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SELECT COMMITTEE ON THE SCRUTINY OF NEW TAXES

Reference: Mining taxes

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SENATE SELECT COMMITTEE ON

SCRUTINY OF NEW TAXES

Monday, 8 November 2010

Members: Senator Cormann (Chair), Senator Hutchins (Deputy Chair) and Senators Bushby, Cameron, Fifield and Williams

Senators in attendance: Senators Back, Bishop, Cameron, Cormann and Hutchins

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Carol Brown, Cash, Colbeck, Coonan, Crossin, Eggleston, Faulkner, Ferguson, Fielding, Fierravanti-Wells, Fisher, Forshaw, Furner, Heffernan, Humphries, Hurley, Johnston, Joyce, Ian Macdonald, McEwen, McGauran, Marshall, Mason, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Pratt, Ronaldson, Ryan, Scullion, Stephens, Sterle, Troeth, Wortley and Xenophon

Terms of reference for the inquiry:

To inquire into and report on:

(a) new taxes proposed for Australia, including:

  (i) the minerals resource rent tax and expanded petroleum resource rent tax,

  (ii) a carbon tax, or any other mechanism to put a price on carbon, and

  (iii) any other new taxes proposed by Government, including significant changes to existing tax arrangements;

(b) the short and long term impact of those new taxes on the economy, industry, trade, jobs, investment, the cost of living, electricity prices and the Federation;

(c) estimated revenue from those new taxes and any related spending commitments;

(d) the likely effectiveness of these taxes and related policies in achieving their stated policy objectives;

(e) any administrative implementation issues at a Commonwealth, state and territory level;

(f) an international comparison of relevant taxation arrangements;

(g) alternatives to any proposed new taxes, including direct action alternatives; and

(h) any other related matter.

WITNESSES

Committee met at 8.57 am

CHAIR (Senator Cormann)—I declare open this first hearing of the Senate Select Committee on the Scrutiny of New Taxes. Today's hearing will inquire into the government's proposed minerals resource rent tax and expanded petroleum resource rent tax. These are public proceedings although the committee may hear certain evidence in camera. Proceedings are governed by rules set by the Senate, copies of which have been given to the witnesses. 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. I remind members of the committee that the Senate has resolved that state public servants shall not be asked to give opinions on matters of policy.

BALL, Mr Morgan Scott, Chief Finance Officer and Company Secretary, BC Iron Ltd

BENNISON, Mr Simon, Chief Executive Officer, Association of Mining and Exploration Companies

FLANAGAN, Mr David Nathan, Managing Director, Atlas Iron Ltd

SHORT, Mr Graham, National Policy Manager, Association of Mining and Exploration Companies

CHAIR—I welcome representatives of AMEC and invite you to make a brief opening statement.

Mr Bennison—I propose to spend two or three minutes making a statement, and my colleagues Mr Flanagan and Mr Ball will make a quick comment in relation to the situation as it affects their companies, if that is okay. We thank you for the opportunity to appear today. AMEC is a national body representing mining exploration across the country. It has approximately 270 member companies in the production/exploration sector and also quite a number in the service provision to the industry sector. We have approximately 35 members in our iron ore and coal space, as they currently sit.

In opening, it is really a concern to our membership in the context of the whole tax reform landscape that is happening across the country not only in the last 12 months but leading in over the last two to three years. We have seen a slow erosion of the profitability of the industry in many shapes and sizes. I would like to exemplify that with the R&D tax reform that was done over the last 18 months where again the industry has seen the exclusion of situations like exploration spend, which have now been excluded under the dominant purpose test, which has created quite a setback for the industry, which has enjoyed this position in the past. We have seen employee share options become a lost opportunity where companies have used those to attract high-level professional people internationally. That has been a concern for us. We have also seen sections 23AG and AF that have been reformed over the last 18 months, which we believe has seriously disadvantaged Australian companies overseas.

We now see another tax in the form of a carbon tax being proposed by government and that again is going to be another cost and another impost facing the industry. That is not to say that the companies shirk their responsibility in the whole greenhouse scenario. We are very conscious of that and AMEC is working closely with our membership to make sure that we take a very responsible attitude in regards to it. But it is another impost and we are very concerned about the long-term profitability of industries.

Going to the Henry tax review and tax reform in general, we have been very disappointed with both the outcome of that review and the government’s approach to tax reform. Obviously the RSPT and now the MRRT have been a product of that process. Again, the lack of consultation with industry has been a very serious concern for us. We think there are still some very serious flaws in the proposed MRRT. We are working with the PTG in the context of trying to correct that. We forwarded our submission to the PTG to this committee’s secretariat and we hope that

that can be taken into consideration in your deliberations. We are very much opposed to this tax on an ongoing basis. We have been since 2 May and that situation has not changed. There are serious concerns and flaws we still see, as I mentioned. The current debate over how royalties post 2 May are treated and credited against the MRRT is a very key factor in this whole process and we do think it is in particular far too complex and very administratively heavy and will place a massive compliance cost particularly on the mid-tier junior end of town.

Overall we are very disappointed in the lack of consultation that has occurred leading into the introduction of the MRRT in July. That probably sticks in our throat as much as anything else in the context of a lack of involvement by the government with industry and essentially doing a deal with three large multinationals at the expense of not only our membership but others as well. I think we saw the legacy of that whole process.

I really want to wrap up my introductory remarks there are. I stay firm for AMEC’s position. We still want to see the tax rescinded over the long term. We are very keen to make sure that we participate in the PTG process as much as we can to correct the situation. That does not mean we endorse the tax but we are very conscious of the need to do the right thing by our membership and work through as best we can with the Argus group. Thank you very much for allowing me to make that statement. I would like now to pass to Mr Flanagan.

Mr Flanagan—Atlas is a member of AMEC because we believe that AMEC best represents the interests of the small to medium companies. AMEC was the only industry body that actively represented on behalf of the juniors with respect to access to rail infrastructure in the Pilbara. AMEC was also a massive advocate in support of the provision of third-party multiuser port infrastructure in the Pilbara. The judge ruled in favour of the declaration of the Goldsworthy rail line because he deemed it to be in the nation’s interest that there be a diverse, multiple number of mining companies operating in the Pilbara. I will just flag that for now.

We would like to acknowledge that within the Policy Transition Group there are a number of members who are genuinely working hard to understand their business model. Their effort is appreciated, but we are really concerned that the principles agreed between the Prime Minister and BHP, Rio Tinto and Xstrata limit the scope for change and limit the scope for redress against a number of barriers which are raised within those principles.

I will comment on what we see as just a couple of trends that have taken place in the iron ore sector over recent times. One of them is that the Pilbara, or the iron ore industry, has typically been dominated by a small number of very large mining companies. That means that you end up with really long-life assets with really large book value and start-up bases. They have a really long life, they take a long time to get up and running and they generate very, very strong returns over the long term. But what has happened in the last eight years is that there has been an influx of some 40 companies pursuing an iron ore business model. To give credit where credit is due, FMG have gone into the Pilbara and built infrastructure, and they have provided an infrastructure service to other companies. Also, the WA state government has gone in and built infrastructure for multiple users. So we are actually seeing a trend towards low-capital-cost projects which take a short time to get up and running and have relatively high operating costs, but there is an opportunity for making a good return if you can get up and running quick enough. That is quite different. That type of business model was not contemplated when the Prime Minister met with those major companies.

Atlas is the classic example of those companies. We have gone in. We actually do not own our mining fleet. We do not own a railway line. We do not own a trucking fleet. So we do not get the benefit of the mine gate sale the way the majors do, where they can inflate the value of the service provided and those sorts of things, and that is a significant thing to point out. In this MRRT, effectively, for those companies which do not get the benefit of the transition provisions—and that is pretty much all of those iron ore companies that come after us now—they will not get the benefit of using market value of their assets and an accelerated write-off, which means that they can only use the book value to write off the assets. The net impact of that is that it will diminish the value of those projects by six per cent. That means that, if you were going out to start a mine and you needed to have an 18 per cent hurdle rate to justify the consideration of that investment—and that is a standard; I think it is very popular in Wesfarmers—you now need to have a 24 per cent hurdle rate in that asset to be back where you started. That means that the return that you need on that asset to require consideration at that end of the business needs to have improved by 30 per cent. So that is a significant barrier, and that needed to be flagged. Atlas is making that case. It does not actually affect Atlas. We will get caught in the transition provisions and we will get the benefit of the market value, but there are going to be a lot of companies to come in the future which are going to be penalised by only having access to that book value.

With respect to the communities in the Pilbara, Atlas are very proud that we, like lots of the other companies, have been a part of investing in those communities in employment opportunities and making royalty payments. Atlas is currently providing housing accommodation for a doctor in Port Hedland. That is because we have a project. If we did not have a project and a mine that was up and running there, we would not be providing those services and benefits. Imposing this tax disproportionately on juniors is going to make it harder for juniors to do that in the future.

Another trend that we are seeing in the Pilbara and in the iron ore industry in general is a trend towards mining lower grade ores. The days of the majors or us exporting a product specification of 63 or 64 per cent across the industry are gone. Those super high grade products on a massive scale being exported out of the country are relatively depleted now. That means that there is more risk, and that means that we need to be incentivised to try and look at ways to beneficiate products: to take lower grade products and add value to them. There needs to be recognition of those barriers to entry. We have seen massive discoveries of iron ore in other countries—Africa is growing in its significance and its capability to satisfy world demand—and at Atlas with our assets we are competing with those countries for capital. So those are some of the trends that we are seeing.

I would just like to flag what we see as being the big barriers to entry. They are enormous, and Atlas have been almost singularly working our way through those over the last six years. We have a competitive disadvantage with respect to the cost of capital. If it costs you more money than it does for the majors then it is harder to break into the industry because you have got a higher base on your cost of capital, so you have got to make more money even to be competitive. In terms of access to capital, we are not as far reaching—there is more perceived risk in our business so it is much harder to get it, and access to it is more cyclical so it is less steady. There is also the question of access to port and transport infrastructure, housing and general infrastructure. It is very difficult to go into a town which has been controlled by one of the majors, and the majors have had an effective royalty subsidy for a long, long time.

In closing my introductory statement I would like to say that the agreement that was struck between the Prime Minister and the three companies was a deal done between the Prime Minister and those three companies. It was not a deal that was done with the industry. It provides a competitive advantage to those three companies to further strengthen their dominance. I think that continuing to engage with the majors like that and entrenching the agreement as it currently stands is going to drive Australia more and more towards being a country where it is dominated by a smaller number of companies and they will have a greater influence on Australia. I do not think it is helpful. Thanks very much.

Mr Bennison—Thanks, David. We will pass now to Mr Morgan Ball from BCI.

Mr Ball—Thanks, Simon. Apologies from Mike Young, our managing director, who was unable to be here today, so I am representing him and the company. We are also a member of AMEC and I support what both Simon and David have put forward. We also strongly support the AMEC submission, which we have been through in detail, and I will touch a bit on that later.

We are similar to Atlas in a lot of ways so I will not repeat a lot of those points. There are three key points I would like to make in relation to the MRRT and then in relation to BCI. The first point from the MRRT perspective is compliance. We are a small company—we are literally transitioning this month from being an explorer to a producer, which is one of the most exciting things that can happen to an exploration company. My background is in some of the big mining companies and I know what it is like to have the services and support around them. I also know what it is like in the junior sector, and I can absolutely tell you that some of the compliance that is coming through for the junior sector is almost impossible to manage when you do not have a cash flow. The result of that will be that, if you do not get the right people—and Simon has talked about reasons we might not be able to get the right people—you may not end up complying despite all your best intentions. I have a department of three people. We cannot possibly stay abreast of all of this the way it is coming through.

The other thing that concerns me is: since the deal has been done, we have heard bits and pieces of what that will involve. As we stand here now, I am company secretary for a public company and I cannot tell my shareholders what it will mean for us from a value perspective. We have run seven or eight scenarios, depending on all kinds of assumptions based on the deal that is being done. They range, in effect on the ONPV, from five to 10 per cent through to 25 to 30 per cent. So there are material differences that we just do not have the answer to at the moment.

The last thing I would like to touch on is BC Iron and where it is unique. We are very similar to Atlas in a lot of the ways that David referred to. We are contract mining, contract trucking, contract rail and contract port, essentially. We were a member of the North West Iron Ore Alliance, initially, and then, as a board, we made a commercial decision to do a commercial deal with Fortescue to access their rail and port facilities. That came at a cost. One of those costs was an operating cost to use their rail and port, and we accept that. The other cost, from BC Iron's shareholders' perspective, was half the deposit. So half our iron ore rights were assigned to Fortescue. To my mind, that is a cost of our accessing infrastructure. How that will be reflected going forward is unclear to us. We are 300 kilometres from Port Hedland. The alternative is: we would remain a stranded deposit, as we stand here today, and we would not be employing, literally, this month, 200 people. We would not be paying our first royalties to the Palyku people next month. We would not be giving water-cart contracts to the local people. So, for those reasons alone, we fully support the AMEC submission and feel that the tax is a real concern for the junior mining sector, which has had the ingenuity in the last 10 years to be in this position. Thank you.

CHAIR—Thank you very much, Mr Bennison, Mr Ball and Mr Flanagan. The Henry tax review was supposed to deliver a simpler, fairer tax system. Listening to you, you do not seem to agree that it has delivered a fairer, simpler tax system. I am not verballing you, am I?

Mr Bennison—Not at all.

CHAIR—You say you remain opposed to this tax. So when Minister Ferguson says that the mining industry has now accepted this tax, your cooperation with the Policy Transition Group proves it. Is he wrong?

Mr Bennison—Correct.

Mr Flanagan—Correct.

Mr Ball—Correct.

CHAIR—So you are essentially cooperating with the Policy Transition Group because you have to cover your bases for the worst-case scenario, but this tax is going to be so bad for your industry that, in an ideal world, you would not want it to see the light of day—is that correct?

Mr Bennison—Correct.

CHAIR—You have made some comments about the work with the Policy Transition Group. Are you of the view that your concerns are able to be properly considered and taken on board by the Policy Transition Group?

Mr Bennison—We hope so. One of the concerns that has been uppermost in our mind over recent months has been the lack of transparency in this whole process. No doubt, that is well known to the committee in the context of trying to understand the assumptions that were made in the original deal. If you cannot get that faith and trust and transparency, it puts a big question mark over future decisions and processes. So that is a serious concern to us. We can only work within the process at the moment. We will have to wait to see the types of recommendations that go forward from the PTG to Treasury and hope that common sense prevails, from our end, inasmuch as considerations of our membership are there and available for us to see go forward to Treasury.

CHAIR—But those terms of reference for the Policy Transition Group are pretty restrictive, aren’t they? There is one condition in there which says that any recommendations have to be revenue neutral. The principles are set in the deal, as you have said. Do you think that there is enough scope for the Policy Transition Group to recommend the sorts of changes that you need?

Mr Bennison—Speaking personally: no, I do not think there is. And I do not think the burden or the onus should have been put on the PTG to actually come out with revenue neutrality. I think that is something that should be tasked to the Treasury; I am sure the secretariat will bring that through, as Treasury is a major component of the secretariat. But it seems an unrealistic expectation, as to a number of the serious changes that must happen. For this tax even to be considered, they are going to have to push the boundaries of those terms of reference to such an extent that I really cannot see how they are going to make it revenue neutral. But I agree with you. It is a big concern for us. I am quite happy to hear other comments from colleagues.

Mr Flanagan—I would just like to add that there was an agreement struck on tax, and then Policy Transition Group has gone out to learn about the impact of that tax on the juniors. The changes that need to be made will actually impact the amount of revenue that is being collected. I am genuinely concerned they are not going to be able to make sufficient changes to make it not damaging.

CHAIR—In your submission you outline a whole series of flaws and you say what the government should do when you suggest a series of improvements. If the government were to go along with all these suggestions, would you then be in a position to support this tax or would you still think it is a bad tax?

Mr Bennison—AMEC's position has been that it still wants this tax rescinded, regardless of its input to the PTG, and we say that from the fundamentals of the whole tax reform situation. We believe that the entirety of the tax environment needs to be taken into consideration when looking at tax reform. As I said in my introductory remarks, we have had ad hoc tax reform applied to the industry over recent years, and it just creates so much uncertainty in the industry—uncertainty in raising capital, uncertainty for investment from shareholders and uncertainty in decision making both for offshore and internally for operations within the companies. We are stuck with this uncertainty until this situation is resolved—probably right through next year. That is a serious impost on the industry.

CHAIR—You mention uncertainty. Of course, your members are in a very different position compared with BHP, Rio Tinto and Xstrata, because presumably they have better knowledge of the government's assumptions, the government's thinking, because they were on the inside. It is not just that they contributed to the design of the new tax to suit their purposes; they have also got better information about what the government is thinking. That is right, isn't it?

Mr Flanagan—Yes.

CHAIR—Is that a concern for you?

Mr Bennison—Absolutely.

Mr Ball—That is why we had to try to model, as well as try and understand the compliance, of nine scenarios. It is not tenable for a small company to be doing that all the time and to be unable to tell the market where we stand as a public company.

CHAIR—Have you asked the government for access to the same information that BHP, Rio and Xstrata have access to?

Mr Bennison—Not directly, but we did through the Policy Transition Group when they met in Perth recently. The question was put, particularly to David Parker, who sat on that group—

CHAIR—The head of the revenue group in Treasury.

Mr Bennison—Yes. The bottom line is that they are commercial in confidence and we cannot get access to that information.

CHAIR—There is a difference, though, between government assumptions and information provided by individual companies, isn't there?

Mr Bennison—That is true, but it appears that there was quite a reliance by government on the industry information and the companies involved in that room. As a consequence, that appears to be the approach or the rationale behind the government's decision not to release those assumptions.

CHAIR—Can you talk us through some of the administrative and compliance related practical issues that you are facing? Essentially, until you are subject to the mining tax you still have to pay royalties, but you have got to presumably prove that you are not yet subject to the mining tax. Presumably you got have got to through compliance mechanisms, irrespective of whether or not you have to pay the tax. That is right, isn't it?

Mr Ball—You always have to pay royalties anyway. Don't forget that. That will come back as a credit, and then there is a timing issue associated with that as well.

CHAIR—Can you talk us through those issues?

Mr Flanagan—I will flag one.

CHAIR—Flag a couple.

Senator CAMERON—I am sure the chair will walk you through each one eventually.

Mr Flanagan—We have got one deposit, which we plan to develop. It is a magnetite deposit which has titanium and vanadium in it. With respect to the capital cost and the market value of the product, how do you proportion it across those different commodities which are and are not subject to MRRT and state royalties? So the vanadium and the titanium are subject to one taxation regime, while the magnetite is subject to another—and they are going to be in the same lump of dirt. This is extremely difficult to manage. It is enough to send you round the twist.

Another innovation which has taken place in Western Australia creates an issue that people fail to recognise. Multiple companies are exploring and maximising the value of the same piece of ground. Most companies are exploring for different commodities. To give you a classic example: during the GFC, the world's largest tantalum mine closed down and Atlas was able to go in and start an iron ore mine on that ground using infrastructure built for the tantalum mine. I would expect that, during the next year, we will again be sharing, to some extent, that infrastructure. So there are two companies using the same infrastructure, with different types of tenure over the same pieces of ground. The compliance cost of that is going to be enormous and it was not even contemplated. There was genuine surprise from the PTG when it was raised.

CHAIR—So you essentially pay a royalty on each product that you extract and pay company tax on profits?

Mr Flanagan—It is actually a comparative nightmare for us. It is our preference to continue to pay state royalties to the government. We are also paying royalties to pastoralists, royalties to impacted Indigenous groups and, in some cases, royalties to the people who provided us with the tenements to begin with. We also pay payroll tax, stamp duty and employees tax—we are paying a lot of tax as it stands. We were happy with the way things were. We see this new tax as a massive encumbrance designed to suit the majors and to create more barriers to entry.

CHAIR—Mr Ball, do you have anything to add on the issue of complaints about administrative issues?

Mr Ball—There are a couple of points that I think of immediately. The first is that, as I understand the MRRT—and I hark back to the fact that I do not have the detail yet—while we will not be creating two sets of books, we will, within our one set of accounting books, have two very distinct calculations. There will be one set of calculations for the MRRT and one for company tax. Trying to work through that is clearly going to be a compliance impost for a small company.

CHAIR—Do you expect your production to be subject to the MRRT when it is implemented?

Mr Flanagan—Yes, Atlas is expecting to be one of the first companies to be paying the tax.

Mr Ball—I can give you an example. Again, we literally started mining this month. Our deal with Fortescue enables us to ship up to 5 million tonnes of iron ore a year. Our all-up cost will be in the order of $50 a tonne. Currently we could sell that iron ore for around $100 a tonne—probably a bit more. Our 5 million tonnes will, in the first year, put us well over any threshold number currently proposed, notwithstanding that we are a small company with a much higher WACC and with all kinds of start-up costs for which we have not yet achieved payback. Under the current threshold, we would be paying MRRT in our first year of production at 5 million tonnes.

CHAIR—If it were not for this proposed tax, what would happen to the profits that will go to Canberra if it is implemented? Would you pay them out in dividends or reinvest them in the development of your company in Australia?

Mr Ball—That is a decision for the board. I do not sit on the board.

CHAIR—What would usually happen?

Mr Ball—In our case, I would suggest that, in the short term, we would look at further business development opportunities in the area where we are operating rather than pay the profits out in dividends.

Mr Flanagan—Typically shareholders invest in your company because they want exposure to that management team and that commodity in that part of the world. You can only maximise their exposure by reinvesting every last cent and that is what companies have done to date—I think the majors are an example of that.

Further on the issue of when the MRRT applies: on our assessments, if a company were to produce in excess of about 1.5 million tonnes per annum, we would expect that company to be subject to MRRT. That would more or less apply to all the companies who are planning to enter the iron ore space. That is a very small export tonnage.

CHAIR—So how would future investment plans be impacted if all of these companies were to have to pay MRRT right from the word go?

Mr Flanagan—It would be significant because if, previously, the hurdle rate had been 18 per cent, it would be 24 per cent after the imposition of the MRRT. So the rate of return needs to be significantly higher to be neutral. For assets which typically only make strong returns in the good part of the price cycle, we see the impact of the MRRT as being significantly negative.

CHAIR—If every company is going to be impacted by this it really makes it even more inappropriate that the government negotiated only with BHP, Rio and Xstrata. If I understand what you said in your opening statement, these are the companies that are established on what used to be a traditional model and you now have a whole lot of innovative companies, 40-odd companies, that are trying to be entrepreneurial and take a new approach. This tax makes it harder to take that new approach and makes it easier for the old traditional model to increase its dominance. Is that correct?

Mr Flanagan—Absolutely. Say I was competing against you and I had the opportunity to increase the tax impost on you by 25 per cent. That is kind of what we are looking at here. Our competitors have negotiated a deal where smaller juniors who start their projects in five years time who do not have an asset today will actually be paying 25 per cent more tax. It goes from 36 to 45 per cent. The general perception is that the majors will have a much smaller penalty.

Mr Bennison—The other aspect of this is that it increases our international effective tax rate enormously. That really knocks our international competitiveness. That is one of our biggest concerns. We are competing in the international marketplace and if we are not competitive then we are seriously going to suffer. We have seen that in the last three months. An example at the moment is the flow of capital coming into companies in Australia that you read about in the press. Nearly 60 per cent of that right now is going offshore. It is not going into projects in Australia. In September there was a $650 million spend, announced in the *AFR*, of capital raised during that month. Again, about nine per cent of that is going offshore. So the whole issue of risk and access to capital that David referred to earlier is profiled by this scenario of the flow of capital now going to South America and Africa because they are destinations that are seen as far more viable than Australia.

CHAIR—So if you had had something in place before you guys got underway eight years ago would you have been able to set up your businesses the way you have?

Mr Ball—It would have been much harder. We are in cyclical businesses. It is hard to give you a categorical answer to that, but our board certainly would not have been able to make a decision as easily as it did to move towards operations.

Mr Flanagan—Probably the best way to answer is that a lot of us have been able to go out and raise capital because of the enormous success of Fortescue Metals Group. There is a perception that you do not have to be one of the majors to go out and raise the capital. It is almost certain that if this tax had been in place then FMG would not have got up the way it has. So there would have been no FMG, which means that there would have been none of us.

CHAIR—When you met with the fuel and energy committee in July we had some discussion around the $50 million threshold. Has the applicability of that been resolved yet? Do you know now whether it applies to profits above $50 million or whether it applies from zero onwards? You are shaking your head.

Mr Bennison—I think it is fair to say that there are some concerns about how it is going to apply.

CHAIR—Do you know how it is going to apply now?

Mr Bennison—No, we do not. We put a tax-free threshold at that mark. We have obviously asked for it to be increased from $50 million to $250 million and we want a tax-free threshold up to that point.

CHAIR—Has anybody been able to explain to you how they determined the $50 million?

Mr Bennison—No.

Senator CAMERON—Mr Bennison, you indicated in your verbal submission that there has been a slow erosion of profitability in your sector. We have evidence before us of minerals profits moving up hugely from 2004-05 to 2008-09. When royalties are staying basically where they are, except for a $300 million hike here recently, and your profits are going through the roof, how can you argue that profitability is coming down?

Mr Bennison—We are arguing that there is an erosion of profitability through an increase in taxes.

Senator CAMERON—That is a comparative thing, is it?

Mr Bennison—Absolutely.

Senator CAMERON—As compared to what you would like and what you would want, profits are coming down but profits are still there. There are still significant profits, aren't there?

Mr Bennison—There are profits in the current cycle. All this is very much dependent upon the current commodity prices, exchange rates et cetera, and they are very cyclical. So you have to look at a very long-term rolling average if you want to get a better understanding of what the profitability of a company is. I think to take it over a very short-term situation is not realistic, and that is where a lot of these companies are coming from. You have to look at the long-term scenario. We are talking about a life of mine of, say, 25 years. A lot of these companies are taking 10 to 15 years to get back the capital invested in these operations. That is part of the context in which this is set.

Mr Flanagan—In 2004 the commodity prices were low. They were just coming off the bottom in 1999, when there was a recession, basically.

Senator CAMERON—You have just argued that it would be harder for you to set up under the MRRT proposal, but all the theories that I have read and all the arguments that I have heard about moving from royalties to an MRRT say that it would be easier for you to set up because you would not be locking in to paying royalties before you achieved a profit. Is that wrong? Has Professor Garnaut got that wrong? Has the Treasury got that wrong?

Mr Flanagan—Another point that you made before was that, in the time that commodity prices go up by 20 per cent, the royalties have gone up by 20 per cent. If the commodity prices go up by 100 per cent then the royalties go up by 100 per cent, because it is gross revenue. Atlas has reported an accounting loss for the last two years.

Senator CAMERON—You don’t like royalties either?

Mr Flanagan—I like royalties because—

Senator CAMERON—I am not surprised.

Mr Flanagan—They are basically a real investment in the state. That was the deal done between the states when we federated the country. I love it that we can do royalties for regions and that it benefits the people where we do our mining.

Senator CAMERON—Did you have discussions with the state government before the state government recently increased the royalties by $300 million?

Mr Flanagan—That was actually a removal of a subsidy provided to the majors, which they have had since—

Mr Bennison—They were done under the state agreement acts and they were also done on iron ore finds. That is where the increase in royalties went up to 7½ per cent. That is my understanding of what you are referring to.

Mr Flanagan—5.6 per cent.

Mr Bennison—Was it 5.6 per cent?

Mr Flanagan—Yes.

Mr Bennison—Sorry. All of this has to be put into context and that is the difficult part of it. At the moment, we are in a state royalty regime that we understand. Now we are being landed with a federal tax system that no-one understands.

Mr Flanagan—It is not equitable. The majors will pay less than us.

Senator CAMERON—Mr Flanagan, when I want to ask you a question I will ask you a question. Let Mr Bennison finish.

Mr Bennison—Now we are seeing an additional tax regime being imposed on the company that (a) we do not understand and (b) we do not know what the ultimate cost is going to be, but it is certainly going to be an additional cost. As much as we appreciate the fact that royalties may increase over the next few years and that will not be credited against the current MRRT, that is going to be a serious concern and that will still add to the erosion of profits to the companies, particularly if there is a serious downturn in commodity prices.

Senator CAMERON—The business model for BCI and Atlas seems to be based on the Fortescue model, which is high debt, high leverage.

Mr Bennison—No.

Mr Flanagan—We do not have any debt in our business.

Senator CAMERON—So the high debt, high leverage model is not about going out and trying to increase the share. How do you view that model in terms of its long-term sustainability?

Mr Flanagan—I suppose this tax makes it more difficult for those companies who want to raise funds. If this tax had been in, there would have been no FMGs, as I pointed out, and if there had been no FMG there would have been no Atlas or BCI.

Senator CAMERON—But if you are the ones who go out and get funds so that you do not have to increase the shares in the company, that is an issue, isn't it? That is an issue with the model.

Mr Flanagan—No. It is all about return on investment. If there is no opportunity to generate that return then there will not be the capital to go and start the mine.

Senator CAMERON—What do you say to Professor Garnaut's assessment that the Australian government has taken a position on the basis of advice of people of knowledge and standing that asserts some hard propositions about the national interest at the expense of some private interests that exercise considerable influence in our polity. Is that not what we are seeing here? Isn't this rent seeking from you guys? Aren't you basically saying 'Leave the royalties there because we are getting a good deal under those royalties—the national interests are secondary to our interests, so leave it as it is; we do not want it changed.' That is the message I am getting from you this morning—regardless of the national interest, it is simply about your profitability and that is the end of it.

Mr Flanagan—No, not at all.

Mr Bennison—I think you have to understand that the industry puts an enormous reinvestment back into the regions.

Senator CAMERON—This morning you were talking about a doctor's house in Port Hedland—

Mr Flanagan—But you have to look at roads and all that. We employ 350 people. They all pay tax. We have paid royalties every year that we have been up and running. We have had up to 45 per cent Indigenous people operating at our mine. We have started three Indigenous businesses that have been up there doing a fantastic job. A lot of people who are not in the Pilbara engaging in the business do not realise that.

Senator CAMERON—I have your quarterly reports here, and nowhere do either of the two companies here say they are going to go broke. Nobody raises the issue of the MRRT in your quarterly reports. Why not?

Mr Flanagan—The tax creates a competitive disadvantage for those companies which are seeking to enter the industry. It effectively provides the incumbent majors with a lower rate of tax and a competitive advantage to strengthen their grip on the industry.

