



MINERALS COUNCIL OF AUSTRALIA

SUBMISSION TO THE SENATE ECONOMICS REFERENCES COMMITTEE

Development and Operation of the Minerals Resource Rent Tax

MARCH 2013

EXECUTIVE SUMMARY

The MCA considers the scope of matters relevant to this inquiry to be both extensive and profound. Indeed, they go to the very foundations of Australia's past, present and future prosperity. Among the issues raised by this inquiry (either explicitly or implicitly) are:

- The minerals industry's contribution to the national economy (notably in this case, the iron ore and coal sectors) and recent industry developments
- The tax contribution of the industry and the broader "sharing of benefits" from industry growth over the last decade
- The MRRT – its design, development and operation – and alternative resource taxation proposals
- The estimation of resource taxation revenues
- The risks to future prosperity from proposals that would increase further the tax burden on the minerals industry.

ECONOMIC AND COMMERCIAL CONTEXT

The minerals resources industry is Australia's most globalised industry and a key pillar of the national economy. New research by the Reserve Bank of Australia has confirmed the significance of the mining industry to the Australian economy and the positive linkages across the economy arising from strong mining activity in the last decade.

The product groups covered by the MRRT – iron ore and coal – are the nation's largest export earners contributing almost \$111 billion to exports in 2011-12 (more than a third of every export dollar earned by Australia). Together, these two sectors employ more than 80,000 Australians directly and hundreds of thousands more indirectly, the majority in regional and remote Australia.

Both industries have entered a phase of heightened uncertainty and volatility in the last 12 to 18 months, with a marked deterioration in business conditions in the coal sector in particular. Lower prices, a high exchange rate, rising costs and increased government imposts have combined to reduce profit margins, leading in some cases to mine closures, job shedding and cancelled or delayed capital expenditure plans. Increased uncertainty now surrounds the coal and iron ore investment "pipeline", with uncommitted projects in the two industries worth more than \$160 billion and a sharp fall-off in capital expenditure in prospect in the absence of new committed projects.

It is now widely recognised – including by official forecasters – that there are no more "easy gains" for Australia from high prices for coal and iron ore. Looking ahead, further gains from the development of Australia's coal and iron ore resources will rely overwhelmingly on expanded export volumes, rigorous cost control and higher productivity. The crux of this challenge lies in arresting the deterioration that has occurred both in terms of operating costs and capital costs.

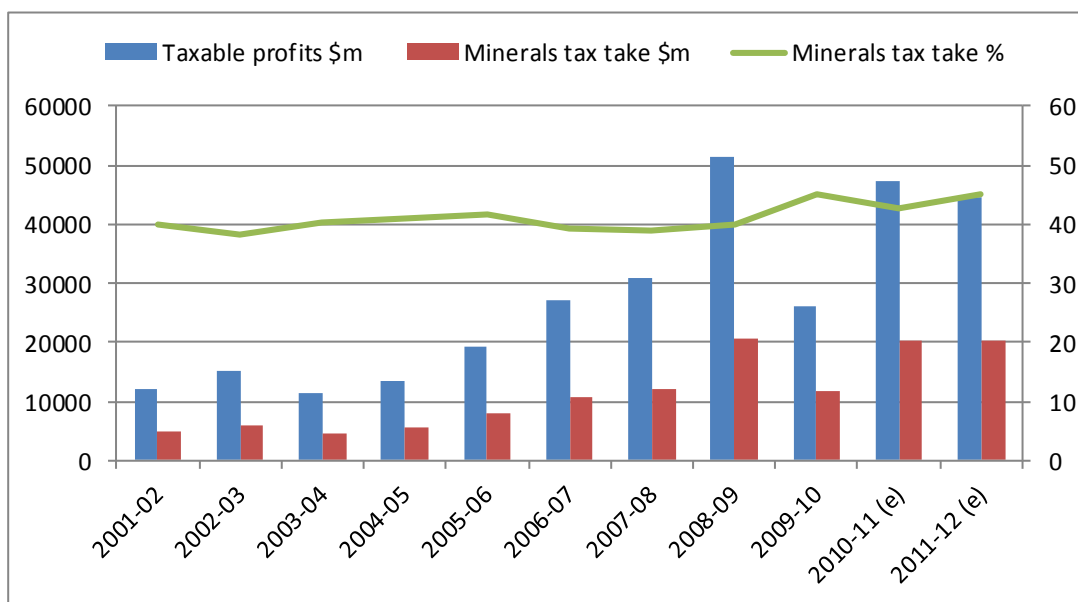
Coal and iron ore projects are highly capital intensive with considerable, high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. Certainty as to the overall tax burden on coal and iron ore *and* specific design features of the MRRT is critical to future investment in these industries, especially given heightened volatility of market conditions. The Minister for Resources and Energy, the Hon Gary Gray MP, has recognised the need for certainty, noting on 26 March 2013 that "even to discuss changes to that tax right now would create uncertainty".

INDUSTRY TAX CONTRIBUTION AND BROADER "SHARING OF BENEFITS"

Minerals resource companies have been Australia's largest taxpayers in recent years and the mining of iron ore and coal were among the highest taxed industries in Australia, even before the introduction of the MRRT. The direct revenue contribution from the minerals industry to Australian Governments has grown markedly, rising roughly four fold over the last decade. The industry's indirect tax contribution is also significant.

Prior to the introduction of the MRRT, revenues from Federal company tax and State royalties alone have totalled more than \$130 billion since 1999-00 (estimates for 2010-11 and 2011-12 by Deloitte Access Economics). The industry tax ratio has remained high and relatively stable averaging 41.6% since 2001-02 (see below). Contrary to claims made during the 2010 tax debate, the industry tax ratio has actually risen in recent years, hitting a decade high of 45.2% in 2009-10 (the last year of available official data).

The minerals industry tax take ratio has remained high and stable



Total royalty payments to State and Territory Governments have risen sharply since 2006-07 due overwhelmingly to growth in coal and iron ore royalties. Coal royalty payments have risen at an average annual rate of 24%, while iron ore royalties have risen at an average annual rate of 35% between 2006-07 and 2011-12. Notwithstanding the uneven distribution of resources across the States, the system of Horizontal Fiscal Equalisation means that all States (including those without large mining industries) have derived benefit from this flow of royalty revenues.

Importantly, a narrow focus on government revenues alone – much less an additional “rent” tax designed to cut in at the peak of the commodity cycle – fails to capture the variety of ways in which Australians have shared in gains from mining industry growth. Analysis by BREE has shown that average weekly real household incomes in Australia climbed almost 40% over the period from 2002-03 to 2011-12, driven largely by higher mineral commodity export revenues. Other official research has confirmed the positive impact of mining industry growth on key economic variables. Hence, what appears to be an underlying premise of this inquiry – namely, that the MRRT is essential for Australians to share in the benefits from mining industry growth – is not supported by the economic evidence.

THE NATURE OF THE MRRT AND ALTERNATIVE RESOURCE TAXATION PROPOSALS

The MRRT adds a third mechanism to taxing resource profits derived from the extraction of coal and iron ore – in addition to State and Territory royalties and Federal company income tax. Royalties provide a “hard floor”, the baseline above which MRRT becomes payable. Company income tax – like the MRRT – taxes mining profits proportional to industry profitability, though it applies to the “normal” return on investment, as well as to “rent”. As the former Head of Treasury’s Revenue Group noted in 2009, “the application of the company tax to the resources sector has acted as a de facto resource rent tax”.

The MRRT is therefore a profits tax on top of a profits tax – in effect, a “top-up” tax during periods of abnormally high industry profitability. It places Australia at the upper boundary of globally competitive tax rates – above nations such as Canada, Brazil and China for iron ore and above the likes of South Africa, Canada and China for coal. Incidentally, none of these competitors has additional imposts in the form of a national Carbon Tax or emissions trading scheme.

The Government-appointed Policy Transition Group described the MRRT as providing the Australian community with an additional return “at the peak of the resources cycle”, recognising the cyclical nature of the mining industry and the volatility of commodity prices in particular. The Australian Government has recognised repeatedly that the MRRT will be volatile (as commodity prices, exchange rates, investment plans and other variables change) and that this is intrinsic to how resource rent taxes are designed to work.

The development of the MRRT should be understood with regard to the following key issues:

- The principles which informed the industry’s position on minerals taxation reform, both prior to and through the development of the MRRT
- The “path dependent” nature of the MRRT’s development, in particular the lack of consultation with industry and State Governments on resource taxation reforms announced in May 2010
- The deep flaws in the original Resource Super Profits Tax (RSPT) proposal.

It is a matter of public record that the minerals industry adopted a constructive, principles-based approach to the reform of royalty and taxation arrangements. And it is a matter of public record that not only were the mining industry and State Governments not consulted about the proposed RSPT; the then Minister for Resources and Energy, the Hon Martin Ferguson AM MP, in his words, “was not properly consulted about it at all”. The industry accepted assurances from Government that there would be an opportunity for engagement, but as Mr Ferguson has stated “it didn’t occur” ... [in] the mining dispute we created our own mess because of a failure to consult”.

As to policy, the RSPT proposal was shown to be seriously flawed and, as the Prime Minister noted, a source of “uncertainty and division”. The Treasurer similarly recognised that the flawed design of the RSPT would have discouraged investment. Among the key design features of the MRRT (in contrast with the RSPT) are:

1. A more internationally-competitive tax rate

Under the RSPT, effective tax rates on Australian projects – ranging from 52% on coal to 57% on iron ore – were simply too high, pushing Australian projects markedly up the global cost curve and sending investments overseas.

Under the MRRT, the interaction of the 30% headline MRRT rate, the 25% extraction allowance, a company tax rate of 30% and a credit for all State and Territory royalties paid results in a more competitive rate, albeit at the upper end of global tax rates. In this context, full crediting of royalties ensures double taxation is avoided and delivers a measure of stability and predictability to the overall tax burden on coal and iron ore projects. The December 2010 PTG report (accepted by the Australian Government) recommended full crediting of all current and future State and Territory royalties “so as to provide certainty about the overall tax impost on the coal and iron ore mining industries”.

