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SELECT COMMITTEE ON THE SCRUTINY OF NEW TAXES

Reference: National Mining Tax

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SENATE SELECT COMMITTEE ON

SCRUTINY OF NEW TAXES

Friday, 19 November 2010

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

Senators in attendance: Senators 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, 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 9.35 am

MORAN, Dr Alan John, Director, Deregulation Unit, Institute of Public Affairs

CHAIR (Senator Cormann)—I declare open this second hearing of the Senate Select Committee on 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. The 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 public servants shall not be asked to give opinions on matters of policy.

I now welcome Dr Alan Moran from the Institute of Public Affairs to the hearing. Would you like to make a brief opening statement?

Dr Moran—Thank you. The submission which I have made on behalf of the Institute of Public Affairs covered two facets of this committee's work. One was the resources rent tax and the other was the various carbon tax proposals.

CHAIR—Thank you very much for a very detailed submission; we really appreciate that.

Dr Moran—I have some supplementary information which I have given to the secretariat here, particularly covering the carbon tax proposals. I will just make a few brief comments on both aspects, if you will bear with me. First, we have the resource rent tax, which is targeted at the sector of mining, which as I guess we all know has spearheaded Australia's prosperity. Mining activity has in recent years faced increased obstruction with matters like more intensive environmental approvals, access to national parks, native title et cetera. There are some suggestions that now something like 20 or even 40 per cent of Australia is, if not off limits, more difficult to prospect into.

Profits-based mining taxes are quite common around the world—indeed we have one in the Northern Territory here—and they do have some advantages, but the RSPT and the MRRT really are based on increasing the taxes on mining activity, and in doing so, in our view, this highly discriminatory tax which is imposed will mean that exploration shifts to greener pastures.

According to the tax office, mining companies are not low taxpayers under the existing regime. Their effective rate is about 28 per cent; that compares to 25 per cent for all industries. Including royalties, mining pays about 41 per cent. The first stage of mining is, of course, exploration, and Australia's share of world exploration activity is quite high. It has historically been around 17 per cent; it has dipped a little in recent years and would certainly fall further if the tax regime became more onerous. I think that in this respect the comments of the Canadian Minister of Finance when the PRRT was announced are quite illustrative. He said:

> If it is what it appears to be, a significant tax increase, that's another competitive advantage for Canada. We're reducing our corporate taxes.

So, even though the taxation arrangements planned under MRRT are less onerous than RSPT—although they are not fully known at this stage, of course—the tax rates will, I think, be considerably higher in Australia than in major nations with which we are competing. We can see no case for an increase in taxes on mining and we consider that such measures would detract from future activity and hence from national prosperity.

The second aspect of our submission covers the various carbon abatement measures which have been planned or are in place. The two which have gained the most prominence, I think, have been the 20 per cent share for renewables by 2020, which is the law already, and the prospect of a carbon tax or cap and trade regime. The 20 per cent share for renewables by 2020, which is the law at the present time, will impose a cost of about $4 billion per year. That cost would be imposed even if the 45,000 gigawatts went to the lowest cost exotic renewable, which is wind; it would be much more if it were other renewables. Wind is about three times the cost of coal based energy. That 20 per cent—

CHAIR—I will just interrupt you there. I assume that the secretariat has advised you that today we will deal with the mining tax specifically—

Dr Moran—Okay.

CHAIR—and we are going to be dealing with the carbon tax at a separate time. Have you made all your comments—

Dr Moran—Okay, that is fine. That is basically—

CHAIR—In relation to the mining tax?

Dr Moran—In relation to the mining tax, yes.

CHAIR—Okay. If you do not mind, we might just proceed with some questions. I ask everybody this question because I go back to the beginning of where the Henry review was supposed to start, which was a root-and-branch reform of our tax system giving us a simpler, fairer tax system. Do you think that what has been put forward by the government has delivered a simpler, fairer tax system?

Dr Moran—In terms of the mining tax or proposal? We actually do not know, at the present time, what the government's final proposals are likely to be with the MRRT. Certainly we do know in terms of the RSPT that this was a very big increase in taxation. The aspect about it—fairness or whatever else—is efficiency in a lot of ways, and that is the most important aspect. If in fact we have a taxation regime which is significantly more onerous than that of other competitor countries, obviously we will have less activity. We have no monopoly on any material. We have a lot of fine resources in Australia, but there is no monopoly.