Senator CAMERON—What should the national interest be? Should the national interest be these big companies that are prepared to pay more tax for a whole range of beneficial issues for the Australian economy, or should it be about your model that says we cannot afford to pay tax—and from what Mr Ball says he does not even understand how it works. Are we just supposed to let you guys run when you do not understand how it operates, you do not want to pay more tax—

CHAIR—I thought it was about a fairer, simpler tax and not more tax.

Senator CAMERON—It is about more tax for the Australian population.

Mr Flanagan—We have not said there are not circumstances where we can pay more tax, but it is unfair when a tax regime has been agreed by our competitors which discriminates against us and, we think, the growth of regional Australia.

Senator MARK BISHOP—In your introductory remarks you made some reference to the process of negotiations with the Policy Transition Group. There have been some remarks in the press. Is it your view that the senior policy people in that committee, who are consulting around Australia, have a full understanding of this new business model and the constraints, or restraints, that you and your companies face viz a vis larger organisations?

Mr Flanagan—The feedback we have is that yes they understand our business model now. They do. It is our concern that they are not actually going to be able to implement recommendations to create a level playing field between us and the incumbent majors.

Senator MARK BISHOP—Now that they have a full and proper understanding of your business model and your legitimate concerns, and bearing in mind that final point you made about not being able to make a set of recommendations, have you put those concerns to both the respective chairs of that group?

Mr Flanagan—We have tried to argue very hard as to why we should have a set of recommendations, and we will wait and see what happens.

Senator MARK BISHOP—Mr Ball, you have made some points about your costs in the start-up phase, before going into production, being about $50 a tonne, and the current price you would gain if you were able to produce would be something in the order of $100 a tonne, give or take. That suggests to me a return of $100 per cent on the investment. How does that then compare with the problems raised by both Mr Bennison and Mr Flanagan when the hurdle rate of return has increased from 18 to 24, when on any basis of calculation you are going to be receiving a return considerably in excess of either 18 or 24 per cent?

Mr Ball—Just to clarify: the costs I referred to are our costs of producing the ore over the life of the mine and the prices I referred to are current prices. When we signed off on our feasibility study the revenue that we could have sold our iron ore for was in the order of $60 to $65 a tonne. So the margin is much skinnier and there is no reason not to think that the price will come to that again.

Senator MARK BISHOP—At the feasibility stage, the margin was thinner?

Mr Ball—Correct.

Senator MARK BISHOP—But increasing demand has meant the margin is considerably higher?

Mr Ball—If we were producing five million tonnes as we speak now, yes, it has. My point was that we would immediately be under the MRRT banner.

Senator MARK BISHOP—But my point is that if the cost of the return at feasibility stage was in the order of $60 to $65 a tonne and your costs were in the order of, give or take, $40 to $45 a tonne, and now your return over the life of the mine is going to go up, on current prices, to $100 a tonne then that suggests to me that imposition of the MRRT, at whatever entry level, you will easily be able to bear it because of the huge increase in price that you will receive, in excess of the price at either pre-feasibility stage or feasibility stage?

Mr Ball—I guess the point is the compliance on us of understanding that will be significant. We are a one-project company so, unlike the three majors, we do not have the ability to spread our costs around projects. As I understand it, those costs are not currently deductible for MRRT purposes. Again, that is one thing we do not have clarity on. So that alone will put X dollars a tonne on our cost base.

Senator MARK BISHOP—Without comment, I accept those additional administrative costs are ongoing. The only point I am making is that your return over the life of the mine will increase from pre feasibility/feasibility stage of $65 a tonne up to $100 a tonne and, on the basis of increasing demand, I suggest even higher. On that basis, whatever additional costs either the state or the Commonwealth impose on projects like yours, my simple take is that there are additional costs but, by hell, you will be able to pay them.

Mr Ball—That is a significant assumption of iron ore price staying as it is and going up. You just need to look at the history of iron ore pricing or any commodity to understand it is a cyclical industry.

Senator MARK BISHOP—It is.

CHAIR—Taking over here, because we have to conclude and go on to FMG, commodity prices from the time the RSPT was announced at the beginning of May to the time the MRRT was announced at the beginning of July, actually went down, didn't they? Is that right?

Mr Flanagan—About 30 per cent.

CHAIR—Yet the government assumed significant increases in commodity prices moving forward in order to come up with a $10½ billion revenue estimate?

Mr Flanagan—Yes.

CHAIR—Are you expecting commodity prices to continue to be at these record-high levels or do you expect them to come off as supply increases moving forward

Mr Flanagan—We forecast flat prices for this financial year and we struggle to understand what will happen moving forward but a lot of the—

Senator MARK BISHOP—Is that flat at new high levels or flat at very low levels?

Mr Flanagan—Flat at current levels.

CHAIR—Which is 30 per cent lower than when the RSPT was—

Mr Flanagan—Which, for our products, is about 110 bucks a tonne, but the Aussie dollar has eroded quite a lot of the value.

CHAIR—If commodity prices increase the royalties that you pay to the state increase as well?

Mr Flanagan—Correct.

CHAIR—Because there has been the suggestion that somehow there is no increased return to the community from—

Mr Flanagan—Because as a baseline, a percentage of revenue, the royalties that we pay to the local people also increase.

CHAIR—The key argument that you have put forward is that this deal that the government has done on the tax significantly advantages your competitors, compared to the situation you find yourself in, and, in turn, disadvantages you. Are you able to provide us with a concise list of all the issues where you feel that the majors get a competitive advantage from the way the tax was designed? You have mentioned a few such as the capacity to offset losses between projects when you have multiple projects. You mentioned a whole series. Market valuation is another. Can you provide the committee with a list so that we can have a very clear understanding of where that competitive advantage is?

Senator CAMERON—Chair, I have a question I would like to put. Could you also advise the committee as to why, if your competitors can provide a better return to the Australian community through their model of operation, you should have benefits, as you have indicated—more incentivisation? Why should the government—in your words—incentivise you more, if you cannot pay a better return to the Australian public out of using their resources?

Mr Flanagan—On a comparative basis, BHP would need to provide accommodation for 150 doctors in Port Hedland to do the same as we are doing for doctors in Port Hedland.

Senator CAMERON—I would rather compare apples with apples and see how we go.

CHAIR—We have to conclude. Senator Back, quickly.

Senator BACK—Could you also take on notice a question in regard to our overseas competitors, the Brazilians particularly. Speaking of Senator Cameron's level playing field, would you contrast the costs imposed on Brazilian producers in supplying to the same markets Australia supplies?

Senator Cameron interjecting—

Senator BACK—That is in regard to, for example, Brazil, which I understand to be our major competitor, and Australia. Thank you.

CHAIR—Thank you very much for your contribution to the committee today.

[9.52 am]

FORREST, Mr John Andrew Henry, Chief Executive Officer, Fortescue Metals Group Ltd

HUGHES, Mr Marcus Paul, Group Tax Manager, Fortescue Metals Group Ltd

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

TAPP, Mr Julian Robin Paul, Director, Strategy, Fortescue Metals Group Ltd

WILLMOTT, Ms Deidre Ellen, Group Manager, Approvals and Government Relations, Fortescue Metals Group Ltd

CHAIR—Welcome. Do you have any comments on the capacity in which you appear today?

Mr Tapp—I am also an economist.

CHAIR—I invite you to make a brief opening statement. Then the committee will ask you some questions.

Mr Forrest—Thank you very much, Chairman. I think the issue goes to the heart of what has built Australia. The country has been built on companies like Fortescue, setting itself goals, targets and ambitions and, where possible, keeping ownership in Australia. We feel that this tax discriminates against all of those companies and particularly and unfairly discriminates against iron ore and coal, without any explanation. I would also say at this point, as we are discussing discrimination: the tax is itself unconstitutional. It will discriminate against those states which wish to encourage investment through changing their royalty regime. I would like to say that at the outset but go further with you and say: the tax which has been contemplated came as the bastard child of the RSPT.

The RSPT, as we know, would have eliminated Fortescue. Treasury knew those numbers, yet they proceeded with it. The RSPT was based on an absolutely flawed, obviously flawed, basis that somehow or other an injection from a taxation credit in failure would balance up against the taking of the economic interest of assets on an unprecedented scale outside of dictatorships in other economies. Here in Australia, that shook the global investment industry. I am sure, Senator Cameron, you would be very aware that Australia relies on foreign capital—

Senator CAMERON—Are you picking on me already?

Mr Forrest—for its investments. Australia and Australians have always had aspirations beyond what this country can afford. Since the very earliest days, Australia has gone overseas to countries like Britain to raise its capital. We do that now, we did it then and we will do it tomorrow. We had contact with 426 different institutions in our recent capital raising. Each one of them expressed their concern about the unnecessary, unpredictable and discriminatory basis of Australia's purported taxation regime as considered under the MRRT. I say to you at the outset that this harms Australia. The very discussion harms Australia.

Continuing on, the discussion on the MRRT, like the discussion on the RSPT, harms the mining industry. It creates an unlevel playing field for the majors. It is simply like discussing income tax with Australia and asking one or two individuals if they would like to particularly frame income tax, which will affect all other Australians, based on how it may benefit their own personal households. That is effectively what happened. The consultation process which has been carried forward for the mining industry—particularly iron ore and coal, which this tax discriminates against—is no more than the sham of the original Treasury discussions. There was no change at all in terms of reference, there was no change in how much money the tax would raise and there was no change in what was allowed to be discussed. It was strictly defined down the path of achieving what the tax before the discussion set out to achieve. In other words, there was no point in having the discussion.

If it hurts the mining industry, one of the principal drivers of the Australian economy, it will eventually hurt every Australian. But I suppose what most excites Fortescue as a company—which is proudly Australian and a company which has used global project finance markets to keep its ownership in Australia—is that it hurts infrastructure. We have a new tax which is being contemplated here. The taxing point is at the mine. Everyone knows that iron ore and coal are absolutely worthless at the mine. It is not until you can get them to a market—until you can get them to a port—that their value begins to materialise, because there are not a lot of people who would want to build steel mills or power plants at the mine; they are all in their own countries, where their own populations are. So you have to have the infrastructure to get it from the mine to the marketplace. Without that infrastructure—as I can tell you from very, very personal experience—your assets are worthless.

That is why Fortescue, in particular, has prosecuted a 5½-year battle with BHP and Rio Tinto, on behalf of all the juniors, to have BHP and Rio Tinto do no more than what they said they would do. What they said they would do—and they have said it a number of times, in acted legislation called state acts—is share that infrastructure. They would share those ports, they would share those railway lines and they would allow, on the basis of ‘build it and they will come’, other parties to use them and other industries to flourish outside their own specific goals for the value of the state and the value of Australia.

Over 35 years and Fortescue’s 5½-year battle, BHP and Rio Tinto have fought an aggressive fight, firstly, to stop Fortescue building its own infrastructure and, secondly, presenting case after case after case to the courts of Australia, right up to the High Court and beyond into parliament, to stop us accessing their infrastructure. This is because the precedent it would create would also establish a flourishing industry of juniors and others, which of course then creates a more competitive Australia, not simply a more competitive BHP or a more competitive Rio Tinto—who are, as we speak, trying to develop what they call the ‘Pilbaras of Africa’. I just want that to sink in. The ‘Pilbaras of Africa’ are a real danger to the people of Australia, because if they get their iron ore going at the level of the Pilbara then all those jobs, all those earnings and all those taxes will be enjoyed by other countries and not by Australia.

And so while they are out there fighting the good fight for their shareholders globally we, left in Western Australia, want to fight the good fight for Australia and we rely on infrastructure to do that. Where, as I brought you to in my comments, you have a taxing point at the mine and an income at the port you rely on infrastructure. BHP and Rio Tinto have fought anyone using that infrastructure and discouraged anyone else from developing infrastructure and this tax is designed by those two and put to what I can only think was a gullible government or, perhaps more fairly, a government which purely had an electoral advantage in mind. They allowed a tax to be designed which would have regulated earnings, which is a polite term for uncompetitive income, to ensure that the Fortescues in the future—everyone who has ever had aspirational stars in their eyes—could not afford to build infrastructure because they would be hit by a tax before they had started earning revenues, which works specifically against infrastructure. If you work against infrastructure—and there is no easy way for me to say this—you work against the interest of every Australian because Australia is starved for infrastructure. If the private sector does not develop it because of very clever manipulation of governments in their sensitive periods going into an election then we work against Australia. That is one of the reasons why I call the MRRT the 'bastard child of the RSPT'. We had an excellent relationship with the previous Prime Minister who understood completely that Fortescue and the other companies which they were negotiating with could not speak for the entire industry. We absolutely refused to sign anything more than a discussion paper which could be used as the consultative basis for the entire industry. But on deposing that Prime Minister, quickly—

Senator CAMERON—Point of order, Chair.

Mr Forrest—then we had—

CHAIR—I am sorry, Mr Forrest, can I interrupt you for a second.

Senator CAMERON—We are running the show here and we—

CHAIR—There is no need to be offensive, Senator.

Senator CAMERON—I do not want a political lecture and I have to say there is limited time for the senators to ask questions. This has gone on now and it is rambling into a political attack on the government and it should stop—

CHAIR—There is no point of order.

Senator CAMERON—and we should deal with that issue and stop the political rhetoric.

CHAIR—There is no point of order. I know there are cameras in the room, but there is no need for a political show. Mr Forrest is entitled to make his opening statement and we will provide him with the courtesy that he is entitled to.

Senator CAMERON—Tell Mr Forrest that. It is not just me.

Mr Forrest—Senator Cameron, if you ignore history, you will repeat its mistakes. We must look at the RSPT; we must look at the MRRT. We must know how it came into existence, why it is a disaster.

Senator CAMERON—Just stop the politics. Let's get on with the issue.

Mr Forrest—This is not politics. I have very good friends in the Labor Party who I support.

Senator CAMERON—It is politics. You know it is politics.

Mr Forrest—If this were an Indigenous issue, I would be on your side. I am against you because this was a really dumb tax. In conclusion there is no authority for BHP or Rio or any other foreign company like Xstrata to speak for the entire mining industry of Australia or all Australians. I finish as I started. It is like inviting one or two people who are members of the Australian community to design an income tax just to suit them. That is what has happened here. It has been done for an election. It is the bastard child of an ill thought out tax in the first place and it should not be discussed further taking up your valuable time.

CHAIR—Thank you very much for your opening statement. Is there anybody else who wanted to add anything?

Mr Forrest—I think we are happy to take questions.

CHAIR—Towards the end it seemed to me as if you were suggesting that the former Prime Minister was getting the process back on track after announcing what was a very bad tax following a bad process. Are you suggesting that the process that former Prime Minister, Kevin Rudd, then put in place was better than what eventuated after the change of Prime Minister?

Mr Forrest—It is absolutely clear now through history, which I know the good senator does not want to hear about, that the then Prime Minister was—

Senator CAMERON—This is going to degenerate if you want to keep that up.

Mr Forrest—The then Prime Minister was resolving the issue and was creating a basis for discussion of a major tax reform for the nation, which we could all have participated in and contributed to. But he was not able to proceed with that because he was deposed. Of course, as we know, the new Prime Minister then gave a very short time—I think the words were, 'We're going to solve it this week.' It is extraordinary for a negotiation to have such a short time frame; it must mean that there is a foregone conclusion in place. Of course, the foregone conclusion is now obvious: it led to the MRRT.

CHAIR—Obviously you are understandably aggrieved that the government negotiated in secret with some of your competitors. You have mentioned the issue of infrastructure. Can you give us the areas where the design of the new MRRT favours your competitors compared to the business structure or business model that you have in place?

Mr Forrest—I will get Mr Pearce to answer.

Mr Pearce—The design of the tax is biased in favour of BHP and Rio in particular—given that they are our major competitors in the iron ore industry in a number of ways—in terms of both design and the combination of elements of the design. The main points are around the application of the mining rights value versus the principles involved in historical cost; the low value they appear to be arguing should be placed on infrastructure, where they are likening it to a railroad in central Melbourne as opposed to high-risk infrastructure linking a port to a mine; the way 'projects' looks as if it is being defined through the consultative panel; and the transferability rules. It is the combination of those particular factors that tends to favour companies with established mines and infrastructure and clusters of mines that help to de-risk that infrastructure in remote locations. The definitional aspects of 'projects' seem to be biased towards BHP and Rio. There is the issue of possible treatment of black-hole expenditure, which is particularly relevant for companies that are trying to develop but may not meet the definition of a project at this point in time.

Senator MARK BISHOP—Black-hole expenditure?

Mr Pearce—Expenditure that is being incurred at the moment but, under the panel rules, may not be deductible given the definition of 'projects' that they seem to be looking to apply. There is also the cost of compliance. The cost of compliance for this thing, per tonne, for the smaller players is going to be horrendous compared to the per-tonne cost of compliance for the larger companies.

CHAIR—On cost of compliance, can you talk us through some of the issues that you are facing there compared to the bigger players.

Mr Pearce—They will have some of the same issues, but in terms of the resources and the cost per tonne, as I say, it will hit the smaller players more harshly. A lot of that is linked to the definition of 'projects', the transferability and the ability to keep track of the expenditure from day 1 all the way through to when you may meet certain definitions and then be able to recognise expenditure against the MRRT.

CHAIR—Do you think the Policy Transition Group will be able to address the concerns you have, or do you think they are too restricted in their focus?

Mr Pearce—I have no confidence at all that they will address these concerns. They are very narrowly focused. The ability to have a meaningful discussion and influence the outcome is, in my view, nonexistent. Part of their terms of reference is that whatever they give to one hand they have to take from another, so the overall outcome really is not up for negotiation and discussion.

CHAIR—Has FMG been able to model the impact of the mining tax—this MRRT—on your business?

Mr Pearce—It has been incredibly difficult because of the lack of detail that we have. We were not privy to the agreement that was put in place between BHP, Rio and the government, so we have done our best with limited information, but until all of these rules are finalised it is a very difficult thing to model.

CHAIR—So your problem is not just the design features favouring the BHPs and the Rios; it is also the fact that they have better access to information courtesy of having been in the room when the deal was done.

Mr Pearce—Yes. We simply do not know. We were not party to those discussions, so it is very hard to know what they know that we do not know. You would have to assume that they know more than us because they were in those discussions and we were not.

CHAIR—Mr Forrest, the Minerals Council is on the record as saying that a profits-based tax on resources would be better than state royalties. What are your views on that?

Mr Forrest—I do not see how you can compensate the owners of those resources, who are the people of the states, with anything less than what a royalty charge is. Royalties were brought into place by the wisdom of the founding fathers of the Constitution and by the states because regularity of income was required. You need to keep politicians sitting where you sit, Chairman. You need to keep policemen on the streets. You need to keep nurses in hospitals and teachers in schools. You do not get that out of a highly cyclical industry. You cannot have Senator Cameron suddenly out of work because the iron ore price collapsed. That could happen.

Senator CAMERON—You would never want that, Mr Forrest, would you?

Mr Forrest—I am enjoying the entertainment. I would be disappointed to not have the good senator here because the iron ore price fell, but that is what would happen if we relied on a profit based tax. It is as though no-one had ever thought of it. The states insist on royalties because it taxes revenues. It is a payment to the people who own those resources—that is, the people of the states, the states themselves—and therefore it is a regular payment. It goes up and down but not the cyclicality of profits in the mining industry, which, as we all know, has its boom and bust days.

CHAIR—When we started the Henry tax review process, it was supposed to deliver a simpler and fairer tax system, but that is not what we have ended up with, is it? It is just more tax rather than a simpler and fairer tax.

Mr Forrest—Yes. This tax is so hideously complicated. The good Senator Cameron cannot work it out and he is very close to it. I cannot work it out, and certainly Ken Henry, when he was trying to explain the RSPT to a bank, was immediately told it would not work, so he could not work it out either. This is the father of the MRRT, and the MRRT is now just more complicated. What we are doing is creating huge buildings of bookkeepers, accountants and bureaucrats in Canberra instead of putting jobs where we need them, in regional Australia.

CHAIR—Has anybody in government been able to explain to you how much, out of the $10½ billion, would be expected to come from Fortescue?

Mr Forrest—Let me return to a pre-eminent expert, Mr Julian Tapp.

Mr Tapp—Before I do that, could I just add to what Andrew said. You talked about profits tax versus the royalty system. There are two things we would like to make clear. The royalty payment is a payment to the states—the states are the owners of the resources—and that payment is an accepted and fair payment for the resources as they are mined in the ground and it goes up and down with the value of the product. The company, Fortescue, already pays a profits based tax. It is called corporate income tax. We do not think it is necessary to have two different profit taxes operating at the same time. We would end up having to keep two sets of books and running two different sets of accounts, and there would be a whole lot of regulatory intervention to try and work out exactly what this tax is on given, as Andrew said before, that the taxing point is at the mine, the point of sale is at the port and you would have to put in place mechanisms to prevent transfer pricing, getting rid of the profit. So you will end up with a regulated rate of return on your infrastructure, and we all know that regulated returns on infrastructure destroy investment in that infrastructure. As for the amount, we are not party to the assumptions. We cannot tell you, as a result of that, exactly how much tax we will pay under the new regime.

CHAIR—But you would expect to be paying tax?

Mr Tapp—We would expect to be paying tax.

CHAIR—And if state royalties were to increase in the future, you would be paying both, including the mining tax, and would not be able to get any increase in the state royalties credited against that?

Mr Tapp—That is correct.

Senator CAMERON—Mr Forrest, I am sorry you are getting a bit agitated about the democratic processes of this country.

Mr Forrest—I am looking forward to it.

Senator CAMERON—I know that, when the democratic processes challenge power and privilege, there is always a reaction. We have seen that this morning. I go to Stephen Bartholomeusz and what he said about your company's establishment—

Mr Forrest—You run your inquiries through a journalist, do you, Senator?

Senator CAMERON—No, I am just asking you a question. Can I ask you this question? I quote:

Unusually for a resources group of its size, Fortescue is quite highly leveraged with high-yield debt, partly to maintain Forrest's control but more particularly because that was the only source of sufficient capital available to the group to develop its existing operations. Thus it has about $US2.6 billion of relatively high-cost borrowings in its balance sheet against stated equity of only $US850 million.

Isn't this one of the fundamental reasons why you do not like the government seeking more tax, because you are highly leveraged, you have a huge amount of debt and your model is quite different from the other models in the industry? So, should government reduce its capacity to get tax for the rest of the community on the basis of your highly leveraged model?

Mr Forrest—I think the telling part of that quote you read out is that it was the only source of revenue we could get to raise the kind of capital which we needed. There is a lot of truth to that. If this tax came around at that time, Fortescue—indeed, Senator, you would be happy with this—would not sitting in front of you; we would not exist. That was the only way we could get the money. We had to go and get the money from the US capital markets. The US capital markets gave us that money by a whisker. It was not easy; it was very tough. We just made it over the line. I take strong issue with the fact that we are highly leveraged. Like all new companies back then that got going, you needed equity and project finance. It is easy to say from glass towers to people in the street having a crack that you are highly leveraged. But that is what people do when they try and keep control. I do not apologise for that. We are not sitting here speaking foreign languages. I am proud to be Australian and to have Australian control of this great Australian company. We needed to borrow money from the only source available. It was not available to us in the equity markets. It was not available to us in the Australian debt capital markets. We had to go international, and we just made it. What we all know now is that had the MRRT had existed then, we would not exist.

Senator CAMERON—You should not confuse my questioning with your dislike for me.

CHAIR—Just ask the question.

Senator CAMERON—You should not confuse my questioning of you on that issue.

CHAIR—Just ask the question.

Senator CAMERON—I want you to come back to—

Mr Forrest—It would be good to have a beer with you. It would be fun.

Senator CAMERON—Once upon a time. I want you to comment on Ross Garnaut. Is he okay? He is not in newspapers; he is in the industry. He says:

... the Australian government has taken a position on the basis of advice of people of knowledge and standing, that asserts some hard propositions about the national interest—

that is what I am interested in: the national interest—

at the expense of some private interests that exercise considerable influence in our polity.

Is he talking about you when he is saying that?

Mr Forrest—I would be delighted and honoured if he were. You picked on my personal preferences again. I happen to like you and Ross Garnaut. I think Ross is a towering intellect, but does he have his feet firmly on the ground after the huge experiences he has had? That is open for debate. He did bring in a very similar tax into Papua New Guinea. It did cruel foreign investment; it did not raise a single dollar of revenue. Only after years and years of pain for that poor country did they get rid of that tax. Since then—

Senator CAMERON—Maybe some other things affected PNG from time to time as well.

Mr Forrest—Speak to the developers and they say, ‘We didn’t want to take the risk on mining and Papua New Guinea and the profits tax, which removed the reward of that risk.’ Mining is inherently risky. I look at that precedent. And I look at his defence of Treasury ever since and his earnest defence of Ken Henry, who did not ring a single banker when he introduced the elegant tax which relied on bank support. I wonder where that sympathy comes from—perhaps it comes from his own vocation.

Senator CAMERON—Okay. Do I still have time, Chair?

CHAIR—No.

Senator CAMERON—I will add some questions on notice.

CHAIR—Sounds good. You gave evidence to the Senate Select Committee on Fuel and Energy that two projects had been delayed and that a final decision had yet to be made in relation to Solomon and the expansion of the Chichester project. What is the status of that now?

Mr Pearce—In a couple of weeks time the board will consider both those projects and whether we will approve them or not. We have said we could possibly fund the Chichesters from internal cash flow and we are still in the process of assessing the Solomon project.

CHAIR—The mining tax is relevant in that consideration?

Mr Pearce—The mining tax weights heavily on a number of fronts, particularly as we are having discussions with the international banks and financiers that provide the finance for these sorts of projects. There is not one meeting we have where the tax is not raised. They are extremely concerned and confused as to why the government would impose a tax like this, particularly so narrowly across the industry, and they are worried about the impacts that it could potentially have on a company like Fortescue.

CHAIR—This might be a rhetorical question. Taxes drive behaviour. If you have two profit based taxes rather than state royalties and income tax, essentially, how do you think that would impact on mining companies structuring their internal affairs?

Mr Forrest—We seem to be entering an era where if something is moving in the economy you shoot it with a new tax. I do not see why that is. As we all know, if we had levied a huge new finance tax when Sydney was beginning to turn into a finance centre, I doubt whether it would exist. If we had levied a huge new manufacturing tax against Victoria, I do not think that that manufacturing state would have existed. I think levying a huge new mining tax, particularly against coal and iron ore, which hurts Queensland and Western Australia dramatically, is not a far-sighted decision. It is a short-term revenue decision, which of course means that it will inhibit growth. It is an economic fact that if you want to inhibit growth you apply more tax to an industry. That is what will happen here; we will inhibit growth. I bring you back to what Rio and BHP trumpet of the Pilbaras of Africa, which is the real danger of inhibiting growth in Australia.

CHAIR—The comment has been made, hasn’t it, that somehow we have got to do this to address the two-speed economy? Have you got a comment on that?

Mr Forrest—You see dislocation at the beginning of any industry growth. You saw a massive shortage of housing in Silicon Valley. You saw people who were living in cars et cetera. You saw people who were trying to get into the industry and could not. Then the software industry and the high-tech industry grew up and created one of the mainstays of the US economy and the reason that the US economy is still competitive. We are seeing the early signs of that here in Australia. It is easy to describe the short term. It has got a kind of journalistic jingoism to it—the ‘two-speed economy’—but it is typical of the early stages of any major structural shift in an economy. The structural shift I refer to here is Australia becoming more competitive against its major sovereign competitors, which is what this is about and what I as an Australian am about. It does not concern BHP, it does not concern Rio Tinto and it does not concern Xstrata, because they are out there investing against Australia.

CHAIR—I think you have said that the Policy Transition Group cannot address the issues with this tax. The tax has inappropriately been negotiated in secret between the government and the three biggest mining companies, your competitors. What should the government do now to fix this?

Mr Forrest—At the very least take it to where the former Prime Minister was taking it, and that is to an overall discussion. It could be called a taxation summit or it could be called something else, but it should not be something which has a sham consultative process and it should not be something which is guarded by three multinationals and which will impact the entire industry and economy.

CHAIR—Have you had these conversations with the government?

Mr Forrest—We of course have, but I could not make it because the time was so short. You were told: 'You will be in Perth at this time for the consultation process.' I just happened to have other obligations—for our Aboriginal people, which is something which I am lockstep with the Labor government about and love them for. I could not be there, so I did miss those consultations. But my colleagues did.

CHAIR—So you missed the policy transitional consultations. Have you had any conversations with government at all where you suggested what you have just put on the table, that it should be part of a tax summit—and what do they say to you?

Mr Forrest—As the Prime Minister's assistant can attest, I have tried to arrange a number of meetings to put these views. I considered her predecessor was on the right track to produce the discussion paper for all of the industry to get involved in and I have been denied an audience on a number of occasions.

CHAIR—So you have not had one meeting with Julia Gillard since she became Prime Minister?

Mr Forrest—I have not had one.

CHAIR—BHP, Rio and Xstrata really have quite—

Mr Forrest—I am sure they have a hotline to the Prime Minister, but we do not know the number.

Senator BACK—Chair, in this whole exercise why is it that we have not heard from the banks? Obviously BHP and Xstrata and Rio—

Senator CAMERON—Because they would have to justify the interest rate rises!

Senator BACK—Were you answering the question, Senator Cameron?

Senator HUTCHINS—I have a point of order. I am not sure that Mr Forrest is in a position to answer for the banks. He has not said anything—

CHAIR—Senator Back is asking some questions.

Senator BACK—This is my question, if I may continue it: we have not heard from the banks in this whole debate, and yet they are critical to it. I want to know why we have not heard from the banks.

Mr Forrest—I have my CFO here, who I would like to answer that, but being chief executive I can possibly step a little further into deeper water than he can. I would say that they are keeping their heads down for fear their heads will get shot off. The banks, during the whole RSPT process, as you are aware, were the lynchpin. They knew it was a disaster straight up, yet you could not get them to come out and say it.

Now, of course, we all know it is a disaster, but at the time they knew they were holding the smoking gun—that it was an absolute disaster of a policy—yet they kept their heads right down. They are doing it now in case there is a MRRT called the BRRT.

CHAIR—Quickly, in closing, I turn to the commodity prices, particularly iron ore prices. I think when you appeared before the Senate fuel and energy committee you indicated that there had been a 30-odd per cent drop between when the RSPT was announced and when the MRRT was announced, yet the government suggests that there would be significant increased in commodity prices essentially to justify the $10½ billion in revenue it would raise. What has been happening in the market since we last met?

Mr Pearce—Commodity prices go up and down like they did last year, the year before and this year. They have been up and down since then. In July they went down quite substantially, and they have risen slightly since. Obviously, the Aussie dollar exchange rate against the US dollar has eroded the Australian dollar value of that commodity price significantly. They will continue to go up and down. The nature of a profit-based tax is that your revenues will not be certain.