2. A fairer transition for existing investments based on a market value starting base allowance

The RSPT’s punitive transition arrangements caused considerable damage to Australia’s investment reputation. For existing projects, which by definition are the successful ones, the RSPT would have simply gathered them into the tax base with the Government taking a 40% stake while avoiding its share of past losses. With the only deduction allowed based on written down book value of project interests, both the scale and the timing of taxes paid by the industry marked the RSPT out as a short-term “tax grab” rather than genuine long-term tax reform. The MRRT lessened (though did not remove) this retrospective element. Allowing market valuation of existing assets is a well-established principle for easing the transition to new tax arrangements.

Other improvements of the MRRT over the RSPT include: i) appropriate differentiation between mineral commodities on grounds of international competitiveness; ii) appropriate recognition of commercial returns for downstream operations based on arm's length principles to ensure the MRRT is levied on the primary resource value only; iii) the provision of immediate deductibility of capital expenditure to encourage investment into coal and iron ore projects; iv) a more appropriate return to capital invested through a higher MRRT uplift rate; and v) taxpayers with low levels of profitability will not have an MRRT liability.

ESTIMATING RESOURCE TAXATION REVENUES

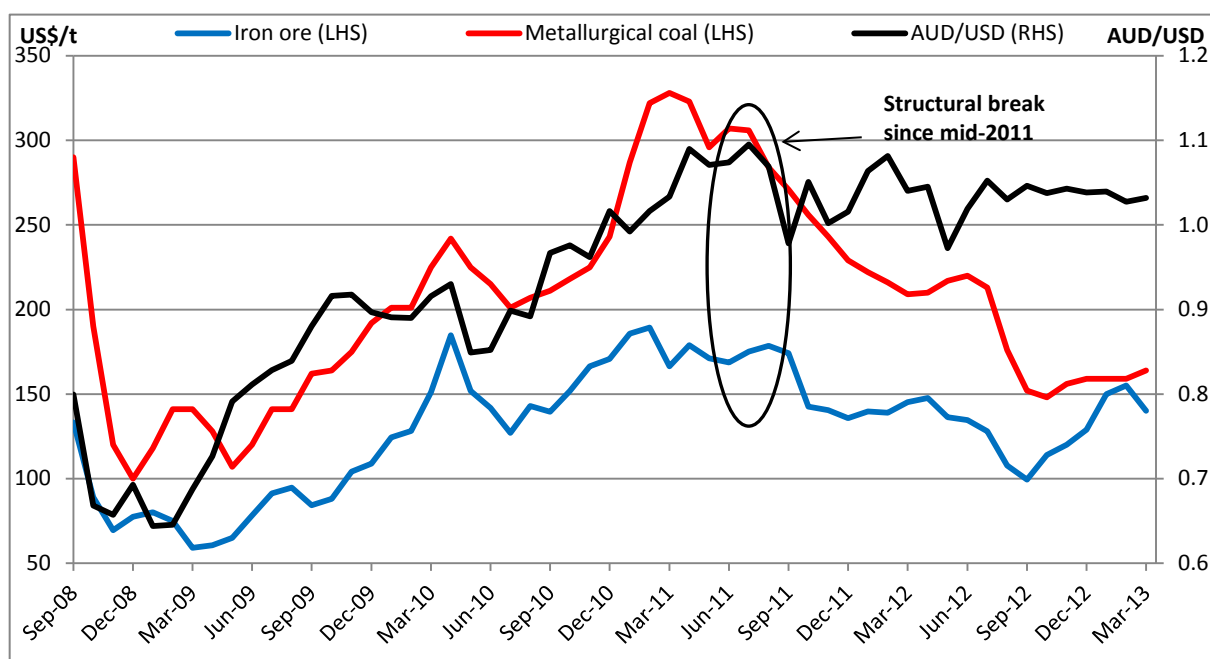
The MCA is not in the business of forecasting revenues for the MRRT, or any other tax. Such estimates are the domain of Treasury and the Government. The industry has sought to draw attention to the nature of rent taxes as complex, highly volatile and very hard to forecast. This is consistent with views expressed by Treasury officials, including the former Treasury Secretary, Dr Ken Henry.

It is also consistent with what is known to be the volatility of other resource rent taxes and the associated scope for forecast errors. Analysis of the Petroleum Resource Rent Tax (PRRT) by Dr Alex Robson of Griffith University has shown it to be a highly volatile source of revenue and one that is extremely difficult to predict even today, many years after the tax has come into force. Examining the forecasting record of Australian Governments since 1997-98, Dr Robson found that forecasts of PRRT revenue have generally been very inaccurate, with the Australian Government tending to overestimate PRRT revenue by relatively large amounts. Errors of more than 100% are not uncommon.

Against his backdrop, there is no evidence to suggest the MRRT is operating in a way that should be viewed as surprising or out of line with market conditions. Important in this latter context are:

- The sharp fall in commodity prices in the September quarter 2012 (the first quarter of the operation of the MRRT) with coal prices staying well down on levels reached in recent years
- What appears to be a "structural break" in the relationship between mineral commodity prices and the \$A/\$US exchange rate (see p. 6)
- The resultant impact on industry profitability with costs remaining high and "sticky"; hence not falling in line with the deterioration in industry conditions.

Relationship between bulk commodity prices and exchange rate



Beyond such variables, the number of additional “moving parts” in the MRRT equation, the fact that it is a new tax and the history of forecasting error with similar taxes undermine any claim that the MRRT is operating other than in a manner consistent with a resource rent tax designed to collect additional revenue at the peak of the commodity cycle.

TAX STABILITY CRUCIAL TO FUTURE INVESTMENT AND GROWTH

Higher taxes distort production and investment decisions and push Australian projects up the global cost curve, leaving resources firms better off pursuing offshore options instead. This in turn threatens investment, jobs, growth and, ultimately, future taxation revenues.

Any move to further increase the tax burden on the iron ore and coal sectors through changing the design of the MRRT would not simply make Australia mining projects less attractive than alternatives in other countries. It would not simply overturn assurances to industry and undermine any residual claims Australia has to maintaining stable and competitive taxation arrangements. It would undercut the very foundations of modern Australian prosperity.

The window to take advantage of resource-intensive develop in emerging economies remains open, but Australia’s position as a premier minerals supplier is more fragile than it should be. The next phase of industry growth faces some real headwinds, in the form of lower prices, lagging productivity and high cost structures. Australia can no longer afford the dangerous pretence that mining offers bounty to be spread around and not earned, or that throwing sand in the wheels of the industry is somehow beneficial to the nation’s economy as a whole.

The MCA recommends that the Senate Economics References Committee conclude explicitly that any adverse change to the MRRT which increases further the tax burden on the minerals industry would seriously undermine both the mining industry and the prospects for broad-based increases in living standards in Australia.

DEVELOPMENT AND OPERATION OF THE MINERALS RESOURCE RENT TAX

The Minerals Council of Australia (MCA) is the peak national body representing Australia's exploration, mining and minerals processing industry. It represents the minerals industry both nationally and internationally in its contribution to sustainable economic and social development.

The MCA's strategic objective is to advocate public policy and operational practice for a world-class industry that is safe, profitable, innovative, environmentally and socially responsible and attuned to its communities' needs and expectations. MCA member companies produce more than 85% of the nation's annual minerals output and account for an even higher share of export volumes.

On 26 February 2013, the Senate referred issues surrounding the development and operation of the Minerals Resource Rent Tax (MRRT) to the Senate Economics References Committee. Matters relating to government revenue receipts from the MRRT form a particular focus of the inquiry, together with "any other related matter".

The MCA considers the scope of matters relevant to this inquiry to be both extensive and profound. Indeed, they go to the very foundations of Australia's past, present and future prosperity. Among the issues raised by this inquiry (either explicitly or implicitly) are:

- The minerals industry contribution to the national economy (notably in this case, the iron ore and coal sectors) and recent industry developments
- The tax contribution of the industry and the broader "sharing of benefits" from industry growth over the last decade
- The MRRT – its design, development and operation – and alternative resource taxation proposals
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ECONOMIC AND COMMERCIAL CONTEXT

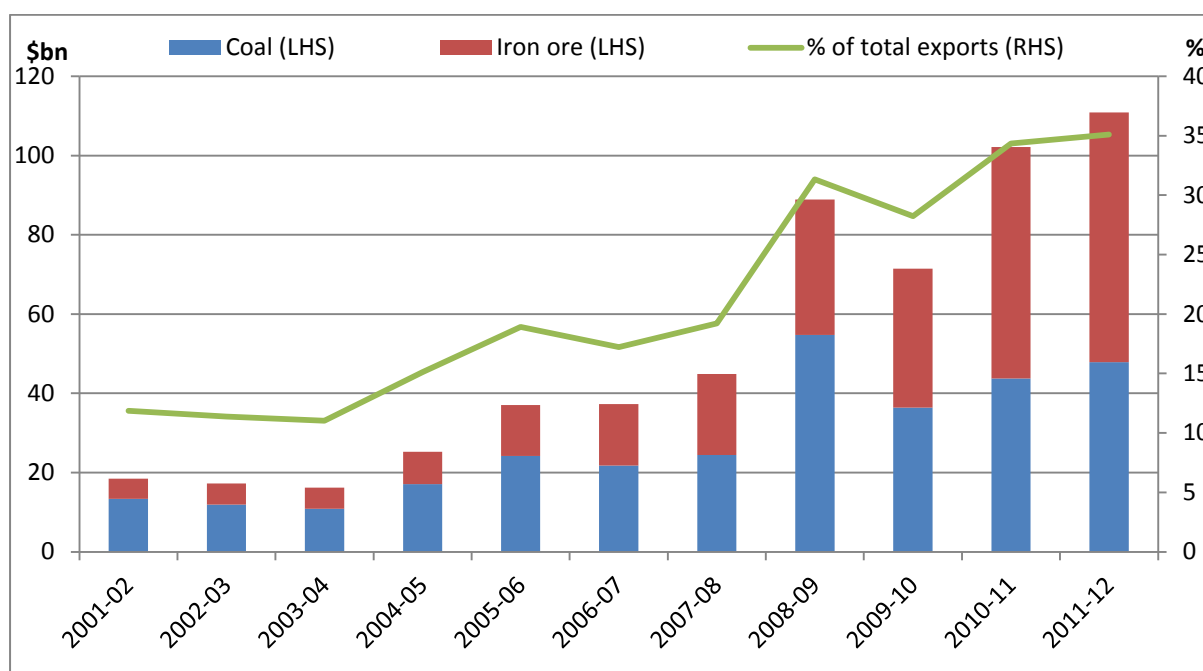
The minerals resources industry is Australia's principal export earner and most globalised industry. It has been a major driver of growth, investment and higher living standards in Australia over the last decade. In recent years, the industry has accounted directly for around 8% of GDP (significantly more when account is taken of mining-related economic activity), upwards of 20% of national investment and more than 50% of Australia's exports of goods and services. The industry's contribution to government revenues has increased roughly four fold over the last decade under taxation arrangements in operation *prior to the introduction of the MRRT*.