CHAIR—But simplification in Henry's mind was that a national tax would replace state royalties, and of course that is now not happening. The proposal is now for there to be a national mining tax alongside state royalties, with state royalties to be refunded up to a certain level and future increases not being refunded, so we are going to end up with two regimes in parallel to each other. Do you think that is simpler?

Dr Moran—I think that obviously it is not simpler. Indeed, you can get into an impasse there, as the Canadians did some 20 years ago when they had state and federal taxes. In fact, at some stages they had a tax rate of over 100 per cent in some provinces as a result of that. It can get to be very complex. Also, of course, the simplification, the purity, with what was proposed with the PRRT was one tax et cetera. Now we have a tax which is confined to only two minerals, coal and iron ore, so it is actually a lot more complex. Certainly, in terms of the elements of substituting a royalty's based tax for a profits based tax, it has got some merits. They are not unabashed merits, but there are some merits in doing that. If that were all that were proposed, I think that there would be far less—there would be very little—opposition to it. Indeed, I think some major companies have suggested that that would be a good idea.

Senator HUTCHINS—Your submission suggests an element of supporting the replacement of royalties with another sort of tax.

Dr Moran—We think that a profits based tax has some merit in it. It does have some demerits as well, but it has some merits, insofar as a depleting mine can be continued for somewhat longer than if it was subject to a royalty based tax. In fact, a mine that is relatively low value in the first place could get ahead with a profits based tax. If it were simply substituting a profits based tax for a royalty regime, I do not think there would be very much opposition to that globally or anywhere. Indeed, some companies would see it—

Senator Hutchins interjecting—

Dr Moran—Then, of course, in a lot of ways it is a wolf of more tax dressed in sheep's clothing of more efficiency.

CHAIR—Just going back to your comment earlier, you said that it is only applied to iron ore at the moment, which you say adds to the complexity. Taxation is supposed to be neutral in terms of impact on investment and so on. How do you think the feature of the tax such that it only applies to iron ore and coal is impacting on the concept of neutrality—that it should not alter positions on investment, production and trade?

Dr Moran—I think it would alter those investments because there will always be a difference in the tax equivalent of a measure imposed on one mineral, if it is a different measure, even if it is supposed to be designed to have the same effect on other minerals. So there will be a disneutrality there. The bigger aspect of the neutrality, though, I think, as Senator Hutchins has suggested, is that it will be raising more money. The case for raising more money from a particular activity has the real impact on creating these non-neutralities and distortions within the economy.

CHAIR—It is doing that for iron ore and coal. The resource rent tax has been abolished for all resources, with the exception of iron ore and coal, and then there will be an expansion of PRRT onshore. Is it going to create a distortion for iron ore and coal compared to the other resources?

Dr Moran—Presumably it will increase the tax on iron ore and coal and, if it does, it will create a distortion against those and for other activities, but we do not know the detail of the tax.

The fact that three of the large companies have given some support to that tax indicates that they have seen some more detail on it which possibly leaves them better off.

CHAIR—There are questions in relation to this. The three companies that have given some support, as you say, are multi-commodity, multi-project companies. BHP has nickel, uranium, iron ore, coal and heaps of other resources, including copper. They have had the resource rent tax abolished for a lot of resources as well as having agreed to pay it on some resources, whereas you have FMG, Atlas Iron and BC Iron who are purely focused on iron ore. They cannot escape the tax anywhere. Do you have some sympathy for the small- to mid-tier iron ore companies that are a bit aggrieved by having been excluded from the process?

Dr Moran—Yes. They are locked into Australia and locked into mining generally, whereas BHP, Rio et cetera are not Australian companies; they are global companies and are relatively indifferent to where their new investment comes from. It seems, looking at some of the analysts reports—and they do not have the full information about the depreciation provisions and that sort of thing—that those three big companies are lightly hit, if not hit at all, by the proposals. There is discrimination there. One of the interesting aspects of that discrimination is the support that Marius Kloppers gave to the tax, suggesting that it should proceed as it is. That support was given in the context of him also supporting a carbon tax of some sort. To BHP, that says to me that this tax is quite a bonanza in the way it is structured, and why he wouldn't he support it?