CHAIR—When the state government in Western Australia puts their budget together, presumably they come and talk to you—you are a producing mining company now—about what your production expectations are, what your commodity price expectations are and the like.

Mr Pearce—Not so much on the commodity price perspective, but they certainly understand our volumes and the volumes that we produce. From our point of view that is done in liaison with the state government, because it is a volume based state royalty. It is value based depending on the iron ore price.

CHAIR—But then they publish those assumptions, don't they, in their budget process?

Mr Pearce—They do it as part of the budget process, yes.

CHAIR—And they also publish the exchange rate assumptions, don't they?

Mr Pearce—I am sure they do.

Mr Forrest—We have a long-term declining iron ore price. It takes into account various expansions. It does not take into account what is being sponsored aggressively by BHP, Rio Tinto and Xstrata overseas. If those industries eventuate then you will see a much sharper decline in iron ore and coal prices.

CHAIR—Essentially what you are saying is that as there is a supply response then the price comes down because it meets demand more readily.

Mr Forrest—My great concern—and why I am here and arguing with some passion with the good senator—is that the supply response is coming. It is as certain as day follows night. The supply response is coming, but the MRRT will help that supply response be met overseas and not enjoyed by Australians.

Senator CAMERON—I am just looking at a chart here that we have been supplied with. I am sorry you do not have it before you, but you would recognise the chart. It shows 2005-06 profits of around about 20 per cent moving up to about 50 per cent in 2008-09. That is quite a sharp rise, and you were talking about 'up and down'.

Mr Forrest—What chart is it?

Senator CAMERON—It is a chart called 'Mineral tax and royalties as a share of mineral profits.'

CHAIR—From the ACTU?

Senator CAMERON—No, it is not from the ACTU; it is from the Treasury actually. I will show you the chart. You can see the profits. I have a simple view: if that is the amount of profits that the mining companies are making, why can't we get more of that back for more hospitals and more infrastructure? If you look at the little one at the bottom of the chart, that is royalties.

Mr Tapp—Did that have company tax on it as well?

Senator CAMERON—That is royalties.

Mr Tapp—So it excludes company tax?

Senator CAMERON—Everybody pays company tax; not everybody pays royalties.

Mr Forrest—If there is company tax on that chart—

Senator CAMERON—I do not want to give you a lesson on royalties.

Mr Forrest—Can we give you a lesson on tax?

Senator CAMERON—Royalties are about you accessing the resource, and you accept that, don't you?

Mr Tapp—Yes.

Senator CAMERON—So there are two different things. Is that correct?

Mr Tapp—Yes, it's—

Senator CAMERON—So let's go on the basis that there are two different things. You were saying that profits are coming down. I would not want the press or the committee, more importantly, to walk away and think profits are going down in the mining industry. They are not going down in the mining industry. Profits are on their way up, and the trend is to go up. Isn't that correct?

Mr Pearce—Not if the iron ore price falls, as most people are predicting, through 2014-15.

Senator CAMERON—But profits will continue to rise, and then you have to offset that against paying off infrastructure, paying off capital equipment. As you go longer your profits increase because you do not have those expenses. Profits are not simply about prices, even though prices are important. Am I being silly here? Is that right or wrong?

Mr Forrest—I do not know. I do not know if that chart you are referring to includes company tax. It might very conveniently not.

CHAIR—I can help you. When we last met you were not able to tell us what your average tax rate would be moving forward should the mining tax be implemented. Do you have a better understanding now of what your average tax rate is likely to be, including company tax?

Mr Pearce—It is difficult to respond because of our lack of knowledge of the details of the tax and our lack of participation in that process.

CHAIR—Again, the government has not shared that information with you and they have shared it with your competitors.

Mr Pearce—We can only assume, because we were not part of those discussions. So my answer really has not changed that much from before. It will vary somewhere between a 38 per cent effective rate to a 45 per cent effective tax rate.

CHAIR—If prices do what you expect them to do, which is go down as the supply response comes in, then really this tax, which was set up at the time of blue sky and high profits, will have a very significant impact on the way down.

Mr Pearce—Correct, it will.

Senator CAMERON—I have another question, which you may want to take on notice. Did Fortescue have any discussions with the state Premier or anyone in the department in Western

Australia or any politicians in relation to the royalty changes that have taken place recently, prior to them taking place?

CHAIR—FMG would have enjoyed those changes, Senator Cameron.

Senator CAMERON—I am not asking you—I am just asking a simple question.

Mr Tapp—There has been no changes of royalties that we face. We face the same royalties as every other mining company does under the mining tax.

Senator CAMERON—There were changes in terms of royalties in Western Australia. I am asking whether you were involved in any discussions with the state government on that.

Mr Tapp—Those changes in royalties applied only to BHP and Rio.

Senator CAMERON—So you had no discussions with them?

Mr Tapp—Not about changing BHP and Rio's royalty rates, no.

Senator CAMERON—But what about royalties in general?

Mr Tapp—No, we understand—

Senator CAMERON—You would have talked to the state government about royalties.

Mr Tapp—We understand that they are looking at potentially putting them up. That has been an issue that has been considered for some time. But, no, we have not had discussions with them directly on that issue.

Senator CAMERON—And you do not have discussions with them on royalties?

Mr Tapp—No, we just pay our royalties.

Senator CAMERON—You just pay them.

CHAIR—A pretty simple process, really, without much surprise.

Senator CAMERON—Especially when they are so low.

Mr Tapp—There is one other point I would like to make. We have not touched on it yet but I think it is a matter that is worth investigating. It is the constitutional nature of the MRRT. We are absolutely resolute in our belief that the tax is technically unconstitutional and we do not believe it can be drafted around. It would be a travesty if parliament were to introduce a tax and you challenge it in the High Court and three years down the track the government ends up having to repay that tax. The damage would have been done to our industry and it will be an absolute nightmare at some point in the future if the money has to be repaid.

CHAIR—On what basis do you think it is unconstitutional?

Mr Tapp—Section 51(ii) of the Constitution. It discriminates between the states. If a state chooses to encourage development by lowering its royalty rates—by the way, the rate that BHP paid on fines was exactly an encouragement of development. That is why they have given reduced rates. If it chooses to encourage development by reducing the royalty rate it is discriminated against by this tax, which imposes a higher tax in states which try to encourage development by lowering their royalty rates.

Senator MARK BISHOP—How is that different to a payroll tax? There are different entry levels, different gross takes and different rates for persons employed in industry between states and across states.

Mr Pearce—It is state based, so the states set their own—

Senator CAMERON—But you do understand there are other legal opinions that differ from that opinion.

CHAIR—We do not understand that because we have not seen them yet.

Mr Forrest—We are certainly putting squarely our belief on the table, and we would like any other belief to be put just as honestly to us.

CHAIR—Thank you very much for your contribution to the committee this morning.

Proceedings suspended from 10.34 am to 10.46 am

PETERSEN, Mr Anthony Edward, Chairman, DomGas Alliance

CHAIR—Welcome. Do you have a brief opening statement?

Mr Petersen—I do. Thank you for the opportunity to present to the committee. The DomGas Alliance is WA's peak energy user group, so we represent gas users and also infrastructure investors and prospective gas producers. Our members currently supply gas and electricity to 200,000 small businesses and two million Western Australians. Natural gas plays a vital role in fuelling Australia's economy. It is even more critical here in Western Australia, where the state's energy needs rely about 60 per cent on natural gas for generation. Whilst this figure is lower in other states of Australia, ABARE are predicting that by 2030 about one-third of all energy requirements will come from natural gas. We believe that natural gas is the only conventional fuel that can currently underpin Australia's transition to a low carbon economy. Given this advantage, we are focused on the tax arrangements that the domestic supply affects.

We believe that any proposal to extend the PRRT to onshore and near onshore projects could have serious unintended consequences for supply. Particularly, our studies show that a 40 per cent PRRT could make some of these projects uneconomic. It could also lead to high energy prices. If this were able to be passed through to customers we believe that such a pass-through would be contrary to the principle of the tax on resources and therefore it should not flow through to the customers. Our preference would be that domestic production of gas should be exempt from the PRRT. We are, however, aware that there are other options available. We believe that the exemption would supply an incentive for domestic gas production. This incentive is particularly required here in Western Australia, where we face a shortfall for domestic gas in the coming years. We also recognise that the government here in Western Australia has relaxed royalties on tight gas from 10 per cent to five per cent to encourage this investment in tight gas exploration and development, and we would ask that the committee make sure that there is no contrary effect by the PRRT on these royalties to incentivise domestic gas production.

CHAIR—Thank you very much. There has not been much talk about the expansion of the PRRT onshore; most of the public debate has focused on the minerals resource rent tax. People seem to think it already exists and works well offshore; that seems to be the theory. What is the problem with the PRRT onshore?

Mr Petersen—Our modelling has shown that most onshore exploration is a fairly expensive exercise. Onshore, the fields are smaller, requiring more wells. It is a much more expensive exercise. Our modelling, when we applied a 40 per cent PRRT, basically said that the 10-year NPV for an onshore type gas project would fall from $70 million into negative, so it would make the project uneconomic. For a near-shore DomGas project within state waters and not too deep, the profitability would drop from about $56 million over a 10-year period to negative $70 million.

CHAIR—If it is a tax on profits, presumably if you do not make a profit then you do not pay tax?

Mr Petersen—We were making the assumption that it would apply the same way as the current PRRT. The PRRT has exemptions for certain costs. Those are available mainly to large companies who can distribute those carried-forward losses to other companies, whereas the typical smaller onshore exploration company does not have a range of exploration activities going on; it is focused on one particular area, such as Latent or Buru, which are looking at one particular area. The assumptions in the paper were that those losses would have to be borne and could not be carried forward either in time or to other companies, when there are multiple investments.

Senator BACK—It would assist me and it would assist the committee if Mr Petersen could give us some indication of what the cost has been to the consumer of domestic gas in WA. Over the past 10 years, what has been the trend, and what is the pattern?

CHAIR—We will get to that in a moment. Perhaps I could just pursue my line of questioning. You talked about projects onshore. Essentially, fields are smaller, there are more wells and it is a more expensive exercise. Of course, there is also the issue of state royalties. Presumably those projects that are not subject to PRRT would have to continue to pay state royalties, and those that are subject to the PRRT would have to pay state royalties as they increase—if they increase. Is that right?

Mr Petersen—Yes, that is right.

CHAIR—Do you have any understanding as to how many onshore producers would ultimately be subject to the PRRT?

Mr Petersen—No, I do not. You would have to ask the Department of Mines and Petroleum. I do not have a view on how big that impact is.

CHAIR—I guess I am interested in seeing what sort of modelling you have done. You say it will impact on supply, and it will impact on prices if producers pass it through. What is your experience of passing costs through? Would you expect it to happen?

Mr Petersen—We can only go on the evidence we were given regarding the major gas producers when there was talk of relaxation of the excise for condensate, for example. There have been various incentives over time to get certain projects up. When it was mooted that the excise on condensate would be removed and that therefore producers would be paying that excise on the condensate, the response was: ‘We will pass that through to consumers.’ We would assume that there would be the same response from the producers to us users.

CHAIR—How large is the onshore gas production industry in Western Australia—onshore, that is?

Mr Petersen—Very small—minute currently, in fact—compared to the gas that is supplied into the domestic market from offshore. There is a lot of interest currently. In the US, for example, you have the shale gas currently supplying nearly 30 per cent of their domestic gas, and that has replaced a lot of imported LNG.

CHAIR—It is minute, presumably, because it is harder to attract investment.

Mr Petersen—It is harder.

CHAIR—So this tax would make it harder yet again.

Mr Petersen—Yes, that is absolutely right. Some of the options that we explore here are things like the flow-through share schemes that have been successful in Canada, in which exploration companies, particularly, can pass through their losses to shareholders and therefore attract that investment from shareholders. There are some other options. For several years there was what they called a frontier. Excuse me; I am not a tax expert, so I will refer to my report. I think it was about 175 per cent uplift for deepwater frontier exploration, and that promoted it. Those options could be available under the current arrangements for onshore exploration for domestic gas purposes.

CHAIR—Are you involved in the Policy Transition Group?

Mr Petersen—No, we are not.

CHAIR—You have not made a submission?

Mr Petersen—We have made a submission to the Policy Transition Group.

CHAIR—But you have not been invited to speak to them or—

Mr Petersen—We gave a short briefing a couple of weeks ago when they were here.

CHAIR—What sort of response were you getting?

Mr Petersen—We just put forward our case and they said they would get back to us from the information that we provided.

CHAIR—But you do not have an understanding as to whether this PRRT onshore would actually raise a lot of revenue?

Mr Petersen—What we have is some figures in our report showing the level of royalties overall and how it compares to state royalties. For the 2005-06 financial year, the Commonwealth government received from petroleum production onshore and offshore in Western Australia about $804 million in PRRT receipts.

CHAIR—But most of that would be offshore, wouldn’t it?

Mr Petersen—Yes, of course.

CHAIR—That is right, because onshore—

Mr Petersen—I do not have the break-up between offshore and onshore.

CHAIR—But there is no onshore PRRT.

Mr Petersen—No, that is right.

CHAIR—So none of it would be onshore; all of it would be offshore. What I am trying to get a sense of is—

Mr Petersen—How big that would be if it were applied to the onshore?

CHAIR—Yes, that is right.

Mr Petersen—It would be very small, as I said, because the amount from the onshore production currently is so small, but what we are trying to do is to encourage that. What we desperately need in Western Australia is more producers of domestic tax.

CHAIR—Let me explain what I am getting to. It is a very small amount of revenue that would come out of it, because it is a very small industry which struggles to get up as it is, yet there is going to be a huge additional compliance burden, administrative burden and so on. You really wonder why the government is bothering to impose this tax onshore if it is not going to raise much revenue yet is going to be a significant disincentive to further development in this industry. That is really where I am coming from.

Senator MARK BISHOP—Is there any onshore gas production?

Mr Petersen—Yes, there is. There are small amounts in the Perth Basin. The Parmelia Pipeline, for example, was basically built on some onshore gas fields up near Dongara, north of Perth. They are not very far; they are only about 300 kilometres north of Perth, so they are not in the North West Shelf.

Senator MARK BISHOP—But it is not the intent of the PRRT to apply to onshore gas production.

Mr Petersen—I believe it is.

CHAIR—Absolutely it is.

Mr Petersen—What we are arguing is—

CHAIR—It should not.

Mr Petersen—It should not. In fact, we would prefer it if that were extended to all domestic supply, because Western Australia has a really critical shortage of supply of domestic gas.

Senator MARK BISHOP—But supply and production are different things.

Mr Petersen—Yes.

Senator MARK BISHOP—A lot of supply, by choice, goes overseas because of price.

Mr Petersen—Yes, and we are trying to encourage it here for domestic purposes.

Senator MARK BISHOP—That is a different argument.

CHAIR—In terms of onshore production, it is very low. If you introduce a new tax, chances are it is not going to increase much. You are saying you already have gas supply pressures, and presumably those pressures will push up the price of energy further, won't they?

Mr Petersen—They could. Here in Western Australia we currently see gas prices asked of around $8, which is nearly two to three times what is being asked over east, because in the eastern states—

Senator MARK BISHOP—Yes, there are a range of unrelated issues. Domestic home gas prices are going up at a huge rate—we all know that; we get the bills every quarter.

CHAIR—But this could make it worse is what you are saying. If you put another 40 per cent tax on something—

Mr Petersen—Our modelling shows at least some profitability and then it goes into negative territory. That would be a very adverse reaction.

Senator MARK BISHOP—The proposal currently has a cut-in level of $50 million for taxation, so the application for you is going to be somewhere between zero and minimal. You have got extraordinarily small production, low prices and a whole range of state taxes that are putting up costs in this state. Even if the 40 per cent came through with the offsets it is going to have, as I say, there will be hardly any effect because of the cut-in factor in this state.

Mr Petersen—I will be very keen to make sure the committee gets the views of those exploration people—the Latents, the Burus and the Empire Oils—

Senator MARK BISHOP—I am just responding, bringing in other factors to the argument you are putting, that is all.

CHAIR—We are hearing from Buru Energy this afternoon, so we will explore that then. Do you have a view on the impact of the state royalty arrangements on exploration/production for domestic gas?

Mr Petersen—We have certainly seen the states drop their royalty rate for what they call tight gas, which is what most people are after in the Perth basin, as an incentive. That has been welcomed.

CHAIR—There is a countereffect: the states are dropping their royalties to provide an incentive but the federal government is wanting to put the tax up.

Mr Petersen—Indeed, so we would argue that the committee should keep in mind that it does not want to be counter to those exploration incentives because, as I said, we desperately need more supplies here in Western Australia.

CHAIR—Do you think people properly thought through the ramifications of this? It seemed like an easy, logical sort of thing—we have a PRRT offshore so let's just whack it on onshore.

Mr Petersen—I do not think they would have taken the Western Australian position into account, otherwise I do not think they would have moved to that.

CHAIR—Is the Western Australian position different from the position on the eastern seaboard?

Mr Petersen—We have fewer suppliers than the eastern seaboard. The eastern states have many more suppliers of domestic gas than we have here in Western Australia.

CHAIR—So the impact of the onshore expansion of the PRRT over east is going to be different from the impact in Western Australia?

Mr Petersen—I believe it would be.

Senator CAMERON—As I understand it, one of DomGas Alliance's main members is Fortescue Metals.

Mr Petersen—They are one of our members, yes.

Senator CAMERON—And you have Horizon Power, Verve Energy, Newmont Australia, Synergy—high powered corporate groups who, according to some witnesses this morning, are concerned that the government would impose any further tax on industry. Is that where you are coming from?

Mr Petersen—Here in Western Australia we would very much like to make sure that any tax arrangements do not provide a disincentive to supplying domestic gas. In fact, we would like to see the reverse.

Senator CAMERON—There are specific issues on gas in Western Australia. I remember the DomGas Alliance giving evidence to the inquiry on the Varanus Island explosion.

Mr Petersen—I do not think it was me.

Senator CAMERON—It was your organisation. They outlined all these specific and special reasons why gas supply was different in Western Australia than anywhere else. Is that correct?

Mr Petersen—We believe it is.

Senator CAMERON—You are limited in terms of the hub that can bring it in and the number of suppliers.

Mr Petersen—The number of producers.

Senator CAMERON—These are very profitable multinationals that supply the gas?

Mr Petersen—The suppliers are joint ventures between some very large organisations.

Senator CAMERON—You retail, do you?

Mr Petersen—We have retailers in our membership—for example, Horizon, Alinta and Synergy.

Senator CAMERON—How do you balance the suppliers' interests versus the retailers' interests in your organisation?

Mr Petersen—I think, like any organisation, we take their views into account and come up with the position that basically gets the message that it is all about domestic gas supply.

Senator MARK BISHOP—Then you have value adders as well?

Mr Petersen—Yes, we have.

Senator MARK BISHOP—Alcoa, Burrup Fertilisers.

Mr Petersen—Correct.

Senator MARK BISHOP—So you have got producers, suppliers and value adders who use gas to get—

Mr Petersen—Correct.

Senator BACK—And end users?

Mr Petersen—Major users, yes.

Senator CAMERON—So basically the corporate elite of Western Australia.

Mr Petersen—That is very flattering; thank you.

Senator MARK BISHOP—Most miners go offshore.

Senator HUTCHINS—Just on that, in response to a question from the chair about the Policy Transition Group you said you had met with them or you had—

Mr Petersen—Yes, about a couple of weeks ago.

Senator HUTCHINS—You met in your own right as DomGas, not part of—

Mr Petersen—We met as DomGas Alliance.

Senator HUTCHINS—What was the response you got from them? You indicated to the chair that you got the impression that they did not grasp how significant the gas was over here, as opposed to in the eastern states. Is that right?

Mr Petersen—I think they might have, but I do not think they were in a position to discuss our submission. My impression was that they were going to go away and read it once they understood where we were coming from. I guess a lot of their other discussions had taken priority.

Senator HUTCHINS—Did they give people any time by which they were going to respond?

Mr Petersen—No, they did not.

Senator CAMERON—Can I come back to this other issue. Who carried out the modelling for you?

Mr Petersen—PricewaterhouseCoopers.

Senator CAMERON—Did Fortescue help fund that?

Mr Petersen—No; it was the alliance.

Senator CAMERON—They would have been part of the funding, would they?

Mr Petersen—PricewaterhouseCoopers took the information and did the modelling for us, so it was not sent to anybody for veto rights, if that is what you think.

Senator CAMERON—Can you provide to this committee the assumptions in the modelling?

Mr Petersen—Do you have the report?

Senator CAMERON—Yes. There are assumptions that underpin the report. Are all of the assumptions included in what you have supplied?

CHAIR—You can take that on notice and then you can—

Senator CAMERON—No. He is answering—

CHAIR—The assumptions.

Mr Petersen—If there are some specific ones, maybe. Organisations like this often have a proprietary model that they will not give us.

Senator CAMERON—But models do not give assumptions. The model is the model; the assumptions are what feed into the model.

Mr Petersen—Sure.

Senator CAMERON—I am asking for all of the assumptions that fed into the model.

CHAIR—The sort of stuff which the federal government does not provide. It keeps secret. That is what Senator Cameron is after.

Senator CAMERON—You do not have to agree with him!

Mr Petersen—I will let you know. I would think so. I do not think it will be a problem.

Senator CAMERON—I am asking for you to supply those assumptions.

Mr Petersen—I will certainly do that.

Senator CAMERON—That is all from me.

Senator BACK—I do want to come back because of this tension between the opportunity of the multinationals to sell gas overseas at a better price versus supplying it into the domestic gas market. I am interested in knowing just what has been the trend in the cost to consumers, commercial as well as households, over the last decade and your predictions leading forward.

Mr Petersen—There were long-term arrangements entered into basically for the North West Shelf basically when it started and the take or pay arrangements and the prices were very good and very competitive and they were around the $2-$3 sort of range. Then those prices about five years ago started to undergo some negotiations and we have seen them now go from $2 to $8 basically. We still only have basically two supplier groups in the market in Western Australia so there is an awful lot of market power in the supply side. And it is not only price, we have seen shortening of terms. Five or six years ago you used to be able to get a 20-year contract; now you struggle to get a seven-year contract, making it very difficult to bank infrastructure projects.

Senator BACK—So your point would be that the incentives to supply the domestic market have got to remain at least as good as they are, if not improve, otherwise we will see concurrently an even greater increase in the domestic price because of the attractiveness of the opportunity to sell offshore.

Mr Petersen—For whatever reason that appears to be the case, but it is indeed the case that the market is struggling with high-priced gas and short terms, and we would argue that whatever incentives there can be to increase supply and the volume of supply are going to help the situation. We believe we are getting to the point here in Western Australia where industry is starting to become uneconomic compared to over east.

Senator BACK—Do we have fields offshore in the mid-west or even further south uneconomic for overseas processing but could be economic for getting into production for domestic use here in WA? Is that the case, or would we always be relying on supplies from further north?

Mr Petersen—There are a range of fields around Perth but there are also a range of smaller fields in what is called the Carnarvon Basin, which is up in the North West Shelf, smaller fields that are not suited to be LNG projects on their own, they are too small, unless you amalgamate them all together. We would argue that some of those fields are ideally suited to become available for the domestic market—

Senator BACK—By major players or by smaller ones?

Mr Petersen—It could be a range of mid-tier organisations. For example, one of our members, Murphy Oil, has been trying to get a domestic program up for several years unsuccessfully. They are having trouble getting supply, getting permits, getting access to the gas reserves. So we would argue that there are a range of incentives needed to make sure this domestic gas is available into the market to give us more diversity of supply. Whether that is smaller onshore fields that are attractive because they are close to Perth or whether they are fields and are not suitable for LNG but are available for access to the domestic gas from a range of needs, either on their own or maybe tolling through a plant or whatever.

CHAIR—If I summarise your evidence today, what you are saying is that Western Australia is exposed to a shortage of gas, the state government has taken action in terms of reducing royalties to provide incentives for additional exploration and production, and this tax which is proposed by the Commonwealth really goes in exactly the wrong direction for what we need in Western Australia, which is more incentive, not more disincentive. Is that a fair summary of what you are saying?

Mr Petersen—That is a fair summary of our point exactly, yes, that we need to be encouraging domestic supply so that we can get more producers and more suppliers into the market.

CHAIR—And that this discourages it.

Mr Petersen—This tax particularly from our modelling here certainly appears to have the potential to discourage it.

Senator CAMERON—Talk about leading the witness.

CHAIR—I was very keen to make sure that the witness was properly understood; that was very important! You can see that you must be providing very good evidence, Mr Petersen, because the Labor senators at the table have started to—

Senator CAMERON—No, it is not very good evidence; it is very bad questioning.

Mr Petersen—I am glad it was clear enough in the information that we provided. Really, there is a different situation here in Western Australia.

CHAIR—It is actually a very serious issue. I know that Senator Cameron, who comes from New South Wales, and Senator Hutchins, perhaps do not quite appreciate the seriousness of our supply issues here in Western Australia.

Senator CAMERON—No, we knew that. I raised it before you did.

Senator HUTCHINS—We do.

Mr Petersen—It is a serious issue and I am really glad that we have had the opportunity to appear before the committee.

CHAIR—So what do you think should happen with this tax, so far as gas is concerned?

Mr Petersen—As I said, we would like the domestic gas supply to be exempt, because that provides the incentive to supply domestic gas. Everybody seems to have this view that domestic gas will be a winner out of a carbon situation, by default. We cannot see that. All we see are increasing pressures on prices and these reduced terms that people are being offered. We are finding it harder and harder to get long-term domestic supply arrangements, whether we are competing with offshore supply or whatever the situation is. And yet people seem to have this view that domestic gas is going to be the winner, anyway. I just want to challenge that and say that I think you should not take it as read. It will only happen if people make sure it happens.

CHAIR—So who would end up still paying the PRRT onshore? Gas would be the biggest chunk out of that, wouldn't it?

Mr Petersen—Yes, although I guess some of the new projects in Western Australia that are being mooted are things like new iron ore mines. The magnetite miners are very energy hungry miners.

CHAIR—So do you suggest that supply to those companies should attract the PRRT?

Mr Petersen—No, what I am asking is: are they going to get a double hit? Are they going to get an MRRT and a PRRT component? If so, what is the result of that?

CHAIR—Triple taxation, because they also get the state royalties, of course, on both ends.

Mr Petersen—So, I just raise it with the committee that domestic gas is not going to be a winner out of any of this unless it is specifically designed to do so.

CHAIR—Let me ask you my final question, which Senator Cameron no doubt will think is a rhetorical question: the Henry tax review was supposed to deliver a simpler, fairer tax system. Do you think that this mining tax with the expanded PRRT, if implemented, would make our tax system simpler and fairer?

Mr Petersen—I am not a tax expert, but it does not appear to, to me.

CHAIR—You seem to be suggesting that it would make it more complex.

Mr Petersen—Yes; it would certainly make it more complex and more difficult, and our modelling shows it would certainly take some producers' projects from being economic to being uneconomic, under the current format.

CHAIR—So rather than sensible tax reform what we are really looking at is a tax grab. I am not asking you to answer that.

[11.19 am]

EDWARDS, Mr James Rhys, Executive Officer, Economics and Tax, Chamber of Minerals and Energy of Western Australia

NEWTON, Mr Robert Geoffrey, Executive Officer, Media and Public Affairs, Chamber of Minerals and Energy of Western Australia

CHAIR—Do you have an opening statement?

Mr Edwards—Yes.

CHAIR—Go ahead.

Mr Edwards—Firstly, the chamber would like to thank the Senate Select Committee on Scrutiny of New Taxes for being here today. I will give you a brief background of the chamber. We are the peak resources representative body in Western Australia. It is funded by its members who generate 90 per cent of all minerals and energy production in the state, and employ about 80 per cent of the resource sector workforce in the state. The Western Australian resources sector is diverse and complex, covering exploration, processing and downstream value-adding and refining over 40 different types of minerals and energy resources. The value of Western Australian minerals and oil and gas industries reached $70.9 billion in 2009-10 and royalty payments to the state alone totalled $2.8 billion, and that is expected to rise to almost $3.3 billion for this current financial year. The resources sector is also the largest employer in regional and remote Western Australian and the largest private sector employer of Indigenous Australians.

With regard to my opening statement, I would like to cover three main points: the chamber's position on resource rent tax reform, the advocacy work we have done to date with the federal government on these various reforms and our key concerns with respect to the minerals resource rent tax, the MRRT. Firstly, the CME welcomes the removal of the resource super profits tax—the RSPT—as originally announced on 2 May 2010, and recognises the progress made under the MRRT and expanded petroleum resource rent tax. However, the CME firmly believes that the implementation of these measures must not adversely affect the Australian minerals and energy sector's international competitiveness. Hence, the CME opposes the introduction of these new taxes until the full impact of the proposed changes are fully understood.

In relation to state royalties, the CME has always maintained a strong preference for the retention of the current state regime administered by the state and with revenues flowing to the state. The state has prime responsibility for the resource project approvals and the provision of non-privately owned infrastructure and, as such, it is imperative that the state government maintain or receive a dividend and Western Australia royalties. That said, the chamber has always been supportive of genuine tax reform of the Australian taxation system in order to provide for an efficient and effective tax regime. The CME has argued that a resource federal rent tax should be prospective, it should only apply to new investment, it should protect Australia's international competitiveness, it should be differentiated by resource commodities, it should be levied at the primary resource and it should be equitable and efficient—that is, competitively neutral. While the MRRT to some extent does address these aforementioned principles, the chamber still has serious concerns around a range of issues, not least of which that there is no streamlining of resource taxes; instead a new tax has been added.

With respect to the work the chamber has done to date with the federal government on this, when the first RSPT was announced we had serious concerns with its structure. The proposed tax did not meet any of the aforementioned key principles and thus did not represent meaningful tax reform. The chamber had serious concerns in the consultation process under the RSPT. There was no consultation prior to the announcement and the consultation that followed was not genuine and very limited in scope. Notwithstanding, the chamber did engage with the federal government where possible—meeting with the RSPT panel and panel secretariat where possible, meeting with state and federal members of parliament and lodging a submission and issues paper with the panel secretariat.

The chamber also co-sponsored a report by Dr Tom Neubig of Ernst & Young, a former director and chief economist of the US Treasury's Office of Tax Analysis, on the economic assumptions underlying the RSPT. That report found that those economic assumptions were seriously flawed. Following the announcement of the MRRT and the removal of the RSPT on 2 July, the chamber has also undertaken a meeting with the Policy Transition Group on 7 October. We have prepared and lodged a submission. We have also assisted in the preparation of two joint industry submissions, lodged via the Minerals Council of Australia. We are currently assisting in the preparation of a joint industry body submission on exploration incentives. While chamber members were involved in the initial MRRT heads of agreement, the chamber has concerns the wider resource community was not involved in those discussions. Further, the chamber has concerns on the very tight consultation frame and also the limited terms of reference under which the Policy Transition Group operates.

