fiscal impact specifically of the 25 per cent extraction allowance is going to be.

Dr Henry—Yes. I am certainly happy to take it on notice. I am just indicating that I am not sure that the question can be answered, but we will see.

CHAIR—Why is that?

Dr Henry—Because of interaction between that allowance and other features of the tax. I could provide you with an answer but if I made different judgments about how far downstream the tax applies I might come up with different answers. I am just being cautious that there are interaction effects here that would have to be thought through—that is all.

CHAIR—So you have a policy measure here which provides essentially an up-front deduction where you cannot assess what—

Dr Henry—No, it is not an up-front deduction as such, though it does interact with features of the tax which could be described as providing up-front deductions.

CHAIR—Under the MRRT regime, as I understand it, taxpayers will automatically be entitled to a 25 per cent extraction allowance that would be offset against the otherwise taxable profit. The extraction allowance is in addition to deductions for the actual cost of extraction. So it is essentially an up-front deduction, isn't it?

Dr Henry—It is essentially reducing taxable profit by 25 per cent. That is what it is.

CHAIR—But you cannot spontaneously cost what the impact of that part of the package is on the budget?

Dr Henry—It would be tempting, obviously, to look at the \$10.5 billion net revenue figure and gross it up by an amount to back out the 25 per cent. But all I am indicating to you is that there are possible interactions with other elements of the tax design that I would need to think through before confirming that that is the case. That is all I am indicating.

CHAIR—In response to question 13, one of the questions that you were allowed by the government to answer—this is in relation to growth dividend—Treasury stated:

The reductions in the growth dividend in 2012-13 and 2013-14 reflect the changed arrangements for cutting the company tax rate.

But in Budget Paper 2 the government stated a 0.3 per cent increase in GDP from the resource tax reforms. So why hasn't the government reduced the growth dividend from the resource tax reforms when you confirmed last week that the changes to the RSPT would mean that the MRRT would have a less positive impact on investment and jobs?

Dr Henry—It is a matter of timing. I think that 0.3 per cent is a long-run figure. That is to say that it would not have an impact over the forward estimates period.

CHAIR—Going back to where the money is coming from geographically, the MRRT will only apply to iron ore and coal. ABARE statistics show that Western Australia accounts for about 96 per cent of Australia's iron ore production. It would then be fair to say that over 90 per cent of the MRRT revenue would be expected to come from Western Australia, wouldn't it?

Dr Henry—It might be fair. I do not know. After all, it is a profits based tax and not a quantitative—

CHAIR—If 96 per cent of Australia's iron ore production is in Western Australia, where would you expect the revenue to come from other than Western Australia?

Dr Henry—I certainly would expect most of it to come from Western Australia, but you put a figure on it. I would need to do some work because it is a profits based tax.

CHAIR—ABARE statistics also show that Queensland would provide to the tune of 56 per cent and New South Wales would provide to the tune of 40 per cent, accounting for 96 per cent of Australia's saleable black coal production. It would be fair to assume that over 90 per cent of the MRRT from black coal will come from Queensland and New South Wales?

Dr Henry—It seems like a reasonable assumption, but it is only that without it being subject to analysis. Again, I would need to subject it to analysis.

CHAIR—In your analysis, in your modelling of the fiscal impact, have you assessed how the state royalty credit arrangements interact with revenue from coal versus revenue from iron ore?

Dr Henry—Yes.

CHAIR—Can you share your conclusions with us?

Dr Henry—I will have to take that question on notice. The Treasurer—

CHAIR—That was a very approximate yes. Would it be fair to say that you would end up getting a larger share of revenue through the MRRT from iron ore related profits than from coal related profits? That was a nod, I think, that the answer is yes.

Dr Henry—No, I asked him if he understood the question.

CHAIR—He does understand the question. I am pleased with that; that is a good start.

Dr Henry—No offence intended. I understood it; I just wanted to make sure my colleague did. It may be that you interpreted the nod correctly, Senator.

CHAIR—So the answer is yes.

Dr Henry—Probably. We have not done the work and you are asking us to make a judgment. We are prepared to join you in your judgment, without having done the work.

CHAIR—My judgment relies on the judgment of the West Australian Treasury and the West Australian government, because their assessment is that, because of the interaction between state royalties and the MRRT as it relates to coal as opposed to iron ore, that the larger share of revenue will come from iron ore. I would like to know how much of the share would come from iron ore as opposed to coal.

Dr Henry—I understand. We will, as I indicated, take that question on notice and see if we are able to provide the committee with that level of detail.

CHAIR—By five pm on Friday?

Dr Henry—I will ask the Treasurer and we will provide an answer to the question by five pm on Friday.

CHAIR—I do not mean to be cute here but obviously we are running hard now against political cycles and pre-election deadlines. If the Treasurer and the Gillard government were of a mind not to answer that question, they are actually under an obligation to state the public interest reasons as to why they think it is not in the public interest for that information to be provided. So next time round I do not want to have just a one-line answer which says, 'The government does not provide this level of detail consistent with usual budget practice.' The next time round either we would like to see the answer to that question or, if the government does not think it is in the public interest for an answer to be provided, a clear explanation as to why they think that is the case so that the government can be judged on that assessment.

In terms of the state royalties, what is going to happen with increases in state royalties that have taken place since 1 May or that will take place moving forward?

Dr Henry—I am unable to answer that question. It may be that that matter has not been finalised.

CHAIR—So that is one of the many issues that indeed still have to be resolved.

Dr Henry—I am not sure there are many issues that need to be resolved, as we discussed earlier, but my understanding is that that is at this stage an open issue.

CHAIR—Just going back to the level of Treasury involvement in the negotiation between the government and BHP, Rio and Xstrata, can you describe for us again in detail what level of involvement Treasury officials did have in those negotiations?

Dr Henry—I cannot add much to what I said last week, which is that we were involved very heavily in the quantification of proposals and beyond that we were involved in a quality assurance or due diligence role in providing advice to government in respect of propositions that the companies were advancing.

CHAIR—So you were not personally present for any of the sessions of the negotiations?

Dr Henry—That is certainly true.

CHAIR—Who was the most senior Treasury official directly involved in the negotiations between the government and BHP, Rio and Xstrata?

Dr Henry—As I have indicated, there was no Treasury official directly involved in the negotiations as such. There were Treasury officials who were, during that time, having discussions with senior executives of those companies about numbers and design issues.

CHAIR—So those Treasury officials were waiting in the Treasurer's office and somebody would come in and out of the negotiations with BHP, Rio and—

Dr Henry—No. I would have to check, but I think that most—and maybe all—of those consultations occurred during that period by phone. I think the Treasury officials, on all occasions—I would need to check—would have been in the Treasury building.

CHAIR—So the way it would have worked was that the Treasurer and Minister Ferguson were having negotiations with BHP, Rio and Xstrata and then somebody would walk out, pick up the phone and talk to a Treasury official and say, 'They have just told us this. Is this right? We have just agreed to do that. What does that mean?' Is that the way it worked?

Dr Henry—That is a relatively accurate characterisation of it.

CHAIR—So who was the most senior Treasury official at the other end of the phone?

Dr Henry—The person with executive responsibility for revenue matters in the Treasury beneath me is Mr Parker, who was here last week. If he received such a phone call—and I am sure he did—he would have been the most senior Treasury person to have received a phone call.

CHAIR—When did you first see the final negotiated agreement?

Dr Henry—When did I first see it?

CHAIR—Yes.

Dr Henry—It was finalised rather late. It was finalised not long before the announcement. All I can say in response to that is that I saw it shortly before the announcement.

CHAIR—How shortly before the announcement?

Dr Henry—I would need to check, but I think the night before the announcement.

CHAIR—Like at 9 pm, 10 pm?

Dr Henry—I really do not know.

CHAIR—Was it early evening or late evening?

Dr Henry—I do not know.

Senator HUTCHINS—Had you eaten?

Dr Henry—That is a very good question.

CHAIR—It is not that long ago. You say you cannot recall it.

Dr Henry—I simply cannot recall. I am not trying to be unhelpful. I simply cannot recall.

CHAIR—Isn't it strange that you were not more directly involved in the negotiations?

Dr Henry—I did not consider it strange, no.

CHAIR—So you are satisfied with Treasury's level of involvement?

Dr Henry—Yes, I am.

CHAIR—And the outcome?

Dr Henry—You are asking me to express an opinion on government policy.

CHAIR—The reason I am asking is that I am wondering whether the Commonwealth—and it is a serious question—was exposed by having ministers handling negotiations like they did with three senior CEOs of major multinational organisations without having high-level input as the negotiations took place in the context of finalising that deal.

Dr Henry—But they did have high-level input from the department. If your question is was I comfortable that the department had sufficient opportunity to provide timely policy advice to the government during the period, I can confirm that the department certainly did have sufficient opportunity to provide timely advice.

CHAIR—So did you model the final agreement before the Prime Minister's press conference of 2 July?

Dr Henry—By 'model' do you mean the revenue impact?

CHAIR—Yes.

Dr Henry—Yes, certainly.

CHAIR—And the MRRT numbers that were used by the Prime Minister and the Treasurer at that press conference were exactly the same as had been modelled by Treasury?

Dr Henry—Yes.

CHAIR—Dr Henry, you and the Secretary to Department of Finance and Deregulation will have to sign off on the *Pre-Election Economic and Fiscal Outlook*, a document which is your responsibility, unlike the budget, which is the responsibility of the government. Are you comfortable to put your name and your professional integrity to the revenue projections for the MRRT and expanded PRRT?

Dr Henry—Yes.

CHAIR—And you are comfortable that those revenue projections reflect the best professional judgment and expertise of your department?

Dr Henry—Yes, I am.

CHAIR—To confirm: the advice we are going to get from the Treasurer imminently will clearly separate any changes to revenue projections due to parameter variations from those that are due to policy changes?

Dr Henry—Yes. That is my understanding. As I indicated earlier, I have not seen the final version of any such document, but I understand that that is the Treasurer's intention.

Senator FIFIELD—Dr Henry, you say you have not seen the final version of that document. You would have seen a draft version. I assume it has been drafted within Treasury or is it a document which requires input from the Department of Finance and Deregulation as well?

Dr Henry—I am going to seek the Treasurer's counsel on how I should answer that question.

Senator FIFIELD—If I might phrase the question in a different way: are we talking about an earlier than usual MYEFO being released?

Dr Henry—I have no knowledge of an earlier than usual MYEFO. I can confirm that.

Senator FIFIELD—You can confirm that?

Dr Henry—I can confirm that I have no knowledge of an earlier than usual MYEFO, but one has to be careful.

Senator FIFIELD—Do you not have knowledge of that because a decision has not been taken, as opposed to preparations currently under way to provide that option?

Dr Henry—I feel I am in a difficult position without the Treasurer's guidance. I do not want to put him in a difficult position by answering these questions. So I think I will refer these questions to the Treasurer.

Senator FIFIELD—Perhaps you could answer this question. Have previous treasurers released earlier than usual MYEFOs shortly before elections or perhaps even after an election has been called but before the caretaker period starts?

Dr Henry—I am hesitating on the 'earlier than usual' bit. In my experience—and I think I am right here—MYEFO is a document which can be released at any time between the start of October and the end of January. MYEFOs published in that period would be regarded as usual timing, these days anyway. They have been published only since the Charter of Budget Honesty was enacted. It is certainly the case that MYEFOs were published after the government—that is, the former government—indicated that it was calling an election.

Senator FIFIELD—That is true, but before the caretaker period formally commences?

Dr Henry—I would need to check that. I think there is an instance of MYEFO having been published during the caretaker period.

Senator FIFIELD—But it would have been a document prepared before the caretaker period?

Dr Henry—Yes.

Senator FIFIELD—Thank you for that, Dr Henry. I appreciate you are in a difficult situation but will the document we are talking about—which the Treasurer will release imminently—cover the forward estimates period or will it look beyond?

Dr Henry—As I have indicated, the document has not been finalised and I would not want at this stage to indicate to the committee what its precise contents might be. I do not wish to mislead the committee.

Senator FIFIELD—Thank you, Dr Henry.

CHAIR—You were expressing caution around comments made in the media. I will put a few more to you and get you to either confirm or deny, as it were.

Dr Henry—Sounds like a good game.

CHAIR—Let's play the game in the public interest, Dr Henry. There was an article in the *Financial Review* on 7 July under the headline 'BHP upbeat on resource tax outcome,' where Treasury sources are said to have confirmed that:

... the speculated \$15 billion figure the original tax would have raised in the first two years was "in the ball park" but could even be higher.

Can you confirm that?

Dr Henry—No. I have no wish to confirm that.

CHAIR—Or deny?

Dr Henry—I have no wish to do that either. I prefer not to comment on it, but such speculation is not uncommon of course.

CHAIR—Taking the journalists at face value and assuming that they have spoken to Treasury officials—and I am sure you would not suggest that they are making it up—it raises the concern for this committee that, if Treasury is providing information like this to journalists, why can't the same evidence be provided to a committee of the Senate?

Dr Henry—Indeed, but I am not sure I share your premise.

CHAIR—So you think the journalists made it up?

Dr Henry—I do not know.

CHAIR—Mr David Crowe and Mr John Kehoe.

Dr Henry—Well the second of those is certainly a very respectable person.

Senator FIFIELD—And Mr Crowe?