The scale of the mining industry's contribution to the national economy and the extent of positive spill overs from mining to other parts of the economy has been confirmed by new research from the Reserve Bank of Australia. It showed that the resources sector as a whole (including mining-related activities across diverse parts of manufacturing and services) is estimated to account for around 18% of GDP and almost 10% of employment.ⁱ

Iron ore and coal – the product groups covered by the MRRT – have played a pivotal role in supporting Australia's current prosperity. They are the nation's two largest export earners, contributing almost \$111 billion to exports in 2011-12, more than one third of total export earnings (Figure 1). Moreover, the rebound in coal and iron ore exports arising from strong economic activity in China in particular helped to cushion Australia's economy from recession in the wake of the Global Financial Crisis (GFC).

Together, these two sectors employ more than 80,000 Australians directly and hundreds of thousands more indirectly, the majority in regional and remote Australia. Employees receive relatively high average salaries (in both cases in excess of \$130,000 per annum) more than double the all-industries average. Both sectors also

Figure 1: Australia's coal and iron ore exports



Source: BREE

have a strong commitment to training Australians with 6.3% of payroll spent on training in the coal industry and 7.3% of payroll spent on training in the iron ore industry.ⁱⁱ

The gains derived by the community from Australia's comparative advantage in coal and iron ore are significant and enduring. Both industries have nonetheless entered a phase of heightened uncertainty and volatility in the last 12 to 18 months, with a marked deterioration in business conditions in the coal sector in particular.

Lower prices, a high exchange rate, rising costs and increased government imposts have combined to reduce profit margins, leading in some cases to mine closures, job shedding and cancelled or delayed capital expenditure plans. Within the resources sector, iron ore and coal saw the largest downgrades to capital expenditure expectations in 2012-13 based on the ABS capital expenditure data released in February 2013. Job losses in the coal industry (full-time employees and contractors) could be as high as 9,000 positions.ⁱⁱⁱ

The average spot price for thermal coal fell by one third in the September quarter of 2012 alone and the average price over 2012 was 22% below the 2011 average price. The benchmark contract price for 2012 Japanese Financial Year (JFY, April 2012 to March 2013) was down 15% from the previous JFY contract price, while BREE forecasts the JFY 2013 to be down a further 14% from the JFY 2012 benchmark. Increased competition in key Asia-Pacific markets from suppliers in the United States and Colombia are among the factors that have weighed down thermal coal prices.

Average prices for high-quality metallurgical coal were down 35% in 2012, with a drop of more than 30% in the September quarter 2012 alone. With prices down around 50% from peak levels in the second quarter of 2011, 2012 marks the second year of sustained downward momentum in metallurgical coal prices as weak demand outside of China continues to weigh on a market characterised by ample supply.

Iron ore spot prices fell sharply in the September quarter 2012 and contract prices in 2012 averaged 16% below the high levels of 2011. The recovery in iron ore prices in late 2012 and early 2013 reflected improved sentiment in China and seasonal restocking, although spot prices have declined in March 2013 due to surging inventories of steel products. BREE analysis concludes that iron ore volatility has been increasing over the past four years, coinciding with the increased use of shorter term contracts and spot trading, with price swings of 30% or more in response to stock cycles and sentiment becoming regular features of the market. Over the medium-term outlook

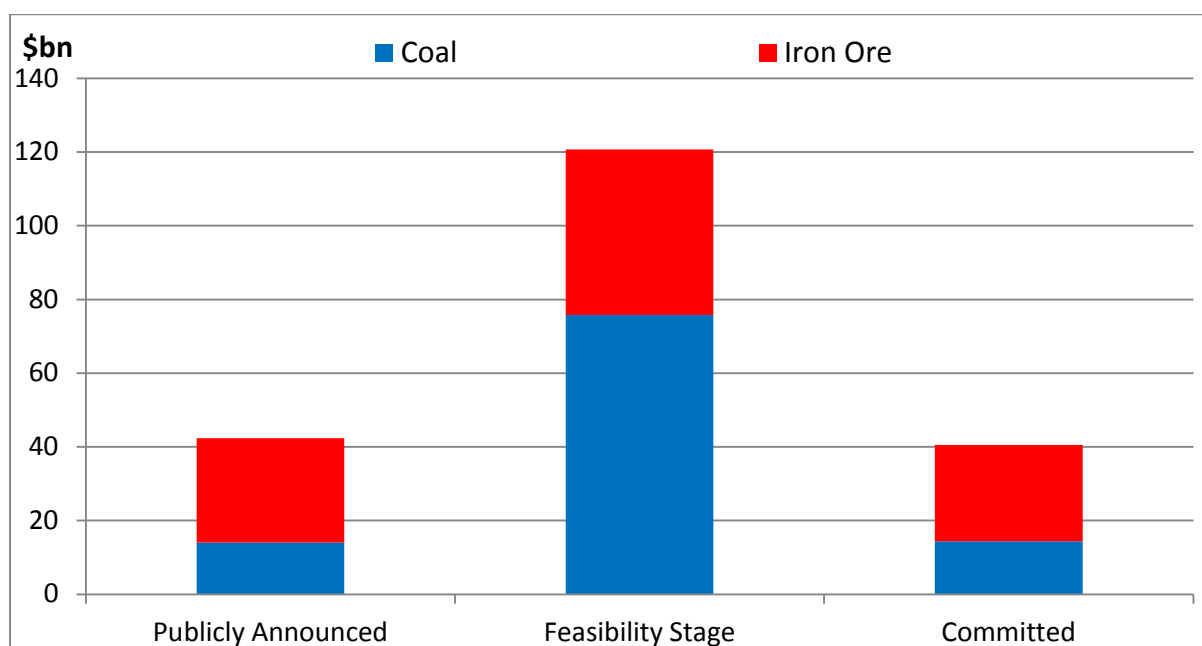
period (2012-13 to 2017-18), BREE is projecting declines year-on-year in contract and spot prices as a response to weaker demand growth in China and substantial supply increases.^{iv}

While emerging economies, particularly in Asia, are expected to underpin demand for mineral resources over coming years, the global supply of resource and energy commodities is expected to grow at a faster rate than the past decade. At the same time, the global economic outlook in the near-term remains clouded by the ongoing European debt crisis, its potential spill-over to major export-oriented developing economies and lingering concerns about US policy actions.

Against this backdrop, increased uncertainty now surrounds the coal and iron ore investment “pipeline”. At the end of October 2012, BREE reported “committed” iron ore and coal projects (mining and infrastructure) worth almost \$41 billion (Figure 2). “Uncommitted” projects in these industries – those publicly announced or at feasibility stage – stood at around four times that figure (\$163 billion based on the mid-point of BREE’s range for publicly announced projects).^v

Often overlooked is that some 73% of the current committed mining investment pipeline in Australia is made up by a few very large LNG projects. In the minerals sector nearly 80% of all projects reported by BREE (mine and infrastructure projects worth more than \$268 billion) remain uncommitted. As a result, the committed minerals sector pipeline dries up relatively quickly from 2013-14 in the absence of new project commitments.