CHAIR—You are from the Institute of Public Affairs, so you take a view on the way public policy processes should work. As far as a best practice model goes for developing a tax, what is your assessment of a government sitting down with three taxpayers and excluding all of the other taxpayers from the discussion, designing a tax in a closed room and then not sharing any of the information afterwards on the assumptions that were used to come up with the features and the revenue estimates?

Dr Moran—That certainly is not a very good model to operate on. A company chairman, a CEO, only has one goal, which is to maximise the wealth of his shareholders. If that means crawling over other people and disadvantaging other people, then he will do so. If you have that very—

CHAIR—That is an important point. I understand that BHP, Rio, Xstrata and so on would act in the best interests of their shareholders as they see it, but what about the position of our national government? Shouldn't they be acting in the public interest?

Dr Moran—Of course, and possibly they thought they were. In terms of consultation with just three companies which have very different structures and very different interests from the industry as a whole, that will only give a partial result and it may be a highly distorted result.

CHAIR—Do you think that what has come out of the negotiations between the government and the three big mining companies has given them a competitive advantage compared to the remainder of the industry?

Dr Moran—It certainly has at the present time. Perhaps the government in its present review is trying to correct that.

CHAIR—Do you feel it has enough scope to do that in its current review? The evidence we have had from those small to medium miners is that the terms of reference are very narrow. There is a prescription that any changes have to be revenue neutral and, of course, they are not allowed to change any of the principal features of the tax. Do you think that the present review has enough freedom and scope to be able to address some of the fundamental flaws?

Dr Moran—We would have to cast doubt on that. Some of the issues seem to be locked in and some are not. But, yes, there is a pole position given to three companies in there and they—

CHAIR—Is that fair?

Dr Moran—No, it cannot be fair and it probably is not good practice anyway.

CHAIR—Alan, you described them as global companies. Australian companies were outside, locked out, and the global companies were in there negotiating with our government. It seems like a strange process to me.

Dr Moran—I would have to agree.

CHAIR—The revenue estimates from the tax have bounced around somewhat. It was $12 billion for the RSPT in the budget. Then, to facilitate the deal, commodity price, production volume and exchange rate assumptions were changed to the point where the original tax would have raised $24 billion. The revised figure was $10.5 billion. Now the exchange rate assumptions have been changed again and it is $7.4 billion. Do you think that a government that relies on revenue from the mining industry ought to be transparent about the assumptions they are using to estimate their revenue?

Dr Moran—Yes. We said something about that in our submission. They were just not credible. There were massive changes triggered between the original proposal and the MRRT. It was not credible that that was only going to cost a couple of billion dollars, and that has been borne out as things have gone by.

CHAIR—Sure, but I am looking again at the best practice from an openness and transparency in the public policy development point of view. The state government in WA publishes their commodity price, production volume and exchange rate assumptions in the budget papers so that, when there are different budget outcomes to what was estimated, people scrutinising the budget can assess whether they are due to changes in any of these variables or whether they are because of decisions made by the government. The Gillard-Swan government have refused to do that. They have refused to release commodity price, production volume and exchange rate assumptions. Do you think they should? It obviously bounces around, based on these assumptions, but do you think it would be important from an openness and transparency point of view to have that information on the public record?

Dr Moran—I think it is hardly ever not the case. Having information on the public record is always the best practice. There may be some cases where it is commercial in confidence, but it would not appear to be the case that, when we are talking about an aggregate tax on the whole of industry, that is not commercial.

CHAIR—Do you think that BHP Billiton, Rio Tinto and Xstrata would have shared commercial-in-confidence market-sensitive information with the government as part of their negotiations?

Dr Moran—I think they would have given their opinions, and maybe they would have been candid and accurate opinions, about where the trends were moving in terms of prices et cetera. They have more expertise, I guess, than the Treasury.

CHAIR—So are you saying that the government might have negotiated with people who had an interest in the design of the tax, taken the opinion of those people who had an interest in the design of the tax as to the underlying assumptions and then just taken that at face value?

Dr Moran—Not necessarily, to somebody, at face value, but I think it would been heavily influenced by those considerations, yes.