Dr Henry—I was not suggesting that Mr Crowe is not.

CHAIR—You would have seen the analysis last week that Goldman Sachs JBWere put out which stated that they looked at the impact of the changes announced last Friday and concluded they would see taxation revenue fall by \$35 billion in net terms to 2020. You confirmed last week that Treasury had not analysed the impact of the tax over a longer period. Can you confirm for us that the \$35 billion is an accurate estimate?

Dr Henry—No, I cannot confirm that and I am quite happy to repeat the comments I made the last time we met to the effect that making such long-term revenue forecasts on a single head of revenue is a somewhat fraught exercise full of risk, particularly when the head of revenue we are talking about is one that is influenced so heavily by commodity prices which, as we have discussed, are quite volatile. One should be cautious about making definitive judgements about future levels some years hence, let us say 10 years hence.

I said the last time we met that, although one should be thinking about the medium to longer term fiscal implications of policy changes, I would not be happy to see in the public domain any Treasury projection over say a 10- or 20-year period of the impact of the MRRT on revenue because I do not believe that the figures would be of sufficient quality to assist public understanding of the revenue impact. I would add that the best assurance of the impact on the budget of government decisions is through the implementation of a medium-term fiscal strategy. This government has, as did the former government, committed itself to a quite carefully articulated medium-term fiscal strategy. It is the implementation of that fiscal strategy that is

important for the budget, much more so than heroic attempts to project the impact on the budget 10 years hence of any particular government decision.

CHAIR—But the thing is that you do that, and you have done it in your budget. You have made long-term projections of the impact of the private health insurance rebate to 2050. You have made long-term projections around various measures related to superannuation. Clearly, here it is a bit of an unusual circumstance, where there is a measure that will only take effect, if it gets up, from 2012 onwards. The original package had a whole range of supposedly related spending initiatives associated with it. So it is not an unreasonable question.

Dr Henry—No, it is not an unreasonable question. It is certainly not an unreasonable question. I did not want to suggest that one should never attempt these things. All I wanted to say is that one should be very careful about the circumstances in which one conducts these long-run revenue impact analyses.

CHAIR—Sure. But the thing is that you have attempted it and you have done the work—that is what we discussed last time—and you have come up with a conclusion. With all of the provisos that that is a long-term forecast, is your assessment of the impact higher or lower than the Goldman Sachs JBWere assessment of \$35 billion in lost revenue?

Dr Henry—I will obviously want to refer that question to the Treasurer.

CHAIR—Why ‘obviously’?

Dr Henry—Because all such questions you have asked previously I have referred to the Treasurer; that is all.

CHAIR—If you have a look at this public interest order of the Senate, it does say that if you do not want to answer a question you should give an indication as to why you think it might not be in the public interest to answer it.

Dr Henry—I am not claiming public interest immunity.

CHAIR—So you are just not answering it.

Dr Henry—I am not claiming that it is not in the public interest for this information to be made available.

CHAIR—So it is in the public interest?

Dr Henry—No, I am not saying that either. I am simply—

CHAIR—You are just refusing to answer the question.

Dr Henry—No, I am not. I am not refusing to answer the question; I have answered the question.

Senator HUTCHINS—The secretary said he was going to refer it to the Treasurer. I think that was pretty clear, Mr Chair.

CHAIR—Has Treasury done any analysis on what the typical increase in a mining company's or project's average tax rate would be with the MRRT compared to what it would be without the MRRT?

Dr Henry—Sorry, I am not sure I understand that question.

CHAIR—Have you assessed the status quo tax status versus the tax status of mining companies or projects once the MRRT applies? You did that work in the context of the RSPT.

Dr Henry—I must be a bit slow; I am sorry. Are you asking whether we have assessed the total tax burden—

CHAIR—Yes.

Dr Henry—as a proportion of, let us say, accounting profit? That is the sort of thing? I really do not know. For individual companies, you mean?

CHAIR—Yes, or projects.

Dr Henry—By individual projects?

CHAIR—Have you done case studies or have you made an overall assessment as to what the average impact would be?

Dr Henry—The average impact? I do not know, but that is relatively easy to find out. I will take that one on notice.

CHAIR—I guess the reason I am asking—and I am surprised that you cannot more spontaneously answer the question—is that on the back of the fact sheet 'A new resource taxation regime' the government has presented how the MRRT works for a mining project that earns a pre-tax rate of return of 50 per cent. I will just talk you through it. The government states that the average tax rate for that project would be 42.3 per cent under the MRRT. Our calculations show that without the MRRT the average tax rate of that project would be 40.1 per cent. That does not appear to be a significant increase in the average tax. Have you done—

Dr Henry—As I understand it—and I have just had it put in front of me—

CHAIR—I am just trying to understand how—

Dr Henry—this is a purely illustrative example—

CHAIR—That is right.

Dr Henry—not pretending to represent the average experience of the industry.

CHAIR—Do you have something that does present the average experience of the industry? If it does not present the average experience of the industry, what is the value of having it on the back of a fact sheet?

Dr Henry—It is intended to illustrate how the tax operates: how it is calculated, how it interacts with depreciation allowances, how it interacts with royalties, how royalties might get uplifted if they are not fully utilised in the tax year, how unutilised losses are uplifted and so on. It illustrates the key design features of the tax without pretending to be representative of the average experience. Indeed, I am not sure how valuable such a piece of work would be that pretends to represent average experience when there is so much diversity and variance in the industry, as we have previously discussed.

CHAIR—Which is why I questioned what sort of value there is in that case study on the back of that fact sheet. Is information on the revenue projections beyond the forward estimates to be included in the Treasurer's imminent information to be released as a result of our questions?

Dr Henry—I do not know, for the reason that I indicated earlier in response to Senator Fifield's question: the contents of the document have not yet been finalised and I do not wish to mislead the committee.

CHAIR—How do requests for advice from the Treasurer on what information you are able to provide work in practice? Do you talk to the Treasurer directly and say: 'This is what I have been asked. These are the answers; which one of them are you prepared to go public on'?

Dr Henry—Sometimes I would speak directly to the Treasurer, and sometimes I would not be involved in the conversation at all and the people in the department would deal with either the Treasurer directly or members of the Treasurer's staff. That is the quite normal practice that has been followed for many years, indeed for decades.

CHAIR—Has the Treasurer or anybody in his office, or anybody in the Prime Minister's office, for that matter, given you any directions in relation to your appearance here today?

Dr Henry—No.

CHAIR—I want to go back to this case study. This is a case study of a company that makes a 50 per cent return and yet does not end up paying tax, or not any significant additional tax. Who would be paying the tax? If somebody who makes a 50 per cent profit does not pay tax, especially in the first two years, who will end up paying the \$10½ billion in revenue?

Dr Henry—Obviously highly profitable companies.

CHAIR—Companies that are more profitable than 50 per cent plus?

Dr Henry—That is 50 per cent of a particular project.

CHAIR—That applies on a project-by-project basis, doesn't it?

Dr Henry—No, not entirely. Principally because of lost transferability it is not possible to be as definitive as you have been. Of course, you also have existing projects transitioning which, because they are mature projects, may well be relatively profitable projects, but the company may have other projects which are not as profitable.

CHAIR—Yes. Again, this is something that favours the larger companies as opposed to the small- and medium-sized companies. The larger companies can always transfer losses from one project to another under this MRRT arrangement.

Dr Henry—Large profitable companies.

CHAIR—Yes. Whereas small companies trying to get something off the ground might have only one or two projects and would not be able to do it, would they?

Dr Henry—We have discussed this. One of the features of the RSPT that encouraged the tax review panel, which I chaired, to recommend it was precisely around that point. That proposal was not successful.

CHAIR—So the government negotiated a different tax with the big end of town, which just happens to disadvantage the small- and medium-sized end of town.

Dr Henry—Well, look, what do I say? The small end of town was hardly jumping up and down with glee—

CHAIR—And joy for a new tax. You can hardly criticise them for that.

Dr Henry—You were characterising a relatively small company that was not in a profitable position. Under the RSPT, that company would not have been facing a new tax; it would have been receiving a tax refund.

CHAIR—They face all of the other consequences around their financing arrangements. The point I am making here is that, for many, the RSPT was a bad tax. But this one, for many, is a worse tax. That is the real issue here. Existing projects will not pay tax if they have to be valued at market, will they?

Dr Henry—Eventually, they should.

CHAIR—When is eventually?

Dr Henry—If the starting cost base is market value then that cost base is written off straight line over 25 years. Provided there is some growth in resource prices they should pay tax as soon as that occurs.

CHAIR—As soon as that occurs—is that expected to be in the first two years of operation of that tax?

Dr Henry—It could be.

CHAIR—Out of the \$10½ billion, how much is expected to come from existing projects?

Dr Henry—I do not know. I do not have that information with me. I will have to take that question on notice.

CHAIR—You are taking it on notice?

Dr Henry—Yes, I will take it on notice.

CHAIR—Just to put context around the question, I assume that economic rent would be incorporated into a market valuation, would it not?

Dr Henry—One would hope so. Indeed.

CHAIR—And then the question arises—and we have discussed this—whether you will use your increased commodity price assumptions to assess market value and how that will impact on the revenue projections moving forward? That is a fair question, isn't it?

Dr Henry—Yes.

CHAIR—If the economic rent is included in the market valuation then how will existing projects end up paying tax over the next two years?

Dr Henry—They will not if prices do not move.

CHAIR—They would have to move significantly.

Dr Henry—They do not move significantly.

CHAIR—Let us talk that one through. For the purposes of assessing the fiscal impact of the MRRT expanded PRRT arrangements, you have already built in increased commodity price assumptions which essentially are directly related to the economic rent to be expected. If the economic rent then drives the market valuation what you are really saying is that for you to generate tax revenue from those existing projects commodity prices would have to increase over and beyond the increased assumptions that you have already built into your model?

Dr Henry—In order to generate revenue in the near term they do not need to even increase at all, because it depends upon the profile that you have for commodity prices. If you have, for example, declining commodity prices in your profile the net present value calculation will obviously discount the entire relevant time horizon of the commodity prices—let us say, 25 years. It is therefore going to be reflective of the discounted average of commodity prices. If the commodity prices are declining you will get revenue in the early years with straight-line depreciation of the market value over a 25-year period. You will get revenue in the early years without any need for commodity prices to increase.

CHAIR—Again, we cannot really assess that because we do not know what your base assumptions are around commodity prices?

Dr Henry—That is right. I appreciate the difficulty you are in.

CHAIR—Which is a very unsatisfactory difficulty for us to be in. I know you understand that point.

Dr Henry—I understand.

CHAIR—In your projections of revenue is Treasury assuming that the market value of companies will increase?

Dr Henry—That they will increase through time?

CHAIR—Yes.

Dr Henry—No.

CHAIR—Essentially, the way it would work is that there will be a market valuation at the beginning and that sets the benchmark?

Dr Henry—At the beginning. Of course, the beginning is not today.

CHAIR—No, the beginning is—

Dr Henry—So that is relevant, as we discussed earlier.

CHAIR—If commodity prices continue to improve over the next two years will that be part of your assessment of market value under the MRRT arrangements?

Dr Henry—I am sorry; my colleague reminds me that it is market value at 1 May 2010.

CHAIR—Indeed. So there are not going to be any adjustments beyond that?

Dr Henry—No, that is right.

CHAIR—Are you going to make contact with our good friends at the Western Australian Treasury and organise a meeting to have a discussion about the way that this MRRT expanded PRRT arrangement is going to impact on the state of Western Australia and discuss with them some of the outstanding issues?

Dr Henry—I do not have any plans to do so.

CHAIR—They have told us this morning that they have sought on two occasions to have a meeting, and that so far there has not been any response to that request.

Dr Henry—Right. Well, I was not even aware of that—I was not aware that they had sought such a meeting. There has not been any personal contact with me, I must say. I am not going to give an undertaking to the committee that I will meet with the Western Australian Treasury and

discuss anything. I do not know. But I will reflect on and make my own judgment about whether such a meeting would be a good use of our time.

CHAIR—If you could please reflect on that, Dr Henry—and hopefully you will come to a very positive and constructive conclusion. I am sure that that would be in the public interest, and we would be eternally grateful for it. So, with those questions, I will hand over to someone else.

Senator FIFIELD—Senator Cormann and I certainly acknowledge the difficult position that you are put in when you find yourself the interface between a Senate committee and the government. I guess it is easy for the Treasurer to decline to answer questions, but when you are sitting here we appreciate the position that you are placed in. You are obviously well regarded by both sides of politics, as evidenced by your appointment by successive governments, and I assume that the passion for public policy still burns strongly within. The question I am going to ask you, you may decline to answer. But I was just wondering if you could indicate whether you have decided whether to make yourself available for a further term of service upon the expiry of your current contract.

Dr Henry—With your indulgence, I am going to decline to answer that question, if you do not mind.

Senator FIFIELD—That is fine. Thank you.

CHAIR—Thank you very much, Dr Henry. Hopefully we will not have to meet in these sorts of circumstances again any time soon, and hopefully after the election we will be meeting in much more positive circumstances from our point of view. Thank you very much for your contributions to the committee, and we look forward to the statement by the Treasurer which hopefully will provide answers to all of the questions that are outstanding from this committee.

Dr Henry—Thank you.