Figure 2: Major mining projects – potential and committed



Source: BREE – ‘Publicly Announced’ and ‘Feasibility Stage’ make up ‘uncommitted projects’

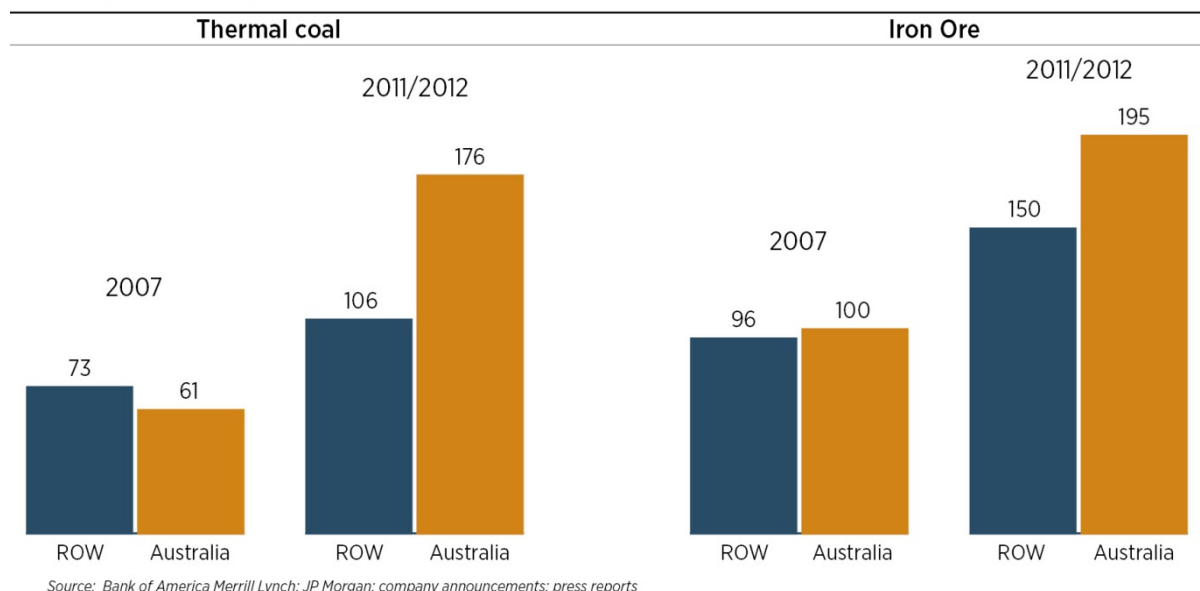
It is now widely recognised – including by official forecasters – that there are no more “easy gains” for Australia from high prices for coal and iron ore. Looking ahead, further gains from the development of Australia’s coal and iron ore resources will rely overwhelmingly on expanded export volumes, rigorous cost control and higher productivity. The crux of this challenge lies in regaining Australia’s competitive edge and arresting the deterioration both in terms of operating costs at existing operations and capital costs for new projects.

Research for the MCA by Port Jackson Partners has shown that within highly competitive markets for thermal coal and metallurgical coal, more than half of Australia’s mines have costs above global averages. Only six years ago, 63% of Australia’s thermal coal production fell within the first two quartiles of the global cost curve. By 2012, this had fallen to 28%. In iron ore, Australia has lost its operating cost advantage for all but established Pilbara operations. At the same time, capital costs for projects in Australia are rising faster than elsewhere. Only five years ago, the costs of Australian iron ore and coal projects were on par with our competitors. Australian projects

are now at a distinct capital cost disadvantage relative to peers. Australian iron ore projects, for example, are currently 30 per cent more expensive than the global average. The situation in thermal coal is worse; project capital costs are 66 per cent above the global average.^{vi}

Figure 3:
Capital Spend to Build a Tonne of New Capacity

2011 US\$ per tonne of capacity



Coal and iron ore projects are highly capital intensive with considerable, high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. Certainty as to the overall tax burden on coal and iron ore and specific design features of the MRRT is critical to future investment in these industries, especially given the heightened volatility of market conditions. The Minister for Resources and Energy, the Hon Gary Gray MP, has recognised the need for certainty, noting on 26 March 2013 that “even to discuss changes to that tax right now would create uncertainty”.^{vii}

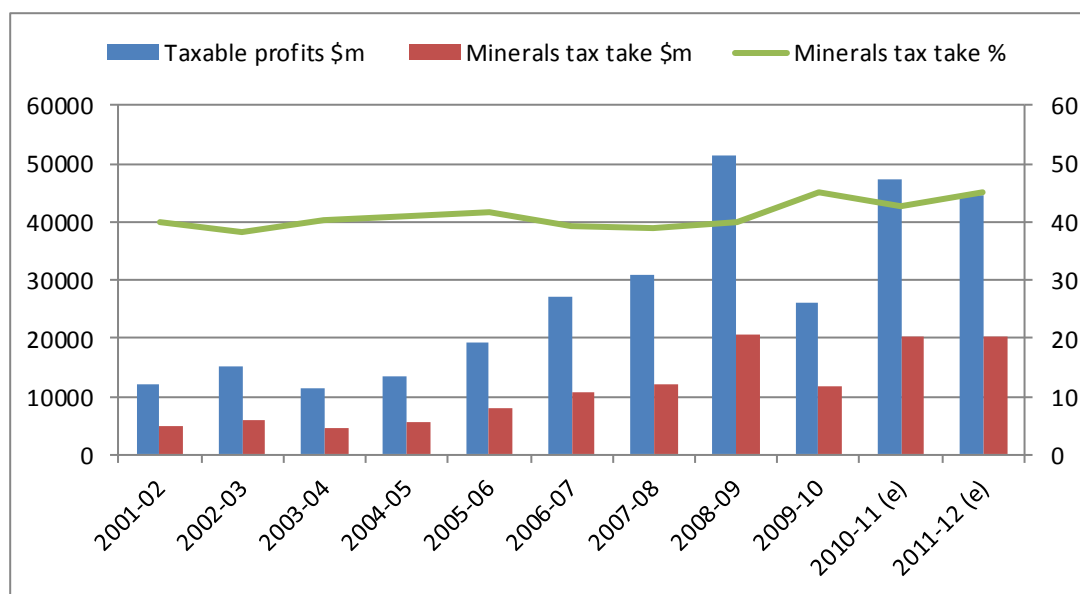
INDUSTRY TAX CONTRIBUTION AND BROADER “SHARING OF BENEFITS”

Minerals resource companies have been Australia’s largest taxpayers in recent years and the mining of iron ore and coal were among the highest taxed industries in Australia, even before the MRRT. The direct revenue contribution from the minerals industry to Australian Governments has grown markedly, rising roughly four fold over the last decade.

Total revenue from the two primary sources of returns from the minerals industry prior to the introduction of the MRRT – Federal company income tax and State royalties – have totalled more than \$130 billion since 1999-00 (estimates for 2010-11 and 2011-12 by Deloitte Access Economics). The industry’s indirect tax contribution is also significant. Higher average wages in the industry have resulted in higher average tax rates, higher average tax payments per person and higher tax collections by the Commonwealth. Returns to the Australian community also come via payroll tax, fringe benefits tax, GST and other indirect taxes, charges and levies.

As shown in Figure 4, the industry tax ratio has been high and relatively stable over the last decade as industry profitability has fluctuated with changing economic conditions. Based solely on official data for company tax and royalties, Deloitte Access Economics calculate the average tax ratio of the minerals industry the period from 2001-02 to 2009-10 (the last year for which official data is available) at 40.5%. Incorporating estimates for 2010-11 and 2011-12, the average ratio since 2001-02 is 41.6%, with the percentage tax over taxable income before royalties moving higher in recent years. Contrary to claims made during the 2010 tax debate, the industry tax ratio hit a decade high of 45.2% in 2009-10 (the last year of available official data).

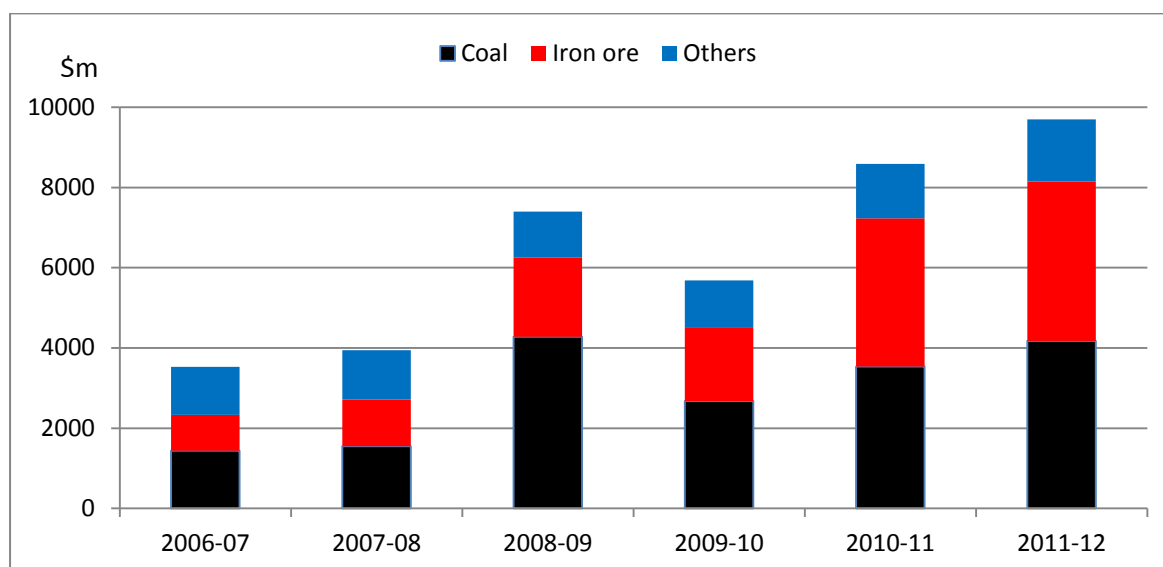
Figure 4: The minerals industry tax take ratio has remained high and stable



Source: Source: ABS, State Budget Papers, BREE, Deloitte Access Economics estimates

Total royalty payments to State and Territory Governments have risen sharply since 2006-07 due overwhelmingly to growth in coal and iron ore royalties. Coal royalty payments have risen at an average annual rate of 24%, while iron ore royalties have risen at an average annual rate of 35% between 2006-07 and 2011-12. Notwithstanding the uneven distribution of resources across the States, the system of Horizontal Fiscal Equalisation means that all States (including those without large mining industries) have derived benefit from this flow of royalty revenues.