Senator HUTCHINS—I am going to contest some of your conclusions. The latest ABS capital expenditure figures show that mining companies are planning to increase their capital expenditure by 50 per cent in 2010-11 to $55 billion. That is this year. I will continue on and I will ask you to respond. The *Australian* reported last week that Australia's small and junior miners are on track to raise well over $4 billion in 2010-11 to fund projects, including domestic plans. The *Financial Review* reports that small and junior mining companies in the mining and energy sectors have raised more than $650 million from Australian and international investors in September. The *Australian* reported in October that FMG has plans to raise over $2 billion in coming weeks to finance expansion plans. That does not suggest to me, Dr Moran, that the small and junior mining companies, let alone the industry, are being all that impacted by this new tax.

Dr Moran—There is certainly a great deal of activity and demand activity generally in the world, and that is driving forward expenditure. It is incontestable that placing a tax on something will eat into the profits and reduce the activity from what it would otherwise be. I am not suggesting that we have adopted a Third World tax regime of total expropriation—no, we have not. We have very good laws here. But any increase in taxation provisions must have an effect of reducing activity compared to what it would otherwise be. You have to look at the counterfactual there. FMG and others are moving ahead very strongly—and why wouldn't they; the Chinese iron ore demand is increasing considerably. If we do impose additional financial obligations on firms, there must be less activity; there cannot be any other answer.

Senator HUTCHINS—If the demand is not there. I suggest that in the next 20 years the demand will be there—we have been advised—whatever the tax is. We would not agree on that. I am just saying this is contestable. Can you elaborate on what I would call an eccentric statement, on page nine of your submission, relating to the 'fallacious basis that mineral deposits are owned by the people'—from? Why would you say that anything under the ground is fallacious and should not be owned by the people? It is an established right that we do. That is why it is called royalties, isn't it. Because it is owned by the Crown.

Dr Moran—There is a whole history of royalties which you probably know almost as well or maybe better than me. But the point about a new discovery of minerals or any new innovation—a Microsoft or whatever—is that it does not exist until it is actually discovered. There are minerals all over the world. Afghanistan is said to have a multitude of very valuable minerals, yet to all intents and purposes they do not exist, because nobody has gone out and proved they exist. Once you go out and prove they are there, then they do exist. The tradition has long been that, once they exist, a share, a relatively small share—two per cent or five per cent—of the value then goes to the government or the people as landowners. The minerals are there, they are dug up and they have become valuable; but they only become valuable once somebody has actually discovered them. Certainly nobody is going to go and discover them unless there is a profitable incentive to do so.

Senator HUTCHINS—We may not agree on this, but the government's intention on these taxes is to increase investment in infrastructure, cut the company tax rate to 29 per cent, cut the immediate write-off to small business assets costing up to $5,000 and to boost Australian superannuation savings. In this tax, that is what the additional tax is going to go to; it is not going to go into a separate fund like they have in Norway or something like that. Dr Moran you might want to—

CHAIR—That was an editorial.

Senator HUTCHINS—I am asking for comment.

CHAIR—I have a question on the ownership.

Senator HUTCHINS—Your editorials are far more savage than mine.

Dr Moran—In response, I want to say, the government is not going to just throw the money away. Obviously it is going to use it for purposes it thinks are better than—

Senator HUTCHINS—Nation building.

CHAIR—No, getting themselves out of debt.

Dr Moran—In doing so you are saying: 'Well, these people are wealthy; we'll tax them more heavily. Those people, we will give a break to, because we will build infrastructure or whatever.' But that itself is a distortion. There is a principle of government policy. I think you would agree generally that we ought to have as much neutrality as possible; we should not be distorting one decision versus another. Basically what you are saying to the mining industry is: 'Well, they can afford it. There may be a bit less activity in these areas, but they can afford it. We will take it to pay the debt or give to superannuation or build infrastructure.'

CHAIR—You mentioned in your submission that on 27 May the Treasury Secretary, Ken Henry, commented that 'it is a legitimate return to the owners, the people of Australia'. But the people of Australia are not the owners of the resource, are they? Under the Constitution the states are the owners, which is why the states charge royalties. That is right, isn't it?

Dr Moran—Yes. There will obviously be a constitutional impasse if things go forward and some states feel they will be disadvantaged.

CHAIR—Though, as far as I am aware, not one single state has said it will abolish state royalties.

Dr Moran—Quite so. Presumably the government had some advice that it could do this, but the states certainly have advice that they cannot do it. You would end up with an impasse like the one in Canada that I discussed earlier, where the federal government had one set of taxes and the provincial governments had other sets of taxes. It became a contest to see who could raise the most and it crippled mining for a couple of years.