Proceedings suspended from 12.08 pm to 12.45 pm

PEARCE, Mr Stephen, Chief Financial Officer, Fortescue Metals Group Ltd

WILLMOTT, Ms Deidre, Head of Government Relations, Fortescue Metals Group Ltd

CHAIR—I welcome Mr Pearce and Ms Willmott from Fortescue Metal Group. I understand you have been given information on parliamentary privilege and the protection of witnesses and evidence. I invite you to make a brief opening statement and then the committee will ask you some questions.

Ms Willmott—Fortescue Metals Group Ltd began seven years ago with no money, no iron ore and a dream. Since that time we have made Australia's largest modern discoveries of iron ore, built the only new major port and rail infrastructure in the iron ore for industry for decades and allowed other fledgling miners onto those facilities, something which others have refused to do. We also completed the largest greenfields capital raising in Australia's history, when we raised around A\$2.5 billion in 2006 to build our project. At that time our major competitors were publicly highly sceptical that our project would see the light of day. Not only did we build our project in record time; we have added hugely to the Australian economy and today employ over 3,000 people and have around 2,000 suppliers and contractors from throughout Australia.

We are now Australia's largest standalone iron ore producer, proudly Australian run and controlled. We are a top 20 ASX-listed company with a market capitalisation of around \$13.5 billion. We are currently producing iron ore at the rate of 40 million tonnes per annum, and with today's prices at over US\$100 per ton, FOB, we are a very significant contributor to export income and the Australian economy. Existing production comes from our Cloudbreak and Christmas Creek mines, which are being expanded to 95 million tonnes per annum. Our major expansion projects, the Solomon and Western hubs, are capable of taking us to over 350 million tonnes per annum. Currently, these projects remain on hold, as previously announced, until we reach certainty with this new tax.

By any stretch of the imagination, Fortescue is a world-class achievement recognised by financiers, the steel industry and investors throughout the world. If the RSPT had been in force throughout that period, none of this would have been achieved. We impressed this point on the former Prime Minister, who agreed to make a number of changes to the RSPT only three weeks ago. Fortescue and other small miners were, however, not represented in negotiations for the MRRT and, as a result, its final design unfairly favours the established multinational, multiproduct mining giants over many other Australian producers caught by this tax. We have raised our concerns with the government and are seeking to have important issues agreed on as principle to direct the implementation committee. In our view, these matters are more than implementation issues; they need to be resolved by government to ensure fairness. Fortescue has major concerns with the tax.

The RSPT itself was deeply flawed. It sought to extract 40 per cent from miners before they had paid their bankers. It would have crippled the mining industry. The government and Treasury promoted that deeply flawed tax. It was Fortescue that exposed the flawed design on behalf of all emerging miners, Australian companies which are the future of this vital industry, yet Fortescue was not consulted on the details on the MRRT. In our view, the MRRT should not

be implemented. It is complex, discriminatory and a \$10.5 billion impost on the resources industry. The lack of transparency around how the \$10.5 billion is calculated is a major concern and risk for Fortescue and other miners. I will now ask Stephen Pearce to detail our concerns with the design of the MRRT.

Mr Pearce—Fortescue are adamant that further amendments are required to the heads of agreement to better reflect the needs of emerging and developing iron ore miners, to reflect the practical reality of this industry segment and to achieve a fairer outcome for emerging companies.

There are seven key items that we believe still need to be addressed to provide clarity and certainty to the industry. With respect to interest deductibility, we remain opposed to a tax of this scale being calculated and levied prior to the deduction of interests and other costs, particularly in a project's first five years of operation. With respect to the uplift rate, the current proposal clearly favours the large multinational companies with access to cheaper funds over emerging companies. In relation to the infrastructure recharge, clarity is required so that the arm's length basis evidenced by external third party agreements forms the basis of the net back charge. There is also the issue of the extraction allowance. Similar to LNG, iron ore is a capital intensive path to market and this allowance should be structured to encourage innovation and new technology. It is essential to better recognise infrastructure capital in the transition arrangements and to encourage ongoing large-scale infrastructure investments. The MRRT threshold should be increased to \$100 million to encourage growth of the smaller players. And we believe magnetite mines should be excluded.

FMG acknowledge that individual companies in the iron ore industry will be impacted differently by each of these factors. The two items that impact Fortescue most significantly are clarity around the arm's length principle to be applied and a better balanced approach to the transition arrangements that recognise the large dollar value invested in high-risk infrastructure assets. Investment in infrastructure should be encouraged and companies should be rewarded for risking the large sums of capital for the benefit of all Australians.

I have a couple of closing comments on the process. FMG have been a loud and constant opposer of the flawed RSPT for a number of key reasons: (1) the devastating impact that such an ill thought-through tax would have had on the whole Australian mining industry; (2) the obvious flaws in the economic theory and the gap between the 'elegant economics' and the practical reality; and (3) the lack of process and consultation with the industry prior to announcing one of the most significant changes to Australia's taxation system.

The Gillard government chose a different path of consultation and worked with three large multinational, multicommodity companies. In my view, they do appear to have addressed a number of the key issues with the RSPT, but a number of key factors have been negotiated that tend to favour them. Genuine consultation and clarity are urgently required to provide certainty to an industry that has the capacity to build the next generation of Australia's wealth. We need certainty of process, manageable legislative risk and delivery of a fairer outcome for all elements of the iron ore industry. And we need the key principles addressed prior to moving to detailed implementation of the heads of agreement that do not adequately represent all elements of the industry.

CHAIR—Thank you very much, Mr Pearce and Ms Willmott. As a result of the efforts of companies like yours, the resource rent tax has in effect been abolished on all resources other than iron ore, coal and oil and gas. Do you think that it should be abolished for iron ore as well? Is that your starting position?

Mr Pearce—Yes. Our absolute preference would be to have no resource rent tax.

CHAIR—You mention your lack of involvement with the Gillard government prior to the announcement of the revised minerals resource rent tax and expanded PRRT arrangements. Have you had any meaningful discussions since?

Mr Pearce—Minister Ferguson visited Perth a week ago and we had a short meeting with him afterwards. But at this stage we have not really had a chance to have any meaningful discussions.

CHAIR—So that was a meeting where you got to say, ‘We don’t like this,’ but there was no response?

Mr Pearce—No. It was a meeting of less than half an hour.

CHAIR—And it was essentially just a curtesy meeting, was it?

Mr Pearce—Essentially, yes.

CHAIR—Have you been given any indication that you will be involved in the policy transition group?

Mr Pearce—It is my understanding that the committee members of that group will not be taken directly from the industry that has a specific interest in the outcome.

CHAIR—So you have not had any opportunity to be consulted prior to the announcement, there has not been any meaningful conversation since the announcement and, as you understand, you will not be part of the policy transition group, either?

Mr Pearce—We hope to participate in discussions and to present our case as meaningfully as possible.

CHAIR—Has the government asked you to provide any details about your financials or any financial modelling in regard to the types of projects that you invest in, as it relates to the MRRT?

Mr Pearce—No. We have provided the government and the former Prime Minister with headline numbers in relation to the capital that we intend to spend and the numbers of people that we would intend to employ if the original RSPT were removed, but not detailed modelling.

CHAIR—What has been happening to the iron ore commodity prices, the spot prices, in the period since April-May 2010?

Mr Pearce—They have eased from what was a high price down to a more moderate price.

CHAIR—In the period 1 May to 1 July, are you aware of any evidence in the market of a significant change in the commodity price outlook?

Mr Pearce—That is a difficult question to answer. I do not pretend to be an expert on forward iron ore prices, but, no, nothing major has changed except that iron ore prices have eased over the last two months.

CHAIR—So, if anything, iron ore prices have eased. You are not aware of any major change. This is your core business—what happens to the price of iron ore as a commodity. That is crucially important for you in terms of your future prospects and your future financial success, isn't it?

Mr Pearce—Yes, it is, but as far as our ability to influence it is concerned, it is a world-set price, so essentially we are a price taker.

CHAIR—Totally. I would not suggest for one moment that there is a significant capacity to influence it. What I am trying to find out is whether, in the period between the announcement of the super profits tax and the announcement of the minerals resource rent tax, there was any significant event, as far as commodity price forecasting is concerned, as far as the commodity price outlook is concerned, that would lead you to the view that there is a significant increase in commodity prices around the corner, specifically in the period 2012 to 2014.

Mr Pearce—My view has not really changed on those price outlooks over the last couple of months.

CHAIR—That is interesting in the context that the government has revised its commodity price assumptions upwards in order to achieve the \$10.5 billion fiscal outcome, budget outcome, revenue projection, from the deal that was negotiated with BHP, Rio and Xstrata. You are not aware of any information that would—

Mr Pearce—No, we are not. Obviously, we do not have clarity of exactly what is behind the government's numbers and forecasts.

CHAIR—Neither do we! That is one of the issues that we have been trying to gain an increased level of clarity on.

Ms Willmott—As we said in our introductory statement, it is a matter of concern to us that there is no transparency on how that figure was made up and, therefore, the expectations of the contribution from individual companies or segments of the industry.

CHAIR—Have you analysed to what extent your average tax rate moving forward would be impacted by the MRRT?

Mr Pearce—It is very difficult to give a precise answer on that because, while many of the factors have been announced in principle within the heads of agreement, the actual detail of implementation is yet to be worked out. The headline tax rate, given that it is a profits based tax, very much depends on your view of forward prices and volumes.

Senator HUTCHINS—So you have not had an opportunity to do any financial modelling on the impact of the MRRT on your project?

Mr Pearce—Yes, we have. We have run extensive models.

Senator HUTCHINS—So you have done models?

Mr Pearce—We have had to make assumptions and vary those assumptions, and we have run extensive models on the impact that it has.

Senator HUTCHINS—So you are secure enough to do the modelling. I am not saying that—

Mr Pearce—We may be wrong in the assumptions that we have made, but we have certainly made a guess on them.

Senator HUTCHINS—What impact does it have on the NPV or the return-to-equity investors for your project?

Mr Pearce—Depending on your interpretation of the assumptions, the impact can be very significant.

Senator HUTCHINS—In what way?

Mr Pearce—If you have a tax that is stripping out a large percentage of your free cash flows that is going to the government then they are not going to your shareholders.

Senator HUTCHINS—That is one of the assumptions you make in that model; is that correct?

Mr Pearce—We run quite a number of models. Depending on your assumptions on price—

Senator HUTCHINS—How many models would there be?

Mr Pearce—We have probably run two dozen different versions of the models to try to understand the impact.

Senator HUTCHINS—One is the worst-case scenario and one is the best-case scenario. I am assuming you have just told us probably the worst. What would be the best?

Mr Pearce—It is hard to describe the best. If you assume a low iron ore price and therefore low profitability then the effective tax rate that we pay will be the sum of the company tax rates and the impact of the royalties. If you assume a higher price, it could be anything up to 45 per cent.

CHAIR—And of course we know—

Senator HUTCHINS—Just on the royalties: are you affected by the Western Australian government—I understand that the royalties rose for fines in iron ore to the same level as lumps on 1 July; is that correct?

Mr Pearce—No, that was an agreement between BHP and Rio.

Senator HUTCHINS—But that did—

Mr Pearce—We already paid the higher rate.

Senator HUTCHINS—You already paid the higher rate.

Mr Pearce—We already paid the higher rate.

CHAIR—In fact—if I can inform you of the beneficial impact for FMG in this—it is fair to say that BHP and Rio are now on a more equal footing with FMG as far as royalty payments are concerned.

Mr Pearce—That is correct.

CHAIR—I will just follow up on the previous question asked by Senator Hutchins. We know, of course, that Treasury is assuming higher commodity prices in order to generate the \$10½ billion revenue projection. If we assume significant increases in commodity prices moving forward, what is the impact of the MRRT on FMG as part of your overall tax liability?

Mr Pearce—At high prices, you pay high tax.

CHAIR—Yes, sure. Have you got any sort of indication in terms of percentages?

Mr Pearce—It does really depend on the interpretation of some of the factors and how they would be implemented, so it could be as high as moving up to a 45 per cent effective tax rate in a higher iron ore price environment, depending on how those factors are implemented.

CHAIR—Essentially, you do not know, and that is where—

Mr Pearce—With the great uncertainty we have, it is very hard to commit to long-term investment.

CHAIR—Which makes it very difficult to you to plan, of course. Can you just talk us through this. You mentioned the argument around not being able to deduct the cost of interest and the way companies like FMG finance their projects—and, I dare say, other smaller and medium-sized iron ore projects would do the same. Can you just explain to us the particular dilemma that you face that is not faced by the major multinational companies from the way this tax is structured?

Mr Pearce—Yes. Around the interest rates, there are a couple of key factors. One is the uplift rate. The uplift rate has been set at the long-term bond rate plus seven per cent under the heads of agreement. That seven per cent rate, in my view, approximates the borrowing cost of some of

those larger multinational companies. For companies like Fortescue and for developing companies, our cost of borrowing is normally at the moment in excess of 10 per cent, so we are automatically penalised under the proposed system compared to larger multinational companies.

CHAIR—And that makes them more competitive than you—

Mr Pearce—It does.

CHAIR—courtesy of the tax design?

Mr Pearce—Correct. So that is one of the major impacts of interest rates. It is fair to say too that the transition arrangements that have been provided for the market value methodology, in my view, also favour the three large multinationals.