Finally, with respect to the minerals resource rent tax we have key concerns. Firstly is the lack of genuine tax reform. The MRRT does not constitute genuine root and branch tax reform, as was the intention of the Henry tax review. Rather, it adds another layer of complexity, an additional layer of administrative and compliance burden on Australia's resources industries, specifically coal and iron ore. We have concerns about the impact on international competitiveness. While the Australian resources industry has an important foothold on the global industry, it does not dominate any one market. Therefore it remains susceptible to changes in policy that alter its attractiveness against resource industries and other jurisdictions that compete for market share. In addition Australia is a high-risk, remote and infrastructure-challenged environment with a small population, which exacerbates skill shortages. Under the MRRT, iron ore and coal projects face a maximum effective tax rate of 45.75 per cent. This may alter investment decisions into Australia compared to other lower taxed jurisdictions. Ultimately, the additional impost of an MRRT will mean less revenue will be available to fund projects, repay debt and provide a return and refund to investors, and this may be a real point of difference between funding a project in Australia versus one outside Australia that is not subject to an MRRT equivalent.

With respect to sovereign risk, as Australia's sovereign risk increases due to the introduction of the MRRT, which could not have been foreseen, foreign companies are less likely to invest in Australia, especially those foreign companies that have made past investments. In the context of the original RSPT and now the MRRT, sovereign risk arises due to the application of the tax to existing projects and the magnitude of the reforms themselves. An example of the impact on proposed changes on Australia's sovereign risk profile and hence investment attractiveness was recently highlighted in the Canadian Fraser Institute's 2010 midyear report while the RSPT was still being proposed. The survey showed that exploration investment attractiveness declined rapidly due to the announcement of the RSPT.

A further concern with the MRRT is the application to low-value resources and also the application of a $50 million threshold. The chamber has significant concerns over the quantum of the threshold, how it was arrived at, whether $50 million is adequate and also how it is operating. We advocate it operates as a tax-free threshold. The chamber also has significant concerns with regard to low-value resources, which usually require significant processing to value add and whose operators will be required to undertake significant and costly compliance measures even though they will be paying minimal or no tax under the MRRT. These concerns also apply to junior developers trying to get their projects up and running.

Finally, the chamber advocates the crediting of all state and territory royalties under the MRRT, including any rises post 2 May 2010. This is critical to ensure that the impact on the Australian resource industry's international competitiveness is limited. The chamber advocates that the crediting of royalties does not occur as part of the MRRT design. The MRRT should not be implemented.

Hence, while the CME's preference is for the retention of the current state based royalty regime, it will support genuine tax reform. However, the proposed MRRT falls significantly short in delivering this reform and, given the critical importance of the recent proposed changes to the future of the Australian resources sector and broader economy, it is imperative that the federal government fully understands the core issues outlined prior to implementing any such reform.

CHAIR—Thank you, Mr Edwards. As an opening question, you say that we should not proceed any further with the MRRT until the impact on our international competitiveness is clearly understood, or words to that effect. What is required for us to properly understand that?

Mr Edwards—I certainly think it requires a longer consultation process and more thorough analysis—or any analysis. We have not yet seen anything come from the federal government on their modelling of what they see as the proposed impact.

CHAIR—They did not do any analysis. When we had a similar inquiry in July they actually made the point. There was some analysis of the impact on investment in jobs for the RSPT, which was done by KPMG and Econtech. Incidentally, the conclusion of that modelling was that investment would increase—you might remember that—and Ken Henry conceded that, given that all of those companies not subject to the MRRT will continue to pay royalties as well as face admin and compliance costs, the impact is going to be less favourable under the MRRT than under the RSPT. But they have not done any separate modelling.

You were very critical of the RSPT in your opening statement. Ken Henry says the impact on the mining industry is going to be less favourable under the MRRT. How can you ever get to a conclusion where international competitiveness is going to be such that you would be able to support it?

Mr Edwards—We need to understand what the baseline competitiveness of the Australian industry is at the moment. I do not think anyone understands that. To undertake genuine tax reform you need to understand what your baseline is. First of all that needs to be understood. Second it needs to be modelled. I think the PRRT process took two years under the Hawke government for consultation with industry to be able to fully understand what the impact was. Will there be an impact? Yes, there will, but we are not sure what that quantum is.

CHAIR—So what you are saying is that you have really got to better understand the positioning of the Australian mining industry across various resources.

Mr Edwards—Correct.

CHAIR—Compared to our competitors internationally.

Mr Edwards—That is exactly right.

CHAIR—Really until we know where we sit it is going to be hard to make an informed decision on where to pitch.

Mr Edwards—That is exactly right. Our concern is how they arrived at a 30 per cent headline tax rate. How did they arrive at a $50 million threshold? We are not sure whether that provides enough shelter to junior explorers or low value resources. Does the 30 per cent make us internationally competitive? Until we understand whether it does or does not, we oppose the introduction of a tax.

CHAIR—I know that as a professional industry organisation you would be constructively involved through the Policy Transition Group as you have been involved in all of these other predecessor processes. Are you confident that these sorts of questions can be adequately addressed through the Policy Transition Group process?

Mr Edwards—The broader issues of the headline tax rate and such do not lie within the remit of the Policy Transition Group, so we certainly have concerns that that is not being considered. The Policy Transition Group really is focusing on the implementation design of the tax—how the tax would function. We do believe that both the time frame and the remit, scope, that the Policy Transition Group is working under is too narrow.

CHAIR—The other thing you said—and I guess that is my second major question—is that if state royalties are not fully credited this MRRT should not be implemented. So what is your understanding as to where that is at at the moment because it seems to be very confusing as to whether or not state royalties will be fully credited including future increases. What is your understanding of where that is at?

Mr Edwards—If there is uncertainty of the crediting of state royalties or if state royalty rises are not credited what will happen is the maximum effective tax rate companies pay will increase. That will lead to uncertainty and they will face a double tax whammy. What we are looking for is certainty in that all royalties are credited so investors in the resources industry know the maximum effective tax rate that they will be paying. If you do not credit royalties, they will not know. It could go up and up and up.

CHAIR—The Commonwealth would say two things though. First, they would say, ‘We do not want to erode our own revenue by states increasing their royalties’. The second thing is that if the states were to increase their royalties now that would essentially be an unexpected increase in your tax burden as well. What is the difference?

Mr Edwards—We would ask for the same process that we are asking the federal government in that we would sit down with the state government and understand what the impact of those royalty increases is going to be. Until we fully understand that, do not increase the royalty rate.

CHAIR—Is that your experience of the way it happens at a state level in Western Australia?

Mr Edwards—I cannot comment on that in the past but I do believe that it does go through a consultation process and we have the opportunity to feed back. We have advocacy positions and modelling to put forward. I do believe that it is a genuine consultation process.

CHAIR—Given that you have got members who were on the inside of the negotiations and a whole heap of members that were on the outside of the negotiations you might not want to answer this, but do you think that as far as tax policy design and public policy development is concerned that it is appropriate for a government to negotiate the design of a tax with three taxpayers excluding everybody else? Is that a sufficiently transparent and open way to develop tax policy?

Mr Edwards—It is certainly not ideal, and we have concerns that that was the process undertaken. We have a broad church of members, and while I think there were genuine efforts to address some of the key principles about prospectivity, differentiation by commodity and taxing at the resource point, and some of those outcomes were reached, we believe that a wider consultation needs to occur prior to the introduction of the tax.

Mr Newton—Those concerns have been expressed to us by our smaller and emerging players, particularly in the magnetite sector.

CHAIR—In your analysis and your advocacy towards the government and otherwise, do you identify the features of the tax that discriminate against the smaller end of town and give an unfair competitive advantage to the more established players? Is that an area of concern?

Mr Edwards—It is. One of the key principles we would like the resource tax to have is competitive neutrality. Regardless of the type of commodity being mined, the finance structure and whether you are underground or open pit, the tax must not benefit one structure over another. It should be competitively neutral. Certainly small and low-value resource companies, who are perhaps expected not to pay much or any tax under the regime, will be facing quite a large administrative cost.

Senator MARK BISHOP—But a lot of your colleagues argue for different rates of taxation on different projects or different metal sources. How does that sit with your argument for competitive neutrality?

Mr Edwards—I cannot comment on what they have said.

Senator MARK BISHOP—Your members do not argue for competitive neutrality.

CHAIR—We are asking the chamber for their view.

Senator MARK BISHOP—They mentioned their members.

Mr Edwards—Competitive neutrality depends on the structure of a tax, and this is where you need to have that genuine tax reform. I am not sure how you arrive at the competitive neutrality; you have to go back to the drawing board to get that.

CHAIR—But suffice it to say that, when you introduce a new national tax, you should not be giving a significant competitive advantage to one section of the industry over another.

Mr Edwards—No, that should not occur.

CHAIR—That should not occur. I guess there is an argument that on this occasion it has occurred. Would you agree that we do not currently have a tax proposal on the table that would be competitively neutral?

Mr Edwards—In terms of the overall effect, I still do not think that we or the government understand what the effect is going to be—hence the uncertainty. However, I would say that—

CHAIR—But the government says it is going to raise $10½ billion, so it must have a degree of understanding. Presumably it knows roughly where it is going to come from.

Mr Edwards—Certainly. But I would say that our concerns certainly lie around the junior, emerging and low-value resource projects. If they are not expected to pay much if any tax, why should they have the administrative and compliance costs to keep up with this additional layer of tax?

CHAIR—Do you have any understanding of where the $10½ billion in revenue would be coming from in terms of the bigger and smaller ends of town?

Mr Edwards—No, we do not. Certainly the state government has made some releases saying that about 60 per cent of the MRRT revenue would come from Western Australia.

CHAIR—Sixty to 65 per cent, yes.

Mr Edwards—Correct. Certainly the more profitable companies will be paying more tax.

CHAIR—Have you done any analysis on a commodity-by-commodity basis? We have had evidence in the past in other committees that most of the revenue would come from iron ore related projects and that, because of the way the state royalty credits interact with the MRRT around coal, there would not be that much revenue coming from coal. Is that something that—

Mr Edwards—We have not modelled that. One thing on modelling is that there is not much information from the government to do good modelling.

CHAIR—Would you expect the government to be more open and transparent around some of that information?

Mr Edwards—Yes, we would. Absolutely.

Senator MARK BISHOP—Could you very briefly explain to me what you mean by ‘competitive neutrality’, Mr Edwards.

Mr Edwards—Competitive neutrality is that a tax should not disadvantage or advantage one commodity, structure or operation over another and should be neutral in terms of the incentivisation.

Senator MARK BISHOP—Later on this afternoon we are going to have magnetite people in here, and they are going to be arguing for a different taxation regime to be applied at different points of their project so that there is sufficient incentive to develop it.

Senator BACK—They are arguing for no tax.

Senator MARK BISHOP—There you go—because they have different costs at different times. In due course we are going to have gold, nickel, iron ore and coal producers. We had Mr Forrest this morning arguing for the application of the tax at a different point in the cycle—at the port as opposed to the gate. Each of those companies wants to have an incentive to produce their minerals and get the highest return, and they say the taxation regime should be different for each project, even within companies. How is that not consistent with your argument for competitive neutrality at the end?

Mr Edwards—As I have said before, the MRRT does go some way to providing competitive neutrality. Having the taxing point at the mine gate to some extent addresses that. Having a tax-free threshold goes some way to addressing that. Getting your full realisation of your downstream assets when valuing your resource goes to an extent to get competitive neutrality. However, our argument is: is the $50 million threshold adequate to provide that neutrality? We do not know; the government has not modelled it.

Senator MARK BISHOP—We are talking about the principle. You and I both know that financing costs and the taxation imposts are different between a gold mine, a coal operation and a high-quality iron ore proposition. None of those are competitively neutral. So how do you reconcile the two?

Mr Edwards—A higher valued resource will pay more tax. That is fine. But what I am saying is that the impact of the tax relative to each of the commodities must not adversely affect that. So one commodity—

Senator MARK BISHOP—What about positively?

Mr Edwards—Exactly—must not have a distinct advantage over another one. A magnetite producer per se must not have a distinct disadvantage under a tax regime compared with a hematite producer or vice versa.

Senator MARK BISHOP—I understand your argument that they do not want to have an adverse impact, but they take it the other way. They want to have a positive incentive to develop a particular project or a particular mine site at a particular time in the cycle. And they say that part of that incentive comes from a taxation regime. That is inconsistent with the proposition you are putting to us.

Mr Edwards—I cannot comment on that. I have not heard that before today.

Senator MARK BISHOP—Different taxation points for different projects and different minerals?

Mr Edwards—I have heard of different taxation points but certainly our membership is advocating for a taxation point at the mine gate and having a slight band within that for administrative simplicity.

Senator MARK BISHOP—Okay. Could I ask a second thing. This morning, the first group who came to see us, AMEC, and then I think Mr Fortescue's organisation, argued that a new business model had emerged in the low and medium-sized sectors of the exploitive industries. That basically had to do with whether they owned, hired, leased or had access to infrastructure.

CHAIR—Lower capital intensity and higher operating costs.

Senator MARK BISHOP—That is right. Excluding the three majors, can you give us any idea of the percentage of the industry where that new model exists?

Mr Edwards—No, I would not be able to give you that.

Senator MARK BISHOP—Is it dominant or just emerging?

CHAIR—This morning they told us that there were about 40 companies in that category.

Mr Edwards—A lot of the time we are not privy to how companies structure their projects. We do not comment on individual projects, so I cannot provide you that kind of detail.

Senator MARK BISHOP—So you do not have any idea of how significant that new business model, if it is a new business model, is in this state?

Mr Edwards—No, I do not.

Senator MARK BISHOP—Thank you.

CHAIR—Has anybody been able to explain to you where that $50 million threshold came from? Do you know whether it applies as a threshold? Once you hit the $50 million threshold, does the tax apply from anything above $50 million or from zero upwards?

Mr Edwards—Certainly, from reading the Policy Transition Group's issues paper, our understanding is that once the $50 million threshold is breached, it applies to both above and below—so the entire 51 per se. Whereas we are advocating for it to be a tax-free threshold, so once $50 million is reached—or whatever the figure might be—only that which is above the threshold is applied.

CHAIR—If it did not go the way you are suggesting, it would really provide some very perverse incentives for you. You could be in a position where it would be better for you to stop production in May. Is it your understanding that most of the smaller companies, surprisingly, are actually going to be hit by the Minerals Resource Rent Tax quite quickly?

Mr Edwards—We have not done modelling on that and we are not quite aware of that.

CHAIR—How quickly will companies meet the $50 million threshold on the current—

Mr Edwards—It depends on how the threshold is calculated—I do not quite know on this but I believe the calculation of the threshold, the PTG reference group we are talking about, not including carry forward losses to be interdeductible, is purely operational versus revenue. Costs under that scenario will reach the threshold much earlier than how we advocated that losses do get carried forward and are part of the MRRT threshold calculation.

CHAIR—The evidence we got this morning was that as soon as you produce more than $1.3 or $1.4 million tonnes of iron ore, inclusive of deducting costs you hit the $50 million threshold.

Senator CAMERON—Mr Edwards, you raised the Fraser Institute—can you just remind me of the context in which you raised it?

Mr Edwards—In terms of the attractiveness of exploration investment in Australia. They do an annual survey—or they did a midyear survey in this respect.

Senator CAMERON—Have you read that survey?

Mr Edwards—Yes, I have.

Senator CAMERON—Can you remind me who was surveyed?

Mr Edwards—I believe they sent it out to approximately 3,000 or 4,000 companies and they got a response from about 500—that is exploration managers and CEOs et cetera.

Senator MARK BISHOP—Did it not claim that South Australia was the most prospective mining province in the world?

Mr Edwards—I cannot remember.

Senator MARK BISHOP—It did.

Senator CAMERON—I have it in front of me at the moment. Are you saying the Fraser Institute are independent and we should place a lot of weight on this survey?

Mr Edwards—No. I am just saying that it is an indication. In terms of the impact on our international competitiveness, it is one example where we have got some feedback on that. Other examples are some of our member companies trying to raise—

Senator CAMERON—I am just on the Fraser Institute; just bear with me. The Fraser Institute say that they are about free markets and small governments. You are aware of that?

Mr Edwards—No. I have not read their mission statement.

Senator CAMERON—So you come here, you use the Fraser Institute as an argument in support of not increasing the tax and you do not know where they are coming from in terms of their philosophy?

Mr Edwards—I have read their survey and their survey questions. Again, we are just using this as an example, but it is not definitive. We do not rely on it as evidence but it is an indication of the feedback we have got from our members. It supports the feedback we have got from our members in terms of the impact they have felt under the RSPT in, say, raising capital overseas.

CHAIR—Senator Cameron would have preferred it if you had gone through a survey from the AMWU.

Senator CAMERON—It would probably be more helpful than this survey, to be honest. The survey also goes on to highlight some areas where taxes are increasing. Can you just outline those to us?

Mr Edwards—I do not have the survey in front of me.

Senator CAMERON—I thought you had read the survey.

Mr Edwards—I have read the survey, yes, but it was some time ago.

Senator CAMERON—So you are not interested in when taxes are going up; you are only interested in using it to try and stop taxes going up here. I must say: you are picking and choosing a bit here. You argue that investment will go to lower tax regimes and then sovereign risk is an issue. When did your organisation determine that sovereign risk was about increases in taxes, because I have never quite understood where this came from? When did you suddenly discover sovereign risk and equate it with governments' rights to increase tax?

Mr Edwards—Sovereign risk primarily extends to an unforeseen event where a person has invested in a particular sovereign jurisdiction and it affects their investment in that regime—such as the RSPT. Companies that had invested in Australia were unaware there would be such significant change, given their investments were made under a supposed standard set of investment parameters.

Senator CAMERON—This is a new definition.

Mr Edwards—No.

Senator CAMERON—It is. The definition of sovereign risk has been about investing in Africa, where a government might nationalise the resources. That was sovereign risk. Sovereign risk was about a country taking over the resources of a private company. Sovereign risk has never been defined, to my knowledge, as a government's legitimate right to put tax increases on companies carrying out business in that jurisdiction?

Mr Newton—What we are talking about here is—

Senator CAMERON—I thought Mr Edwards was going to answer. If he cannot answer it, you answer it.

Mr Newton—What we are talking about here is a quantum shift—the introduction of a federal resource rent tax. Many of these companies made investment decisions unaware of the impending implementation of this.

Senator CAMERON—How about GST? Was that a sovereign risk?

CHAIR—We went to an election where it was pursued—

Senator CAMERON—The 'never, ever tax'. Remember that one—the GST? Did I hear you complain about sovereign risk when the GST was introduced?

Mr Newton—The resource rent tax is specific to our industry. It is obvious that we will comment on the implication for sovereign risk.

Senator CAMERON—So if a government puts a tax on generally that you do not know about that is not sovereign risk. But if it is simply a tax that focuses on the high profitability of the mining industry that is sovereign risk. Is that correct?

Mr Newton—It is sovereign risk in the sense that this tax was announced with little consultation and companies have already made investment decisions.

Senator CAMERON—So the issue is the process, not the outcome. Is that what you are saying?

CHAIR—There is certainly a huge process.

Senator CAMERON—Chair, I did not interrupt you. You are supposed to be keeping this in good order. Do not contribute to bad order.

Mr Newton—Sorry, Senator. Could you repeat the question.

Senator CAMERON—In terms of sovereign risk, are you now saying that government cannot make a decision about tax for the mining industry without you saying it is a sovereign risk?

Mr Newton—No, we are not saying that.

Senator CAMERON—What are you saying?

Mr Newton—We are saying that sovereign risk applies when there is a quantum shift in the taxation regime—that is, the introduction of a completely new federal regime having an impact on companies that have already made investment decisions in Australia on the basis of an existing taxation regime, such as a state royalty regime.

Senator CAMERON—Are you saying state royalties should stay in place even though everyone has said—even the Minerals Council—that they are inefficient?

Mr Newton—Even since the announcement of the Henry tax review's terms of reference the Chamber of Minerals and Energy have held a strong position that we support the state based royalty regime.

Senator CAMERON—That is fine. Is that because it is highly inefficient and it does not provide a decent return to the community for the exploitation of their resources? Is that why you support it?

Mr Newton—No. We support it because the state government has an active involvement in the administration and the approval system for our industry here in Western Australia. We also know that the money that is collected by the state government will be spent in Western Australia.

Senator CAMERON—Are you saying that every dollar that is raised from taxes on the mining industry in Western Australia should be expended solely in Western Australia?

Mr Newton—No, Senator, I am not saying that. But if the GST is any experience, once the money heads over the Nullarbor—

Senator CAMERON—I am not asking about the GST.

Mr Newton—I am answering the question. Once the money heads across the Nullarbor, there are no guarantees it will return.

Senator CAMERON—How do you deal with the two-speed economy? The mining industry is helping to drive up the dollar, creating problems in the rest of the Australian economy in terms of competitiveness. Do Western Australian mining companies have no responsibility for that? Do they just go on and do what they want to do, regardless of the implications for the rest of the economy? Is that what you are telling me?

Mr Edwards—Certainly the chamber and the mining industry would work with the WA government and the federal government on any issues that may arise out of a booming resources sector.

CHAIR—The mining industry does pay company tax, doesn't it?

Mr Edwards—It certainly does. In terms of resource shortages, we have strong advocacy programs and strong training programs to try to address those skill shortages. So the industry certainly takes a very proactive stance on addressing any issues that may arise out of a resources boom.

Senator CAMERON—What discussions have you had in relation to the high dollar and the implications that has in other states in terms of employment, in terms of profitability and in terms of the position of the Australian economy? What discussions have you had in the past two months on that?

Mr Edwards—On the high dollar, we have not had any discussions with the others.

Senator CAMERON—It seems that you have this myopic view that it is all about Western Australia—all the profits should come back into Western Australia; we should not act as a nation. Is that what you are saying—that we should not act as a nation?

Mr Edwards—No.

Senator CAMERON—How, then, if all the profits come back to Western Australia, do you act as a nation to deal with some of the issues I have raised?

Mr Edwards—I will just reiterate that the WA resources industry pays significant taxes, both federal and state, which contribute to the overall Australian resource economy. We are a big contributor to GDP and we are a big contributor to employment—and that is across the nation, not just in WA.

Senator CAMERON—But, in terms of profitability versus royalties, the profitability is massively outstripping the royalties by factors of—I do not know—10? Twenty? It is just not working, is it? The royalties are just not working in terms of getting a fair share. Whether they come back to Western Australia as a state alone or are part of the national benefit, royalties are not providing the proper returns, are they?

Mr Edwards—We believe strongly that the resources industry does provide its proper return, and that is through royalties, through income tax—which does rise with profit—through the social infrastructure we provide, through resource infrastructure, through employment and through payroll tax. I think it is fair to say that—

CHAIR—On this point, do you have an understanding of your average tax rate, moving forward, if you pay both state royalties and MRRT as well as company tax?

Mr Edwards—The maximum effective tax rate we have modelled at a higher level. It is near on 46 per cent.

CHAIR—How does that compare internationally?

Senator CAMERON—I have a point of order. I understand that you are not giving us a fair go in length of time—

CHAIR—You are having a fair go.

Senator CAMERON—I understand that you want to come in whenever there is a sticky question, but you are the chair. You have to provide some fairness and equity. To come in in my line of questioning like this is not proper. You should not do it. I do not disrupt you when you are asking your questions. So I just ask for a fair go.

CHAIR—You have had a very fair go in terms of your time for questions and given the representation of Labor senators on this committee. It is absolutely appropriate for questions to be asked. On that point of order, there is absolutely no problem with asking questions that pursue the same line of questioning on this particular point.

Senator CAMERON—I made a serious point that needs to be determined, and you have come in to try to take them off on another track. I would appreciate being allowed to take my questioning to the witnesses.

CHAIR—Please conclude your questions as soon as you can.

Senator CAMERON—Okay. I want to come back to this issue of whether the benefits of the mining industry should stay solely in Western Australia or whether there is a need to have a national view on the benefits and the negatives that mining brings in terms of some other industries in this country. Can you remind me again: are you saying that all of the profits of the mining industry should come to Western Australia?

Mr Edwards—We are not saying that. We are saying that, as the situation is now, mining companies pay income tax, which is a federal tax. They pay payroll tax, they pay royalties and they employ personnel in all states of the country. We are certainly not saying that all profits should be solely attributed to WA.

Senator CAMERON—Fortescue Metals have a specific model. That model is based on extremely high leveraging. It seems to me that there is an analysis going around that that is one of the reasons they do not want to move to a profit based tax—because they need every cent of profit to actually deal with the leveraging they have in terms of debt. Have you done an analysis of that?

Mr Edwards—No, we have not. We do not comment on individual companies' positions.

Senator CAMERON—Even if that individual company is out publicly running a very strong argument against the tax, you do not look at how they operate. Is that the same for BHP and Rio Tinto?

Mr Edwards—We would say that the tax needs to be competitively neutral, so companies can either fund projects off their balance sheet or they might have to go out to the debt markets, depending on how they are structured. So depending on how they are structured, they should not be more or less adversely impacted by the tax. We need to try to aim for something that is competitively neutral.

Senator CAMERON—But if that structure means that there is not a fair return to the Australian public, shouldn't the government look at that structure?

Mr Edwards—I cannot comment on FMG's—

Senator CAMERON—You can comment. There is nothing to stop you commenting on the structure of a company who argues that there should not be an increase in tax. I am saying that they are arguing that because of the specific structure—that Fortescue's structure is one that does not allow that they pay extra tax because they want to keep the shares in-house and they are very highly leveraged. Is that in the national interest? That is what I am asking.

Mr Edwards—I cannot comment.

CHAIR—Senator Cameron, I think the witness has said they do not have a comment on this, so I do not think—

Senator CAMERON—Can I ask you to take that on notice and see whether you can get some permission to make a comment on those structures? If you want to enter the debate I think it is fair and reasonable that you enter the debate the whole way and that you actually deal with some of the hard issues that are out there.

Mr Newton—Happy to take that on notice, Senator?

Senator BACK—Following Senator Cameron's questions, do you understand what role the Commonwealth Grants Commission plays?

Mr Edwards—To an extent, yes.

Senator BACK—Could you explain it in your terms?

Mr Edwards—It certainly looks at the revenue raised in the various states and the revenue flowing back to the federal government and the reallocation of that revenue to states perhaps who need it more or—

Senator BACK—That is broadly also what I understand it to be. Senator Cameron was asking you whether it was fair that Western Australia seemed to keep everything that it generated. Are you aware of what the current level of return to the state of Western Australia is in terms of GST percentages?

Mr Edwards—I believe it is 68c in the dollar.

Senator BACK—And do you know what the indicated trend is for that figure? Is it going up, going down?

Mr Edwards—It is heading downwards.

Senator BACK—To what?

Mr Edwards—I am not aware of their lowest figure.

Senator BACK—I have heard the figure 54c in the dollar.

Senator HUTCHINS—Secede!

CHAIR—Our eastern state colleagues do not take these things very seriously, Senator Back. Just keep asking questions.

Senator BACK—I do, simply because—

Senator CAMERON—It is a Howard government initiative.

Senator BACK—Chair, I do not remember interrupting Senator Cameron. I understand the figure for New South Wales, Queensland and Victoria to be slightly over 90c in the dollar. Do you understand that?

Mr Edwards—Correct.

Senator BACK—South Australia is about $3.61, Tasmania, $4-odd and Northern Territory about $6 returned. Those are what I understand to be the figures. Are they consistent with your understanding? Would it be a reasonable assumption that there is equalisation that occurs between the states?

Mr Edwards—Yes.

Senator BACK—Are you aware of any intended change to the Constitution whereby royalties are going to cease to be the assets of the people of a state or territory?

CHAIR—Senator Back raises constitutional issues. Have you got any views on the constitutional issues that arise from the proposed mining tax?

Mr Newton—Only what we have heard publicly about the recent release of FOI documents which are published in the *West Australian*. I think Shane Wright was the journalist. Certainly in Western Australia there is no constitutional question about the states right to raise a royalty. For now, our focus is on working with the Policy Transition Group in trying to minimise the impact on our sector’s international competitiveness.

CHAIR—You raised earlier the absolute need for all state royalties to be credited under this arrangement. Of course, if there are different rates of royalties in different states then it does raise a question as to whether reimbursement or crediting of state royalties in the context of a national tax does discriminate between states, and of course moving forward. You have not assessed that as an issue any further than just reading it in newspapers?

Mr Newton—No, we have not.

CHAIR—It is something you might want to have a look at. We were interrupted before, but in terms of international competitiveness you mentioned a rate of 46 per cent if the MRRT comes into place—royalties, company tax.

Mr Edwards—That is correct; yes.

CHAIR—How does that compare with our competitors overseas?

Mr Edwards—It is at the high end of the taxation rates—certainly for iron ore. Compared with Quebec, Brazil or China it would be higher. For coal, I think India and one other jurisdiction might be slightly higher, but we would still be higher than most other jurisdictions.

CHAIR—When you went into the Henry tax review process in good faith and made submissions and everything else, did you expect the final result to be a tax increase or did you expect the final result to be a simpler, fairer tax system?

Mr Edwards—We certainly expected a simpler, fairer tax system.

CHAIR—Is that what you got?

Mr Edwards—Definitely not.

Senator HUTCHINS—Is Fortescue a member of the chamber?

Mr Edwards—Yes, it is.

Senator HUTCHINS—Have you two been personally involved in discussions with the Policy Transition Group?

Mr Edwards—Certainly the chamber has had a meeting with the Policy Transition Group on 7 October. However, I was not present and I believe Mr Newton was not—

Mr Newton—Not as an active participant.

Mr Edwards—present at that meeting.

Senator HUTCHINS—No doubt you put your position, or the chamber did?

Mr Edwards—Correct.

Senator HUTCHINS—Do you know the times when they were going to come back to you with responses to what you put to them?

Mr Edwards—No, I believe we just have what they had published in terms of their time frames.

Senator HUTCHINS—We had Fortescue here this morning and one of their officers was quite adamant that this tax—you have just hinted at it—may be unconstitutional.

CHAIR—Mr Forrest himself.

Senator HUTCHINS—I thought it was also the Pommy bloke, whatever his name was. Has the chamber sought legal advice on the constitutionality of the tax?

Mr Edwards—No, we have not.

Senator HUTCHINS—You are more interested in trying to work through this by consultation and discussion.