Figure 5: Mineral royalties by commodity (2006-07 to 2011-12)

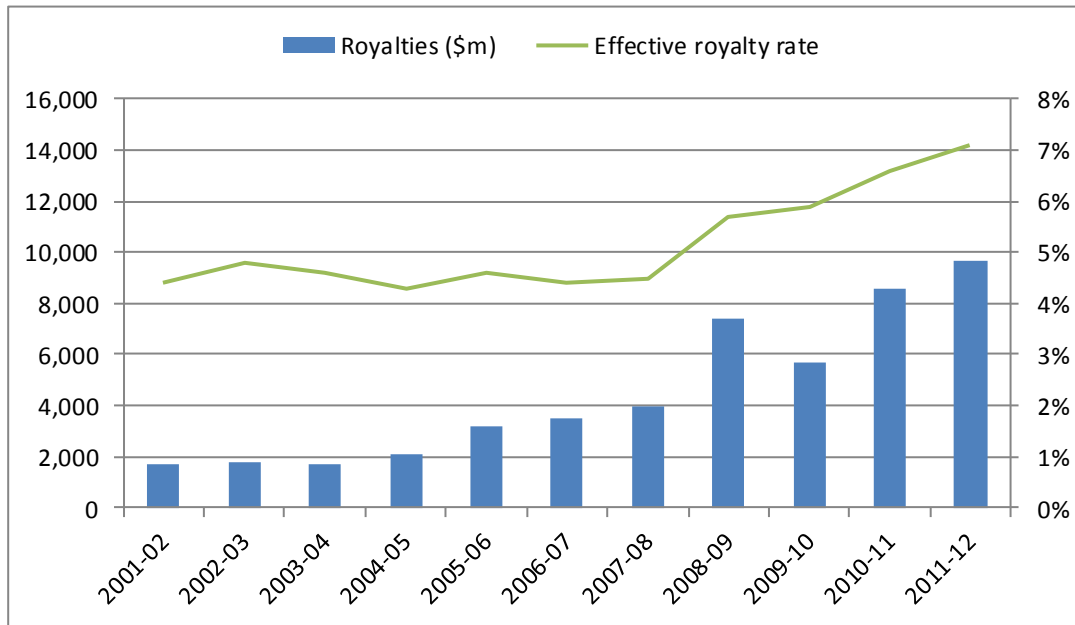


Source: ABS, State Budget Papers, Deloitte Access Economics estimates.

The general stability in the minerals industry tax ratio is no surprise. On the one hand, company tax is a steady share of profit. On the other hand, royalties – typically levies on production volumes or values – have seen their rates rise as industry revenues have increased. This has meant that the largest part of the minerals industry tax take already moves with profit, and the other part has tended to move with profits over time.

In reality, the overwhelmingly majority of royalties are based on the *value* of mineral production – not volume. While varying from State to State, relatively high royalty rates have applied to export coal and lump iron ore. Moreover, States have responded to rising profitability by lifting royalty rates since 2006-07. States have lifted royalty rates, and the composition of minerals mined has shifted towards those with higher royalties, to such an extent that royalties have lifted faster than profits over recent years, increasing the effective royalty rate.

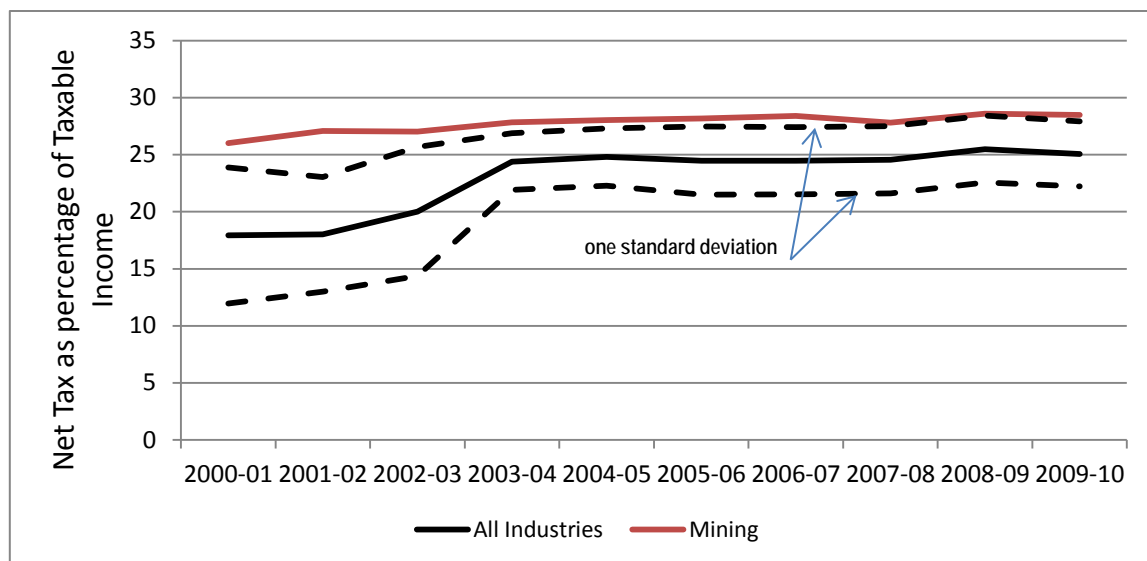
Figure 6: Royalties – Australian minerals industry (2001-02 to 2011-12)



Source: ABS, State Budget Papers, BREE, Deloitte Access Economics estimates

Data for net company tax from the Australian Taxation Office (ATO) confirm that mining (including oil and gas) is among the highest taxed industries in Australia. After refunds and credits, the net corporate tax rate on mining has been consistently above the average of total industries. Professor Sinclair Davidson of RMIT has shown that over the decade to 2009-10 (the last year of official data), the average effective company tax rate for mining (net corporate tax as a percentage of taxable income) has remained above the average of all industries, plus one standard deviation.^{viii}

Figure 7: Average effective net company tax rates for all industries and mining



Source: ATO Taxation Statistics (various issues). Calculations by Davidson (2012).

Importantly, a narrow focus on government revenues alone – much less an additional “rent” tax designed to cut in during peak periods of the commodity cycle – fails to capture the variety of ways in which Australians have shared in gains from mining industry growth. Hence, what appears to be an underlying premise of this inquiry – namely, that the MRRT is *essential* for Australians to share in the benefits from mining industry growth – is simply not supported by the economic evidence.

That evidence shows clearly and overwhelmingly that Australians have shared in the benefits of mining industry growth with industry tax arrangements *prior to the introduction of the MRRT* being only one of a variety of channels whereby this has occurred. The additional national income generated by the higher terms of trade since 2002-03, associated with higher mining exports, has been estimated at 15% or more of GDP, directly increasing the buying power of Australian consumers and industries.^{ix}

Analysis by BREE has shown that while average weekly real household incomes in Australia climbed almost 40% over the period from 2002-03 to 2011-12. While Western Australia and the Northern Territory enjoyed the highest increases in real weekly household income during the “Millennium Boom”, households in all jurisdictions had increases in weekly earnings of about 30% or more over the period 2002-03 to 2011-12. Indeed, across a range of key economic variables (employment, interest rates and income) Australia has performed much better during this period compared with the preceding eight years (1994-2002).^x

Table 1: Key economic variables: Before and during the Millennium Boom

Economic variable	Unit	Period average	
		1994-95 to 2002-03	2003-04 to 2011-12
Employment in Australia	index	1.06	1.10
Employment in mining sector	index	0.96	1.53
Unemployment rate	%	7.4	5.0
Average household income	index	1.09	1.16
Nominal interest rate	%	5.6	5.1
Real interest rate	%	5.0	4.5

Source: ABS with BREE calculations

Modelling undertaken for the OECD confirms that the mining boom was largely responsible for the positive income and consumption effects observed in the last decade. Moreover, the higher incomes accruing to Australians have been spread widely across income groups. Between 2003-04 and 2009-10, households in all income quintiles experienced income gains, after living cost changes. Based on ABS Household Expenditure Survey data, AMP and NATSEM estimate the between 2003 and 2009 discretionary spending by households in the lowest income quintile increased from 31.9% to 33.5% of their total expenditure.^{xi}

Treasury research of “Mining Boom Mark I” concluded that the benefits of the resources boom “have spread well beyond the sectors and regions most closely linked to the mining sector”.^{xii} Subsequent Treasury analysis has shown that over the course of the last decade there has been a narrowing in the dispersion of regional unemployment rates – with a smaller proportion of regions experiencing high unemployment. Compared with the late 1990s when less than 15% of local regions had unemployment rates of less than 5%, by September 2010 the figure had risen to around half.^{xiii}

As noted previously, growth in mining activity – driven largely by a rebound in coal and iron ore exports through 2009 – helped to cushion Australia’s economy from the global recession in the wake of the GFC. Strong growth in industrial production in the mining sector continued throughout the GFC and into the recovery of 2009, even while production in other sectors stagnated or went backwards. Mining sector export income totalled \$138 billion in nominal terms during 2008-09, or 11% of GDP. Significantly, both export prices and volumes increased over the period.

Analysis by Deloitte concluded that:

The rapidly improving strength of Australia's mining sector during 2008-09 played a key role in shielding Australia from some of the worst consequences of the global financial crisis and the ensuing global recession. ... But for the performance of Australia's mining sector, the economic downturn in the latter part of 2008 and early 2009 in Australia would likely have been far more severe.^{xiv}

Economists at the Reserve Bank have outlined the various channels by which the benefits of mining sector growth have been distributed widely throughout the economy.^{xv} Benefits have accrued *directly* to Australian residents as the sum of: direct labour costs, payments to domestically sourced inputs, taxes and royalties and after-tax profits paid to Australian resident owners of mining equities. In addition, a significant share of the total cost of mining investment is spent acquiring domestically supplied labour and other inputs, further adding to the incomes of Australian residents. Summarising this work, Deputy Governor Phillip Lowe concluded in February 2012 that:

*The indirect effects come through a variety of channels. Day to day, they can be hard to see but they do percolate through the economy. In effect, **there is a chain that links the investment boom in the Pilbara and in Queensland to the increase in spending at cafés and restaurants in Melbourne and Sydney.** This chain starts with the high terms of trade that has pushed up the Australian dollar. In turn, the high dollar has meant that the prices that Australians pay for many manufactured goods are, on average, no higher than they were a decade ago, despite average household incomes having increased by more than 60 per cent over this period. The stable prices for many goods, combined with strong disposable income growth means there is more disposable income to be spent on services in the cities and towns far from where the resources boom is taking place. As I said, this chain can be hard to see, but it is real, and it is one of the factors that have had a material effect on the Australian economy over recent years (emphasis added).^{xvi}*

In terms of sectoral changes in economic activity, the evidence suggests that contrary to claims often made about the negative impacts of the "boom":

- The adjustment challenges of the last decade are not unprecedented - leading and lagging sectors have always been a reality in Australia while industry-level changes in real output and employment shares have remained below peaks recorded in the 1970s
- Major structural trends such as the relative decline of manufacturing and growth of services are long standing and not unique to Australia
- There is clear evidence of a "secondary services boom" arising from the terms of trade boom whereas manufacturing sector performance appears better than predicted based on empirical analysis^{xvii}
- Improvements in the flexibility and adaptability of the Australian economy due to policy reforms have reduced adjustment costs relative to past mining booms.^{xviii}

THE NATURE OF THE MRRT AND ALTERNATIVE RESOURCE TAXATION PROPOSALS

The MRRT is a profits-based, resource rent tax on cash flows from extracting coal and iron ore in Australia. It is designed to tax only the rents or profits attributable to the value of the resource.