CHAIR—How?

Mr Pearce—Because they have a very large resource base that they would be able to take through and grandfather into the proposed MRRT. Again, the lack of clarity around these rules makes it a little hard for us to comment on the specifics, but a company like Fortescue may well decide to go with the historical cost option for transition. The negative for us is that the transition rules are nowhere near as generous under the historical cost option as they are under the market value option.

CHAIR—You have put those questions and those arguments to the government?

Mr Pearce—We have. In our negotiations with the previous Prime Minister's government we believe we had very good recognition of some of these issues. That was the subject of our press release on 29 June where we set out how we had been able to discuss those factors with the previous government.

CHAIR—That was before the change of Prime Minister.

Mr Pearce—That was before the change of Prime Minister, yes.

CHAIR—Your view would be that since the change of Prime Minister you are actually worse off than where you started under Kevin Rudd.

Mr Pearce—We are better off than the original RSPT but worse off than the position we had managed to negotiate that we were intending to put out for discussion to the broader industry.

CHAIR—In terms of the average tax, and you talked about up to 45 per cent, how does that compare in terms of international competitiveness of tax rates?

Mr Pearce—One of our major concerns is that this tax puts Australia in an internationally non-competitive position. It is my understanding that the highest comparative tax rate, and you will see this in articles that have been published, is around 40 per cent. So having an effective tax rate at, say, 43 to 45 per cent will clearly penalise Australia in terms of international competitiveness.

CHAIR—You mentioned that, if the RSPT had applied, a company like FMG would not have got off the ground. I am paraphrasing, but I think that is what you said.

Mr Pearce—That is correct.

CHAIR—If the MRRT had applied, which means that the tax has been abolished for all resources other than iron ore, coal et cetera, how would that have impacted on your capacity to start from scratch?

Mr Pearce—We went back and ran the RSPT proposal over the original models of Fortescue that we used to raise the funds about five years ago. Clearly we would not have been able to raise the money if the original RSPT proposal existed at that time. I cannot give you an answer on the MRRT at the moment because there are just too many uncertainties in terms of how the factors are going to be applied.

CHAIR—Everybody in the industry that I have talked to tells me about uncertainties and things that are not resolved. I think you mentioned it does not just go to implementation issues; there are issues of principle.

Mr Pearce—Correct.

CHAIR—Yet the government want all of us to believe that they have fixed the mining tax issue, that they are ready to move on, that everybody is happy and that it is just a matter now of going to the election—and everything takes its course. Do you think that the mining tax issue has been fixed?

Mr Pearce—No, we do not. As I outlined in my presentation, we believe there are seven primary issues that still need to be addressed. It is very hard for anyone but the three large companies that were party to those negotiations to represent that the tax issue has been solved. We simply have not been party to any of those discussions. From what we can read and see, the uncertainties that still exist are very significant for us.

CHAIR—Did the government ever explain to you why they chose to negotiate with BHP, Rio and Xstrata at the exclusion of FMG, Atlas, BC Iron, Gindalbie and others?

Mr Pearce—No, we have not received any explanation as to why they have picked the three largest of the 320 companies and have not really spoken in any detail to the other 317.

CHAIR—Why do you think they have chosen those three and not talked to the other 317?

Mr Pearce—All I can surmise is that believe they will be the largest payers of the MRRT.

CHAIR—Is that a reasonable argument?

Mr Pearce—It is difficult to know. I am not privy to the models that BHP and the other companies run.

CHAIR—Let me rephrase the question. Is the impact on the industry only an impact in terms of who is going to pay the tax over the next two years, or are the uncertainties and all of the other issues impacting on you beyond whether or not you are going to be paying the tax in the first year or two?

Mr Pearce—The uncertainty has a major impact on a company like Fortescue at this point in time. We have, per our stock exchange release of a month or two ago, deferred any investment decisions on both the Solomon project and the Western Hub. The sorts of sums involved that we are talking about are \$15 billion to \$20 billion of investment. We would love to have certainty around these issues so that we can move forward as a company, expand rapidly and create jobs for Australia.

CHAIR—You mentioned the emerging lower grade magnetite iron ore industry issues which are uniquely affected under the MRRT. Can you talk us through some of the impacts, and have you discussed those impacts with anyone in government?

Mr Pearce—We raised the issues in that brief meeting that we had with Minister Ferguson. We have not really had any response at this point in time. Magnetite is an emerging industry in the very early days of its life cycle. It also requires significant investment in downstream processing.

CHAIR—You have raised those issues with Minister Ferguson. There has not been much of a response, but has he given you an indication as to when a conclusive response to those issues will be forthcoming?

Mr Pearce—No, we have not really had a response at this point in time. I am assuming that they will be dealt with as part of the committee process.

CHAIR—Okay, but there are two levels of issues. There are the implementation issues, which the transition group will look at, but this is a more fundamental issue, isn't it?

Mr Pearce—Correct, and we would prefer that the government sit down with the rest of the industry segment and discuss and agree on some of these key issues of principle. It is very difficult to imagine, given the heads of agreement that has been established, that they will move away from some of those key principles. But there are three or four major key principles that need to be addressed for the balance of the industry.

CHAIR—And, essentially, by taking a look at the interests of the industry as a whole rather than one very specific part of the industry?

Mr Pearce—Correct. I mean, many of the issues that the emerging and developing iron ore segment is facing are very different from the issues that the three majors face.

Ms Willmott—And our concern—following the introduction of and the salesmanship around the RSPT—is to make sure that there is a thorough understanding of the differences in the industry. Magnetite is fundamentally different from hematite in its cost structures, in its margins and in how it is handled, and it is difficult to understand why some low-margin ores or commodities were taken out and this one was left in. For those companies—which is most—who

were not involved in the consultation, it seems arbitrary and it is difficult to see what the expectations are in terms of what tax will be levied on those parts of the industry.

CHAIR—But do you have an expectation, from a process point of view, that the government will resolve those principle issues before they go to an election?

Mr Pearce—It is very difficult to give you an impression on that. These are the same people who introduced the RSPT without proper consultation with industry. So I do not, at this point, have a high level of confidence. Nonetheless, we will keep fighting the battle.

CHAIR—Let me ask you this question then: if you have not got a high level of confidence at a time when the government is five minutes away from calling an election, how much confidence can you have that they will sit down with you and deal with these issues reasonably after an election, if they are returned to government?

Mr Pearce—We are extremely concerned about both the political process and the legislative process that may eventuate post any election. It is a major concern, given that we do not have a heads of agreement that covers many of the issues that we need addressed. We are extremely concerned about the legislative and political process post the election.

CHAIR—So, essentially, right now there is—and if this is not resolved before the election there will be—a high level of sovereign risk that you face as a major company with these issues unresolved?

Mr Pearce—Correct. That uncertainty will continue to run. It will continue to damage Australia's reputation. It will continue to impact decisions to invest.

CHAIR—In the context of the RSPT, I think that a number of FMG projects were put on hold.

Mr Pearce—That is correct.

CHAIR—So they were what—\$15 billion to \$20 billion projects?

Mr Pearce—That is correct.

CHAIR—Do those projects remain on hold or has there been a decision on the back of the MRRT to change them?

Mr Pearce—No, those projects remain on hold. In terms of any investment decision, we are progressing with reviews and the early stage permitting. But we will not be making an investment decision until such time as we get clarity.

Senator HUTCHINS—I just want to follow up on the two dozen assumptions you have made on the financial models. One of the assumptions is that you are arguing for interest which is deductible against company tax—for deductibility against the MRRT. Won't this encourage banks and other institutions to increase interest rates?

Mr Pearce—No, I do not believe so.

Senator HUTCHINS—You do not believe so?

Mr Pearce—No. Remember that, fundamentally, a project still needs to be sound to be bankable. So you are not going to make investment decisions. The financial markets are competitive, in any event. So I do not believe it will have an impact.

Senator HUTCHINS—Again on the assumptions, your company was very opposed to the superprofits tax. In fact, I recall your chief—

CHAIR—A great Australian.

Senator HUTCHINS—donned working gear to conduct probably one of the best dressed protests I have ever seen in the country.

CHAIR—Were you there?

Senator HUTCHINS—No. I saw you there though.

CHAIR—I was definitely there, standing up for Western Australia.

Senator FIFIELD—Senator Cameron has led some well-dressed protests in his time. He is very sartorially splendid.

CHAIR—It was a very successful demonstration too. All of the taxes have been axed except on iron ore and coal.

Senator HUTCHINS—You said you had been involved in a meeting with the minister last week or the week before.

Mr Pearce—That is correct.

Senator HUTCHINS—The words used by the chair were that it was a ‘courtesy visit’ or something like that. Is that the way you saw it?

Mr Pearce—Minister Ferguson briefed a number of WA representatives from the mining and exploration industry. Following that meeting we had a discussion that maybe went for 20 to 25 minutes where we raised briefly the key factors that we were concerned about. We raised them and at that time we did not really get a response to any of the key issues.

Senator HUTCHINS—Could you reasonably expect a response there and then considering the discussions that had already occurred between the government and other groups?

Mr Pearce—I suppose we were looking for some clarity as to how the rest of the industry was going to be engaged and we were disappointed.

Senator HUTCHINS—You did not get any confidence that the industry would be?

Mr Pearce—No, we did not.

Senator HUTCHINS—Are your views specifically concerning Fortescue? Would they be representing any other industries or groups or is it, Mr Pearce, that there are a number of affected players that cannot sing from the same hymn sheet?

Mr Pearce—I believe you will have other members of the iron ore industry and mining industry presenting to the committee shortly. In all of our approach and with the issues we have raised we have tried to not only wear a Fortescue hat in our discussions but also represent emerging and developing companies that want to become the next Fortescue. Those sorts of companies face unique issues in getting their investment proposals up and taking significant risks in doing so with large sums of capital. We have tried to represent that part of the industry as well.

Senator HUTCHINS—With the projects that you say you are considering deferring, is that the best way to—

Mr Pearce—We have deferred them.

Senator HUTCHINS—You have made the final investment decision to defer them?

Mr Pearce—We have made the decision to defer any investment decision on those projects.

Senator HUTCHINS—So you have not made the final investment decision not to proceed with the projects?

CHAIR—That is not the way it works.

Mr Pearce—We were planning to make final investment decisions on these projects shortly and we have deferred any decision to invest and proceed because of the uncertainty with the tax.

Senator HUTCHINS—So you have deferred the decision?

Mr Pearce—Correct.

CHAIR—Did you have any view on the removal of the resource exploration rebate, which has been scrapped by the government as part of the deal?

Mr Pearce—I would have to say that I was particularly disappointed with that. In our discussions with the government prior to the MRRT being announced, we had certainly argued that the exploration rebate should be retained. So we were particularly disappointed that the exploration rebate had not continued or that the flow-through share scheme proposal, which has been on the table for probably the last decade, also has not progressed.

CHAIR—When did you find out that the resource exploration rebate had been scrapped?

Mr Pearce—We read it in the press release announcing the MRRT.

CHAIR—Unlike your competitors, who were on the inside of the meeting negotiating the overall design of the announcement.

Mr Pearce—I am assuming that they had knowledge. I cannot speak for them. We had no knowledge prior to the announcement.

CHAIR—So the government did not consult at any time with you about the effects of removing this rebate?

Mr Pearce—No, they did not.

CHAIR—Has the government provided any explanation to you on why it chose to exempt miners under a \$50 million threshold?

Mr Pearce—No, we have had no discussion as to how that \$50 million threshold was arrived at.

CHAIR—If you had to hazard a guess, how do you think they came up with \$50 million?

Mr Pearce—I do not understand any reasoning to set that particular amount. We would prefer to see the threshold at \$100 million so that you are encouraging smaller and developing miners to grow and giving them that exemption through that key growth phase.

CHAIR—So on what basis would you prefer \$100 million? How do you come up with a hundred million?

Mr Pearce—It is larger than \$50 million. To me it is set at a level that would approximate about a six-plus million tonne iron ore producer. We believe that should encourage some of the junior iron ore producers to develop and get established financially.

CHAIR—Do you have clarity as to what the MRRT application is going to be for those that have a profit above \$50 million? Is it going to be for the dollar above or is it for the whole amount?

Mr Pearce—We have absolutely no idea as to how that transition around the \$50 million will be handled.

CHAIR—Again that is yet another example adding to the uncertainty, I guess.

Mr Pearce—It adds to the uncertainty and adds to the difficulty in modelling any outcomes and understanding the impact that it has.

CHAIR—Would some miners be able to structure their affairs to get below the \$50 million profit threshold?

Mr Pearce—It may be possible to put different projects in different companies. It would be a lot of effort and a lot of administration to try to do so. I do not believe that miners would be highly motivated to do that.

CHAIR—Depending on how the tax take applies, if you were approaching the \$50 million profit threshold how would that influence your behaviour as a mining company?

Mr Pearce—It is difficult to speculate.

CHAIR—Fair enough. Just going through the levels of risk, would the smaller miners face different risks relative to the larger miners in terms of being able to access the value of MRRT tax credits?

Mr Pearce—Yes. A lot of the smaller miners are single project companies and therefore will not be able to benefit from let us call it the transferability you can have through multiple projects. That will make it more difficult for them to get benefit from any carry-forward credits et cetera.