Mr Edwards—Correct.

CHAIR—In one sentence what would be your preferred outcome of this whole debate on the mining tax?

Mr Edwards—We would certainly like to see the implementation of the MRRT stopped until it is fully understood what the international implications are for the Australian resources industry, and genuine long-term consultation take place with the resources industry.

CHAIR—Thank you very much Mr Edwards and Mr Newton. Thank you very much to the chamber for your contribution to the committee.

[12.08 pm]

MARNEY, Mr Timothy, Under Treasurer, Department of Treasury and Finance

COURT, Mr Michael John Reginald, Executive Director Economic, Department of Treasury and Finance

CHAIR—I invite you to make an opening statement and then the committee will ask you some questions.

Mr Marney—I believe, in one form or another, we have provided statements and submissions to you. I think that was in the form of this committee.

CHAIR—No, it was actually to a previous committee. The WA Treasury appeared on 13 July before the fuel and energy committee. This is now the Select Committee on the Scrutiny of New Taxes. It is a different committee, but similar people are involved.

Senator CAMERON—It is doing the same thing.

CHAIR—We are following on with the all unanswered questions that emerged when you last appeared.

Mr Marney—We have concerns around the MRRT in relation to three elements. The first relates to the impact on the Western Australian resources sector and, in turn, given its importance nationally, the impact upon the national economy. Our second area of concern relates to the sovereignty of state governments and their fiscal management, and our third area of concern relates to the need to clarify a number of arrangements which may or may not be key issues in the implementation of the MRRT. To date these issues are yet to be addressed by the Policy Transition Group issues paper. In some respects some of the issues we are concerned about fall outside the scope of that Policy Transition Group.

To put this into perspective, and you may already have heard some of this information relayed to you today, but almost half of the nation's mining industry is accounted for by Western Australia's resource sector and Western Australia accounts for well over 40 per cent of the nation's total merchandise trade exports. The national significance of the resources sector should not be underestimated, and indeed in the last five years I think what we have seen is a significant structural shift in the national economy towards the most productive areas of industry which have emerged as the resources sector. So workforce and capital have flowed over the past five years in vast quantities towards its most productive use, which is in the resource sector. That is inextricably linked to developments in the world economy and developments in Asia, China and India in particular.

From a broad economic policy perspective, our concern is that the impact of this proposal in terms of economic consequences is not known. From what we can gather or evidence that has been provided to us, it has not been comprehensively modelled so we actually understand the implications of this policy change for the nation and for the state of Western Australia in particular.

Further, almost 20 per cent of state government revenue is from resource royalties. To put it in perspective, it is almost the same amount in dollar terms as it costs to run our entire health system for 12 months. This is a very significant revenue source for the state and any intrusion into that resource base that is not on clear and defined terms is of extreme concern from a fiscal management perspective.

Senator MARK BISHOP—Did you say 20 per cent of all state revenue comes from the resources sector on an annual basis?

Mr Marney—Almost 20 per cent. I think the precise figure is around 18 per cent.

CHAIR—That includes the Commonwealth grants and everything else. Own source revenue, it is a larger proportion.

Mr Marney—A much higher proportion of own source revenue. The state's dependence on royalties is quite significant.

There has been some argument that this policy initiative flows from a desire or an expression on the east coast that the resource sector needs to pay its fair share. I would point out to the committee that the resource sector pays company profits like the rest of the economy and I suspect the federal coffers have done very well in the last five years out of the profit performance of the resource sector in this state. On that basis that is how companies pay their fair share. Royalties are paid to the state in recognition of the state's resource, being the commodity in the ground, that the state is giving away to the resource company. The royalty is a payment for that community asset. It is not a return to the broader nation in the form of paying a fair share. That is what the company profits tax system is all about.

There are a number of elements of this proposal that remain unclear. That causes us some concern. Those issues relate to, in particular, how the new proposal will interact with existing royalty regimes, including those applying to the North West Shelf project, where there is a royalty sharing arrangement in place, which, again, is of significant benefit to the state. How the MRRT interacts with the existing royalty regime at a state level is still a matter on some confusion. There has been the suggestion recently that the extent of the refund or rebate provided to resource companies in lieu of the state royalties paid would be capped. That was an area of particular concern because that essentially cuts the state out on any further access to the royalty revenue base. As I said, that is an issue that needs to be clarified. There is considerable uncertainty from both our perspective and, I believe, the resource sector itself. Why are we concerned? The last time we shared a tax base with the Commonwealth was in, I think, 1942, and that was the income tax base, where we gave the Commonwealth access to the income tax base for a finite period. Obviously some finite periods are much longer than others.

Senator MARK BISHOP—By agreement.

Mr Marney—By agreement. It was for a finite period.

Senator MARK BISHOP—And extended by agreement. Be truthful here.

Mr Marney—Indeed.

Senator MARK BISHOP—There was no attempt by the state of Western Australia or other states to take it back.

CHAIR—You can ask questions. Let the Under Treasurer finish his opening statement.

Mr Marney—I think discussions have been held on numerous occasions—

Senator MARK BISHOP—[inaudible] states to take back taxation. You know that and I know that.

CHAIR—Let's treat the Under Treasurer with some respect and let him finish his opening statement.

Mr Marney—There are a number of other areas of uncertainty around how this resource rent tax will operate. The taxing point is a particular issue of concern that I think brings considerable uncertainty in terms of interaction with our existing royalty regime and it brings concern from industry in terms of uncertainty as to the incidence of taxation and where it will fall. There is also administrative uncertainty in terms of it existing within two different regimes of royalty payment: one Commonwealth based and one state based. Those issues are fairly significant in consideration of whether or not this policy is of net economic benefit to the nation.

Further to that, there are elements relating to the Regional Infrastructure Fund, which was proposed as an investment by the Commonwealth that would flow from revenues raised by the resource rent tax. There is uncertainty as to the extent and governance of the Regional Infrastructure Fund. Of concern to us would be statements by the Commonwealth, including by the Prime Minister during her visit to Perth on 9 July this year, where it was indicated that Western Australia would be allocated $2 billion from the proposed $6 billion, or thereabouts, Regional Infrastructure Fund. Our estimates suggest that Western Australia's contribution to the MRRT revenues would be in the order of 60 to 65 per cent of that revenue pool, so it would stand to reason that around that proportion should come back in terms of infrastructure, yet that does not appear to be the intention of the Commonwealth. That also requires clarification.

Those are probably the key issues weighing upon us in our analysis and evaluation of the proposal. Indeed, that is summarised in various elements of correspondence to the Commonwealth seeking clarification.

CHAIR—Thank you. When WA Treasury appeared before a previous committee of the Senate, you stated that it was extremely unlikely that this WA government or any future WA government would give up imposing royalties on the extraction of its resources. Given some of the debate about state royalty refunds and credits I have to ask you the question: is there any prospect that Western Australia would agree to freeze state royalties at their current levels moving forward—that is, is there any prospect that state governments in Western Australia would agree to lock in no increases in royalties into the future?

Mr Marney—It is quite unusual for state governments of any persuasion to sacrifice flexibility on their revenue base. Given that much of their revenue is controlled by the Commonwealth already, the autonomy over existing revenue bases at a state level is extremely important in terms of financial management for states and the ability to respond to service delivery needs of the community. On those grounds it is only my speculation but I think it would be highly unlikely that a state government in Western Australia of any persuasion would agree to stepping out of, effectively, the royalties base. I think that would be something driven largely by community sentiment as well.

CHAIR—Would the federal government be able to enforce such a proposition—that is, to lock in no increases, a freeze, in state royalties moving forward—against the will of the WA state government?

Mr Marney—I am not sure that they would be able to do that directly. However, they have many tools in their toolkit to compel states to behave in a certain way when it comes to financial matters.

CHAIR—They would have to, what, threatened with fiscal consequences elsewhere?

Senator CAMERON—John Howard wrote the book on that!

Mr Marney—That would be one option, that there would be penalties elsewhere financially for not acting in a certain way in a policy space.

CHAIR—What is the status—

Senator CAMERON—Just on this point, did the Howard government ever use that type of approach that you have just described?

Mr Marney—I would not describe that approach as being peculiar to any persuasion of government.

Senator CAMERON—I am asking you: did the Howard government use this approach that you are complaining about?

Mr Marney—I do not think I was complaining; I was offering an opinion on the basis of a question from the senator.

Senator CAMERON—Okay. Now, did the Howard government use that against the Western Australian government?

Mr Marney—I would say that it has been a longstanding Canberra practice.

Senator CAMERON—And did the Howard government do it?

Mr Marney—I would say it has been a longstanding Canberra practice.

Senator CAMERON—I asked you: did the Howard government—

CHAIR—Senator Cameron, I think the witness has answered.

Senator CAMERON—He is being evasive. Treasury is the same here as it is elsewhere!

CHAIR—Senator, we do not have much time. What is the status of the reduced discount to the royalties paid by BHP and Rio as far as the crediting of state royalties is concerned? Is that captured?

Mr Marney—The concessions?

CHAIR—Yes. You removed the concession, which is an effective increase in royalties paid by BHP and Rio. Is that captured by the crediting of state royalties or is that outside of it?

Mr Marney—We have no confirmation that it is captured or that it is not captured. We do not know.

CHAIR—In terms of any future increases which have already been flagged, I think there has been discussion about the state government moving to increase royalties on iron ore to 7½ per cent. You would not know whether that would be captured or not captured?

Mr Marney—We have sought clarification as to how future increases of that nature would be treated. We are yet to receive clarification.

CHAIR—Since you appeared before the previous Senate committee on 13 July, have you had any in-depth discussion with federal Treasury on how the mining tax and interaction with state royalties is to operate?

Mr Marney—No, we have not. We have a number of pieces of correspondence in to them and we are awaiting a response.

CHAIR—Is that unusual? When WA Treasury appeared last time your representatives were seeking to be quite generous and said, 'Well, they've been a tad busy,' and there had been all these negotiations around this tax. There have been another two or three months since then. WA obviously is in the frame more than any other state, perhaps other than Queensland. Would you have expected that there would have been some more interaction?

Mr Marney—While at the point in July it was clear that they had been busy on many things in Canberra, I think nothing has changed. Obviously there has been an election, and that creates a whole body of work for the likes of Treasury—

CHAIR—But the Policy Transition Group has been to Perth. Have you been invited to appear before the Policy Transition Group?

Mr Marney—We have had one meeting with the Policy Transition Group. Many of the issues we have sought clarification on fall outside the terms of reference of that group.

CHAIR—That does not help then. When you appeared before the previous committee—and you have said it again today—you said that between 60 and 65 per cent of the mining tax, or the

MRRT, would come from WA. You even released the methodology on how you derived that estimate. Has the Commonwealth talked to you about your assessment that up to 65 per cent of the MRRT would come from WA?

Mr Marney—Not to my knowledge. They have not spoken to me directly and, to my knowledge, they have not spoken to my officers.

CHAIR—So nobody has said to you that you are wrong?

Mr Marney—Correct.

CHAIR—At the time, you said that it was preliminary analysis and that it was on the conservative side. Have you done further analysis since then?

Mr Marney—Not a great deal. We would require further information and modelling at the Commonwealth level to be able to go any further into the analysis, which is one of the things our submission to the previous committee was calling for—detailed modelling and evaluation so we could examine some of these issues.

CHAIR—So you stand by your estimate that up to 65 per cent of the mining tax revenue would actually be sourced in Western Australia?

Mr Marney—It is our best guess at this point in time on the basis of information we have.

CHAIR—I guess it would be open to the Commonwealth to correct you if you had made mistakes in your methodology or if they wanted to share higher quality information with you. You would be open to reassessing to come up with a more accurate estimate but so far they have not done it?

Mr Marney—We would be welcoming not only of detailed modelling work to get an assessment from the Western Australian perspective but also of detailed modelling and evaluation to ensure the costs and benefits of this proposal are fully understood before it is implemented.

CHAIR—You mentioned the Regional Infrastructure Fund. There is $6 billion of it and $2 billion goes to Western Australia, but that of course is over a 10-year period, isn't it? So really on an annual basis it would be $200 million into Western Australia, whereas Western Australia would be paying between $3 billion and $4 billion from the tax on an annual basis. Is that right, roughly?

Mr Marney—Coming at the same issue from a different angle, I think our current net fiscal subsidy to the rest of the nation is around $11 billion per annum. By 2012-13 or thereabouts we estimate that that subsidy will increase by around $3 billion to around $14 billion per annum. So that is what flows out of the state to the rest of the country versus what gets spent in WA in terms of Commonwealth services, welfare payments and the like.

CHAIR—Sure. In the first year of operation it cranks up. The revenue estimate from the Commonwealth is $4 billion. In the second year it is $6½ billion and it is $10½ billion over the forward estimates. If you say up to 65 per cent, that is about $6.8 billion out of Western Australia. In a full year of operation, it is around about $4 billion. It is proposed under the Regional Infrastructure Fund that about $200 million comes back. That is very bad deal, isn't it?

Mr Marney—I am not sure that there is a deal here at all.

CHAIR—Sorry, I mean that in a colloquial sense. It is not a very fair share going back to the great state of Western Australia, is it?

Mr Marney—It would not be difficult to—

Senator CAMERON—Point of order: I am not sure that it is fair to be asking an officer for a political view on the fiscal equalisation between the federal government and the state government. It is not normal to do that. I know we are in Western Australia, I know you are a Western Australian senator and I know you are trying to get the best out of this that you possibly can, but you should be fair and reasonable with the officers that are appearing here. They should not be asked for these political views. They should be asked questions in their area of expertise.

CHAIR—Senator Cameron, I note your point of order. There is of course evidence from WA Treasury that up to 65 per cent of the proposed national mining tax would come from WA. There is evidence from WA Treasury about the Regional Infrastructure Fund and I think it is quite proper for the committee to explore the correlation between how much is proposed to go to Canberra through the national mining tax and how much would come back.

Senator CAMERON—Then you should have had the Treasurer here, not the officers.

CHAIR—Are you aware whether the proposed arrangements for the Regional Infrastructure Fund changed between the RSPT and the MRRT?

Mr Marney—I am not aware of any changes in the infrastructure fund. The details both then and now remain somewhat unclear.

CHAIR—But the proportion of the revenue to come from WA under the MRRT is higher than the proportion that would have come out of WA under the RSPT, isn't it?

Mr Court—The RSPT applied to a broader range of minerals, with the Minerals Resource Rent Tax applying to iron ore, coal—Western Australia is by far the largest iron ore producer.

CHAIR—To the tune of 96 or 98 per cent. Do you think the Commonwealth would be able to provide a state-by-state breakdown on where the mining tax revenue would be expected to come from? Would they be able to assess where the revenue would be expected to come from?

Mr Marney—Again that is the sort of detailed modelling work that we would like to see undertaken prior to implementation of the proposal. We would be happy to work with them cooperatively on that task.

CHAIR—The federal government have not shared with you the underlying assumptions driving their mining tax revenue estimates, have they?

Mr Marney—No, the basis of the revenue estimates is not something that we are privy to.

CHAIR—But you publish those underlying assumptions that drive your royalty revenue in your budget papers, don’t you?

Mr Marney—That is correct. We publish the assumptions around price, around volumes in aggregate and also around exchange rate, and we also provide sensitivity analysis around those as well.

CHAIR—A final question from me before I hand over to some of my colleagues: there has been a suggestion, which has been confirmed by Dr Henry, that because of the way the MRRT and the state royalty credits interact in relation to coal, there would only be a very small proportion of the MRRT revenue coming from coal and that most of the MRRT revenue will actually come from iron ore related projects. Is that something that you have assessed as you reviewed the impact of the MRRT? If you have, can you explain to us how that happens?

Mr Marney—It is something we have not yet been able to assess in detail, because of the lack of information and clarity around the way in which the resource rent tax will operate in conjunction with our existing royalty regime.

CHAIR—It is more than four months now since the national mining tax was proposed. The state government in Western Australia has made an assertion that up to 65 per cent of it will come from WA, yet federal Treasury or the federal government still have not spoken to you about much of the detail. I have got to say that I am extremely concerned about this.

Senator CAMERON—Point of order: this inquiry is not inquiring into whether you are concerned about something. It is here to ask questions of Treasury. We do not need monologues from you—with greatest respect, Chair—on these issues. I would like to hear what the Treasury thinks about the issues. You have had a real good go, mate. Give us a go.

CHAIR—Thank you very much for your further observation, Senator Cameron. Senator Hutchins.

Senator HUTCHINS—Thank you, Mr Chair. Mr Marney, you expressed some concern in relation to the taxing point. Will the Treasury have separate discussions with the Commonwealth Treasury on the implementation of these taxes? You may be aware ,or you may not be, that the Policy Transition Group was here. Would you have met with the Policy Transition Group, or would that have been more for the miners, et cetera?

Mr Marney—No, the Policy Transition Group invited us to meet with them, and two of my officers did meet with them and were able in a brief meeting to communicate the key areas of concern that we have. Most of those areas of concern, as I said previously, are outside the scope of work for the Policy Transition Group, but that taxing point issue would be one of the key issues that we would expect to work with them cooperatively to resolve in the event that the proposal goes ahead.

Senator HUTCHINS—You mentioned administrative uncertainty. Is that tied in with the taxing point? Do you see that as a huge hurdle to overcome?

Mr Marney—The taxing point issue is probably the most complex element of implementation.

Senator HUTCHINS—So it would not have been reasonable to get an answer that day, because—

Mr Marney—No, there is a fair bit of work to do on it. Hopefully, that is where the Policy Transition Group will focus.

Senator HUTCHINS—Representatives of Fortescue Metals appeared this morning and were quite adamant that they did not believe the tax was constitutional. To your knowledge, has the Western Australian government sought advice on whether or not the tax is constitutional? If it has, is it considering challenging it in the High Court?

Mr Marney—That is a matter for the government itself, but I can confirm that, as Under Treasurer, I have not sought legal advice at this point.

Senator HUTCHINS—So, as with have other people who have appeared before us, you wish to conciliate and get an outcome? Whether or not you like the outcome is a very different thing.

Mr Marney—I think the freedom of information documents that were released recently raised the question of whether there is a legal constitutional issue. At some point that issue will need to be resolved.

Senator HUTCHINS—Thank you.

Senator MARK BISHOP—Mr Marney, you can assure us that the state government of Western Australia is not giving any consideration to the re-imposition of a tax that it freely gave up in 1942 or thereabouts, can’t you?

Mr Marney—At this point, I think the only consideration of those sorts of base-sharing issues were canvassed in the Henry review.

Senator MARK BISHOP—They may have been canvassed in the Henry review. You raised the point particularly in your opening comments that the state had surrendered taxation measures in 1942—once given away, not returned. I am simply asking you not for a discussion of the Henry report but whether you can confirm to this committee that the state government is not considering seeking back those powers that it freely gave up.

Mr Marney—I can confirm that that is not an active area of consideration by government. My example was made merely to point out the sorts of things that occur when two levels of government try to share the same revenue base. It can end in unintended consequences.

Senator MARK BISHOP—I understand that; I just wanted to clear it up. You had a discussion with Senator Cormann about the Regional Infrastructure Fund and the amount of return to the state of Western Australia. Of course, we have considerable understanding of how regional infrastructure funds are practised in this state. The current government has imposed one since it came to power a bit over two years ago. Would you describe that state based regional infrastructure fund as a model of efficiency that should be copied by the Commonwealth?

Mr Marney—Are you referring to the Royalties for Regions initiative?

Senator MARK BISHOP—I am.

Mr Marney—That is a policy setting of the current government based on commitments made by the National Party in the election process. In this forum I would be reluctant to comment on whether it is efficient or otherwise.

Senator MARK BISHOP—But it nonetheless is a regional infrastructure fund that goes to particular parts of this state, does it not?

Mr Marney—It hypothecates a proportion of our royalty revenue for expenditure—both infrastructure and recurrent spending—in regional areas.

Senator MARK BISHOP—How is that hypothecation of a particular amount for particular purposes in particular parts of this state by the state government pursuant, as you say, to an electoral undertaking—and I accept all of that—different in principle to the Regional Infrastructure Fund that I think either Mr Rudd or Ms Gillard has foreshadowed and that the current government has not to my knowledge walked away from? How is it different?

Mr Marney—The difference is based on our numbers. The very simple difference is they hypothecate the whole cake and only give half of it back in terms of share, because it has been flagged that we will only receive around $2 billion as opposed to a fair share, which would be closer to $4 billion. The other element is—

CHAIR—Sorry; that is assuming that $6 billion is adequate investment in infrastructure from the mining tax.

Mr Marney—I was about to go to the broader point, which is—

Senator MARK BISHOP—One which has a difference in quantum. Secondly, that is a difference in quantum in the share, but also in the case for Royalties for Regions all of the money that is hypothecated is spent back in the regions. In the case of the resource rent tax, my understanding, if it is still correct, is that two thirds of the money collected by the tax would be redistributed to the rest of the nation in terms of company tax reductions and superannuation.

Senator MARK BISHOP—That is correct.

Mr Marney—The difference is, on the one hand, there is a 100 per cent hypothecation of the revenues back to the regions; on the other hand, it is one-third hypothecation back to where it came from and, of that, one third is not a proportionate share based on the state's contribution, so very different parameters involved. In principle—

Senator MARK BISHOP—Different parameters in terms of application—almost as if there is a difference in price—but in terms of principle, both the Commonwealth and state governments are hypothecating a particular tax to be spent in a particular way in a particular area. I accept that the quanta are different and I accept that the proportion give back is different, but this is in principle no different.

Mr Marney—In principle, this is very different. The Royalties for Regions policy settings and hypothecation are all about contributing back to the areas which generate the royalties. It is about reinvesting in those communities both in an economic infrastructure sense and a social infrastructure sense to support the ongoing expansion of the resource sector.

Senator MARK BISHOP—So we have toilets in Bunbury—

Mr Marney—If I can finish—

Senator MARK BISHOP—We have public toilets in Bunbury that sing and cost $250,000 per unit. That is a worthwhile give back of state government moneys?

Mr Marney—You asked me a question about principle, so I will remain at the point of principle. The essential difference is, rather than being a reinvestment into the sector of the economy that generates the return, the resource rent tax in its broader sense is a redistribution of income and wealth to the east coast.

Senator MARK BISHOP—And a fair amount of the Royalties for Regions is not investment or reinvestment but recurrent expenditure, is it not?

Mr Marney—That is correct and, as is always the case, you cannot just plonk an asset out in a region and forget about it. It requires investment. There are some assets out there that require additional funds to maintain their operations. There are communities that require annual expense funding rather than more capital assets.

Senator MARK BISHOP—The final point I want to raise—because you have raised the issue and I will pursue it another time—is that you passed some comment that the Treasury had only had one meeting with the Policy Transition Group, and you are awaiting further information on developments. I read a report last week in the paper that the state premier had issued an instruction to all departments—but in particular yours, Treasury and Finance—that they were not to provide any information to the Commonwealth when the Commonwealth sought it on the application of the proposed new tax. Can you confirm or deny that instruction has gone out?

Mr Marney—I would deny it. I have no knowledge of being instructed not to provide information.

Senator MARK BISHOP—So if the Commonwealth's public servants are seeking information from WA Treasury or finance on the proposed tax—

CHAIR—It has already taken them four months.

Senator MARK BISHOP—this application and the like—all of the detail; that information to the extent that you have it—there is no prohibition on it being passed back to the Commonwealth?

Mr Marney—Correct.

Senator MARK BISHOP—Thank you.

CHAIR—It would be good if it could be a two-way street.

Senator CAMERON—Mr Marney, when you raised the question on the finite agreement, the 1942 agreement, exactly the same point did jump into my mind, but I will not go over that. So secession is not on the cards? Is that correct?

Mr Marney—I am not aware that that is a policy currently being formulated.

Senator CAMERON—I was surprised that you raised it, I must say. I want to come to the fiscal subsidy. What records do you have to go back to on the fiscal subsidy that has come the other way into Western Australia? I am not sure if there is a correct technical term for that. If there is, tell me what it is.

Mr Marney—I think I understand the question: what is the cumulative fiscal benefit to the state? It is true that Western Australia benefited from the Commonwealth Grants Commission arrangements for a significant period of time. It was a beneficiary state, but in the last 10 years that status has turned. The concern is, from our perspective, that it has turned so far so quickly.

Senator CAMERON—I will come to that, because it does raise legitimate issues for Western Australia and the Commonwealth. Can you provide the committee with the details of the amount of money in current dollars and the years where there was a net benefit to Western Australia, a subsidy to Western Australia?

Mr Marney—The reason I answered the question in terms of Grants Commission relativities treatment is that I do not think our net fiscal subsidy methodology goes back forever and a day. We will provide you with whatever we have got on the history of that series and we will provide you with some history on the Grants Commission.

Senator CAMERON—Is that because when the money was coming in it was not important to record it?

Mr Marney—No, it is more that the policy need had not been identified to monitor it. I suppose that is part of the issue. It is also a question of the data sources around calculation.

Senator CAMERON—Could you provide us with whatever information you have on that. I think it is important to get this into balance. You raised the concept of the net economic benefit to the nation. Does this mean you have to compare the net economic benefit to the nation with that to Western Australia? There is a balancing act, isn't there?

Mr Marney—Yes, potentially.

Senator CAMERON—I have raised with previous witnesses the issue of the two-speed economy. Western Australia does not act in the federation in isolation. What happens in Western Australia has an effect elsewhere. So the booming minerals sector, the growth in jobs in Western

Australia, affects areas outside Western Australia because of the high dollar and the lack of funding that may be available for investment in other areas because it is coming into the Western Australian mining industry. Do you accept that you need to balance both Western Australians' needs and the national needs?

Mr Marney—Being part of a federation requires that. The question is: what is actually in the national interest? If a particular resources boom is cyclical in nature then you probably would not be as concerned. But if it is viewed that the prosperity of the resources sector is more a long-term structural issue then the policy response should actually be to facilitate structural adjustment so that labour and capital can flow to the resource sector, to the area of the nation that is most productive. In some respects the MRRT actually stands in the way of that adjustment, which is to the detriment of the nation as a whole.

Senator CAMERON—I am well aware of neoclassical economics and the arguments that you are putting forward, but in reality you argued that there was a vast increase in employment. I think they were the words you used. Workforce and capital had moved to the mining industry in vast quantities. There is other analysis that we have here. If you take the national view, the amount of employment in the mining industry could never be described as vast in the context of the national economy, could it?

Mr Marney—The resource sector is a capital intensive industry. The employment effect of prosperity in the resource sector tends to be felt outside the resource industry. It is in manufacturing, in engineering and in the service sector, where the miners actually spend their incomes. It is in housing construction, it is in the trades.

Senator CAMERON—You said that there were vast numbers of jobs being created. That is not vast. Even if you take Western Australia and compare it with the rest of the country, you could not describe it as vast. Maybe you want to elaborate on that. I do not have a lot of time. If you want to elaborate, I will put that on notice.

Mr Marney—I might just say a vast number of jobs created in the broader sense as a result of resource sector prosperity.

Senator CAMERON—I still think there are different views we have had. Dr Peter Brain, from the NIEIR, is a recognised economist in this country. He says:

For the most part, the mining industry adds minimal value to non-renewable resources. In this respect, the words 'resource rent', though technically accurate, are misleading: the rent concerned is not payment for use over a period of time, as in the rent of a building, but the price for the final sale of state-owned resources.

Do you agree with that?

Mr Marney—That is why we call it royalties, not rent.

Senator CAMERON—On net export revenue, Peter Brain is arguing that for mining investment it is considerably less than gross revenue. Is that your understanding?

Mr Marney—I am not aware of the analysis.

Senator CAMERON—Could I ask you to look at his submission and give me your views on the analysis where he says:

Net export revenue from mining investments is considerably less than gross revenue. … The importance of the industry for net exports is best assessed after deduction of these items—

and he talks about a range of items that have to go in there. Can you give me your views on that analysis? I think it is an important issue that we need to deal with.

Mr Marney—I am happy to have a brief look at it.

Senator CAMERON—A brief look at it?

Mr Marney—Yes.

Senator CAMERON—What does that mean? I am asking you whether you would analyse it. You are here giving evidence. I am not asking for a brief look at it. I am asking whether you are prepared to have a look at that and do a proper analysis to advise this committee as to whether it—

CHAIR—Senator Cameron—

Senator CAMERON—Let me finish.

CHAIR—I think the witness has answered the question. The witness is quite entitled to provide appropriate and proportionate resources to answering the questions you ask. You can ask the questions and he will answer them the way he sees fit to answer them. I do not want you to harangue the witness.

Senator CAMERON—Well, please define ‘brief’.

Mr Marney—I will look at the analysis. I will have my people do a preliminary review of the analysis and see whether or not there are simple conclusions we can draw. I am not prepared to allocate my time or the time of my staff as a research input into this committee’s operations. You have asked me a series of questions. I have answered everything as honestly and fully as I can, but I am not going to go away and do work for you, basically.

CHAIR—That is fair enough. Are there any further questions or is that it?

Senator CAMERON—That is it.

CHAIR—Mr Marney, we are very appreciative of your evidence before this committee. It is very instructive for us. I have a final couple of questions following on from Senator Cameron’s questions. In terms of assessing the risk to the Australian economy, do you assess the level of interstate trade? Is that something that you monitor?

Mr Marney—We try to. The data on interstate trade is particularly difficult to get a good story out of. A lot of it is port of arrival issues. There is a lot of trade that flows across the Nullarbor because the goods arrive in the port of Melbourne.

CHAIR—I completely appreciate the difficulties in collecting data. The reason I am asking the question is the number of trains that come in from over east fully packed with goods from over east that are essentially funded by people who make a living out of the resources industry over here. I think it would be fair to say that that increased dramatically in recent years, so to that extent there flow-on implications for the broader economy. That was the point you were trying to make earlier, wasn't it?

Mr Marney—I think the flow-on effects are twofold in terms of the broader economy. One is company profits: the profits of the resource sector are already taxed and that flows to the Commonwealth. And, yes, the import of goods and services and, indeed, tourism on these east coast are beneficiaries as well.

CHAIR—Of course, as revenue from state royalties increases it does have an impact in terms of the Commonwealth Grants Commission processes as well. That is driving some of the adjustments there, isn't it?

Mr Marney—Correct. A large proportion of the royalties received are equalised away and redistributed to other jurisdictions as part of the Grants Commission processes.

CHAIR—A final question from Senator Bishop.

Senator MARK BISHOP—Mr Marney, you made some points earlier about the backwards and forwards of state and Commonwealth revenues and the disproportionate nature. It is also a fact that this state is the subject of disproportionately high FDI, both equity and debt, in the mining and resources sector compared to the rest of the country, isn't it?