The MRRT applies in conjunction with State and Territory royalties and Federal company income tax. Hence, from 1 July 2012 the MRRT added a third mechanism to taxing resource profits derived from the extraction of coal and iron ore. It is designed to provide the community with an *additional* return from accessing Australia's finite mineral resources during periods of abnormally high profitability associated with the "peak of the resources cycle", in the words of the Government-appointed Policy Transition Group.

Royalties provide a "hard floor", the baseline above which MRRT becomes payable. Under the MRRT, State and Territory royalty payments remain and the liability to pay them exists regardless of the MRRT. The royalties that

entities pay on iron ore and coal are credited against the MRRT liability of a project to ensure – as noted in the Explanatory Memorandum of the MRRT legislation – “that the royalties and the MRRT do not double tax the mining profit”.^{xix} Royalties paid on projects in respect of MRRT assessable receipts will be neither transferable nor refundable under the MRRT.

Royalties are generally applied on the basis of volume or value without regard to the profitability of a mining operation. Hence while royalties recover a portion of resource rents when mining profits are high, they will also tax mining operations where no economic rent is present. What is notable as shown above is that royalties has increased faster than mining profits in recent years, increasing the effective royalty rate and claiming more of any “rent”.

Company income tax – like the MRRT – taxes mining profits proportional to industry profitability, though it applies to the “normal” return on investment, as well as to “rent”. Income tax is designed to tax an entity’s annual profit, but is not specific to a type of profit (as is the case under the MRRT). Whereas under income tax, State mining royalties are viewed as costs that reduce profits and are deductible, under the MRRT they are viewed as another way of taxing the resource, and so are credited against the liability for MRRT to avoid double taxation.

As the former Head of Treasury’s Revenue Group noted in 2009, “the application of the company tax to the resources sector has acted as a de facto resource rent tax”.^{xx} The MRRT is therefore a profits tax on top of a profits tax – in effect, a “top-up” tax during periods of abnormally high industry profitability.

In making recommendations on the MRRT, the PTG cast the policy challenge as finding a balance whereby:

1. Australia maintains an internationally competitive fiscal regime for minerals taxation
2. The legitimate needs of States and Territories, including a relatively stable revenue stream, are met
3. The application of royalties (which represent a direct cost to industry irrespective of capacity to pay) do not unnecessarily damage the relevant industries and prevent optimal resource extraction
4. Australians as a whole are able to capture an appropriate return from the profits of industry at the peak of the resources cycle.

Under the MRRT, highly profitable coal and iron ore projects with an MRRT liability should face an effective tax rate (ETR) of not more than 46%, noting that other key features of the MRRT (such as the starting base allowances) will also affect ETRs over the life of a project.^{xxi} This clearly puts Australia at the upper boundary of globally competitive tax rates according to benchmarking of minerals taxation regimes – above competitor nations such as Canada, Brazil and China for iron ore and above the likes of South Africa, Canada and China for coal. Incidentally, none of these nations has additional imposts in the form of a national Carbon Tax or emissions trading scheme.

Analysis of the total tax take (royalties and company tax) by Goldman Sachs released in January 2013 has confirmed that, even without the MRRT, Australian iron ore and coal producers are at the upper end of the global resource royalty and tax scales. Australia was found to be within the top quartile of countries based on a total tax take of 44% compared with a global average of around 39%.^{xxii}

The PTG described the MRRT as providing the Australian community with an additional return “at the peak of the resources cycle”, recognising that the minerals tax take, like the minerals profit cycle, is volatile.^{xxiii} Australian Government Ministers have pointed out repeatedly that the MRRT will be volatile (as commodity prices, exchange rates, investment plans and other variables change) and that this is intrinsic to how resource rent taxes are designed to work. Hence, the volatility of the MRRT is not a design flaw; it is a deliberate design feature.

The Assistant Treasurer stated in the Second Reading Speech at the time of legislation was introduced into the Parliament in November 2011 that:

We will see volatility in MRRT revenue, particularly as prices and investment plans change, but that is good for the nation and for the industry.^{xxiv}

Similarly, as the Treasurer pointed out on 25 October 2012:

The design of a resource rent tax is such that it delivers the revenue when profits are high and in the case of commodities where prices are high and of course when they go down, it doesn't necessarily deliver the same amount of money. ... we've had a real crash in commodity prices which has not only affected the resource rent taxes but it's affected company tax as well.^{xxv}

The Finance Minister made the same point on 30 October 2012, stating:

There are obviously swings and roundabouts in MRRT revenue, a profit based tax, so by design it will collect more when profits are high and less when profits are low.^{xxvi}

Treasury officials have similarly emphasised the high level sensitivity of MRRT revenue to the exchange rate and to assumptions about commodity prices. On 24 February 2011, the former Treasury Secretary, Dr Ken Henry, told the Senate Economics Legislation Committee that:

As we all know, these particular revenue estimates [of the MRRT], and, indeed, of course, the actual revenue eventually collected, is highly dependent upon the exchange rate and commodity prices for individual commodities – iron ore and coal. It is a matter of fact on the historical record that the exchange rate, particularly the Australian dollar-US dollar exchange rate – and that is the one that matters most with these revenue estimates, as you know – and also the world prices of iron ore and coal have been amongst the most volatile parameters that economic forecasters or revenue forecasters would confront. That is something that is very well understood.^{xxvii}

Research by the Australian Parliamentary Library has noted that:

The revenue derived from the MRRT will be heavily dependent upon (Australian dollar) commodity prices. In particular, movements in exchange rates and world prices for iron ore and coal will be fundamental in determining the revenue raised by the MRRT. The revenue flows will be highly procyclical. That is, MRRT revenues will vary significantly with nominal GDP growth. In addition, the design features of the tax in terms of how mining profits and losses are defined and deductibility of certain types of expenditures mean that there will be significant lags in MRRT collections in the event of significant rises or falls in commodity prices. This is similar to the way in which company tax revenues fluctuate with nominal GDP growth. In short, significant volatility will be a feature of the tax.^{xxviii}

The MCA therefore considers that any inquiry into the *operation* of the MRRT should take the volatility of the tax as an essential reference point. In terms of the *development* of the MRRT, the MCA considers that this should be understood with regard to the following key issues:

- The principles which informed the industry's position on minerals taxation reform, both prior to and through the development of the MRRT
- The "path dependent" nature of the MRRT's development, in particular the lack of consultation with industry and State Governments on resource taxation reforms announced in May 2010
- The deep flaws in the original Resource Super Profits Tax (RSPT) proposal.

The Minerals Council of Australia adopted a constructive, principles-based approach to reform of mineral royalty and taxation arrangements through the Australia's Future Tax System Review (the Henry Review). From the outset, the MCA emphasised that any move away from existing State and Territory royalty regimes had to be based on extensive and detailed consultation with industry and State Governments and reflect sound tax policy principles.

The principles put forward by the MCA prior to and through the development of the MRRT were as follows:

- **Internationally competitive:** the overall tax burden on the industry should be competitive with tax burdens in other countries
- **Prospective:** tax changes should not undermine the basis upon which past investments have been made (i.e. no retrospective application)
- **Differentiated:** reforms should recognise that capital investment and financial return characteristics differ across resources commodities such that different minerals can sustain different tax burdens;
- **Resource-based:** a resource-based tax should be limited to the value of the resource (not reach into the value added from infrastructure and other activities such as processing and smelting); and
- **Equitable and efficient:** Reform of taxation and royalty arrangements should promote economic activity and improve the efficiency, simplicity and fairness of the tax system without compromising competitive neutrality.^{xxix}

Through the 2010 tax debate – and perhaps in its aftermath – the extent of the industry’s preparedness to engage in meaningful consultation for reform became obscured. Yet it is a matter of public record.

Also a matter of public record is the failure – both of process and of policy – that surrounded alternative reform proposals arising from the Henry Review. The development of the MRRT cannot be understood without reference to the Australian Government’s failure to consult with the minerals industry on proposed resource taxation reforms announced in early May 2010.

The profound folly of the Government’s approach to resource taxation reform was clear at the time and has only become clearer with hindsight. It is a matter of public record that not only were the mining industry and State Governments not consulted about the proposed RSPT; the then Minister for Resources and Energy, the Hon Martin Ferguson AM MP, in his words, “was not properly consulted about it at all”. The industry accepted assurances from Government that there would be an opportunity for engagement, but as Mr Ferguson has stated “it didn’t occur” ... [in] the mining dispute we created our own mess because of a failure to consult”.^{xxx}

As to policy, the RSPT proposal damaged Australia’s reputation as a stable investment destination for mining and would have made Australian resource projects uncompetitive internationally.