CHAIR—So in a strange way smaller and medium-size companies all the way up to FMG might actually end up paying MRRT comparatively sooner because they are not able to offset some of the losses from other projects.

Mr Pearce—That could be a very real outcome.

CHAIR—That seems to be unfair.

Mr Pearce—There are a number of elements we believe are unfairly structured in the heads of agreement as it is currently presented, particularly towards the smaller end of the industry.

CHAIR—What is your assessment of the compliance and administration costs related to the application of the MRRT?

Mr Pearce—I have not done a formal assessment but obviously there would be a reasonably significant burden in terms of administration, completing returns et cetera, as there is with any tax.

CHAIR—Have you had any interaction with the West Australian Treasury or the West Australian government around any of these issues?

Ms Willmott—Not at a formal level. We have spoken to them and share their concerns, and they share our concerns about the imposition of the tax and particularly the extent to which the tax will be paid from Western Australia by Western Australian companies and projects.

CHAIR—Dr Henry this morning agreed with the assessment that most of the tax revenue would actually come from iron ore, not coal, under the MRRT because of the way the state loyalty credits would interact with payments of MRRT under profits based on coal and iron ore. Have you made any assessment of how iron ore is being impacted by the MRRT compared to coal as the other resource subject to MRRT?

Mr Pearce—No, I have not made any formal assessment, but it would be my expectation that iron ore would pay a larger share of the MRRT than coal.

CHAIR—Why do you think that is the case?

Mr Pearce—I would expect because of the volumes and the values involved with iron ore.

CHAIR—And of course 96 to 98 per cent of iron ore production is generated in Western Australia, which makes the MRRT very much a tax on Western Australia, doesn't it?

Mr Pearce—Yes, it does.

CHAIR—So we have a minerals resource rent tax now which has all of the minerals, other than iron ore and coal, excluded. Most of the revenue will be generated from iron ore profits—96 or 98 per cent of which comes from WA. That seems unfair from a national balance point of view, doesn't it?

Mr Pearce—WA is a very lucky state in terms of its endowment of resources. One of the major issues I have with the way the tax and the infrastructure fund has been structured is that government have largely withdrawn from spending significant sums on regional infrastructure for the last 10 to 20 years. It has really been the mining companies that have opened up regions of states, opened up remote areas, by spending significant dollars on infrastructure. That is at risk given the recycling of relatively small amounts through the infrastructure fund back into WA.

CHAIR—Are all of your projects in Australia?

Mr Pearce—At the moment all of our active projects are in Australia—that is correct.

CHAIR—Whereas BHP, Rio and Xtrata have a global portfolio of active assets, don't they?

Mr Pearce—That is correct.

CHAIR—How does the MRRT impact on you compared to some of the other companies?

Mr Pearce—As an individual company where our operations are located solely in Australia, and all within iron ore, obviously we have a very direct and significant potential impact from the MRRT and therefore I would expect our effective tax rate under the MRRT to be higher. If you were a multinational company and a multicommodity company, the impact from just iron ore and coal would be watered down by the lack of impact through the other commodities and through the other countries.

CHAIR—It was reported in the media last week that Mr Forrest wanted to ensure that the taxing point took into account the cost of rail infrastructure.

Mr Pearce—That is correct.

CHAIR—Can you explain to the committee the specific changes to the design of tax that would be needed and the rationale behind all of this?

Mr Pearce—A company like Fortescue takes significant risks in investing significant amounts of money in infrastructure. If you look at the history of the Pilbara, Fortescue is the only company that has managed to build significant infrastructure in the Pilbara, outside of BHP and Rio, for the last 40 years. That took significant vision, significant risk and significant sums of capital. The reason the infrastructure is so important in the way it is treated within the MRRT is that, without the infrastructure, you have a stranded, valueless resource. It does not matter what the tax rate is on that; if it is not coming out of the ground you are not going to get anything. We need clarity particularly around the arm's-length provision in the heads of agreement. We believe that infrastructure can then be fairly treated in the MRRT regime, that investment in infrastructure should be encouraged within the country and therefore treated appropriately within the MRRT, and that past investment in infrastructure should be better reflected in the transition provisions.

CHAIR—But of course, yet again, all of this is subject to your overall position, which is that the MRRT should be scrapped altogether?

Mr Pearce—I believe that the government can raise significant revenue just from income tax, which is already a profit based tax on companies, and that the sums that they will receive in future years, given a view on iron ore prices, will be higher than they currently estimate.

CHAIR—So the combination of revenue for state and federal governments from company tax and state royalties is essentially enough to provide a fair share to the Australian community. Is that your proposition?

Mr Pearce—Yes, we believe so.

CHAIR—Does the MRRT have any implication for FMG's long-running battle to gain access to rail infrastructure in the Pilbara?

Mr Pearce—I do not believe that it has a direct impact. Those matters have been before the courts and the tribunals. Recent judgments were passed down. I do not believe there is a direct link between the two.

CHAIR—Thank you very much your contribution to the committee today.

Mr Pearce—It was a pleasure.

[1.31 pm]

BENNISON, Mr Simon, Chief Executive Officer, Association of Mining and Exploration Companies

FLANAGAN, Mr David Nathan, Managing Director, Atlas Iron Limited

YOUNG, Mr Michael Charles, Managing Director, BC Iron Limited

CHAIR—I welcome the representatives from the Association of Mining and Exploration Companies, AMEC. Do you have any comments to make on the capacity in which you appear?

Mr Flanagan—Atlas Iron is a member of AMEC.

Mr Young—BC Iron is also a member of AMEC.

CHAIR—I understand you have been given information about parliamentary privilege and the protection of witnesses in evidence. I invite you to make a brief opening statement, after which the committee will ask you some questions.

Mr Bennison—Quite honestly, I am quite happy to take questions. I do not really have a prepared opening statement. Obviously, if there are any issues that we would like to raise that are not addressed through the questions process, we will reinforce those at the conclusion.

CHAIR—Maybe you can explain to the committee who AMEC is and what you are all about.

Mr Bennison—AMEC is a national organisation. It represents mainly the mid-tier to junior production and exploration companies across Australia. It has about 140 members in this category. It also represents a vast number of the service industries to the resource sector, particularly companies that are involved in drilling and equipment supply. We have over 100 companies that fit into this category. Effectively AMEC acts as an advocacy and policy organisation for these members.

CHAIR—How long have you been going? Why were you formed initially?

Mr Bennison—AMEC was formed in 1981, so it has a long history. It was formed by a group of junior explorers and also a number of mid-tier producers. There was a difference between the needs and the policy and advocacy of the junior to mid-tier companies across Australia versus the big end of town. One of the things that AMEC has tried to do is make sure the smaller operators across the country have a voice within the capital, in particular, so it is for those companies particularly on national policy issues.

CHAIR—Do you think that the Rudd and Gillard Labor governments have sufficiently taken into account that voice, those views, or have they been focusing on the big end of town?

Mr Bennison—It is probably split. I think in the process of the initial policy arrangements with the RSPT we were part of the general consultation process that was put in place.

CHAIR—That was post the announcement, after the announcement, of the tax?

Mr Bennison—That is correct. We obviously have unfortunately had little participation in negotiations that have taken place since the Prime Minister announced the new regime within the MRRT and obviously in the period from her appointment into the conclusions around the MRRT.

CHAIR—So you were not involved in any consultations around the design of the so-called resource super profits tax initially, were you?

Mr Bennison—Not on the initial occasion, no. Basically it was handed to us as a confirmed arrangement. We had tried to participate in the Henry tax review process, under the impression we would get involved in issues relating to exploration and development programs. That is the only component where we had any input.

CHAIR—So essentially the government announces the resource super profits tax, you then are involved in the consultation process after that has been announced, but before that reaches any conclusion there is a change in Prime Minister, the Prime Minister has a meeting in her office to conclude the deal with BHP, RIO and Xstrata. You were not part of that process of negotiation under the new Prime Minister, were you?

Mr Bennison—Correct.

CHAIR—Have you been given any indication about your level of involvement as the voice for the small and mid-tier companies in the policy transition group?

Mr Bennison—No, at this stage we have not had any engagement with the government formally to see how we will be engaged in that process. That is something we obviously hope to take up with the government. We have written to the Prime Minister and to relevant ministers, the Treasurer and the Minister for Resources and Energy, in an effort to engage them. We have done that since the appointment of the new Prime Minister and obviously since the resolution of the MRRT arrangements.

CHAIR—So you have sought a meeting but you have not heard back yet about a meeting, have you?

Mr Bennison—Correct.

CHAIR—Has the government asked you to provide any details about your financials or any financial modelling in regard to the types of projects your members invest in?

Mr Bennison—At this stage, no.

CHAIR—How can they assess the impact of the tax, the MRRT, on the small and medium end of town versus the big end of town if they do not have that information?

Mr Bennison—That is a good question. I assume that they will be engaging some of our members to perhaps glean that information.

CHAIR—Are you aware whether they have engaged any? You have two of your members here. Have you been asked for—

Mr Flanagan—We did handover the information as part of the consultation process on the RSPT. I would expect that would have given them an inkling but I can only guess at what went on inside the MRRT negotiations.

CHAIR—Okay, but the design of the MRRT was negotiated with BHP, RIO and Xstrata. Have you been asked to provide information around how the MRRT would impact on a company like yours?

Mr Flanagan—No, not since the MRRT has come out.

Mr Young—No, we have not either.

CHAIR—The government faces a dilemma. They want to be seen to have fixed the mining tax issue but they also want to make sure that the impact on revenue in the budget was minimised. In order to achieve that, they have increased their commodity price forecasts. You are experts, you are operators in the iron ore industry. What has happened to iron ore spot prices, as far as you are aware, in the period between May and July 2010.

Mr Young—We receive a daily market report called the *Platts Steel Market Daily*. That is basically a company which collects information on ore sales and sends it to subscribers. We get this as an iron ore miner. On 30 April 2010 the iron ore spot price for 62 per cent iron delivered into China was US\$176 a tonne. As of 9 July 2010, the midpoint for that same one is US\$119.

CHAIR—So it has gone down?

Mr Young—Significantly. If we do what is called an FOB netback—in other words, we remove the price of shipping and the price of shipping water to China, effectively—that price has gone from \$164 a tonne down to US\$110 a tonne for Australia to China capesize vessels. That is an example of how the spot price has come down since 30 April 2010.

CHAIR—In that same period, are you aware of any significant improvements in the commodity price outlook?

Mr Young—The commodity price outlook, particularly since the GFC, has been a bit more guesstimate work than it has been in the past. But all of the commodity price forecasts, long-term forecasts, that I have seen—for example, Credit Suisse—have the iron ore prices down below \$100 a tonne. It goes out and then it comes down.

CHAIR—So that is, if anything, less than what it has been.

Mr Young—That is right. From the anecdotal evidence that I have had in discussing iron ore prices with a lot of the analysts, they are just waiting for things to settle down with regard to

what is happening in Europe before they start making some forecasts. We are starting to get some better news out of the States, but certainly there was a dip in the sentiment in the last several months.

CHAIR—So the analysts are sensibly waiting to see where things are settling. You are telling me that, if anything, spot prices have gone down. The medium- to long-term forecasts for commodity prices in relation to iron ore are going down. Where would the government be getting information that the commodity prices are expected to increase?

Mr Flanagan—I am not sure. For our budget purposes we are assuming a flat iron ore price for the next year.

CHAIR—The thing is, regarding commodity prices, for companies like yours it is really your core business to have a sense of that, as best you can, to have a good handle on that.

Mr Young—Yes, but anybody in the mining industry understands that there are swings and roundabouts on commodity prices. You try and estimate them as best you can and make the assumptions based on the best information.

CHAIR—Sure, but which way are the swings and roundabouts trending?

Mr Young—You are getting into an area where I am not an expert, but having been an intense observer over the last three years I know that basically what happens is that the price falls out. In three to four years normally the price in any forecast will fall down and then they will basically just straight line the price to CPI. What that price falls to depends on the analyst. There can be quite a wide range. Normally what you do when you are doing your modelling is find a consensus view and use that. There is ample information in the public domain for people to make an assessment on that. When public companies like Credit Suisse start to make the analysts do the predictions on the companies then they will state their assumptions.

Mr Flanagan—It is also very sensitive to currency.

CHAIR—Sure, which is why it is going to be very important for us to see what assumptions the government has used on currency, on commodity prices, on production volumes. We were led to believe by Dr Henry this morning that the release of that information by the Treasury is imminent—whatever the definition of ‘imminent’ is. We shall see what happens there. Have you done any analysis, either through AMEC or individual companies, looking at to what extent the average tax rate of your members would be impacted by the MRRT?

Mr Young—We have done some work on that. I am sorry, I do not have this as a handout. There is some information on my spreadsheet here that is confidential. We have assumed an iron price of US\$105 a tonne. We flatlined it for the assumption so that we did not change any other variables. We assumed an Australian-US dollar exchange rate of 90c for the life of our deposit, which is approximately 10 years. We basically assumed that the first saleable form at the mine gate is assessed at the FOB price, which is the price you receive when you sell it at the ship’s rail. We also looked at deducting the port, rail and haulage prices—in other words, the price that I need to pay to transport my ore from the mine gate to the ship’s rail. That is called the net back.

I believe that is the principle behind what is going to take place, although when I look at the MOU there is not a lot of detail. We ran six cases because of the uncertainty of all the variables.