Mr Marney—I do not know.

Senator MARK BISHOP—You do not know that we get more investment per capita into the mining sector than Victoria and Tasmania and the rest of the Commonwealth?

Mr Marney—Again, where that investment is classified is highly subjective: a lot of the investment occurs in Collins Street but it is actually resource sector investment. So it is hard to draw solid conclusions on the basis of where investment per capita happens. Are you talking about financial investment?

Senator MARK BISHOP—Yes, I am. You were making a play about the give-back from the Commonwealth to the state, either via the GST or the proposed PRRT. I am just making the point that there are other sources of revenue into this state. One of them is investment. There is a massive investment going into resource projects from top to bottom in Western Australia that is not occurring at the same level in the rest of the country—

Mr Marney—Private sector investment.

Senator MARK BISHOP—Yes, private sector investment, private sector FDI—hence the boom in this state. That is the only point I am making.

Senator CAMERON—Mr Marney, this is something you do not have to answer right now. Can you provide details to the committee of the process that the state government undertakes when it sets out to increase royalties: what discussions it has with the mining sector as a whole, what individual discussions it has with mining companies and how it deals with the issue, as we have been told, that increasing tax means that there are problems for certainty in the mining industry? So the issue is: how do you deal with this, how do you get certainty and how do you deal with sovereign risk in terms of royalties?

CHAIR—You might like to answer that now, if you wish.

Mr Marney—I am happy to take it away and consider it. Most of that issue is dealt with by the government of the day rather than by the bureaucracy.

CHAIR—You have a couple of case studies on how this has actually been handled. You have got one that is happening at the moment, I would have thought.

Mr Marney—Yes. But, again, a lot of that happens at the political level, not at the public servant level. I will answer what I can, but just take it with that caveat in mind.

CHAIR—Yes. Thank you very much for your contribution to the committee today. It is very much appreciated, Mr Marney and Mr Court.

Proceedings suspended from 12.58 pm to 1.58 pm

HARRISON, Mr David, General Manager, Advocacy, Chamber of Commerce and Industry of Western Australia

NICOLAOU, Mr John, Chief Officer, Membership and Advocacy, Chamber of Commerce and Industry of Western Australia

RICHARDS, Mr Noel, Senior Policy Adviser, Resources and Energy, Chamber of Commerce and Industry of Western Australia

CHAIR—I welcome the WA Chamber of Commerce and Industry of Western Australia. I invite you to make an opening statement, after which the committee will ask you some questions.

Mr Nicolaou—Thank you. I will keep my opening comments relatively short. Our appearance before you today is in relation to the MRRT. We will outline our position, which is reflected in our submission to the Policy Transition Group, a copy of which is provided to you today.

Overall, we remain opposed to the introduction of the MRRT. We believe it is a major new tax that has been introduced without appropriate consultation and debate on its merits and on its impact on the sector and the broader economy. We are concerned that such an important tax has been rushed in without the broad parameters being understood, and that it has been determined and discussed within a few days with a few special groups and not the wider industry sector or the wider business community.

We are concerned about the lack of transparency over the revenue estimates and the key assumptions behind those estimates. We believe that the tax is centred on the revenue that would be raised rather than on a genuine commitment to tax reform, and we believe that such an approach is flawed in nature and really does represent a missed opportunity to undertake more wide-ranging and fundamental tax reform to Australia's tax system.

We believe that the tax has been brought in to help bring the budget position back into surplus, but we are concerned that a tax of this nature is dangerous because it is unclear what implications it might have on such an important sector not only of WA's economy but of the national economy. Such a tax does not generate significant amounts of revenue relative to the Commonwealth's total tax base, and it is for that reason also that we are concerned about the administrative efficiency of such a tax.

Finally, we do not believe the tax fits the criteria of good tax design, most importantly in relation to the issue of competitiveness. There has not been adequate debate and discussion around what impact a tax of this nature might have on Australia's competitiveness as a destination of choice for the mining sector. I am happy to leave my comments at that, and we will take questions from there.

CHAIR—Thank you very much. To summarise what you have just said, the Henry tax review was supposed to deliver a simpler, fairer tax system, but this mining tax does not come into that sort of framework, does it? Are you suggesting it makes it more complex and less fair?

Mr Nicolaou—We believe that the tax in its current form does not meet the criteria of good tax design and really goes against the grain of what reform to Australia's taxation system should deliver. In relation to the tax in isolation, we believe that it has issues in relation to what impact this tax would have on Australia's competitiveness. There are issues in relation to its administrative efficiency, the adequacy of the tax revenue that will be raised relative to the costs borne by industry and also in relation to the government in raising the revenue. There are also concerns around the economic efficiency of the tax. Those things form the foundations of our concerns surrounding the tax in its current form. We believe that the tax should therefore be deferred to the tax summit next year as part of a wide-ranging review of Australia's tax system. It is something that CCI would embrace, and I believe the business community as a whole would certainly embrace a wide-ranging review of Australia's tax system. It provides a real opportunity for the most distortionary taxes to be abolished or eliminated and leveraged better off our traditional tax sources that are efficient by nature and non-distortionary.

CHAIR—You raise a whole heap of issues there. How confident are you that the Policy Transition Group will be in a position to address your concerns?

Mr Nicolaou—We are concerned that the PTG is not able to work through these issues adequately given the time frame from which it is supposed to report on the MRRT and the level of consultation it had prior to the new MRRT being introduced. It is on that basis that we believe it should be deferred to the tax summit to allow for more genuine interrogation of the tax in its current form and a debate on merits of other rent based taxes and other forms of taxation that could be levied not only on the mining sector but on the overall economy.

CHAIR—You talk about a time frame. The terms of reference are not really that broad either, are they? Is it just a matter of time or a matter of focus as well?

Mr Nicolaou—That issue was certainly raised in our submission to the Policy Transition Group. We were concerned not only that the time was limited, in that there was one month to report, but also that the scope of the terms of reference was quite limiting. For that reason we deliberately expanded our submission beyond the broad scope of the PTG..

Mr Richards—The key issue for us there is that the terms of reference require the transition group to be revenue neutral in its recommendations. So we are quite concerned about how we can get fundamental change in the design of the tax if the Policy Transition Group has to be mindful of the government's bottom line in all the recommendations it makes. We are not confident that they can actually deliver fundamental change if that is a key issue for them.

Mr Nicolaou—And this is not about the sector or the economy paying less tax. It is about better ways of levying tax that is adequate to fund the responsibilities of the Commonwealth and state governments.

CHAIR—You say that you have gone beyond the scope of the terms of reference in your submission to the Policy Transition Group. That might make you feel better—and they are all very serious arguments, I am sure—but do you actually expect that the Policy Transition Group will be able to respond to them?

Mr Nicolaou—We are not in a position to really understand what the transition group's focus is in terms of the level of consultation, but we were involved in the consultation on the MRRT when the group came to Perth. We did not leave that focus group session with a degree of comfort that it was genuine consultation. I guess that is where I would like to leave that issue.

CHAIR—It is a key point, though, is it not? If the Policy Transition Group is not in a position to explore the issues of concern that you have, then somebody else has got to be able to do it. There has to be another platform for you. Have you had direct conversations with the government—for example, bilateral, one-on-one discussions between the government and the chamber? Have there been other forums in which you have been able to raise these issues other than the Policy Transition Group?

Mr Nicolaou—Yes. We have had discussions with Commonwealth and state government officials over the past few months. We certainly have a very similar position to that of the state government, and we have spoken at length with departmental officials and the Premier of the state on this tax and our opposition to the tax. We have spoken to other interest groups, including the small miners in AMEC. We have had discussions with the Treasurer of Australia about our position on the MRRT as well.

CHAIR—What did he say? When you said you have all these concerns and you are unhappy about all these things, what did he say to you?

Mr Nicolaou—The Treasurer's position is fairly clear. He believes that the tax in its current form will be implemented.

CHAIR—But you also thought that about the RSPT, did you not? That is a rhetorical question; I am not expecting you to answer it.

Mr Nicolaou—The issue of the RSPT came at a time when there was quite a lot of turmoil around the tax because it was so significant and potentially economy destroying that we took a very activist position on that at the time. On the basis that there was genuine consensus not only amongst those in the mining sector but the broader WA economy, we were adamant that we could help effect change.

CHAIR—I guess what I am saying is that governments will always try to preserve the status quo until they have no choice but to try to come up with a different proposition, which is what happened with the RSPT. So if the Treasurer says to you that the MRRT is here to stay, that does not necessarily mean that it is. I am trying to find out what the vehicle is that you can use to get change if the Policy Transition Group is too narrow in its focus.

Mr Harrison—I think the simple answer to that is that CCI, through its extensive local and national networks, is using every avenue possible to raise our concerns. We are having regular and frequent discussions with ministers and senior advisors. I think the simplest and easiest way to describe the current situation we face is that the federal government, from the Prime Minister and the Deputy Prime Minister to the Treasurer and down, do not share our concerns about the tax.

CHAIR—As they did not with the RSPT, until they had to. What are your thoughts about the way the government has negotiated the MRRT version of the tax—negotiating it with the three biggest mining companies only, and excluding, I guess, 99 per cent of the industry?

Mr Nicolaou—We are strongly of the view that that is not an appropriate level of consultation, because it does not represent the broader sector nor the broader business community's views. Our belief is that true consultation is public by nature and is representative across not only the mining sector but the broader business community. That is the avenue through which you can get true debate around the merits of a tax or otherwise, and more meaningful outcomes in the end.

CHAIR—You mentioned that you have had conversations with Commonwealth Treasury officials. Did they share with you some of the underlying assumptions of values to estimate the revenue from this tax?

Mr Nicolaou—We have not really had any true consensus there, in terms of the position we hold versus that of the government.

CHAIR—When you say you had no true consensus, have they shared any information?

Mr Nicolaou—No, sorry—in terms of your view there: no, we have not received any information about the elements of the tax. So I guess our position is: it is difficult because we cannot advocate strongly for certain design parameters because we do not know the underpinning assumptions behind that. I guess that is one of the key issues that we have.

CHAIR—So it is difficult to assess whether it is in the public interest or not. It is difficult to argue the merits of this tax because the government is holding some of the key information—which you need, to make informed assessments—secret. Is that right?

Mr Nicolaou—It is unclear as to why some of the information is being withheld—or not. Our view is that we cannot provide, and nor can the broader business community provide, an appropriate assessment as to the merits of certain design parameters of the MRRT without all the underpinning assumptions being made public, to allow for that analysis to be undertaken.

CHAIR—Certain sections of the industry have said, and the Minerals Council is on the record as saying, that profits based taxes are preferable to state royalty regimes. Does the chamber have a view on that? Have you assessed that as an issue?

Mr Nicolaou—I think the important issue there is: that is a debate that we need to have. It is a debate that really has not been had, because a position was formed immediately, without consultation across the broader business community. That is a debate we would like to see happen as part of the tax summit—a debate around the merits of rent based taxes versus royalty based tax arrangements, because there are pros and cons for both. In order to arrive at a position that is least distortional to a sector, particularly the mining sector, we need to have that debate as part of a tax summit. That is the position we hold.

CHAIR—So if this was taken to a tax summit and it came out in the same fashion at the other end of the process, you could raise support for this tax?

Mr Nicolaou—There are other issues, though, attached to rent based taxes that are levied by the Commonwealth versus royalty based arrangements that are levied by the states. That is an issue that also needs to be worked through. One of the concerns that we have had all along is that the state government has not been brought into the discussions around the introduction of a new tax that overlays a royalty regime. So those constitutional issues around who is taxing the mining sector certainly need to be worked through as well before we introduce a new tax.

CHAIR—We had Mr Marney here this morning, the Under Treasurer, and I have to say that I was amazed that—on something that is supposed to be a massive tax reform and which has serious implications for federal-state financial relations—there has been hardly any interaction between the Commonwealth and the state government at all. Have you had conversations with the state government about their level of interaction with the Commonwealth on these issues?

Mr Nicolaou—The state government, from our discussions, are very concerned that such a tax could be proposed—a tax that, in effect, replaces state royalties—without appropriate levels of consultation. I think it is an issue that has significant implications for the federation because there are concerns that there is a broader agenda there—in effect, for the states to lose a revenue base that is important to their overall levels of financial autonomy.

CHAIR—Ultimately, the states will continue to raise their royalties, will they not, and the Commonwealth may or may not be successful in getting the mining tax up? If the mining tax does get up, those smaller companies not subject to it will continue to pay royalties and those that do pay the mining tax will be exposed to future increases in state royalties, as far as we know. It seems to be quite messy.

Mr Nicolaou—And our concern is around the complexity of this tax because of how it overlays with state based royalty regimes. A state like Western Australia would never cede its ability to levy a tax in the form of royalties on resources in its province. That is why it is a concern that a new arrangement like this has been proposed without appropriate levels of consultation as to how the two would interact to minimise the distortions that could be created and also the complexities that could be created.

CHAIR—You raised constitutional issues and the accrediting of royalties. Can you talk us through your concerns?

Mr Nicolaou—We are not really in a position to comment widely on that.

Mr Richards—Certainly not on constitutional issues. We are not lawyers, so we cannot make comment there, but certainly our concern would be, looking back at the Henry review's recommendations, in talking about the idea of a resource rent tax Henry did stress that there should be negotiation between the Commonwealth and the states on any such rental tax that should be levied at the Commonwealth level. Going back to your previous comment, as far as we are aware, there has not been any detailed negotiation between the states and the Commonwealth. It has led to this type of issue now where we have uncertainty as to whether future royalty increases ought to be accredited or not. That is really the concern that we have highlighted. We are disappointed that the Commonwealth has not made steps so far to discuss it in detail and negotiate with the states on an appropriate sharing of risks and revenues around the resource rent tax.

CHAIR—The other issue you have raised here is the $50 million threshold and you are not quite sure how that has been determined. What do you think the basis is for that $50 million threshold?

Mr Richards—Anyone’s guess is as good as mine really. I think the problem there is that we do not know where that $50 million figure comes from, and that is why our comments in that area have been fairly limited. We do not really know what assumptions and calculations went into actually calibrating that threshold. What is clear in our minds is that the threshold ought to serve primarily the issue of tax efficiency in order to protect smaller miners and also to ensure the government is not allocating resources unnecessarily where they are going to have a small tax intake from that particular part of the sector. So our feeling is very much that that threshold ought to be calibrated around the issue of tax efficiency to ensure that smaller miners are protected and administrative efficiencies are achieved in the tax so that the government is not exerting too many resources.

CHAIR—Just going back to this issue of international competitiveness, have you done any assessments of the average tax rate that mining companies are going to be subject to if or when the MRRT is in place and how that compares internationally?

Mr Richards—No, we have not done any comparisons like that. It is a little bit difficult to compare tax rates across the globe like that. What we have done is look at some survey evidence: for example, I think everyone is quite familiar with the Fraser Institute survey, which showed Australia’s ranking as a mining destination falling quite substantially following the introduction of the RSPT. It goes back to our key concern that international competitiveness has not been raised in the PTG terms of reference. It does not seem to have been really an issue for the Commonwealth government in its deliberations on this tax as well. So our concern is that this tax may be designed and implemented without actually thinking about what this might mean for Australia’s international competitiveness. As we know, the mining sector—particularly the bigger miners—operates in a global environment. Resources such as capital and labour and even skills and technology are highly mobile, and so we are concerned that this tax is going to be designed and implemented without considering the impact on international competitiveness.

CHAIR—And of course it impacts on those bigger miners in a different way to the smaller and medium miners, doesn’t it?

Mr Richards—That is right, yes. As I said, the bigger miners obviously operate in a global environment. The smaller miners are more domestically focused as well. So it does have different impacts in that sense.

CHAIR—And I guess there are different design features of the tax which favour the bigger miners compared with the smaller and medium miners. Have you looked at the tax design feature specifically and how they impact on different parts of the mining industry?

Mr Richards—No, we have not looked specifically at that. Obviously the threshold is key for smaller miners. Our focus has very much been on the principles and process and on the broader issues around the tax as opposed to focusing on the tax design.

CHAIR—If you are a multicommodity, multiproject company like BHP or Rio, then being able to transfer losses from project to project is going to be more beneficial to you than it is to a company like BCI, who has got one project and one commodity. That is not something that you have looked at in detail, is it?

Mr Richards—No, we have not. Like we said, there are different organisations that are making contributions, so we have left those kinds of technical issues to them.

CHAIR—Understood.

Mr Harrison—At this point I think it is worth putting on the public record that CCI's position on this all along has been to represent the broader business community of Western Australia. Certainly the mining sector are members of CCI, but we represent nearly 6,000 businesses—small, medium and large—across the state. So it is a tax which we believe will have a negative impact on a wide variety of sectors of the economy, not just the mining sector. That has been our position all along—to represent the broader business community and the impacts this tax will have on it.

CHAIR—That is the impact on the economy in WA rather than nationally?

Mr Harrison—Our primary focus is on Western Australia and our members that work within this state.

Senator CAMERON—The Western Australian Chamber of Commerce and Industry is part of the Australian Chamber of Commerce and Industry. What discussions have taken place with the Australian chamber in relation to the two-speed economy?

Mr Nicolaou—I cannot honestly say with any degree of certainty around issues of a two-speed economy, but we are shareholders of the Australian Chamber of Commerce and Industry. They represent CCI at a national stage, and the other state chambers. They have been very supportive of the position we held in relation to the old RSPT and PRRT and the new MRRT. The two-speed economy is an issue that has not been discussed at an executive level in any great detail, but it is fair to say that this is a challenge that most policy makers and advocates will be turning their attention to over the course of the year ahead.

Senator CAMERON—Outside of, say, Queensland and Western Australia, the predominance of members would be in the manufacturing sector, chemicals and a whole range of other areas that do not specifically rely on the mining industry.

Mr Nicolaou—The Australian Chamber of Commerce and Industry is the most representative business association of its kind. It has over 350,000 members, and the state chambers are a significant part of that picture. I would say that its membership is representative of the Australian economy. There is no particular weighting one way or another. Certainly ACCI in its charter is about promoting policy that leads to outcomes that increase competitiveness, competition and efficiency through the economy.

Senator CAMERON—I am surprised that the ACCI has not had a discussion on the two-speed economy given that the mining industry is part of the issue of driving the strength of the dollar. It means that there are problems in other states in relation to competitiveness and productivity and exports. You have not spoken about that at all.

Mr Nicolaou—The direction of our discussions with ACCI has been around broader policies that can help expand the capacity of the economy and ensure that those negative effects that come with one very fast-growing sector versus some slower growing sectors do not materialise. I believe and certainly CCI believe that if we did build in place policies that allow the mining sector to grow at the size of its workforce to have adequate levels of infrastructure then you would not see the negative effects, such as increased wages and higher interest rates, flow through to the rest of the economy. That is where ACCI in conjunction with CCI will be focusing its attention around the supply-side policies rather than demand management policies in the form of a mining tax.

Senator CAMERON—What do you say to the submission that Professor Ross Garnaut has made? Professor Garnaut is in mining, as well as a whole range of other areas. He said:

The Australian government has taken a position on the basis of advice from people of knowledge and standing, that asserts some hard propositions about the national interest, at the expense of some private interests that exert considerable influence in our polity.

What do you say to that?

Mr Nicolaou—If you are referring to the Henry review of Australia's taxation system and some of the policies and proposals that were embedded within that document, we strongly support the release of the Henry review and a debate around the merits of all of the recommendations in that review.

Senator CAMERON—No. I am asking you to comment on the position that the government has taken a stand against people who exercise considerable influence in our polity.

Mr Nicolaou—I am not really in a position to be able to respond to that.

Senator CAMERON—In point 6 of your summary of key points on page 6 of your submission you state:

To genuinely compensate the community for the use of its non-renewable resources, the Government should ensure that returns are devoted to accumulating alternative assets that will benefit society in the long run.

Given that there has been basically a static royalties take over the years and a massive increase in profitability, if the status quote maintains how do we meet this challenge that you have laid out in point 6?

Mr Nicolaou—With your views in relation to the royalty arrangements, we need to remember that they are based on a percentage ad valorem royalty by and large and so they do increase in line with rising prices and rising volumes. That has allowed the state government to—

Senator CAMERON—This is the fundamental issue: profits are going through the roof and the royalties are not going anywhere near that. The graphs we have been supplied with show that basically it is sitting still and the profits are going through the roof.

Mr Nicolaou—That is in relation to prices. We are going through a commodity price boom where you are getting prices rising at extraordinary levels. This is not likely to be a permanent phenomenon and we need to make sure that we do not put in place taxes or policies that are designed for a point in time rather than are needed to ensure that we do have a genuinely efficient and non-distortionary tax in the long run.

Senator CAMERON—So how do you deal with these extraordinary levels of profit as you described them? How do you deal with them to get a fair shake for Western Australians and the country?

Mr Nicolaou—In relation to profit levels of mining companies, we could open that up to all of corporate Australia, but the mining sector in this state reinvests in this state considerably in terms of new projects, both greenfield and brownfield projects, which generate wealth and opportunity for the broader economy. If you look at the amount of investment in the pipeline in this state alone, the mining sector has about $170 billion worth of investment that is either under construction or slated for construction in the years ahead.

Senator CAMERON—Isn’t that being done on the basis that there is going to be significant profitability? It is not being done for companies to lose money, is it?

Mr Nicolaou—No, it is not. It is based on a broader view of the structural shift in the global economy towards developing Asia and the needs of that part of the world in relation to our key commodities.

Senator CAMERON—And the projections are that prices will maintain a pretty high level for a fairly lengthy period of time; isn’t that correct?

Mr Nicolaou—There are varied projections. I cannot really comment with any degree of certainty, but there are optimistic projections that it will remain high. But there are also others that suggest that prices will decline as new supply comes on stream. A concern that we need to keep in mind is that the supplier response to higher commodity prices will be there. There are mining projects all over the world, and if we price ourselves out of the market by making Western Australia or Australia an unfavourable destination to do business then the dollars will go elsewhere.

Senator CAMERON—I think that is part of the argument that is being put forward by the mining companies. There have been other assessments made by Treasury, by other academics looking at it and by other industries to say that there will be a lengthy period of high profitability in the industry. If that is correct, how do we then get the return to deal with point 6 in your submission if that stays like that?

Mr Richards—I might just clarify that. Our comment on that particular issue was more trying to highlight the issues around what the government was actually intending to spend MRRT revenues on, which we did not believe goes towards the goal of achieving intergenerational equity and trying to grow assets for the future. I do not think we would say we disagree that there should be additional taxes on miners in order to capture some of these increasing profits. What we are saying is that the MRRT itself may not be the way to do that; there might be better options out there. That is what we are trying to say: let us talk about this in the wider context of tax reform at a national tax summit.

Senator CAMERON—Mr Richards, are you an economist?

Mr Richards—Yes, that is right.

Senator CAMERON—Do you understand the Brown tax?

Mr Richards—No.

Senator CAMERON—You do not?

Mr Richards—No.

Senator CAMERON—You are not aware of where the Brown tax theory comes from?

Mr Richards—No.

Senator CAMERON—I am surprised, because here you are arguing about this, and the Brown tax has been around for over 60 years and is the basis of the MRRT. Yet you are telling us that there are other things to do but you do not know about something that has been around for 60 years. I am a bit surprised about that, I must say.

Mr Nicolaou—The research suggests that the Brown tax has not been effective in its implementation across various jurisdictions around the world.

Senator CAMERON—Where?

Mr Nicolaou—I would have to take that on notice.

CHAIR—New Guinea is one of them. Communism has been around for 80 years; that has not been all that effective either.

Senator CAMERON—You are really having a dig in the bottom of the barrel if you have to go there, to be honest. You would be better off just sitting quiet.

CHAIR—We have decided that 60 years means nothing.

Senator CAMERON—Chair, again I will repeat to you that I do not interrupt you. Do not interrupt me, especially with nonsense like that.

CHAIR—You have interrupted me on other occasions.

Senator CAMERON—Where has the Brown tax been introduced? Do you want to take that on notice?

Mr Nicolaou—I will take that on notice, but there is research. I am sure it is in the Henry review, but again I do not want to say things without the information behind me. There have been concerns around a Brown tax for many years, and that is why it has not been widely adopted throughout different jurisdictions around the world. That is not to discount a form of Brown tax in Australia, but we need to debate it.

Senator CAMERON—How does the Brown tax work?

Mr Nicolaou—It is a rent based tax.

Senator CAMERON—The advice we have is that rent based taxes are being introduced by every new economy that is moving into new resources, so these new competitors that you are talking about will have a Brown-type tax implemented. That is what seems to be happening. Do you agree with that?

Mr Nicolaou—I cannot comment one way or the other on that.

Senator CAMERON—So you are not really an expert on the Brown tax.

Mr Nicolaou—I am not an expert on the implementation of Brown taxes in future in other jurisdictions.

Senator CAMERON—You say in point 6 that we:

… should ensure that returns are devoted to accumulating alternative assets that will benefit society …

Give me an example of some of these alternative assets.

Mr Nicolaou—Our belief in relation to using royalty streams is that the funds and revenues generated from such taxes are best used to build long-lasting assets that generate benefits for the wider economy and future generations. What we are talking about there is basic infrastructure that generates an economic dividend to all. That is where the funds from a tax of this nature should be directed, rather than to general expenses.

Senator CAMERON—And there is a deficit of infrastructure in Western Australia?

Mr Nicolau—There are bottlenecks right across the states and there is a looming pressure point for the state in terms of its future potential.

Senator CAMERON—So the market has not been able to deliver an efficient approach to bottlenecks?

Mr Nicolau—I would not say the market is responsible for that. The state government and the Commonwealth government have primary responsibility for some key pieces of infrastructure, such as ports, roads, rail and the like.

Senator CAMERON—And those have to be paid for somehow, don't they?

Mr Nicolau—They do. It is not about paying for all of them in year one. A long-lived asset can have 50 years worth of economic benefit. It is about ensuring that there are policies in place that enable those sorts of projects to be developed and potentially act against debt to smooth that intergenerational equity transfer.

Senator CAMERON—Is the chamber aware of the World Bank study called *Mining royalties: a global study* by Otto, J?

Mr Richards—Yes. We used that in our submission to the PTG.

Senator CAMERON—Did you pick some of the things out of that?

Mr Richards—Yes.

Senator CAMERON—It says:

Unlike specific and ad-valorem regimes however, during the early years of a mining operation when establishment costs far exceed any income, minimal or no royalties will be collected.

What it is basically saying is that a profits based approach lets a company build up to achieve a profit and then you tax the profit, so it is better for start-up operations. Why didn't you make any comment on that, or don't you agree with that?

Mr Richards—On the whole, that paper is where we took our comments from. It was talking about the importance of considering a variety of options. That is exactly what we have quoted in our piece. The fundamental message from that paper is that you cannot discount royalties or one over another. It really depends on the resource. It depends on a variety of issues.

Senator CAMERON—So you do not agree with the World Bank comment on that? I am still not sure.

Mr Richards—I cannot make any comment here or there. I think it is important to get the key message from the paper rather than one or two parts of it.

Senator CAMERON—You have picked parts out of the paper and put them to us.

Mr Richards—They were the key messages.

Senator CAMERON—One of the key messages here is that a profit based royalty is better than having royalties that come in too early.

Mr Harrison—What we do find in the paper is that there are pros and cons of both a rent based and a state royalty based scheme. We are not in a position to comment specifically on that quote that you are referring to. But in the paper you will find in the executive summary that we are finding that there are issues surrounding both tax proposals, and that is why we are suggesting that we need further consideration, further discussion and further analysis of what these different tax systems will mean so that we can determine what is the best outcome.

Senator CAMERON—The World Bank also says in this paper:

> … an optimal level of taxation that maximizes the net present value (NPV) of the tax revenues or, more appropriately, the NPV of all social benefits the country receives from its mineral sector …

Have you done any analysis along those lines?

Mr Nicolau—No, I have not.

Senator CAMERON—You have not looked at the social benefits?

Mr Nicolau—Again, the points that we raised in our submission are really to highlight the issues that need to be explored. The World Bank paper that you are referring to does highlight some of the issues that need further exploration in designing and implementing the most effective and appropriate tax for Australia and Western Australia. We do not have the capability to undertake the level of research and analysis that you are referring to.

Senator CAMERON—You say you have picked out certain parts, the key messages. One of the key messages in this paper is:

> In recent years some governments with sophisticated tax administration capabilities have tended to move away from specific and ad-valorem royalties to profit-based regimes.

You did not happen to mention that in your submission?

Mr Richards—I think the issue there is 'sophisticated tax regimes', so it really depends on which regimes they are talking about.

Senator CAMERON—You are saying we do not have a sophisticated tax regime?

Mr Richards—I am not saying that. I am just saying we need to think about what those sophisticated regimes are that they are—

Senator CAMERON—No, you don't. You simply have to think: have we got a sophisticated tax regime? Do we have a sophisticated tax regime?

Mr Richards—I cannot comment on that.

Senator CAMERON—You cannot comment?

CHAIR—I think you have had your final question, Senator Cameron. We should always be polite with our witnesses, Senator Cameron. Just going back to the Brown tax for a moment, a key feature of Brown taxes is that the government pays for the losses of the firm at the same rate as it taxes profits, which is of course not a feature of the MRRT but was a feature of the RSPT, which has been rejected. Do you think it is good public policy for a government to underwrite the losses of mining companies at the same rate as it taxes the profits?

Mr Nicolaou—I think that is where the RSPT came unstuck. It introduced those sorts of moral hazard problems. The feedback from the mining sector overall is that they did not want this element in any tax design. It was something that did not help them in any way. Particularly for some of the smaller miners, it did not help them in sourcing finance, which is critical to them bringing new projects on stream.

CHAIR—So a tax which would lock the government into 40 per cent of losses without being part of the risk assessments or the management decisions is not really a good tax, is it?

Mr Nicolaou—We were very concerned with that design feature of the old RSPT. I think the result that we have today with the new redesigned MRRT is a reflection of that. Industry did not want it. Industry were concerned about the role that government was playing in a highly competitive sector like the mining sector.

CHAIR—I just want to put on record that the MRRT certainly is not consistent with the Brown tax, because that is of course a key feature of it. On the Regional Infrastructure Fund: the Regional Infrastructure Fund is supposed to spend $6 billion over 10 years, which is $600 million a year, for a tax which in its second year will raise $6½ billion in that one year alone, so less than 10 per cent per year is to be spent on regional infrastructure funding. Do you think that that would be an appropriate proportion if that tax were to get up? If this tax were to go ahead, do you think that it would be an appropriate investment in infrastructure flowing from that tax revenue from our resources?