- Effective tax rates on Australian projects under the RSPT were simply too high. After the RSPT was announced, Treasury admitted that the headline tax rate of 40% was “arbitrary” and that it had not been benchmarked against Australia’s global competitors.^{xxxi}
- The RSPT’s definition of “super profit” – any return above the long-term bond rate of less than 6% – was just a flawed mechanical proxy for “resource rents”. If miners worked harder or smarter, the RSPT was a punitive tax on effort and expertise.^{xxxii}
- The RSPT meant massive expropriation of shareholder wealth without fair compensation. The spectre of government claiming a 40% stake in successful mines without having borne any investment risk created massive “sovereign risk” concerns. As a result, major projects around Australia were put on hold.^{xxxiii}
- KPMG analysis showed the crippling impact of the RSPT on future investment. It slashed the value of “greenfield” coal and iron ore projects by 57% and 46%, respectively.^{xxxiv} Around \$38 billion of announced copper, nickel and gold projects were at risk, with some projects becoming economically unviable.

- Access Economics found that the RSPT would have added the equivalent of 7.5% to the cost of mining, pushing Australian projects up the global cost curve and sending investment overseas, with impacts 50 to 100 years into the future.^{xxxv}

In terms of Australia's investment reputation, one indicator of the strength of the reaction to the RSPT was a mid-2010 survey by the Canadian-based Fraser Institute which found the international response to the RSPT to be "extraordinarily negative". As a result:

- The average score of Australian States declined from 62.9 out of 100 in the 2009-10 survey (conducted in late 2009) to 40.9 in the survey update.
- The average rank of the Australian States fell to 31st out of 51 jurisdictions in the update, from 18th in the 2009-10 survey.^{xxxvi}

The Government subsequently acknowledged the design flaws in the RSPT. The Prime Minister described the RSPT as a source of "uncertainty and division", recognising the need for "improved resource tax reforms" to "maintain Australia's standing as a competitive and attractive destination for investment and strengthen our economy in the future".^{xxxvii} The Treasurer similarly acknowledged that the flawed design of the RSPT would have discouraged investment. The most important thing, in the words of the Treasurer, "was to get the design of the tax right so it encouraged investment." "Yes the design (of the MRRT) is different and that's a good thing, it's a better tax for that."^{xxxviii}

The foundation agreement for the MRRT was reached based on the principles outlined above for the development of an internationally competitive mineral resource tax regime that also provides the Australian community with an additional return at the peak of the resource cycle. On a number of fronts, the MRRT is a marked improvement on the RSPT and much closer to sound tax reform principles.

Firstly, the MRRT establishes a more internationally competitive tax rate. As designed, under the MRRT profitable coal and iron ore projects should face an effective tax rate of not more than 46%. This is achieved through the interaction of the 30% headline MRRT rate, the 25% extraction allowance, a company tax rate of 30% and a credit for all current and future State and Territory royalties paid.

By contrast, as noted above, effective tax rates on Australian projects under the RSPT – ranging from 52% on coal to 57% on iron ore – were simply too high. As Chris Richardson of Deloitte Access Economics has observed, "the RSPT risked sending mining investment overseas – a risk magnified by its 40% (headline) rate".

The point here is simple. Although minerals aren't mobile, new investment in them is. As all impacts are felt at the margin for greenfield projects, the cost impact of resource rent taxes at 'high' rates would be to send some greenfield developments towards Canada, Indonesia, Brazil and others. ...

By reducing the headline rate and including the extraction allowance, the MRRT proposal got the important part right – a lower rate. That is because, as Deloitte Access Economics has consistently stressed, the effects of any design flaws in a resource rent tax are turbocharged if rates are too high. ...

A higher rate for the MRRT could therefore pose similar risks to those raised by the original RSPT proposal, including (1) capturing part of the reward for miners' efforts and expertise, and hence (2) pushing Australian mining investment back in the global 'queue'.^{xxxix}

In this context, full crediting of royalties is a key design feature of the MRRT imparting a measure of stability to the overall tax burden on coal and iron ore projects and so as to avoid double taxation of the mining profit. The December 2010 PTG report (accepted by the Australian Government) recommended full crediting of all current and future State and Territory royalties "so as to provide certainty about the overall tax impost on the coal and iron ore mining industries".^{xl}

Secondly, the MRRT (through the availability of a market value starting base allowance) lessened dramatically the retrospective element of the RSPT. It was the spectre of the government claiming a 40% stake in successful mines without having borne any investment risk which created massive “sovereign risk” concerns – about government “moving the goalposts” on past investments – and resulted in major projects around Australia being put on hold in mid-2010.

The unprecedented nature of the Government’s proposal – along with the lack of genuine industry consultation that preceded and immediately followed the announcement in May 2010 – showed the Government’s willingness to make substantial and unheralded changes to the tax arrangements for existing operations. Specifically, it was the punitive transition arrangements under the proposed RSPT (a starting base allowance based only on the accounting book value of assets) which caused particular damage to Australia’s investment reputation.

On new projects, the RSPT sought to share the risks with the miner – getting more tax from a successful project, but handing back its share of losses on unsuccessful projects. But for existing projects, which by definition are the successful ones, the RSPT would have simply gathered them into the tax base with the Government creaming off a 40% stake while avoiding its share of past losses. With the only deduction allowed to companies based on written down book value of project interests, both the scale and timing of taxes to be paid by the industry marked the RSPT out as a short-term “tax grab” rather than genuine long-term tax reform.

The transition arrangements of the RSPT were clearly unfair, as Deloitte Access Economics has noted.

Governments were not a ‘silent partner’ risking taxpayer funds in establishing existing mines, but the RSPT implied that they still wanted large returns from them.

That is, the RSPT didn’t share the downside risk, but wanted its share of upside gains. The RSPT automatically cherry picked the winners of history without picking up the costs of the failures.^{xii}

By virtue of both the very high tax rate and the dragging of existing projects into the tax base without fair recognition, the RSPT created a massive wealth transfer from existing shareholders to government. Notwithstanding denials from senior Treasury officials that there should be any perceived increase in sovereign risk, the point was obvious to many economists, including specialists in resource rent taxation whose work had been cited to justify particular features of the RSPT. Hence, Professor George Fane commented that:

*Applied to existing successful projects with no compensation for past investment, it would be equivalent (economically, if not legally) to the nationalisation, without compensation, of 40 per cent equity in the relevant projects. Unless the government proposes to search out all those who have invested in failed projects and refund them 40c per dollar of losses, plus accumulated interest since 1901, or whenever, then a rent tax applied to existing successful projects, with past investments carried forward at the government bond rate, is **equivalent to the nationalisation with less than full compensation of part of the equity in the relevant projects** (emphasis added).*

... in the context of a rent tax applied to existing as well as new projects, the ‘cast-iron guarantees’ that the tax rate will never be raised and that tax credits for future projects will be honoured are a joke: it is like being offered a guarantee from someone who has stolen your wallet that they will never steal from you again.^{xiii}

The MRRT is characterised by a number of other improvements over the RSPT. They include:

- *Appropriate differentiation between mineral commodities on grounds of international competitiveness*

Capital investment and financial return characteristics differ across resource commodities, starkly between oil and gas and mineral commodities, but also significantly between mineral commodities. Critical to the design of the MRRT is the principle that any new taxation arrangements must preserve the international competitiveness of Australian mining operations (current and future) across a broad base of commodities in a highly competitive global resource environment. Modelling work by KPMG in the context of the RSPT debate demonstrated the

relative scale of the tax's impact across different mineral commodities (in terms of Net Present Values on "greenfield" investments) to the point where projects in a number of sub-sectors outside of coal and iron ore became no longer viable. It is important to record in this context, as noted by Reserve Bank research, that the "mining boom" has not been experienced equally across mineral commodities.^{xliii}

- *Appropriate targeting of the tax to the value of the resource*

The MRRT has been designed to apply only to the value of minerals at the valuation point and not to infrastructure, downstream processing, manufacturing or transport. Ensuring commercial returns for downstream operations based on arm's length principles has been a fundamental principle advanced by industry in discussions on minerals resource tax reform.

- *All post 1 July 2012 expenditure (whether capital or operating) will be immediately deductible*

The provision of immediate deductibility of capital expenditure ensures that, compared with the RSPT, the MRRT encourages investment into coal and iron ore projects. In effect, taxpayers are able to defer payment of MRRT where they invest or re-invest into projects. This is a more appropriate design feature for a resource rent tax and is consistent with the PRRT.

- *A more appropriate return to capital invested through a higher MRRT uplift rate*

Compared with the RSPT, the higher MRRT uplift rate (LTBR+7 percentage points) provides for a more commercially realistic application of the tax taking account of capital costs and risks. The RSPT's definition of "super profit" – any return above LTBR – was nothing more than a flawed, mechanical proxy for "resource rents". The lower headline rate, the 25% extraction allowance and the higher uplift rate all act to limit the pitfalls of a "super profits tax" acting as a flawed, simple proxy for resource rents. Under the MRRT, as modified by the PTG recommendations, where project expenditures, losses, royalty credits and book value starting base amounts are not able to be used immediately, they are to be carried forward and uplifted at LTBR+7. Note that starting base losses are uplifted only at CPI.

- *Taxpayers with low levels of profitability will not have an MRRT liability*

Under the MRRT as designed originally, taxpayers with low levels of resource profits (i.e. \$50 million or less) would not incur an MRRT liability. Subsequently, the PTG recommended that a taxpayer's MRRT liability should be phased-in from \$50 million to \$100 million to avoid taxpayers facing a very large change in their MRRT tax bill as they cross the \$50 million threshold. These threshold rates were raised further – beginning at \$75 million and phasing out at \$125 million – in negotiations over the MRRT prior to passage of the legislation through the House of Representatives.

ESTIMATING RESOURCE TAXATION REVENUES

The MCA is not in the business of forecasting revenues for the MRRT, or any other tax. Such estimates are the domain of Treasury and the Government.