In today's company tax rate, our average tax rate would be around 36 per cent. That includes company tax plus royalties; they are basically six per cent above the company tax rate. The RSPT had about a 55 per cent effective tax rate for our company, and the MRRT in its six iterations that we ran varies between 40 per cent and 53 per cent effective tax rate. That equates to an impact on our NPV of between minus five per cent and minus 21 per cent. That is quite a wide range.

CHAIR—And the range is determined by things like commodity prices and exchange rate.

Mr Young—No, the commodity prices were kept flat so that there were no other variables. We were just looking at the effect of the assumptions of the MRRT while leaving the commodity price and the exchange rate flat.

CHAIR—Understood. So how do you get to the range of 40 to 53 per cent? What is driving the differences?

Mr Young—We changed the variables. When we looked at the MOU that was provided to this committee a couple of days ago, we said, 'There's some uncertainty in there, so we're going to run some variables.' The first thing we ran was whether or not the charges from the mine gate to the ship's rail would be deducted from the assessable MRRT iron ore price. If you are selling it at the mine gate, you have to net off the cost to get it from the mine gate to the ship. We call that a netback. So we played with that variable: we said either 'yes, you get a netback' or 'no, you don't'. We looked at a marketing fee, because we do pay a marketing fee—it is confidential but it is in the range of two to five per cent—and whether we can deduct that from the price. We looked at whether the \$50 million profit threshold would be like a marginal tax rate or if when you hit \$51 million you would pay the whole thing. I believe it is that if it is above \$50 million you pay just for above the \$50 million.

CHAIR—We were told by Dr Henry that that is one of the issues that is yet to be resolved.

Mr Young—We need to come back to that because that is really critical. The other question is whether that \$50 million threshold is the MRRT assessable profit, the EBITDA or the NPAT. There are so many variables in there. We did not even run with those; we just assumed it was NPAT. Then we took our capital base and did the capital of our project, which is \$74 million for the capital and the sustaining capital. It is a very low capital project because we are in a joint venture with FMG. We are using their rail and their port, and all of the mining equipment is contract. We have to build a camp and we have to build a 55-kilometre road, and that is it. It is very low capital, very much like Atlas's projects which are also very low capital.

So we looked at that as a variable, comparing that to the market value of the company. Again we had to make an assumption, and the assumption was based on some of the public domain literature by some of the analysts like Ernst and Young and KPMG. We assumed that our starting base project value would be two times our market cap as a rough guess. Those are all the different variables we ran. I can clean this up and provide it to the committee if I get clearance from my chairman.

CHAIR—That would be good. At the bottom of all of this, essentially you still face under the MRRT a potential overall tax rate of 53 per cent. Where does that leave us in terms of international tax competitiveness?

Mr Bennison—If you took, for example, the recent work published by KPMG where they identified Canada at 40 per cent, Brazil at 38 per cent and China at 31 per cent effective tax rates, the position seen by a number of our members is that we are still really being pushed to be internationally competitive, and that is a problem. A number of people have come out and said that we are internationally competitive. Our argument would be that that is not the case and that much work still has to be done to make sure that the companies are internationally competitive.

CHAIR—Mr Young, you mentioned that you looked at the heads of agreement which was tabled after a question from this committee. Was that the first time that you saw a copy of the heads of agreement?

Mr Young—Yes, it is.

CHAIR—So you had never actually seen in writing what the government had agreed to in terms of those detailed tax design features with BHP, Rio and Xstrata?

Mr Young—No, that was the first time I saw it.

CHAIR—So the only reason you have access to that information is because this committee has been asking those questions.

Mr Young—Absolutely. I wanted to congratulate the committee, but I did not want to be seen to be—

CHAIR—I do not really want to pat the committee on the back; I am concerned that it takes questions from a committee like ours to get information which I would have thought should have been spontaneously volunteered.

Mr Young—Can I add something about the heads of agreement as I went through it and as we were modelling this. We have had to do six iterations based on the various assumptions. My assumption, cynical as it may be, is that the companies who negotiated this MOU will have only done one model because they understand the underlying assumptions of all these points, and we do not.

CHAIR—So they have a competitive advantage, in effect, compared to you because they would have been part of the discussions?

Mr Young—Yes, absolutely. And that is part of the consultation process that I would have expected. The first time I knew that there had been an agreement with the mining industry was over my Weet-Bix watching Sky News. When you look at how many miners there are in Australia currently mining iron ore, it is BHP, Rio, Atlas, Murchison, Mount Gibson, Cleveland-Cliffs and Grange Resources. Next year there will be BC Iron and probably Gindalbie.

CHAIR—How many is that in total?

Mr Young—Nine.

CHAIR—I guess the question here is that we are not talking of a large number of companies—

Mr Young—Sorry, and FMG.

CHAIR—And a very small one—FMG. The question here is this: given the government somewhere along the line made a decision to axe the tax, to quote you, Mr Flanagan, for all resources other than iron ore and coal under the MRRT, it would not have been that hard, would it, for the government to talk to all of the eight or nine companies that were working in the iron ore industry if it had been of a mind to have a genuine negotiation with the iron ore industry that was going to be impacted by this.

Mr Young—That is right. Clearly, we would have hopped on a plane, as we have done today, and come over. It is not that far from Perth to Canberra.

CHAIR—Regarding the iron ore side of it, and leaving coal aside for a moment, we are really talking about eight or nine companies at the most. Why wouldn't the government have talked to all of them?

Mr Flanagan—As the biggest companies, those three companies would have the biggest potential revenue to be collected, so I can imagine—

CHAIR—In the short term?

Mr Flanagan—Yes—depending on how you understand these assumptions in the memorandum of understanding.

CHAIR—Yet we are reading in the *Financial Review* that BHP will not have their revenue impacted for 25 years. How would that happen? Where do you think that \$10½ billion is going to come from?

Mr Flanagan—I do not know if that is necessarily true or not, but one of the big differences between the majors and us small guys is size, and that size provides more capital shelter against being impacted by the MRRT. It provides a lower cost of capital; therefore the sensitivities in these uncertainties are different for both of us.

CHAIR—So in fact you could be impacted more quickly than BHP and others—we had this discussion with FMG earlier—because you cannot transfer losses between projects to the same extent, can you?

Mr Flanagan—Correct. One of the issues is the market value or the book value. If we take a small value and we are forced to write it off over 25 years, the incremental benefit of that discount every year is much smaller than if you have \$60 billion. With the fluctuating commodity prices over that time, that imposes a disadvantage on those guys who were not in the room that day.

CHAIR—How does it make you feel that there were three competitors, for want of a better word, that were not only driving the design of a new tax on mining but also have a clearer understanding of all of the underlying assumptions which mean that they are in a much better position than you guys to assess the impact on them as opposed to your capacity to assess the impact on your companies?

Mr Young—By not being in the room, particularly with Rio Tinto and BHP, who have clearly shown that they do not wish to share their rail infrastructure and will fight tooth and nail to avoid it, a cynic might think that the deal they have negotiated for themselves would be prejudicial to any of their competitors in the Pilbara. A cynic might say that.

CHAIR—But you are not a cynic, are you?

Mr Young—No, I am a pretty naive, glass-half-full type of person.

CHAIR—How does the MRRT impact on incentives to explore for new sources of iron ore?

Mr Flanagan—It is more difficult to work with an MRRT than without one. So those companies that are excluded from it that are exploring for nickel are going to be able to keep a larger portion of their profits than those that are in iron ore. The pool of money that is available to go out and conduct grassroots exploration moving forward is going to have a greater likelihood of going into those areas where there is going to be a lower rate of taxation.

CHAIR—So, if you are an investor and you have capital to invest, you would invest it in resources other than iron ore or coal because you will not be subject to this tax.

Mr Flanagan—Management decide, of course! But, if you had two projects that were relatively similar in prospectivity, you would invest in the one that had the greater return. If you then look at it from a higher level, it in a sense discourages investment in grassroots iron ore and coal exploration.

CHAIR—How much prospectivity is there in the context of iron ore exploration? How much are we selling ourselves short?

Mr Flanagan—I got one of our geologists to look at a potential iron ore endowment model on the Pilbara. If you took a Chinese perspective on iron ore and lowered your cut-off and looked at the whole Pilbara, the Pilbara could in theory supply a concentrated magnetite form of iron ore plus DSO for the whole world for well in excess of 500 years.

CHAIR—So there is still a lot of resource out there, non-renewable as it is.

Mr Flanagan—Yes. So you are constrained by infrastructure and people who can access the capital to go out there and have a crack at starting a mine.

Mr Young—That having been said, 10 years ago people would not have foreseen a junior iron ore sector. FMG, Atlas and we have been able to establish a beachhead. In our case, with the assistance of FMG with our joint venture, we have been able to get our ore to port. As time moves on I would expect that there would be more access to infrastructure and other deposits

found closer to infrastructure—there is the Anketell port, for instance. So the junior sector has established a beachhead, and there is no reason why it cannot work side by side with the majors.

CHAIR—How do all of these unresolved features of the MRRT impact on your capacity?

Mr Flanagan—There are a couple of elements there. If you are a company that is able to convey to its shareholders with a great degree of certainty what this MRRT means, those shareholders are going to have a greater degree of confidence in holding shares in that company. I get queries from my shareholders and they say, ‘David, what does this tax mean for you?’ I am not able to give them that degree of certainty, so—

CHAIR—Is anybody able to give them that degree of certainty?

Mr Flanagan—If you are in the room I would have thought that you would have a high degree of certainty.

CHAIR—You mean the ones that were in the room.

Mr Flanagan—Yes, those three guys: BHP, Rio and Xstrata. They would have that. That is my view. I suppose that makes it easier for them to convey the investment proposition. They have that greater certainty; therefore they have a greater likelihood of being able to access those funds. Because those businesses are currently generating very strong cash flows, unlike us—we are just getting up and running—the cost of capital and access to capital for those guys is not an issue. Uncertainty hits those companies that are growing. We are currently negotiating to bring a partner in for our Ridley magnetite project, which is in the Pilbara, close to the coast. We are getting a lot of interest in it, but we are spending a lot of time talking to these guys about all these unknown variables in relation to the tax.

CHAIR—Presumably, the banks would be interested in what the variables are before they provide finance?

Mr Flanagan—Bank financing is not on the table for these projects.

CHAIR—Never?

Mr Flanagan—Not traditional Western bank financing.

CHAIR—What sort of finance, other than equity finance, would you traditionally access and is that being impacted by—

Mr Flanagan—Traditionally, for those sorts of projects, it is Chinese sovereign wealth funds or equivalent from different countries. They pursue strategic investments and they align with integrated businesses. They are able to extract their values through the whole thing. They see risk in these projects as being significant and, therefore, they need to get a high degree of technical understanding. The way that this tax is to be implemented will create uncertainty until it is resolved, if it is resolved. Then, it will create more delay for the period where we need to try to convey it and make the potential investors understand it. If that is two years delay, it will have a significant effect on the value of a project because time is money.

CHAIR—If you are not able to get to speak to the government, as I say, it is five minutes before an election, to resolve some of these unresolved issues, how much confidence do you have that you will be able to resolve these issues after an election if the government is returned?

Mr Flanagan—That is a good question. I think the government spoke to the majors because they wanted to know how they could collect sufficient revenue from the taxes to do whatever. Really, we are a rounding error in the size of the revenue they will collect from the juniors. But the uncertainty has a significant impact on our business. I certainly hope that we can resolve these things as quickly as possible but we do not foresee them being resolved before an election.

CHAIR—Have you had meaningful discussions with the government since 2 July?

Mr Flanagan—We have met with government and we have asked them questions to try to resolve these issues around market value and the \$50 million but we have not been able to resolve them. On that basis, I do not think they have been meaningful.

CHAIR—Have they given you an indication of the time lines or the process that will be followed in order to resolve them?

Mr Flanagan—They have referred it to the consultation policy committee—

CHAIR—But that is an implementation group, isn't it?

Mr Flanagan—Yes.

CHAIR—Are the issues to be resolved just implementation issues, or do you think there are more substantial questions? Listening to your comments about the design features it seems to me that they really are catering for the BHPs, the Rio Tintos and the Xstratas. I am not trying to put words in your mouth but it sounds to me as if you still have some fundamental concerns that go beyond mere implementation issues. Is that a fair characterisation?

Mr Young—It is a fair question. I have six columns here, six different variables that I am modelling because I have no certainty. As I said to you before, the people who were in the room have certainty that one of these columns is closest to correct. So, firstly, I just want certainly on that. I just want to go with this table and explain it to somebody who is in the know and basically say, 'Can you please tell me which of these columns I should be modelling and telling my shareholders about?' As the CEO of a public company staring down the barrel of an election and the inherent delay that represents, that bothers me.

Mr Flanagan—From a compliance point of view with the ASX, we are obliged to make material disclosures to the market, just to keep the market informed. There are a number of measures on what is 'material', and one of them is if something can impact the value of your company by more than 10 per cent. So there are some companies that have an understanding of whether this is material and some companies that do not. We feel disadvantaged by that.

CHAIR—So you do not actually know whether it will have a material impact or not because you do not know. That would just be a matter of the government saying, 'This is what it will

mean for you'. Is there nobody in government who has been able tell you from an advice point of view: this is where you fit into the equation?