Mr Nicolaou—We are very concerned about the amount of funding that would come back into this state as result of a tax that really is levied predominantly on Western Australian miners. Analysis by the Treasury department in this state estimates that up to 65 per cent of all revenues will be raised out of this state, yet Western Australia will receive just one-third of the infrastructure that comes from the $6 billion fund, which is a fund that lasts over 10 years.

CHAIR—You are going to the next level down, and I understand what you are saying. We are getting $200 million per year out of the $600 million per year, and that is not proportionate to the 65 per cent coming from Western Australia. But, even more so, if you look at how much the tax is going to raise overall and then how much of it is going to be invested in infrastructure overall, leaving the WA equation aside for a moment, it is really only a very small percentage. Most of it is going into consolidated revenue for other government spending.

Mr Nicolaou—And that is the concern we have. Our belief is that rent based taxes, royalties, should be reinvested back into an economy through infrastructure, for example, that provides dividends for the whole economy over a long period of time. The concern we have with the current design with the regional investment fund as well is that only a small portion of that revenue is feeding back into infrastructure building and nation building, and instead it is just going into consolidated revenue, which in effect is used to fund general government expenses. That does not impose a discipline that we would like to see in terms of getting the maximum social and economic benefit out of a tax of this nature.

CHAIR—And of course trying to get budgets into surplus that were in deficit. How confident are you that, if this tax were to get up, these parameters are not going to be expanded in future?

Mr Nicolaou—We are very concerned about the potential for this tax to be expanded and broadened through the different design elements of it. We have made it very clear in our submission to the Policy Transition Group that, if a new tax were to be implemented, they would lock it in to ensure that the scope of the tax does not broaden further than was agreed to.

CHAIR—How could they possibly lock it in, because of future parliaments or even this parliament if circumstances were to change? If the government has a majority to introduce the tax they could well have a majority to amend the tax. There is nothing that you can do to lock it in. How would you do it?

Mr Nicolaou—I guess there are no guarantees, but enshrining it in legislation would provide some degree of certainty for the sector that a new tax would not be imposed on them over the medium term.

Senator CAMERON—Is the chamber aware of the International Monetary Fund's view that these types of taxes should be widened in resource economies?

Mr Nicolaou—The issue that you raise is fair and the fact that it is applying to two minerals only does violate a core principle of good tax design. While we are not advocating the broadening of the scope to all minerals—

CHAIR—It seems that Senator Cameron might be.

Senator CAMERON—I was just asking a question about the International Monetary Fund.

CHAIR—All deriving out of the Treasury offices in Canberra.

Senator CAMERON—Chair, I do not think the International Monetary Fund operates out of Treasury.

CHAIR—But the official who wrote that report did—absolutely.

Senator CAMERON—I know you do not like Treasury because of the multibillion dollar hole it found.

CHAIR—I love Treasury; I do not like your government.

Senator CAMERON—It is a serious question and we should not be distracted by the Chair. It is not his job to distract people.

Mr Nicolaou—It is a serious question and there are issues in relation to the design of the tax as it currently sits. For that reason we believe that the tax needs to be reconsidered and put on the table as part of the tax summit. We believe that it has been poorly thought through because of the urgency, which became apparent in putting forward a new form of tax to replace the RSPT.

Senator CAMERON—What do you do then if you put on the tax summit and it goes a year out or two years out. You would then be arguing more retrospectivity, wouldn't you?

Mr Nicolaou—I think it is a core principle of taxation that you would not want to see retrospectivity.

Senator CAMERON—This is about rate seeking and delay, isn't it?

Mr Nicolaou—With respect, it is about getting the taxation system right. Our belief is that it is not about reducing the tax burden or shifting tax to other parts of the economy; it is about getting the tax design right. That will actually provide the incentives for the economy to grow into the future with minimal distortions. That is our position in relation to that. It is not about delaying, deferring or avoiding tax.

CHAIR—Thank you for your contribution.

Proceedings suspended from 2.48 pm to 3.05 pm

ANWYL, Ms Megan Irene, Executive Director, Magnetite Network

MACKENZIE, Mr William Ross (Bill), Chairman, Magnetite Network

CHAIR—The committee welcomes the Magnetite Network, specifically Mr Mackenzie and Ms Anwyl. I invite you to make an opening statement and then the committee will ask you some questions.

Ms Anwyl—I am the Executive Director of the Magnetite Network, known as MagNet, and Bill Mackenzie is the chairman of the committee. I will just make a couple of opening comments and then Bill will speak to the presentation. It is fairly brief.

To set some context, the Magnetite Network was established a bit over a year ago and represents the needs of magnetite producers. As the committee is no doubt aware, the magnetite industry is fairly new to Western Australia, and although there are two operating mines—one in Tasmania and one in South Australia—there has not traditionally been much magnetite ore mined in Australia. We have three members: Atlas Iron, CITIC Pacific Mining and Extension Hill. Bill Mackenzie, who is the chairman of the Magnetite Network, is also the Managing Director of Extension Hill. I believe that you may have heard from the Managing Director of Atlas Iron, David Flanagan, this morning in another context, and I will speak briefly about CITIC Pacific Mining in a moment. We as a group have just lodged our submission to the PTG, the Policy Transition Group. It has been the position of the Magnetite Network that, whilst we cover three companies in terms of their projects, we also have a lot of liaison with much smaller projects.

You can see from the map on page 3 that there are actually a lot of potential projects in Western Australia. It is fair to say that a significant number of these companies are not represented by any of the traditional peak bodies. Some of them belong to the Chamber of Minerals and Energy or the Association of Mining and Exploration Companies or the Geraldton Iron Ore Alliance, but on the whole they tend to be very lean and mean exploration-type companies, so it has certainly been the habit of Magnetite Network to be involved with these companies. Our contention is that when it is mined magnetite has a very low value and it is very difficult to even track this because it has not traditionally been sold as raw ore. It is really only after the beneficiation process that magnetite has a value. We note that the beneficiation process is similar to some other base metals that have been exempted from the tax and we will come back to that shortly. We also think that the taxation of magnetite concentrate is contrary to the policy intent stated by the Prime Minister and a range of other senior ministers. What I would like to do, if I could, is hand over to Mr Bill Mackenzie, who will speak briefly on the difference between magnetite ore and haematite ore and the more technical matters associated with that.

Mr Mackenzie—Thank you for the opportunity to present to the committee. Essentially, our case is for exclusion of the production of magnetite concentrate. That requires us to go down the path of, ‘What is iron ore?’ There are really two types of iron ore products around. Haematite and magnetite are the two minerals. They are both iron oxides. Magnetite is very magnetic and naturally occurring. It is just a highly magnetic substance.

Magnetite concentrate is produced throughout the world. There is very little in Australia. Less than two per cent of Australia's iron ore is produced as magnetite concentrate and that is because we are well endowed with the direct shipping stuff. The USA, China, Canada and Brazil have extensive deposits of magnetite, which they are mining and concentrating into magnetite concentrate and using as feedstock into their steel business.

With your permission I have a few samples that will show the difference between the different ores. This is haematite ore. It is the characteristic red colour of the Pilbara. What happens in the Pilbara is that you have these ores that are formed by natural processes that basically take the ore as it was originally laid down at the bottom of the ocean billions of years ago as bands of dark iron-oxide-rich material and then lighter silica-rich material. This is the banded iron that is talked about throughout the industry. You take the natural banded iron where it is magnetite—as you can see there is lots of magnetite and a magnet sticks to it—oxidise it and in the oxidising process the magnetite turns into haematite and through other natural processes the silica leeches away. This is what you get left with, which is your direct shipping ore. It is not magnetic—the magnet falls off.

That is basically what lies around in the Pilbara and is dug up and is able to be taken straight into the blast furnaces. That is valuable product. It is very rare on the earth's crust that these processes take place. There is plenty of banded iron around but not much of it has been enriched by natural occurrences. That is very high in iron and very low in silica. This stuff here, on the other hand, as we mine it, you cannot put that into a blast furnace. There is too much silica in it. We have to break this up into its individual mineral components by crushing, grinding then using our magnets to form this stuff here. I could bring it around but it would leave you black and dirty. It is a very fine powder. I am happy to show it to you and bring it up if you want.

Senator HUTCHINS—I think we get a sense of it.

Mr Mackenzie—Yes, it is very fine, black powder. It is pure magnetite. It is pure Fe_3O_4. Rather than relying upon aeons of time and lots of geological processes we actually add the value to the product. In the presentation we have here we have essentially got a DSO production process. We mine the ore, crush it, put it on a stockpile, put it on the ship and off it goes. Over 98 per cent of Australia's iron ore production is like that—it is direct shipping ore. There is blending of different ore grades and so on to get a consistent quality, but that is essentially all that is done.

If you turn to the next page, the bit in the middle—the grinding, the separating using magnets, the concentration—is the process that adds value in Australia to yield this magnetite concentrate. Concentrate is fundamentally different from the ore. For every tonne of ore we process only 25 per cent to 45 per cent of that is actual product. The rest of it is unsaleable and stays on the mine site as waste.

On the next page is a flow sheet for a typical copper-gold type project: you crush it, you grind it, you separate the individual mineral components within the rock and you extract the valuable ones leaving the waste products behind. Similarly for alumina, where again you take bauxite and you put it through a process of grinding and dissolving it in caustic soda and extracting only the alumina to make it pure alumina concentrate. Getting magnetite concentrate is very similar to those two processes. The base metals are exempt from the tax but magnetite is not. We think that is a fundamental misunderstanding of the definition of 'iron ore' and we think it is probably contrary to the policy intent of not taxing the value added by the miners. I will hand back to Megan now to run through the state of the industry in Australia.

Ms Anwyl—We are probably drawing towards the end of the opening statement. The next slide that you have there is on the economic benefits of magnetite. What I have done there is take the three member companies of MagNet, bearing in mind that there are lots of other projects out there, and attempt to estimate the sorts of mine life capex involved in developing these projects and so forth to give some idea. These are all effectively the early stages of these projects, so there could be much greater expansions of them down the track, but you will see that for those three companies there is roughly a $13 billion capex for developing the projects.

The next slide is a summary of CITIC Pacific's Sino Iron project, which is located south of Karratha. You will see that there are some very significant mine lives. There is a 450-megawatt power station being constructed on site and a desalination plant at 51 gigalitres, which is actually larger than the existing Perth water desalination plant. Our point is that, in terms of the value adding, it is not just about the extra beneficiation processes that occur largely on site but also about the construction and the running of power stations and water desalination, in the case of this project. I am sure members will have heard about the mid-west region, of which Extension Hill is one project. In some cases there will be slurry pipeline used to transport the concentrate to the coast, as per CITIC Pacific, and in other cases the projects are hoping to have extensive rail systems built. So, again, we are talking about the provision of potentially large amounts of infrastructure, which would have some application for third-party users potentially as well.

I will continue. We framed the MRRT in the context of a comment taken from the agreed principles attachment to the media statement of Prime Minister Gillard and others on 2 July. We have set out MagNet's position, which Bill and I have already alluded to. Effectively, we say that the ore as it comes out of the ground has a very low, if any, value. As I said, it has not been traded in the past. Even magnetite concentrate has tended to be used within the country where it is mined—for example, magnetite has been mined for more than a hundred years in China, and it has tended to have steel mills located right beside the magnetite mines—so there has not been a lot of seaborne trade to track. The government has also talked about taxing the value of the resource rather than the value added, and various comments have been made about the desire of government to ensure that the taxing point is as close as possible to the mine gate. There has also been some discussion about the point of extraction. In the case of magnetite concentrate, the bulk of the beneficiation will go on at the mine site, so we like to talk about the point of extraction rather than the mine gate for that reason.

I will turn to the next slide. It is in fact a direct replication of the six key points that the Magnetite Network has put to the PTG in its submission. Our submission was only just lodged last week. I am not sure if the committee would like me to go through those.

CHAIR—Maybe just quickly, yes; that would be good.

Ms Anwyl—Just quickly: we touched on some of these things before, but they are that, firstly, concentrate can be readily distinguished from other iron ore products, and this provides a simple method by which magnetite concentrate could be excluded. We are talking about the Fe_2O_3 hematite ore, which Bill showed you in a big lump as it comes out of the ground, versus the highly beneficiated Fe3O4. So we are saying that right upfront there is a chemical composition difference which makes it very easy to draw a line in terms of definitions, and we will come to that in a moment in summary.

Secondly, we believe that excluding the concentrate is consistent with the government's stated policy intent to tax the value of the resource rather than the value added. Thirdly, we say that it is basically inequitable and inconsistent to include this concentrate in the tax when, to our knowledge, all other concentrates—given that we are talking about iron ore and coal only as being subject to the tax—have been excluded. The fourth point—and this is in our submission, which will be a public document; it will be accessible—is that we do not believe there will be a great deal, if any, tax to be payable by the magnetite concentrate industry.

Mr Mackenzie—That is just on the basis that, if the taxing point is set as close as possible to the mine and if the value of the ore is determined by netting back costs including a commercial rate of return on the capital employed post the mine, we have demonstrated in our submission that it would appear that there would be little if any tax payable by the industry.

Ms Anwyl—Moving along, we mention the fact that there will be a significant compliance burden on producers and that there would also be a public cost in terms of administering the tax when in fact there may not be any net gain. Our final point is that to include magnetite concentrate in this proposed regime will have an adverse impact on the fledgling industry by deterring investment and jeopardising the significant regional development and economic and social benefits that might otherwise occur.

I think it is really important to note that, with respect specifically to the Western Australian projects, they are either wholly or partially financed by foreign investment. It is, I guess, trite to say that there is magnetite present all over the world. From the point of view of potential investors, let us bear in mind that, in the case of CITIC Pacific's Sino Iron project, that investment decision was made prior to this issue having occurred. Indeed, it was made prior to the carbon tax having been fully flagged prior to the 2007 election. So we are talking about whether foreign investors are going to be willing to look to develop these very large projects—when I say 'very large', I mean they are very capital intensive—and whether they will choose Australia over some other venue. We believe that there are some very real value-adding and provision-of-infrastructure benefits from having these projects here in Western Australia, but the feedback that we have had from particularly some of the smaller companies that are not actually members of the Magnetite Network is that this has impacted significantly on the interest that they were receiving in their projects. That is a summary of our position to the PTG. Would you like to speak to the final point, Bill?

Mr Mackenzie—I will just expand on that last point. Remember, at the outset I said there are very few places on the earth's crust, on the planet, where the geological processes have created direct shipping ore, but, on the other hand, there is plenty of magnetite around, not just in Australia. We do not have a mineral province like the Pilbara, which is one of two or three of its kind in the world. The steel industry has a heap of capital looking to invest in new supply of magnetite. It is a fledgling industry in Australia. That capital may well go elsewhere if the investment climate is not right. We certainly do not have a monopoly or even a major position in terms of our resource endowment of magnetite.

Lastly, rather than just saying that there are problems with the thing, we are proposing a fairly simple solution to exclude magnetite, which is simply the definition here. The definition reads: 'An iron ore commodity means any ore from which iron is extracted, not being (a) a product produced from an iron ore commodity or (b) magnetite which has been concentrated or upgraded by processing ore otherwise than by washing, drying, crushing or screening or a combination thereof.' The genesis of that also is in Western Australian state development agreement legislation. That is probably the most tried and tested iron-ore-specific legislation in Australia, so that is what we turn to, and we think the solution is pretty simple: by taking some words out of the Western Australian legislation and effectively excluding magnetite from the MRRT regime.

CHAIR—Thank you very much. You have made a very good case, you have presented it well and I understand where you are coming from. But ultimately what you are saying is: you do not want the proposed national tax on mining to apply to magnetite and you are leaving the battle on iron ore more broadly for others to fight. Is that the approach you are taking?

Mr Mackenzie—From the Magnetite Network, yes; that is correct. With respect to the issue of the fundamental problems with the design of the tax, the real-world issues that that creates in terms of the undefined start point/end point in time or in space of a project, the termination of value, who the taxpayer is—given it is a project tax and not a corporate tax—all of those issues are specific to companies, so MagNet has left the design issue arguments to individual proponents and the rest of the industry. We are saying there is a compelling case for magnetite as a commodity to simply be excluded, the same as every other mineral concentrate producer is.

CHAIR—But in looking at your submission to the PTG offering a definition of iron ore, we should not take that as you supporting the MRRT as it applies to iron ore; we should just say that you are focusing very narrowly on what you think is a legitimate perspective from a magnetite point of view. Is that correct?

Mr Mackenzie—Exactly. If we can, reading from the summary, which is in the PTG presentation, it says, 'The members of MagNet do not support the proposed MRRT.'

CHAIR—Okay. That clarifies it for me.

Ms Anwyl—You have heard from Atlas Iron's managing director this morning, who I think has a pretty emphatic position. Atlas Iron are an interesting case in terms of our membership, because they have haematite, which they are already shipping quite extensively, as well as magnetite reserves.

CHAIR—Presumably you would have put those arguments around the specific circumstances of magnetite to the government on a number of occasions. What sort of response do you get from government? I understand where you are coming from, but what sort of feedback are you getting from the government?

Ms Anwyl—I think it is important to note that we have had a very full opportunity to submit to the PTG in terms of the day's hearing here in Perth and also the members have had private meetings with Minister Ferguson. I think it is fair to say that there has been an extensive opportunity to have that discussion with Minister Ferguson. I am not sure that there has been a very full dialogue with other senior members in the government, and I think it is also important to note that whilst the modification of the RSPT to the MRRT was welcomed by the magnetite network, it was not privy in any way to the agreement that was reached effectively between the three miners—BHP Billiton, Rio Tinto and Xstrata.

Indeed, I think it is important to also state that traditionally, given the new nature of this industry in Western Australia, it is probably fair to say that the major iron ore miners have not supported the development of a magnetite industry—

CHAIR—Why is that?

Ms Anwyl—I do not know why—

CHAIR—Is it competition?

Ms Anwyl—One can only surmise there is a competitor.

CHAIR—Okay, but if that is the case it is highly inappropriate, isn't it, for the government to negotiate exclusively—some would say in secret—with the three biggest mining companies that have a different perspective from yours and that of other mining companies, and essentially negotiating with companies that are keen to see you guys not succeed. How do you feel about the government negotiating the design principles of that tax?

Senator CAMERON—I raise a point of order: it is unfair for you to be putting to these witnesses a proposition that you have come up with about the government that is not true. You should at least stick to some questions that are accurate without the political—

CHAIR—I will ask my questions and will leave it to the witnesses to answer.

Senator CAMERON—As long as they are not improper questions.

CHAIR—It is fair to say I think, Senator Cameron, that the government negotiated exclusively with the three biggest mining companies. I think Ms Anwyl made that point herself in her comments.

Senator CAMERON—That is not the point that you made. The point you made was different to that.

CHAIR—Let us leave our discussions for the parliament and let us ask questions now of the witnesses. Are you concerned about the way that this tax was negotiated with, as you have just mentioned, companies that are not keen to see your businesses succeed?

Mr Mackenzie—If I can answer that both from my company's perspective as well as from the MagNet perspective. I am disappointed that there was not a green paper-white paper consultation process to get these issues out and inform the design principles of a new tax.

CHAIR—So you are saying it would have been preferable if there had been a more transparent and public process where everybody had an equal opportunity to put their respective perspectives on the table for consideration? Is that a fair representation of what you said?

Mr Mackenzie—Certainly, I would have preferred a green paper-white paper consultation. That is a preferable and a formal way to have positions stated.

CHAIR—Understood. In your presentation you go to the economic benefits of magnetite. You mentioned capital expenditure, the ongoing employment, royalties and annual export revenue. You did not put in there company tax payments. I am pre-empting a question that I suspect might come from some of my colleagues about revenue of $6.3 billion with what looks on the face of it a return to government of only $335 million. Of course, that does not include company taxes on top, does it?

Ms Anwyl—No, and it is important to note that none of these projects are in existence yet, so these are total projections. There is no magnetite being mined in the state yet. That royalty is strictly a state royalty that we are referring to there. I have not done modelling of the percentage of return to the federal government.

CHAIR—I am just making that point because you are probably underselling the return to government at all levels that might be coming if these projects do ultimately end up producing and providing a return to the economy and to government.

Mr Mackenzie—In our PTG submission we developed a conceptual greenfields magnetite project. It set out a set of assumptions around the capital, where that capital would be spent whether it is in mine, in processing or in transportation to port. It set out some operating cost parameters which are—I will not say industry rules of thumb—typical of what we would expect the industry to do. We then used those parameters and put them through the PTG's model. On the assumptions that are outlined in our submission we determined an effective tax rate of 37 per cent for the magnetite industry—10 per cent of all revenue went in company tax and five per cent of all revenue went in state royalties.

CHAIR—You mentioned the PTG submission. Is there any chance you will be able to share your PTG submission with the committee? Would you be able to provide us with a copy of that?

Ms Anwyl—Subject to—

CHAIR—Others organisations have provided us with that.

Ms Anwyl—I do not think there will be any issue, but I just want to alert the PTG.

Senator HUTCHINS—This morning we had Atlas Iron before us. Mr Flanagan said—and I am assuming this is the lower grade iron ore he was talking about; is that right?

Ms Anwyl—They have existing haematite mines.

Mr Mackenzie—Atlas Iron has existing haematite mines as well as a magnetite proposal.

Senator HUTCHINS—These are proposed. You have not got anything actually moving or getting crushed at the moment, have you?

Ms Anwyl—No.

Senator HUTCHINS—I looked at the diagrams and saw two squares and a lot of circles which were the areas under construction and the proposed construction. So the rail and port are the ones under construction.

Ms Anwyl—Yes.

Senator HUTCHINS—You do not own any rail line or any port facility, do you?

Ms Anwyl—Of the three member companies, Sino Iron, as you say, is under construction. They are building their own port. They are going to be using slurry, so there is no rail in that instance. They have spent a significant amount of capital, but they do not own rail lines. As I said, they will have a private port. It is important to note that Atlas Iron's existing infrastructure assets relate to its haematite mining. Whilst it has recently acquired the Balla Balla project that was previous owned by Aurox and it also has the Ridley Magnetite Project, there would not be, in my view, significant infrastructure assets owned there. They do own significant infrastructure assets by way of having helped to finance the port and so on, but that is all for their haematite production. I hope that clarifies the situation.

Senator HUTCHINS—So there are no iron ore rights assigned to, say, Fortescue? We were told this morning that they have haematite rights. We were told that half the iron ore rights were assigned to FMG so that they can use the port and the rail.

CHAIR—That was BC Iron.

Ms Anwyl—That was BC Iron. I think you may have heard from the Canadian gentleman Mike Young.

Senator HUTCHINS—That is a unique sort of arrangement.

Ms Anwyl—BC Iron is haematite specific in the first instance. It is perhaps not entirely unique. There are other examples of having done what is called mine gate sales or various equity sharing arrangements, such as the FMG BC Iron arrangement, but Atlas is not privy to those sorts of arrangements.

CHAIR—Just on that, the Mid West magnetite producers would take advantage of the Oakajee port once it gets underway, wouldn't they? Or would they be shipping things through Geraldton?

Mr Mackenzie—It is both. The projects will initially start through Geraldton and then, in the case of Gindalbie, which is a Mid West project, it will transition through to Oakajee.

CHAIR—But Gindalbie is under construction now. How far away are all of the others? Give me a general sense.

Mr Mackenzie—I am not a Gindalbie spokesman, but I believe their latest public timetable is that they will be in production in the middle of next year with their haematite operations. Their magnetite operations will follow by the end of next year. The Extension Hill project is currently slated to start at the end of 2013.

CHAIR—Some of the other projects are proposed but are not yet under construction. If magnetite is not excluded from the scope of the MRRT, are there question marks about whether those projects will get up at all? How serious is the threat of the MRRT to the likelihood of those projects getting up or not getting up?

Mr Mackenzie—That is difficult to say on a project by project basis. Each project has its own circumstance and ownership, whether it is private or shared infrastructure and so on. Generally, though, as I have said in point 6 of our submission, there is a lot of capital looking to generate new supplies of magnetite into the world steel industry. That capital is mobile and it can go elsewhere. There certainly are difficulties in assessing what the impact of the MRRT will be on a magnetite project in the varying circumstances that apply.

Some magnetite projects will own all their infrastructure downstream from the process plant, including the land transportation and the port. Others will share land transportation and port, others will own their own power supply and others will have third-party access to grids. So it is difficult, because of the lack of detail in the MRRT design papers, to determine the impact. The bottom line is that a royalty is a very simple thing to determine in an investment decision—it is a percentage of revenue—whereas the determination of the MRRT is very difficult to model. Particularly, we cannot model it at the moment because the design detail is not available.

CHAIR—By the sound of it, what you were saying before in your opening remarks is that you did not necessarily expect magnetite producers to pay large amounts of tax. The real concern you have is one of compliance and administrative burdens. Is that right?

Mr Mackenzie—Yes. The position that we do not expect it to pay a lot of tax is based on a series of assumptions set out in our PTG analysis. The project parameters, if you like, are set out. In terms of the design parameters, we have assumed that the taxing point is as close as possible to the mine and that the value of the ore at that point is the sale price less all the operating costs less a commercial return on the capital invested up until that point. If those assumptions are wrong, the industry may well pay a significant amount of MRRT. Our problem is that we do not know.

CHAIR—So, even in your PTG discussions, nobody has shared any more information with you on these questions?

Mr Mackenzie—In terms of the PTG, from my perspective, we have only presented to the panel.

CHAIR—It was not a two-way street? They did not give you feedback on features or issues?

Mr Mackenzie—A number of comments were made in the issues paper about where the panel would make its recommendation, but, again, we do not know where the government will decide.

Senator CAMERON—This is very interesting. I have just had a look at some of the issues you raise on the net. Before I go to that, I will say that I had a look earlier at the Atlas Iron quarterly report. When they talk about the Ridley and Balla Balla magnetite projects, they are saying that the only issue for them—or the only issue they raise—is to actually bed down the development of these projects so they can get first access to available infrastructure. There is nothing in their quarterly report about the taxes or any of that; it is about simply having access to infrastructure. Why would that be?

Mr Mackenzie—That is a question best posed to Atlas.

Senator CAMERON—Do you not represent them here?

Mr Mackenzie—We are representing the industry, but individual project-specific and commercial matters are not something for us.

Senator CAMERON—They also say that alternative divestment strategies are being investigated. Basically, it looks like if they cannot get access to infrastructure then they are looking to divest.

Mr Mackenzie—Atlas are on the record as having said they are looking for a development partner for these projects. Once again, these are fundamentally different in the amount of capital needed, compared with starting up a direct-shipping ore project with shared infrastructures, which is very low capital. A magnetite mine is very high capital. For both of those projects—Balla Balla and Ridley—it is on the public record from the owners of those companies that they are seeking a development partner simply for balance sheet support.

Senator CAMERON—Are you aware of CITIC Pacific Mining?

Mr Mackenzie—Yes.

Senator CAMERON—Are they one of the major investors in magnetite development in Australia?

Mr Mackenzie—Yes. They are currently developing the Sino Iron project.

Senator CAMERON—They are a state owned Chinese investment company?

Mr Mackenzie—CITIC Pacific is listed in Hong Kong; I am not sure of the state owned component.

Senator CAMERON—In the analysis I have seen, it is a state owned investment company, it is investing as much as $18 billion in magnetite iron ore projects and it is part of the overall Chinese longer term—what they call 100-year—strategy to get a balance between hematite and magnetite to drive the prices down and have competition. Is that your understanding?

Mr Mackenzie—As I said, direct-shipping ores are quite rare commodities. The quality of the direct shipping—

Senator CAMERON—No, that is not what I am asking. I am specifically asking: is this part of the Chinese steel mills’ approach to get a balance between hematite and magnetite, to try to suppress the price of hematite?

Mr Mackenzie—I cannot comment on the steel mills' commercial drivers and strategies. What I can comment on is the decrease in quality of direct-shipping ore from the Pilbara, which is driving the demand for magnetite. Because magnetite is a higher quality product, it is required to offset the decline in DSO.

Senator CAMERON—If you as the industry association have not heard of this strategy and I can pick it up in two minutes I am really surprised. If you have not heard that this is a deliberate strategy by Chinese state owned companies and the Chinese mills to help drive down the prices—

CHAIR—Senator Cameron, what is the relevance of your point to this inquiry's terms of reference?

Senator CAMERON—The terms of reference are clear. Let me tell you—you have asked the question. They are about the application of the tax. We have a lobby group coming in here today arguing that it should not apply to them and I am saying that I have seen, from my very quick look on the net, that this is a deliberate strategy by CITIC Pty Ltd, by the Chinese steel mills, to have a competitor in place against hematite, which will mean there will be less tax paid. That is all I am putting to you. If you do not know about it, I am shocked. Anyway, I will move on.

Ms Anwyl—Can I respond to that. Can I please just restate that our membership body has three members, in the same way that the Chamber of Minerals and Energy has a number of members. Whilst I have a fair degree of knowledge about each of the members I am not in a position to answer questions about commercial motivations, for example. But I have certainly heard conjecture about the long-term strategies of Chinese steel mills and so in that context I acknowledge that. It is very clear that magnetite concentrate, which has never been produced in Western Australia, is a very desirable feedstock for Chinese and other nations' steel mills and to that extent there is foreign investment by other countries in some of the other projects that are not undertaken by our members. They are represented by dots on the map that has been put forward.

Senator CAMERON—The report I have seen says that Baosteel Group Corp. and Anshan Iron and Steel Group are amongst the steelmakers that are pushing this investment to try to balance up the need for hematite. Be that as it may, I want to now come to this issue. You are not giving the impression that these are small start-up operators who are really doing it tough and that this tax would make it so much more difficult for them. We are talking about Chinese funding, are we not, for some of these projects? I do not have a problem with Chinese funding—I am not doing a Barnaby Joyce—I am simply saying that we really need to get the facts on the table here.

Ms Anwyl—I think I said at the outset that in the case of these member companies some or all of the funding is sourced from China. To be clear, in the case of Atlas Iron there is the Ridley project that has been on the market for quite a while. They do not have a funding partner. They are seeking to divest about 70 per cent of that project. There have been copious amounts of media around managing director David Flanagan's comment about how he believes the RSPT, as it was, impacted upon a range of commercial negotiations they were having at the time. I think the announcement of the RSPT was on 2 May.

In fact, the Indian media carried stories about how an Indian government-owned or substantially government-owned corporation was relooking at its interest in the Ridley project. The Balla Balla project similarly is, if you like, on the market. There has been a lot of comment around these issues generally. I acknowledge Senator Cameron's comment. I have not perused Atlas's quarterly report yet, but I acknowledge—

CHAIR—I assume that Senator Cameron is not suggesting that foreign ownership should drive tax structures specifically—

Senator CAMERON—I am just asking questions.