It is a matter of public record that mining companies provided information to Treasury about economic parameters (including industry valuation data, exchange rate and commodity price forecasts and expected volumes) in consultations prior to the Government's announcement of new resource taxation arrangements on 2 July 2010. Similarly, the signed Heads of Agreement is a public document – the elements of which were reflected in full in the terms of reference of the PTG.

However, it is equally clear – as stated by senior Treasury officials in testimony – that:

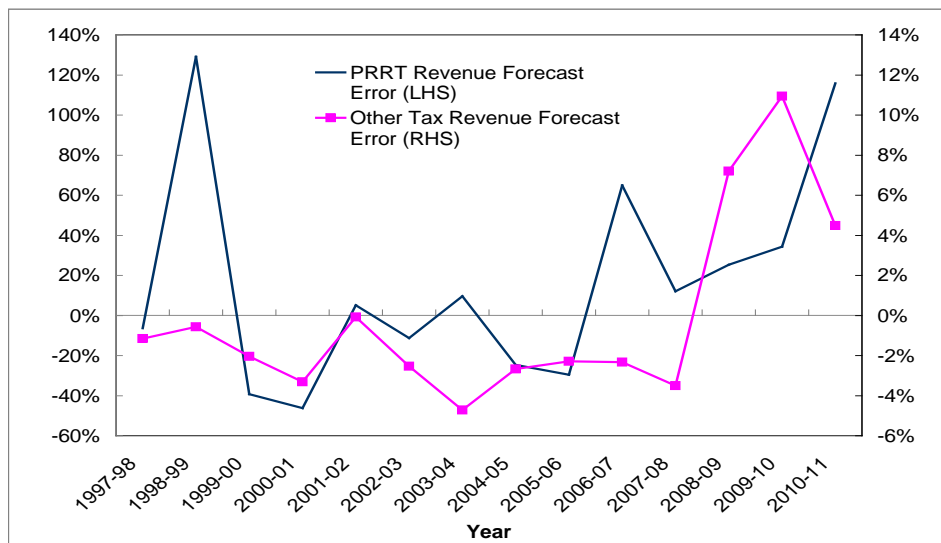
- At every stage, the Government relied on Treasury modelling of MRRT revenue;^{xliv}
- Treasury exercised "quality assurance" or "due diligence" on information provided to Government by mining companies;^{xlv}

- Companies did not provide expectations of how much tax would be paid under the MRRT.^{xlvi}

The industry has sought to draw attention to the nature of rent taxes as complex, highly volatile and very hard to forecast. Again, this is consistent with views expressed by Treasury officials, including the former Treasury Secretary, Dr Ken Henry.

It is also consistent with what is known to be the volatility of other resource rent taxes and the associated scope for forecast errors. The experience of the Petroleum Resource Rent Tax (PRRT) underlines both the inherent volatility and variability of resource rent taxes. The PRRT is similar to the MRRT in many respects; in particular, both taxes are targeted at similar bases (i.e. economic rents). Analysis of the PRRT by Dr Alex Robson of Griffith University has shown it to be a highly volatile source of revenue and one that is difficult to predict.^{xlvii}

Figure 8: PRRT and Total Tax Revenue Percentage Forecast Errors, 1997-98 to 2010-11



Source: Budget Papers, various years; author (Robson) calculations

Using various statistical measures of volatility, Dr Robson found that PRRT revenue in some instances has been three orders of magnitude larger than volatility of aggregate Commonwealth revenues. This is due principally to the relative volatility of the tax base and the degree to which individual components of the tax base – prices, exchange rates, volumes and costs in global oil and gas markets – are themselves volatile.

Secondly, examining the predictability of PRRT revenue based on the forecasting record of Australian governments since 1997-98, Dr Robson found that forecasts of PRRT revenue have generally been very inaccurate, with the Australian Government tending to overestimate PRRT revenue by relatively large dollar amounts. Forecast errors of plus or minus 40% of actual revenue are the norm, with errors of more than 100% not uncommon. A comparison with other sources of tax revenue is also instructive, showing the percentage errors in PRRT forecasts are many orders of magnitude larger than the forecast errors of all other tax revenue.

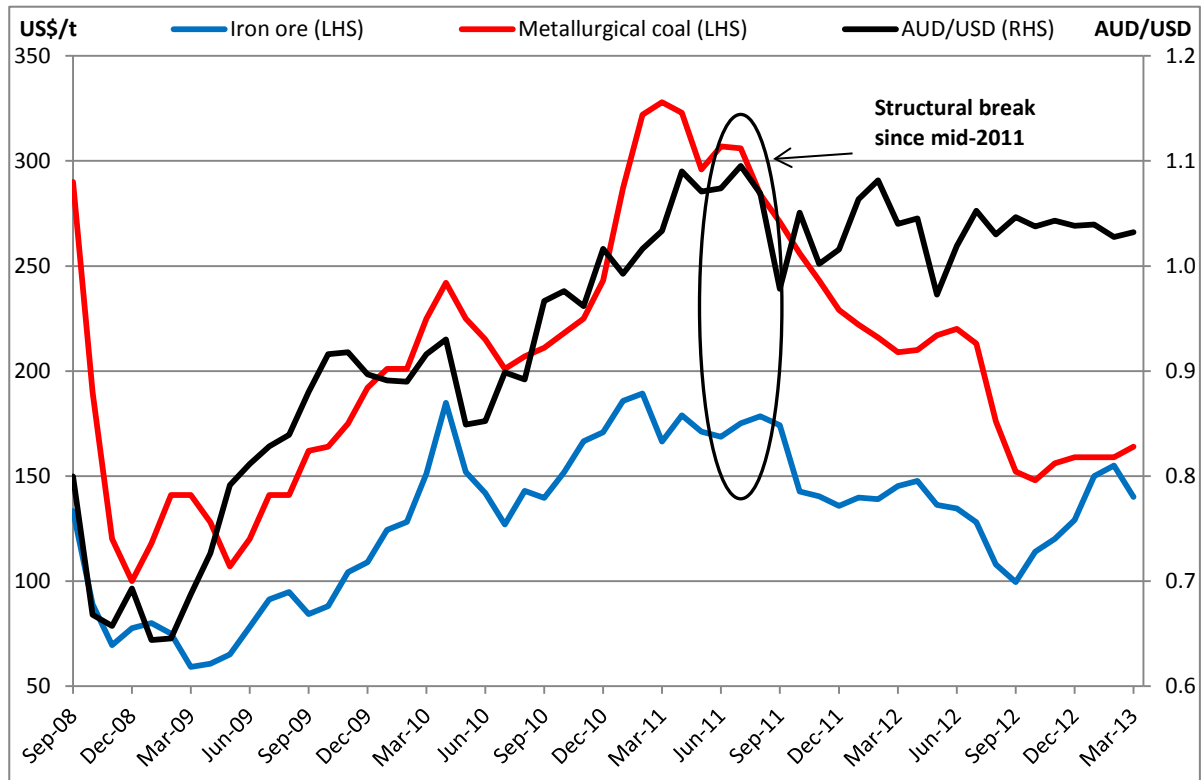
Both the volatility and unpredictability of PRRT revenues are due to uncertainty regarding resource prices, exchange rates, aggregate production volumes and aggregate allowable costs under the PRRT. The same is true for the MRRT. Against his backdrop, there is no evidence to suggest the MRRT is operating in a way that should be viewed as surprising or out of line with market conditions.

Important in this latter context are:

- The sharp fall in commodity prices in the September quarter 2012 (the first quarter of the operation of the MRRT) with coal prices staying well down on levels reached in recent years

- What appears to be a “structural break” in the relationship between mineral commodity prices and the \$A/\$US exchange rate (see Figure 9)
- The resultant impact on industry profitability with costs remaining high and “sticky”; hence not falling in line with the deterioration in industry conditions.

Figure 9: Relationship between bulk commodity prices and exchange rate



Source: ANZ, Reserve Bank of Australia – March average as at 26 March 2013.

Beyond such variables, the number of additional “moving parts” in the MRRT equation, the fact that it is a new tax and the history of forecasting error with similar taxes undermine any claim that the MRRT is operating other than in a manner consistent with a resource rent tax designed to collect additional revenue at the peak of the commodity cycle.

TAX STABILITY CRUCIAL TO FUTURE INVESTMENT AND GROWTH

Higher taxes distort production and investment decisions and push Australian projects up the global cost curve, leaving firms better off pursuing offshore options instead. This in turn threatens investment, jobs, growth and, ultimately, future taxation revenues.

Australia’s minerals tax regime has been characterised by perpetual uncertainty in recent years. Any move to further increase the tax burden on the iron ore and coal sectors through changing the design of the MRRT would not simply make Australia mining projects less attractive than alternatives in other countries. It would not simply overturn assurances to industry and undermine any residual claims Australia has to maintaining stable and competitive taxation arrangements. It would undercut the very foundations of modern Australian prosperity supported by the “reform era” policies begun three decades ago.

The window to take advantage of resource-intensive develop in emerging economies remains open, but Australia's position as a premier minerals supplier is more fragile than it should be. The next phase of industry growth faces major headwinds, not least in the form of lagging productivity and high cost structures. Australia can no longer afford the dangerous pretence that mining offers bounty to be spread around and not earned, or that throwing sand in the wheels of the industry is somehow beneficial to the nation's economy as a whole.

The reform era begun in 1983 was defined in essence by the political recognition that Australia needed to compete and pay its way in the global economy. That the old model of protecting uncompetitive, inward-looking industries and loading increased costs onto the more globally efficient parts of the economy had failed. That reconnecting to the global economy via the principle of comparative advantage, making the economy more flexible and allowing resources to move to those parts of the economy where they are used most productively provided the only viable, long-term basis for growth in living standards.

Consistent with this perspective, the MCA recommends that the Senate Economics References Committee conclude explicitly that any adverse change to the MRRT which increases further the tax burden on the minerals industry would seriously undermine both the mining industry and the prospects for broad-based increases in living standards in Australia.

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