Mr Flanagan—Not on all those queries, but I think that it is also probably a bit of an unintended consequence. Something like the \$50 million threshold is so small that it is inconsequential to the majors. So they would not have given a great deal of thought to the definition of how that would work. That is a classic example. If Simon Bennison at AMEC had had a representative in the room representing us, they would have been able to have that clarified there and then. But it could not be done because AMEC was not involved.

CHAIR—So it is a lack of due process.

Mr Flanagan—Yes.

Senator FIFIELD—I am looking for an analogy here. It is really a bit like if you had the government getting Coke and Pepsi into a room to discuss the future of taxation in the beverage industry and then coming out and saying, 'We've reached an agreement with the industry.' Would that be a fair analogy?

Mr Flanagan—Yes, that is exactly how it appears.

Mr Young—I just wonder which one was Pepsi and which one was Coke!

Senator HUTCHINS—I have a few questions, Mr Young, on your modelling. If I heard you correctly, you said that all up the taxation at the moment is about 36 per cent. Is that right?

Mr Young—That is correct. As that iron price falls then the average tax rate actually goes up because of the way royalties are structured.

Senator HUTCHINS—On one of the half-a-dozen models you mentioned—tell me if I am wrong—you were saying that the tax rate went up from 40 to 53 per cent.

Mr Young—That is correct.

Senator HUTCHINS—One of your concerns of course is that you want to know which one of those models it will be. You are hoping it might be the 40 per cent rather than the 53 I imagine.

Mr Young—Correct. When I ran these cases the best three, if you like, were basically between 40 and 44. From what I have read in the MOU—and you can read anything and interpret it the way you want—the biggest thing that affects us is what is called the FOB netback. So the assessable MRRT or sale price is very important to us and that has the biggest effect. We would like certainty on that. I believe from reading the MOU that it is that way, particularly the line that says 'arm's length principles on all transactions pre and post first saleable form'. The inference in that line is that it is a netback price.

Senator HUTCHINS—Most of your models, if I am correct in what I heard you say, are around the mark of 40 to 43 per cent.

Mr Young—It is in that area.

Senator HUTCHINS—Thank you.

CHAIR—In relation to the \$50 million profit threshold under the MRRT has the government provided any explanation to you on why it chose to exempt miners under the \$50 million threshold?

Mr Bennison—We have not formally approached the government in regard to the detail of the MRRT either. At this stage—

CHAIR—Sorry, you have not approached the government on the detail of the MRRT?

Mr Bennison—Not in asking about the specifics. We approached the government about getting engaged in the whole process. Post the announcement of the MRRT we are still looking for engagement so that we can work through it and better understand it. We have yet to get a response back from government on some form of engagement to do that.

CHAIR—Would you have any idea as to why the government have chosen \$50 million and not some other number?

Mr Young—Maybe somebody had one of those Magic 8-balls on their desk or something. It is an arbitrary number.

Mr Flanagan—I think that the intention of that number is to somehow provide some sort of compensation for the higher cost of capital to the juniors. On my assessment Atlas will be paying 40-something per cent on that first \$50 million. Thereafter it needs to be higher. I think \$100 million is a fair number.

CHAIR—Do you know whether you are expected to pay for the \$50 million and above or just for the amount above the 50 million?

Mr Flanagan—No I do not. Again, we have tried to figure out what that means. Even just before we came in here I had a small argument with Mike because I thought it was your profit number but then your MRRT is another number. I have actually informally put that to government and they have not been able to provide any clarity on whether the tax is payable on the first 50 or whether it kicks in on the money over and above the 50.

CHAIR—Again, Dr Henry was not able to give us clarity on that this morning either. Would some miners be able to structure their affairs to get below the \$50 million threshold? What would happen if you approach the \$50 million threshold—what would you do?

Mr Young—Our project is going to be well and truly above the \$50 million threshold, so this is speculation; this is not BC Iron. But, if you are running a small mine and you are approaching \$50 million towards the end of the financial year, you might think about doing care and maintenance for a month if it means you are going to save tax.

CHAIR—That would have an impact on jobs, I guess. Do smaller miners face different risks relative to larger miners in terms of being able to access the value of the MRRT tax credits?

Mr Flanagan—Absolutely. If you are a single project, single commodity company, you do not have that transferability. Typically, as I said before, smaller guys have smaller balance sheets, smaller projects that have lower values; therefore they have less access to those credits. On the infrastructure issues and their backing from the FOB price, and even the FOB price, and the interaction between marketing internal ungrouped marketing agencies for tax purposes, there are a whole bunch of opportunities for optimising tax that juniors would not have.

Mr Bennison—One of the biggest challenges, when you talk about the \$50 million—and your question just then—is that the administrative cost and the burden in trying to track all these parameters that have been identified in the heads of agreement for the juniors are far greater than for, obviously, a larger company. So, for them to have the structures and the programs in place to be able to do that and know exactly when trigger points are going to be reached, it is going to be very difficult and extremely costly. They will have to make that decision as to whether it warrants the cost, but there is no doubt that for the smaller operator the current arrangements, instead of what we hoped tax reform might be, which is to be more efficient and effective, appear to have become a far more complicated and administrative-heavy arrangement.

CHAIR—You pre-empted one of my questions. So there are going to be increased compliance and administration costs out of all this aren't there? Is it conceivable that some of your members would end up paying more to administer and manage the compliance regime than what would ultimately be generated in revenue for the government?

Mr Bennison—I could not accurately answer that. As Mike just said, you could speculate that there will be some smaller producers that, through obvious reasons of compliance and audit, are going to track this process. I would say that, yes, sure, in the early days, just to make sure the systems are in place and that there is not going to be in any sort of breach through due diligence, the costs of doing this are going to be extremely heavy. But again, until we have worked through the whole detail to see how the final design of this will look, we are really speculating on what that might involve.

CHAIR—Presumably, the final design as such is what was announced on 2 July. Given the government's assertion that the deal is done and it is all fixed, and it is going to be how it is going to be implemented in practice, do you expect the design features to change?

Mr Bennison—I honestly do not know, but there are some aspects that, given the opportunity in this panel process in the future with the transition group, we would certainly like that opportunity to see whether some of those can be put on the table. As Mr Flanagan has alluded to, if we could get the \$50 million to be extended to \$100 million, and the justification underpinning that, then perhaps there are some parameters that are up for negotiation. Obviously this is going to depend very much on Treasury and the government being able to explain what the long-term impact will be on their revenue.

CHAIR—Do you think that Julia Gillard, Wayne Swan and Martin Ferguson should do deal mark 2 and sit down with all the smaller and mid-tier end of town and do another deal?

Mr Bennison—I will let my colleagues alongside me be advocates for that. I am sure that those companies that have not been inside the tent, so to speak, with these negotiations—which we thought were going to be offered that opportunity with the appointment of the new Prime Minister—would like the opportunity to go back in there and negotiate some of these parameters.

CHAIR—What do you mean by ‘to go back’? To get in?

Mr Bennison—The tent that was put by the Prime Minister about 10 days ago.

CHAIR—The guy that was really good at consultation? So you would like to get into the inaugural Gillard tent, so to speak? It is not so much a matter of going back into it, is it?

Mr Bennison—No, but I think that, with the parameters that are put around the MRRT as it stands at the moment, there are a number of companies who would say—and my colleagues either side of me will attest to this—that it would have been very useful to be able to have input and put some justification behind some of the numbers. Maybe they have got justifications. We are just speculating here, so I will be guarded in my comments. But we would certainly look forward to seeing that detail so that we can feel comfortable that post the election there are no hidden secrets or issues that are going to in some way put question marks around the due diligence or shareholder expectations et cetera for the future.

CHAIR—So you would expect to see that detail before the election?

Mr Bennison—Ideally, yes. We would like to see it as soon as possible. By the same token, we would like to engage the government in discussing those issues with them as well.

CHAIR—Going back to the issue of the emerging lower-grade magnetite iron ore industry, what are the unique impacts on that part of the industry from the MRRT? There have been arguments that magnetite should be excluded for a range of reasons. Can anyone here talk us through this?

Mr Bennison—I will start off and I will then throw to David. We have a considerable number of magnetite producers in the west and I think it is fair to say that their preferred position would be to be exempted from the MRRT arrangements. Their justification is pretty much on the in-the-ground value of their product and the extraction cost. They are obviously drawing parallels to other commodities that have been exempted—whether it is bauxite or others—where the value add and the actual treatment of this product down the track is the real issue for them. So, from a magnetite point of view, their position has been made quite clear and I know that they have had some discussions with the government, but to what detail I am not quite privy to. David might have some more information on that.

Mr Flanagan—We are really just at the beginning of the magnetite industry in Australia and the potential for magnetite to make a significant contribution to the Australian economy. In the short term, in those construction jobs, thousands and thousands of people would have employment opportunities out of it. But the magnetite projects are typically very long life. Atlas

have a magnetite project and we would envisage that having a mine life in the order of 35 years. So there is a significant opportunity there. Because it is a new industry and it is very capital intensive, there is an element of technology risk in starting these projects and a very large capital risk. So they in themselves are a reasonable barrier to entry into that industry. Typically, to go and start these sorts of industries—which would employ so many people and break such new ground and do so much value adding of a very low-grade product—the government would often provide taxation incentives in some countries. So, in effect, what this MRRT does is it creates uncertainty and effectively another barrier to entry for investors to come and get those projects up.

CHAIR—So it might actually kill a part of the industry in its infancy?

Mr Flanagan—Well it is definitely not increasing the price and value of them.

CHAIR—Or its likelihood of survival.

Mr Young—But let us keep in mind that Australia does not have a monopoly on magnetite in the world.

CHAIR—As we do not have a monopoly on iron ore in the world, either.

Mr Flanagan—Correct. So if we take iron ore, its in situ grade at the mine is somewhere between 25 and 42 per cent FE, and that is not saleable in its raw form. You cannot put that into a blast furnace, except like in handfuls. To do it commercially it is just not viable. There are billions of dollars of capital expended and a lot of operating costs expended on turning that into a saleable form.

The argument is that by the time you back-calculate the cost of that capital into the whole project for your MRRT and the book value of that and back out your costs from your FOB price, the impact is relatively minimal—and that may well be the case. If that is the case then the cost of implementing this MRRT is going to be very high compared to the benefit that is given to the nation. One of the key principles of the Henry tax review was to simplify tax. I can actually see each one of these magnetite mines having an MRRT compliance division, which may well cost half a million to \$1 million just to run. So, if it is not going to collect a lot of revenue and it is just going to make things more difficult, why have it?

CHAIR—Just going back to our discussion before, we talked about your models and your six different scenarios. When you analyse your tax burden, what is the time profile of the tax liabilities that you are looking at? Do you incur your significant tax earlier in the project, later in the project, or is it evenly spread?

Mr Young—I do not have that level of detail with me; this is just an overall view for the tenure of mine life. We will be in production later this year. We will produce about 2½ million tonnes next year, leading into 2011, and then three million the year after, so we will be through five of our 36 million tonnes before the tax kicks in.

CHAIR—Would you be expecting to pay tax in the years 2012-14?

Mr Young—Again, I do not have the data in front of me, but I am pretty sure we will be paying tax from the get-go because we have such a—

CHAIR—The MRRT from the get-go?

Mr Young—Yes. We have a relatively low capital base. It really depends on the market value versus the capital base, but it would appear that we will be paying it right upfront.

CHAIR—So you might be one of those companies that contributes to the \$10½ billion that the government expects to raise.

Mr Young—Yes.

CHAIR—You think so; you just do not know how much. Have you given any advice to the market over the last two years about an expectation of significant improvement in the commodity price outlook?

Mr Young—No. We generally shy away from putting that into the market because in the public domain there are a lot of analysts and companies doing that. As a company our policy is to provide the capital costs and the operating costs with great clarity and openness but to let the analysts of each of the companies decide on price forecasts. If you were putting that material out into the market, as Dave said, you would have to have a compliance division. There are companies like Credit Suisse—

CHAIR—But in terms of your own assessments—and I guess it is going back over old ground—you are not aware of any significant improvements in the commodity price outlook in the last two or three months?

Mr Young—To be quite honest, I have not looked at enough on a month-by-month basis. We are looking at it over the life of the project. As Dave has already mentioned, right now for our forward projections, because of the uncertainty of the market, we are basically doing flatline projections. When we do our internal assessments and communications we basically lay those assumptions out, and for the time being we are using flatline projection.

Senator HUTCHINS—Earlier you were talking about capital. How long does it take to repay mine capital generally?

Mr Young—Of course, it depends on how much you borrow, I do not mean to be glib.

Senator HUTCHINS—Yes

Mr Young—We have borrowed US\$50 million from a Chinese company and will be paying that back over a five-year period.

Senator HUTCHINS—Just five years?

Mr Young—Yes, \$10 million a year over five years. We had a very low capital project.

CHAIR—You are close to the ocean?

Mr Young—No, we are close to FMG.

CHAIR—Do they let you use their railway?

Mr Young—That is correct. We have a joint venture and we have access to the railway and the port.

CHAIR—FMG has already expended all of the capital. Their profit would be quite different in terms of the capital intensity of their project, wouldn't it—not that I am expecting you to answer for them? The answer is yes.

Senator HUTCHINS—You are doing a good question and answer job yourself, Chair.