CHAIR—Do you have further questions?

Senator CAMERON—Yes, I have further questions. I do not have a xenophobic view on this at all, not like some other senators who, every time China is mentioned, go berserk. I just want to try to get the facts on the table here. The other report I see is that:

China is pumping cash into developing the mines as its steel mills are forecast by Rio Tinto Group to consume more iron ore during the next five years than Australia has shipped throughout history.

Is that your understanding? Has Rio Tinto got it right there—will the Chinese mills consume more iron ore in the next five years than they have consumed through the whole history of extraction in Australia?

Mr Mackenzie—What I am aware of is seaborne iron ore demand into China is increasing. The production of steel in China is increasing rapidly. Whether that translates into the specific statistic you just outlined, I am not sure but certainly it is ongoing. As I have said in relation to that, if it comes from the Pilbara it is continuing to decline in quality. The magnetite is needed by the industry.

Senator CAMERON—You only need to tell me that once, to be honest. You have got two charts showing the DSO production process and the magnetite concentrate production process. On the top of the DSO production process, when you dig the haematite from an open pit mine it is worthless, isn't it, in the context that you are saying that magnetite is worthless? Is that the same?

Mr Mackenzie—No, not so. This particular ore is of a quality that is able to be fed into a steel mill; therefore, it has value.

Senator CAMERON—I thought you said it was worthless until you went through this process.

Mr Mackenzie—The magnetite is worthless. The magnetite is not internationally traded. Magnetite, as I think Megan said, is a large proportion of feedstock into the steel industry worldwide but generally it is located close to a steel mill so it is not seaborne trade. As those mines run out next to steel mills those steel mills need to source ore, that is the growth in seaborne iron ore trade.

Senator CAMERON—So in looking at this process, basically you have the same process as the existing miners—so you mine it, crush it and grind it—and there would be some crushing and grinding in terms of the DSO process—

Mr Mackenzie—Crushing and screening.

Senator CAMERON—You need to grind so you can sell the stuff, don't you?

Mr Mackenzie—You need to grind it to separate the silica from the iron bearing materials in the banded iron.

Senator CAMERON—And then it goes through the classifying cyclone, the magnetic separator, another cyclone, another magnetic separator, the thickener, the concentrate pump and then it is a slurry. Does some of your members' product go out in a slurry?

Mr Mackenzie—It is a slurry at some form in the process. Ultimately, it is dewatered before it goes onto the ship and that water is then returned to the process.

Senator CAMERON—So it can go out in a slurry so it does not have to go through the filtration of a pallet plant approach.

Mr Mackenzie—It must be filtered. It is not exported as slurry; it is exported as a dry powder or a moist powder.

Senator CAMERON—What about the pellet plant process?

Mr Mackenzie—That may or may not happen in Australia. Some projects will sell pellets, some will sell concentrates and some will sell a mixture of both.

Senator CAMERON—So what is the difference between the DSO process where you are digging it up, crushing it and using machinery to move it from one spot to another and then maybe blending it—

Mr Mackenzie—The difference is that there is no grinding. I will go through it: the autogenous grinding, the primary classifying cyclone, the rougher magnetic separator, the regrind mill, the tailings thickener, the tailings dam, the secondary classifying cyclone, the finishing magnetic separator, the magnetite thickener—

Senator CAMERON—But you are saying there is value-adding.

Mr Mackenzie—That is the value-adding in Australia. That is to produce a saleable concentrate from magnetite ore, which is not saleable.

Senator CAMERON—Value-adding is normally a process like turning iron ore into steel, but this is a completely different process. You are just digging this stuff out of the ground and doing no more than getting it to a stage where it is of some basic use.

Mr Mackenzie—With due respect, no. The whole basis of this is that the ore is directly shipped in a form it in which it is marketable and usable in an iron furnace. So where do you finish your value chain? Are you saying you have to make refrigerators and motor cars to be at the end of the value chain?

Senator CAMERON—I think so. That would be the general view.

Mr Mackenzie—But it is a chain and there are links along the way. And a major link that is not currently present in the DSO industry in Australia is the concentration.

Senator CAMERON—Your product goes into steel mills.

Mr Mackenzie—Yes.

Senator CAMERON—So does BHP's and Rio Tinto's.

Mr Mackenzie—Yes.

Senator CAMERON—The value-adding is then done in the steel mills. This is production process, this is extraction. You need to do this to extract the mineral, don't you?

Mr Mackenzie—Yes. BHP, Rio and all the other DSO producers do not have to do that, simply because their products are such that the work has been done for them.

Senator CAMERON—But it is still mining, and the mining is no good to you unless you go through this process. But you are calling it value-adding in Australia.

Mr Mackenzie—Indeed, it is.

Senator CAMERON—I suppose there would be some argument about that. I am not sure whether that is really value-adding other than in terms of getting it ready to be able to sell it.

Senator CORMANN—How much value does this product have when it comes out of the ground?

Mr Mackenzie—When it comes out of the ground it is something like 30 per cent iron.

Senator CORMANN—So how much value does it have when it comes out of the ground?

Mr Mackenzie—It cannot be used as feedstock going into a steel mill unless it is processed.

Senator CORMANN—So, once you have gone through this process, how much value has it got them? What is the dollar value when it comes out the ground and what is the dollar value when you put it into the steel mill?

Mr Mackenzie—I would need to mine three tonnes of it to extract the valuable bit. Two tonnes of it stays behind—that is the first point.

Senator CAMERON—But the Chinese obviously believe it is worth while doing this.

Senator CORMANN—It goes to the definition of value-adding: if you take it out of the ground with no value and you then—

Senator CAMERON—Chair, have I got the call or not?

Senator CORMANN—We are running out of time.

Senator CAMERON—I just want to finish my line of questioning, thanks very much. The Chinese see value in doing this, don’t they? The majority of investment in this is coming from China.

Mr Mackenzie—Certainly there is foreign investment, and most of it is going to China—that is the largest market.

Senator CAMERON—But the investment is coming from China as well.

Mr Mackenzie—And the product is going into the world market.

Senator CAMERON—Yes, but I am talking about the investment. The investment going into this product in Australia is from China.

Mr Mackenzie—Not all of it is from China. There are other—

Senator CAMERON—What percentage of the investment is not from China?

Mr Mackenzie—For example, there is a similar process being undertaken by Mitsubishi at the moment.

Senator CAMERON—How much of the financing for magnetite is Chinese sourced?

Ms Anwyl—Do you mean for our three projects? It is difficult to—

Senator CAMERON—Your three projects.

Ms Anwyl—Of our three projects, CITIC Pacific Mining is entirely Chinese investment. Atlas Iron is looking for an investor. No doubt, there are some Chinese investors, but it is substantially an Australian owned company.

Mr Mackenzie—We have got 60 per cent state owned Chinese investment and 40 per cent private owned. If that is floated then it is on a stock exchange.

Senator CAMERON—Just take this on notice: why should the Chinese investors or the overseas investors—it does not matter who it is—get specific benefits that Australian miners, or other miners, may not get? It seems strange that you should be arguing that something that does the same thing when it gets on the boat and into the steel mill should be treated much differently here. It just does not make a lot of sense to me. If you have got a better argument than this, I would like to hear it.

Ms Anwyl—From the context of value adding, it would seem that we have got different definitions around that, and I acknowledge your comment—

Senator CAMERON—I am not sure whether your definition is a proper definition; that is all I am saying.

Ms Anwyl—And I am acknowledging that, Senator Cameron. My point is that in terms of beneficiation, that is, the difference between the DSO, direct shipping ore, that goes out with very little beneficiation and the sort of capital expenditure and operational expenditure by way of energy, extra jobs involved and all the rest of it, there is a significant beneficiation process. Some of the projects will create pellets, some will not. Again I acknowledge that. There are not steel mills being built in Western Australia but I would suggest to you that the domestic gas issue is a massive factor in terms of whether or not there will ever be any significant value adding in the context that I understand you to be saying.

Senator CAMERON—I am not arguing that point. That is not the point. The point I am making is that when we put this stuff on the boat, it goes overseas, it goes in a steel mill, it does the same thing. So why should it be treated in differently? That is all I am trying to deal with.

CHAIR—I think we have explored that point. It is fair to say that if a company is entirely Australian owned, entirely foreign owned or part or one way or the other, for the same process, it would be exactly the same, of course. You are arguing that because you essentially have a product that is not worth anything and you will end up not paying much tax but you are going to be burdened with a lot of administration along the way, there is a justification for you to be taken out of it because it is not sufficient to justify the expense of increased compliance and so on. You are not really worried about being exposed to significant levels of tax; you are worried about significant levels of administration and compliance costs for no benefit to the community.

Mr Mackenzie—That certainly is very valid that there will be a very large compliance cost in this, on the basis that the assumptions that are in here and where the taxing point will be and how the taxable value will be determined, we do not believe there will be a significant amount of tax paid. However, if we are not excluded, we have this uncertainty in the investment of our client.

CHAIR—Thank you very much for your contribution to the committee today. It has been very useful. If you can share your Policy Transition Group submission with us, that will be very much appreciated.

[4.03 pm]

STREITBERG, Mr Eric Charles, Executive Director, Buru Energy Limited

CHAIR—Welcome. We invite you to make a brief opening statement and then the committee will ask you some questions.

Mr Streitberg—I am not at all familiar with this process, but I am happy to have the chance to talk about where we are at. As you are aware, the onshore oil and gas business has been subject to the royalty regime and then, to our astonishment, we were told that we were going to be pulled in under the PRRT regime. That raises a significant number of issues for us. It is both in relation to what the tax burden might happen to be and also the fact that we are trying to force a tax that was designed for the offshore into the onshore where the structure of the industry is quite different, and that raises all sorts of issues for us.

The other thing is that, apart from the other coal seam gas producers on the East Coast, the rest of the onshore industry is relatively small. There are not many of us and we do not produce a lot of oil and gas. The revenue from the application of PRRT to the small onshore explorers is likely to be very small but it will bring a compliance burden that is extremely difficult for us. It is a complex tax. Nobody really understands it very well. It is not administered particularly effectively by the ATO. We have a very small number of people in the company, as do most small companies, and the compliance burden is going to be very onerous for us.

The other area where the PRRT is going to really cause some problems is in the unconventional space, where we are trying to produce shale gas. Currently, the coal seam gas guys have done some sort of deal on the PRRT with the government. They are all major international companies so, presumably, they have the resources to be able to deal with it. Most of us do not.

CHAIR—Thank you very much, Mr Streitberg. How much onshore oil and gas production is there in Western Australia at present?

Mr Streitberg—Apart from Barrow Island, which is under—

CHAIR—That is offshore, isn't it?

Mr Streitberg—Yes. It is under a different regime. I am not sure what they will do about Barrow Island. There basically is not any. We produce about 60 barrels of oil a day, but there is quite a bit of exploration going on at the moment.

CHAIR—So would you expect to be paying a lot of PRRT if it did come into effect onshore?

Mr Streitberg—On current production?

CHAIR—Yes.

Mr Streitberg—No.

CHAIR—But what about on projected production—say, over the next five to 10 years?

Mr Streitberg—Not on our conventional production but, if we are able to get one of these unconventional players to work—the modelling is quite difficult. Firstly because we just do not have the resources and, secondly, because the terms are so unclear it is really quite difficult to come up with a credible model of what the onshore PRRT is going to look like.

CHAIR—It will look the same as the offshore PRRT, won't it? You are shaking your head; Hansard cannot pick that up.

Mr Streitberg—No, it will not. The tax was designed for a specific set of circumstances in the onshore, where fields are discovered and defined, there is an FID—

CHAIR—Do you mean offshore?

Mr Streitberg—Yes. There is a big investment and then, bang, things come on stream and they produce at a steady rate for 20 years. What we would normally do is have a long period of appraisal and development, building our production up slowly, with a lot of exploration. It is quite a different regime, and the way in which the tax operates, we think, would penalise us pretty severely compared to the offshore.

CHAIR—Why would it penalise you more severely?

Mr Streitberg—Because where you switch from exploration into appraisal, the trigger for that is not entirely clear in the onshore. It is in the offshore because you go through an exploration phase, then you say, 'Righto, I'm going to commit $10 billion to develop this field,' and then the switch gets triggered there. In the onshore you do not have that. You may go through a very much longer exploration and appraisal period so you do not get the uplift from exploration, during the five years where you are drilling wells, to get to that point—and that has a massive effect on what looks like the starting base would be for your project.

CHAIR—At present you would be subject to state royalties.

Mr Streitberg—Yes.

CHAIR—And you would still be subject to state royalties until you were hitting a threshold?

Mr Streitberg—My understanding is the state royalties are deductible or offset, if you like, against the PRRT.

CHAIR—That is if you become subject to the PRRT. Isn't there a threshold below which you are not subject to the PRRT and you continue to pay your state royalties?

Mr Streitberg—You will continue to pay state royalties in all circumstances, but my understanding was that once you start paying PRRT, the royalties are essentially an offset to the PRRT.

CHAIR—But if you pay the royalties and they do not get refunded, presumably you would still have to go through the compliance and administrative requirements to prove that you are still outside the PRRT—is that right?

Mr Streitberg—Yes, and that is an extraordinary administrative burden. We do not really understand how it all works because there is only a handful of companies that pay PRRT at the moment—the Chevrons, the Woodsides et cetera—and most of the PRRT expertise is actually inside those companies, so it is very difficult to find it, even amongst the consultants. We have had to make a lot of assumptions about how all this stuff will work.

CHAIR—Have you had any interaction with the Policy Transition Group?

Mr Streitberg—Of course, yes.

CHAIR—Did they explain to you how some of this will work?

Mr Streitberg—They do not know.

CHAIR—The state royalty regime is comparatively simple.

Mr Streitberg—Extremely simple. You go through an initial arm wrestle on just exactly where the taxing point is, and from then on it is very simple. It is also a negotiable rate if, say, you are in a project that is marginal. For example, they have just reduced the royalty on tight gas in Western Australia to five per cent to try and encourage exploration for tight gas. So there is that flexibility to be able to make changes to try and increase domestic gas supply.

CHAIR—So the state government has reduced the royalties as far as domestic gas production is concerned, but then this would really counter that because it will increase the tax burden.

Mr Streitberg—Yes.

CHAIR—We had the DomGas Alliance here this morning who told us that there is a supply problem and that this is not going to help. They were actually on your side of the argument on this particular issue, saying that this is going to make it harder to get more production domestically of domestic gas.

Mr Streitberg—Absolutely; I completely agree. It is one of the few times that we are on the same side.

Senator CAMERON—You just have to say yes or no. He’s not bad at this!

Mr Streitberg—We have had a lot of interaction with the DomGas Alliance because in some respects they are on the opposite side of the fence to us, but in this I think they are aligned. The DomGas industry has the resources to be able to properly analyse this. They are all big companies, such as Alcoa, and they have looked at this pretty hard. They are very concerned that it will affect exploration onshore—with some justification, I think.

CHAIR—Most of the focus in the public debate on this mining tax package, which was announced on 2 July, has centred around the MRRT. There has not been much discussion on the impact of the onshore expansion of the PRRT. Why is that?

Mr Streitberg—We are the most active onshore explorer in Western Australia, and my staff who can focus on these things are me and my CFO.

CHAIR—You are saying there are not enough people who are able to dedicate the time to hit the drum on it.

Mr Streitberg—Absolutely.

CHAIR—This is a good opportunity for you today, then. You had better make sure that we understand all of the issues you have with this. You have talked about the unconventional space. Can you explain that for us?

Mr Streitberg—There are two types of oil and gas production, one of which is that you stick a hole in the ground, the oil and gas gushes out, you process it and sell it. That is getting much more difficult. You have probably all heard about peak oil and the concerns there. Australia is only producing half of its current oil needs so we are importing half of our oil at the moment. What has happened, particularly in the US, is that there has been a revolution in the way people think about oil and gas reservoirs. There has been a big shift to shale gas and tight gas, the so-called unconventional reservoirs. We are only just in the very first part of trying to understand that in Australia. We are doing some work on that at this very moment up in the Kimberley. Western Australia's onshore has been reasonably well picked over for conventional oil and gas, so we are trying to focus on the unconventional oil and gas.

There are two things here. If we are going to come under the PRRT regime, there is a whole bunch of stuff that needs to be looked at to make sure the application into the onshore actually works and does not kill off exploration. We put in a submission to the PTG which deals with all those aspects in detail.

CHAIR—Do you have a copy of that?

Mr Streitberg—I do not now.

CHAIR—We are allowed to have it as far as the PTG is concerned. It is only an issue for you, as to whether you are prepared to share that information with us. Others have.

Mr Streitberg—I am happy to provide it to you. I was not sure what the PTG's sensitivities were to this and how it interacts. If there is no issue between you and the PTG—

CHAIR—If you are happy to share the information then we are happy to receive it. It is really your information.

Mr Streitberg—I am happy for you to receive it. Apart from the philosophical objection we have to bringing the PRRT into the onshore—if that is what happens—our submission to the PTG is very narrow in scope because there are very direct guidelines about what you can and cannot make a submission to the PTG on—one of which is that you cannot say you do not like it and you do not want it because it is going to be applied.

CHAIR—We can take as a given that you do not like it and you do not want it—that is right, isn't it?

Mr Streitberg—I think it is unnecessary, it is going to complicate our lives and it is not going to raise a lot of revenue.

Senator CAMERON—On that point, if you don't know how it works, how can you make that judgment?

Mr Streitberg—I know how it works in a general sense. We have obviously constructed a model. If the model is applied as it is in the offshore, it will generate revenue if we manage to find something and get it in production. It will also have the effect of reducing the amount of risk capital that goes into the business. The oil and gas industry needs huge amounts of risk capital upfront to make these things work, and anything that reduces that reduces the chances of getting domestic gas in Western Australia or getting more liquid production in Australia. We have obviously taken what we can and what we understand of how it works in the offshore, and for some projects it will generate revenue. But they are theoretical ones at the moment; we do not have any projects that will generate revenue. I assume the coal seam methane guys have and that they have modelled this and come to some deal about where the taxing point is et cetera, but none of that is transparent to us. We do not know what they have done, and that is another concern for us—that whatever those guys have done a deal on, it is a bit like with the iron ore miners: it is going to flow over to the sorts of things that we do, and that may not be appropriate either.

CHAIR—Has anybody in government shared with you how much revenue they expect to come from the onshore PRRT expansion part of it?

Mr Streitberg—My understanding is that there has been no modelling for it, except for the coal seam methane people, which of course are huge projects and all those FIDs being made on the east coast had to have been made on the basis of an expectation of how the tax would work. But we have no information on that.

Senator CAMERON—Is one of your major shareholders ARC Energy?

Mr Streitberg—Yes, that is one of them.

Senator CAMERON—Are they your biggest shareholder?

Mr Streitberg—They are.

Senator CAMERON—What is their expertise?

Mr Streitberg—ARC Energy was the company that I was formerly involved with. We were taken over by AWE. ARC is a subsidiary of AWE, so AWE are the shareholder.

Senator CAMERON—Can you explain AWE to me briefly?

Mr Streitberg—They are a mid-cap Australian oil and gas company. Their principal production is in Bass Strait and in New Zealand.

Senator CAMERON—So they have shares in your company?

Mr Streitberg—Yes.

Senator CAMERON—Have they offered any expertise to you to analyse these issues or would that be imprudent for them in terms of protecting their shareholding?

Mr Streitberg—You would have to ask them that question. They are a separate corporate entity with their own people.

Senator CAMERON—Are they getting on the board?

Mr Streitberg—No.

Senator CAMERON—I am thinking about a company of that size—a mid-cap company. You are here telling us you do not have the resources to deal with this and you do not know how it operates. If I were a shareholder I would be saying you had better get some expertise pretty quick.

Mr Streitberg—With respect, we tried to do that. There are very few people with the expertise. We engaged BDO, and they have done some modelling for us. It is very unclear how it is going to work on these projects. You just have to make so many assumptions about how it is going to work that you cannot get a clear answer, but you can tell things which would make it work better. We have a lot of those in the PTG.

Senator CAMERON—I know your website says you have very big exploration capacity right through the basin.

Mr Streitberg—Yes, the Canning Basin.

Senator CAMERON—Are you the biggest?

Mr Streitberg—We are probably the second biggest in terms of area after New Standard Energy.

Senator CAMERON—So you have a fair bit of exploration resources there and obviously you are doing that because you are going to make a profit someday.

Mr Streitberg—We hope so.

Senator CAMERON—And you should pay a fair share of tax on that profit.

Mr Streitberg—I do not think that is the issue, frankly. We will be paying royalty and corporate tax plus all the other taxes.

Senator CAMERON—But all the analysis that is out there now is that modern economies are not going for royalties, because they are just not keeping pace. In Australia the royalties are not keeping pace with profitability. Is that your understanding?

Mr Streitberg—No, I do not think that is true at all. Royalty is only a minor part of the tax burden, frankly.

Senator CAMERON—But a royalty is not a tax as such.

Mr Streitberg—It certainly looks like it to us.

Senator CAMERON—But isn't royalty you paying to use the state and the country's resources?

Mr Streitberg—I am not sure I want to get into a philosophical debate—

Senator CAMERON—It is not philosophical. That is what a royalty is. You are complaining about royalties—

Mr Streitberg—I was not complaining about royalties. I have never complained about royalties.

Senator CAMERON—Sorry, I take that back. You are complaining about the new tax.

Mr Streitberg—That is correct.

Senator CAMERON—But you have to understand that royalties are not a tax in the same terms as a company tax. Do you not accept that?

CHAIR—One is on production.

Senator CAMERON—Every time I ask a witness a question you take them down a path—

CHAIR—There is no need to harangue the witness.

Senator CAMERON—I am not. I am just asking the witness questions and I would appreciate if you did not interrupt every time I ask a question of some substance.

Mr Streitberg—I am not going to be drawn into a debate on whether a royalties or profits based tax is an appropriate way for the community to share in the resources. That is for government to come to a view on. All I am saying is that, with respect to the structure of the industry and the amount of tax that gets paid, our view is that that has to be at a level which allows the companies to reinvest in the industry and to make a reasonable return for their shareholders. Our view is that the tax burden in the generalised modelling that we have done has the potential to increase past that point where it is a reasonable return to the community and it gives us the ability to have enough surplus funds to reinvest.

Senator CAMERON—I am interested in this generalised modelling. Can you give us a copy of that modelling and the assumptions that go into that modelling?

Mr Streitberg—It depends what purpose you want to use it for.

Senator CAMERON—So that we can understand where you are coming from in your submission.

Mr Streitberg—Maybe you should get Treasury to supply that to you.

Senator CAMERON—You said you had done—

Mr Streitberg—That is fair enough; it is an internal thing that we have done.

Senator CAMERON—But understand where I am coming from: the assumptions that you feed into your model determine the outcome of the model.

Mr Streitberg—That is correct.

Senator CAMERON—You are using that modelling as an argument for why there is a problem. I am simply saying: let us see the assumptions of the modelling.

Mr Streitberg—No, I think you have taken a step too far on that. The PRRT will make you pay additional tax at some point. All the model does is tell you what that point is and how much it is.

Senator CAMERON—It depends what you factor into the model.

Mr Streitberg—Of course.

Senator CAMERON—You said you do not understand how the tax works. What did you factor in?

CHAIR—If the government shared that information then it could factor more accurate information into it, Senator Cameron.

Senator CAMERON—I am just asking Mr Streitberg what he factored in.

Mr Streitberg—You asked me a specific thing that you are interested in. What do you want? Oil price, gas price, cost, facilities—

Senator CAMERON—What you did in your modelling.

Mr Streitberg—Those are the things that go into your modelling.

Senator CAMERON—But what quantum are you putting in in various aspects?

Mr Streitberg—I am trying to understand.

Senator CAMERON—Whatever you figured in the model generates the outcome?

Mr Streitberg—Sure.

Senator CAMERON—All I am asking is: are you prepared to provide to the committee a copy of your modelling and the assumptions in the modelling?

Mr Streitberg—Not at this point.

CHAIR—I just interrupt you here, Senator Cameron. I think you have pressed that point for long enough. You are asking the witness to share something with us, which the government is not prepared to share with this committee, the community or business at large. You have put that question to Mr Streitberg often enough. If you have further questions, I am happy for you to ask them.

Senator CAMERON—Mr Streitberg, you have used the modelling as an argument and if you are not prepared to say what the modelling is then we have to ask: is it good and effective modelling? That is all.

CHAIR—Senator Cameron, the modelling would be much more accurate if the government were to share some of the information they are keeping secret so that all of us can have a more informed debate about whether or not the tax that is on the table is in the public interest.

Mr Streitberg—What did Treasury use to model the onshore PRRT? Frankly, I do not think anybody has any idea. The questions we asked of PTG made it quite clear that nobody has thought about this.

Senator CAMERON—Would you be prepared to pay royalties, as distinct from a profits tax? Is that what you are saying?

Mr Streitberg—Yes.

Senator CAMERON—Isn’t the theory behind the profits tax that you do not pay a tax until you start making a profit and with royalties, you pay them almost immediately?

Mr Streitberg—Yes, but the royalty regime is more about stability. Simplicity is a major factor. Can I ask whether you have you ever looked at a PRRT model?

Senator CAMERON—I am asking you the questions.

Mr Streitberg—Sorry.

Senator CAMERON—You can be sorry all you like; I ask the questions. If you are not prepared to answer, that is up to you. All I am saying to you is that the royalties come in early, they come in low and they stay low.

Mr Streitberg—Yes.

Senator CAMERON—So if you make big profits the community does not get a fair share.

Mr Streitberg—They do; we pay corporate tax.

Senator CAMERON—Yes, but you also have to pay a share of the resources that you are using, don't you?

Mr Streitberg—We are doing that through the royalties.

Senator CAMERON—Which are very low and inefficient.

Mr Streitberg—That is your view.

Senator CAMERON—No, it is not mine; it is evidence we have had.

CHAIR—It is your view, Senator Cameron.

Senator CAMERON—No, it is not. It is my view but it is also backed up.

CHAIR—Senator Cameron, you can ask questions, but I do not think you should be having an argument with the witness.

Senator CAMERON—I'm not having an argument.

CHAIR—This is not somebody who is in parliament on the other side. I think it is fair to characterise what is happening here as you having an argument, Senator Cameron. I think you are getting way out of line.

Senator CAMERON—You do not need to help Mr Streitberg. He has been very effective in putting his company's position. He does not need your help.

CHAIR—I think you are getting out of line, Senator Cameron, and I want you to come back to a more appropriate line of questioning.

Senator CAMERON—That is appropriate.

Mr Streitberg—No, excuse me, if I might just say, you may have a philosophical view that a profits based tax is more effective for whatever your philosophy is. I do not share that view in relation to the onshore oil and gas industry.

Senator CAMERON—So if they make huge profits—

Mr Streitberg—I wish! We don't.

Senator CAMERON—If you do not make huge profits then isn't a profit tax better than a royalty.

Mr Streitberg—The level of the royalty is—

Senator CAMERON—So low.

Mr Streitberg—It is not so low. It is low enough that it does not impact on our industry to stop investment.

CHAIR—What is your average tax rate—royalties and corporate tax combined—at present?

Mr Streitberg—We hardly pay any corporate tax, because we do not make a profit.

CHAIR—Sorry, let me rephrase that. You are currently not in production. If there is the wrong tax burden, of course, you will never be in production. But if you were in production, running your normal operation, what would be your average tax rate—royalties plus company tax?

Mr Streitberg—Is a very, very difficult question to answer, because it depends on what your deductions are under corporate tax. But if you are paying 10 per cent royalty just on the very face of it and you are paying 28, 29 or 30 per cent—whatever the corporate tax rate turns out to be—I guess you can add the two together on a very simplistic level.

CHAIR—So it is just shy of 40 per cent. So if you then ended up with another 40 per cent PRRT on top of—

Mr Streitberg—Yes, but when you take the deductions into account, your effective tax rate goes up to somewhere around 50 per cent or over, and I am sure the MRRT guys have been telling you this.

CHAIR—How does that compare with what would be imposed by way of taxes in equivalent jurisdictions—your competitor nations, I guess—as far as this sort of investment is concerned in this industry?

Mr Streitberg—It ranges all the way from Norway, where they are much higher, to places like New Zealand and Thailand, where they are much lower. It would certainly be in the higher quartile.

CHAIR—If I summarise your point, in Western Australia there is no domestic gas production industry at all at present—not yet, we would like to have one. There is a small domestic oil production industry—yes?

Mr Streitberg—Yes, which is us.

CHAIR—If the onshore expansion of the PRRT happens in its current form, will there ever be a domestic gas production industry?

Mr Streitberg—I do not know the answer to that. It probably will not kill the whole thing. I have to be honest. People will still invest but they are going to invest with the expectation of a lower return, which means you will get less risk capital, and that is what our industry is all about—generating risk capital.

Senator CAMERON—Mr Streitberg, I want to come back to where I was before the chair came in over the top of me. Does your board take the view that royalties are the equivalent of a company tax?

Mr Streitberg—I have no idea. I have never asked them that direct question.

Senator CAMERON—Do you?

Mr Streitberg—I am not quite sure I understand the question.

Senator CAMERON—Do you see a distinction between royalties and corporate tax?

Mr Streitberg—Of course.

Senator CAMERON—Well, explain the difference to me, because I am confused about some of your earlier evidence on that.

Mr Streitberg—I am not sure if I am here to provide a lesson in economics to the committee, frankly.

Senator CAMERON—I am not asking for a lesson; I am asking how you distinguish royalties from corporate tax. How do you see it? You are bundling up corporate tax, as Senator Cormann is trying to get you to do. That is not correct, is it? They are different animals, aren't they?

Mr Streitberg—Of course they are. They are calculated in a different way.

Senator CAMERON—And they are for different things, aren't they? No?

Mr Streitberg—Well, you are trying to lead me to say that—

Senator CAMERON—I am not trying to lead you to say anything. Senator Cormann does the leading; I am only asking.

Mr Streitberg—I am not sure how productive this is, frankly.

Senator CAMERON—I think it is productive. I think it is important to understand. If you have come here to give evidence that there is a problem moving to a profit based tax from a royalty, I need to be sure you understand what royalties are and I need to be sure that you understand the difference between royalties and corporate tax.

CHAIR—There is no need to be patronising to the witness.

Senator CAMERON—I am not being patronising. I am being absolutely clear in what I am saying.

Mr Streitberg—I will table our submission to the petroleum policy transition group. That sets out pretty clearly what our concerns are with how the onshore PRRT works.

CHAIR—Thank you very much, Mr Streitberg, and thank you for your contribution to the committee this afternoon.

Committee adjourned at 4.36 pm