Mr Flanagan—Just on the question about mine life, and this is an important issue: for the juniors in the iron ore industry, our mine lives on start-up, on actually pressing the button on a project, would typically be in the order of five years or less—at around that level. So our ability to generate a return for our shareholders on the back of all of that sunk capital to that date needs to be captured over a much shorter period of time. If there is a year of uncertainty it impacts 20 per cent of the mine life on start-up, but if you are a big producer with a 25-year mine life then the relative uncertainty has a much smaller impact on your business.

CHAIR—When did you find out that the resource exploration rebate had been scrapped by the government?

Mr Flanagan—On 2 July.

Mr Bennison—Yes, basically when the MRRT was announced.

CHAIR—So you found it out watching Sky News over your breakfast Weeties?

Mr Young—Yes, over the Weet-Bix with Sky News.

CHAIR—The government never consulted with you on the effects of removing this rebate?

Mr Bennison—No.

CHAIR—Has the government provided you with any explanation since then as to why it has removed the rebate?

Mr Bennison—No, not directly. All we have gleaned is what has been in the media in the context that a number of people out of government have said that the RER was not valued by the industry, which is not correct.

CHAIR—Why is that not correct?

Mr Bennison—The industry has always welcomed an RER and has made this known to the government on a number of occasions. Given the amount of conjecture that has been around this over recent times we have actually put a chronology together that identifies the times at which government has been engaged in this process from when the RER was first announced. We have gone to great lengths to explain to government that the RER is very different to what the industry was initially asking for and what the government committed itself to in the 2007 election policy platform, which was really an exploration development program modelled around the flow-through shares. The flow-through share arrangement was there to address a taxation asymmetry problem that we had and a distortion that we believed needed to be addressed. That was there to provide equity finance for the sector; versus an RER, which was more or less there to rebate industry, and also in part address that asymmetry, but which really was not addressing the issue of raising equity finance, which is the major hurdle for exploration and exploration development within this country.

CHAIR—If I can paraphrase what you are saying, the resource exploration rebate was better than nothing—

Mr Bennison—Absolutely.

CHAIR—It was not as good as what you had been promised before the last election by the government when they promised flow-through shares but it was better than nothing, but you have actually now ended up with nothing.

Mr Bennison—Correct. I think the important thing is there are distinct differences in the roles of both programs.

CHAIR—Can you explain that for us?

Mr Bennison—The whole issue for the exploration sector is that to get the amount of capital that is required to drive exploration in this country requires the raising of significant capital. That is done through equity finance, and that is why the flow-through shares, for want of a better description, had been proposed from industry and were supported by government in the election platform, as opposed to the rebate itself, which was cash back—after you had made the expenditure you would go and claim the rebate and get reimbursed the rebate. That is fine, but that allows you only to put a certain amount—at that stage it was 30 per cent—back into exploration and other expenses, whereas if you were raising the full equity from the flow-through shares arrangement you would be putting all that expenditure on an annual basis, and any other further raisings, back into the full exploration program.

CHAIR—You guys are running mining companies. Have you ever been forced into a process like this? Have you ever experienced any process like the one that you have had to go through over the last two or three months?

Mr Young—No, absolutely not.

CHAIR—Mr Bennison?

Mr Bennison—I think it is rather unfortunate. We were expecting, through the consultation process for the RSPT, our submissions to be taken into consideration. Again, issues surrounding exploration development programs were clearly identified in those. That is now being transitioned, if you like, into the current arrangements of the government through the MRRT. We thought we were going to, in good faith and with an open mind, go into a negotiation process. Sadly, that was not forthcoming. A select group of people were allowed in the room to negotiate.

CHAIR—Sorry to interrupt there. When Julia Gillard became Prime Minister, she promised that she was going to can the very ineffective advertisements being run by the government in exchange for you also canning, as a sign of good faith, the very effective advertisements that you were running. Do you feel a bit cheated having, in good faith, pulled these ads and then not being invited to the table for the negotiation?

Mr Bennison—Without doubt. We are extremely disappointed. We thought it would be all inclusive but obviously it was not.

CHAIR—When did that become obvious?

Mr Bennison—I could not tell you the exact time, but it was when we heard that there were three majors basically sitting in the room negotiating a deal.

CHAIR—Regarding the \$10½ billion the government expects to raise, you have told me that you expect to be subjected to the tax in the first two years of its operation. Would you be subjected to it?

Mr Flanagan—I am not sure. It comes back to market valuations and book value.

CHAIR—Do you have any sense as to how much of the \$10½ billion is going to come from the majors—BHP, Rio and Xtrata—and how much of it would come from the medium-tier end of the market?

Mr Bennison—We are not privy to any of that.

CHAIR—As far as you are aware, would the government be aware of it? Presumably they would.

Mr Bennison—You would like to think so.

CHAIR—But they have not shared that with you?

Mr Bennison—No.

CHAIR—Do you think they should?

Mr Flanagan—In the early days, we were quite surprised at the variance in some of the Treasury estimates of what they were going to get in. There is inherent concern amongst the industry as to whether the \$10.5 billion is in fact \$5.5 billion or \$15.5 billion—we are not really sure—and where it is going to come from.

CHAIR—I guess the one thing we know is that the way the government has minimised the impact on revenue is by assuming that commodity prices are increasing significantly when the evidence in the market is that, if anything, in that period prices have come off and are expected to come off slightly moving forward. That is right, isn't it?

Mr Flanagan—We are forecasting flat commodity prices for the next year. We do not know after that.

CHAIR—Are you intrigued by how the government can come up with assumptions to underpin its revenue projections, that somehow iron ore prices are going to go up significantly?

Mr Flanagan—I suppose the shareholders should feel happy that everyone is so confident that prices are going to go up, but we do not have the certainty around that.

CHAIR—Ken Henry shared with us that he agreed with the proposition that most of the revenue would come from iron ore. I guess all will be revealed. You said at the beginning that you might have some concluding remarks for the committee at the end of our questions. Is there anything that you would like to share with us that we have not raised with you so far?

Mr Bennison—What is critical in trying to sum up is that we really need transparency and honesty in this process. They are a couple of critical ingredients that we feel frustrated with and have been lacking to date. We want to get rid of all the speculation that is occurring, not only in the media but elsewhere, to make sure that people have the confidence to be able to let their shareholders know and to make sure that companies in the exploration space have more certainty as to where they will be sitting in the next four to six months.

Trying to raise capital out there at the moment is an extraordinarily difficult task. Junior explorers in particular are suffering at the moment, and they can clearly identify that, so the sooner that this speculation on what is in, what is out and what the details surrounding this whole process are is over—in particular, for us to get confidence back into the very high risk reward component of the exploration industry—the better. I think that can only come with the government addressing that component. It is a pity that that was thrown out within the original negotiations of the MRRT.

There are aspects of that that we would obviously seriously like addressed as soon as possible so that the exploration sector in particular can have confidence and can go back out to the marketplace and we can see a much improved investment in the exploration end of town. I will just reinforce that. Over the last 10 years, we have seen investment deteriorate in Australia from about 25 per cent of global expenditure down to about 12. That is still continuing to drop. We just cannot afford not to be out there looking for the new deposits and the new mines over the next five to 10 years, at that rate of decrease in exploration. So there are lots of issues underpinning why we need to be back in this space and why we need to develop programs that are going to enhance the industry being able to get confidence back in its investment fraternity and the capacity to raise equity finance in that area.

CHAIR—I am sorry to ask another question here, but are you actually saying that, before the change of Prime Minister, as far as you were concerned the process was on the improve and that

since the change of Prime Minister the quality of the consultation and negotiation process with the mining industry at large is worse than it was before the change of Prime Minister?

Mr Bennison—No. I think that at the moment we are disappointed with the negotiations that have taken place without consultation with the exploration sector in particular in this whole process.

CHAIR—In the mid-tier sector there have been none, haven't there?

Mr Bennison—Yes, that is right.

CHAIR—So that is less than you had under the previous Prime Minister?

Mr Bennison—Correct, but at least we were going through a consultation process that was part of the government's initiative to try and get industry input. A lot of people had various views on the value of that process, but at the moment we have no engagement at all with the government in trying to make sure that those things that are of value, in particular to the exploration sector—for example, the exploration rebate—are kept on the table and negotiated through.

CHAIR—I am being very naughty, and I do not really want to put you in a position where you have to directly criticise the Prime Minister, but I take it, reading between the lines, that, unless there is some meaningful discussion very quickly, really you are in a worse position now as the sort of smaller and mid-tier end of the mining industry than you were before Senator Hutchins's colleagues decided to make a change at the top. But take that as a comment and not a question. That was a rhetorical comment, Mr Bennison. I am not asking—

Senator HUTCHINS—You have been making all the comments, Mr Chair.

CHAIR—I do not mean to put you on the spot here. Senator Fifield still has two or three closing questions.

Senator FIFIELD—I just want to go back briefly to where this all began with the announcement of the Henry review that we were going to see root-and-branch tax reform, the greatest tax reform that Australia has seen since the Lord knows when. When I think of tax reform, I tend to think that there should be three elements to it. You want to be abolishing a tax or two, you want to be making some existing taxes simpler and you want to be reducing the overall tax burden. I ask each of you in turn whether you think that what has eventuated from that process meets any, all or none of those three elements which I think are essential if you are going to call something 'tax reform'.

Mr Flanagan—No, it is more complicated, there are more taxes, and we do not understand them, so it makes investment decisions more difficult. On that basis, I do not think it feels like tax reform.

Senator FIFIELD—Mr Bennison?

Mr Bennison—I concur. I think one of our biggest issues is this. We thought we were going to get something long term before we entered this whole process, something that was going to be more efficient, more equitable and more effective, and I think industry feels short-changed in that area. We are seriously concerned about the long-term administrative costs of this to the smaller companies. Unfortunately I guess we will just have to wait and see and have faith in some sort of process in the longer term.

Senator FIFIELD—Mr Young?

Mr Young—It certainly does not tick any of those boxes. More to the point, what it does do is introduce more risk into the sector. For example, when you are looking at the risk in investing in a company you look at commodity risk, technical risk, logistical risk—and we have seen that recently with far-flung countries—marketing risk and country risk. What this tax did was introduce a new level of country risk for Australia, which is really disappointing to me, having lived here for 23 years and worked in the industry. Australia was seen as very safe in terms of sovereign risk. I think there is an opportunity through this process, and I would hope that there is a process. For example, with some of that country risk the damage that has been done will take some time to heal. One of the ways of doing that is, for example, bringing in a flow-through share type scheme, which the government did promise, because that would then introduce some more investor confidence.

CHAIR—Would you trust any such promise if it were made? It was made before the last election.

Mr Young—I told you I was naive! I agree, but that is for the politicians to work out. That introduces something that I have found personally frustrating. Our company was founded 3½ years ago. I was the only employee when we started and we built it up. We have now got about 40 or 50 people on site and by the end of the year we will have 200. So it has been quite a transition. David has been through a very similar transition. Both of us have been around the industry together and have known each other for almost 20 years. The way I run my company is that I promote consultation with all government departments and all stakeholders. So when I listed the company in December 2006 the first three phone calls I made were to the native title people, the station owners and FMG, because I knew that FMG was critical to our success because of their proximity. Since that time we have engaged at all levels of government in all governments, both federal and state—both state governments in fact because we had an election while our project was running. I pride myself on being consultative with our stakeholders. In fact, I stepped out while FMG were speaking to talk to some of the guys in the environmental division here in Canberra to see if they wanted to catch up and have a coffee, because that is the way I run the company. So I was really personally disappointed, given there is only a handful of iron miners, that we were not consulted. There are not very many junior iron miners in Australia; it is a hard task, and to actually get a mine up—what David has done and what I am about to do—is very difficult in this country because of the barriers to trade. So I was personally disappointed that we were not consulted and, as a councillor and a member of AMEC, I was disappointed that AMEC was not even able to talk on behalf of the junior sector.

Senator HUTCHINS—You are making some observations about not being consulted by government about this particular tax. Is that your experience with government on any aspect of taxation?

Mr Bennison—No, not at all. We have a very broad portfolio of taxation issues. I will not go into them but obviously there is R&D tax and fuel tax—you name it and we have been there. Our discussions with Treasury and with the ATO have been fantastic. We have had very good relationships with government departments and the ministers. This is to us an absolute one-off, not having confronted it before, and it really does hurt. We think we have done the right thing by the government and all those concerned and then to be treated as we have after entering this whole relationship in very good faith is extremely disappointing to say the least.

Senator HUTCHINS—But with other government departments, as you were saying, the environmental guys—

Mr Young—Very approachable.

Senator HUTCHINS—But are you only talking about taxation issues there as well?

Mr Young—We do that through consultants, and my CFO mainly does a lot of that. He is the numbers man; I am a lowly geologist. He has also said that he has had no pushback from any departments in any of the other dealings that we have had. And that goes right through the company—the environment, heritage—we have very good relationships. So, again, it really accents our disappointment.

CHAIR—As there are no other questions, thank you so much for your assistance to the committee. I wish you success in all of your endeavours moving forward. You do make a great contribution to the Australian economy. I do hope that this government, or future governments, will go through proper public policy development processes to ensure that your important work is enhanced and not hindered. Thank you very much for your contribution today.

Mr Young—Thank you.

CHAIR—I would like to thank all witnesses who have given evidence to the committee today.

Committee adjourned at 2.46 pm