CHAIR—I do not think there is dispute between the Commonwealth and the states that the Commonwealth is not allowed to tax the property of the states. I also think there is no dispute that the resources are legally the property of the states. That is why they are structuring it as a profits based tax—because they are saying the Commonwealth can impose profits based taxes. But, given that it goes all the way back to the main gate now, when does a profits based tax become a royalty? How much profit do you make on a resource at the main gate before you have been able to transport it to a port?

Dr Moran—The answer is that the resource is worth very little at the main gate. The reason why the iron ore is so valuable is because those companies have taken the dirt and graded it et cetera and transported it extremely efficiently to the ports. Most minerals are worth very little at the mine site. Obviously, gold and diamonds are different.

CHAIR—This is one of the ironies that Andrew Forrest has put up. He says: ‘You aren’t prepared to take into account all the costs of infrastructure that I have had to put up. You just want to assess it over there. I’m going to be totally disadvantaged compared to some of my competitors in terms of the way the mineral resource rent tax is structured.’

Dr Moran—Any minerals or royalty tax really ought to be levied as close to the actual production as possible; otherwise, it is a discriminatory tax on a railway over there and not a railway somewhere else. Andrew Forrest definitely has a good point there.

CHAIR—Royalties are essentially the sale price for the resource. The states are selling the resource to the mining companies for them to add value and do whatever they want to do. That is right, isn’t it?

Dr Moran—The normal concept of a royalty is that you have found something and it is yours but the land is owned by someone other than you and therefore we will take a share of it. A justification at one stage was that there were some special provisions of defence and property rights which have to be clarified—there is a mining warden to be paid for et cetera—so there will be additional funds to be collected by the government.

CHAIR—Professor Garnaut essentially says that the states are competing with each other to attract investment, which is why they are not charging royalties that are high enough. That is his justification for suggesting that that is why the national government should take over and take all that away.

Dr Moran—I do not have any problem with the states competing against each other—

CHAIR—I think it is a good thing.

Dr Moran—So do I. But if they are competing down to the bottom we would take a look at it. There are a whole stack of reports by analysts—I have included them and you may have even more of them—that show the royalty rates in Australia, Mongolia, China, Chile and all over the world. Royalties here are not low; they are generally somewhat higher than in other countries.

Senator HUTCHINS—The Western Australian Premier was considering putting them up a while ago.

CHAIR—He has put them up.

Dr Moran—Yes, he has put them up. On the aggregate level of royalties, there are any number of analysts' reports that coldly examine that and some of the tax regimes globally and demonstrate beyond any doubt that Australian royalty rates are not low.

CHAIR—As I understand it, if one state puts royalties up all it does is reduce the amount of GST revenue they get back through the Commonwealth Grants Commission—what they call horizontal fiscal equalisation, which is another impediment to states perhaps charging what might be considered a more appropriate level of royalties. Have you got a—

Dr Moran—The fiscal equalisation issues with the Commonwealth are long standing, and they do have an effect there, but nonetheless, Western Australia is a rich state compared to South Australia as a result of royalties and its mining activity generally.

I do not know whether the—

CHAIR—It is a big state, too.

Dr Moran—It is a big state, yes, and it is rich. Most states in Australia are quite well run, and it is quite well run. It has resources and it has a lot of taxation revenue from those.

CHAIR—It has got a good government, that is why.

Senator HUTCHINS—We won't do any editorials!

Dr Moran—It has not always had that though, I think.

CHAIR—No, that is true!

Senator HUTCHINS—In the final pages of your submission, before you go into the carbon tax, you make a very clear comment—and I would just like you to comment on it—about native title covering 40 per cent of the continent and then you talk about national parks accounting for 7½ per cent of the land area of the continent.

Dr Moran—Yes.

Senator HUTCHINS—Is there any particular reason that you refer to that? Is it because you believe, say, that native title has gone too far? Or do you believe that we should be able to mine in national parks? Is there an IPA view?

Dr Moran—I do not think that mining in national parks is forbidden in Australia, is it? It was basically saying that over the years we have been less accommodating to mining than we once were. Native title has added a complication and there are lots of cases tied up with it. No company is going to go ahead and do something until those things are clarified. There is a cost involved in that.

If it is permitted to mine in national parks, it is much more difficult and there are some—

Senator HUTCHINS—There are many restrictions on national parks.

Dr Moran—Mining generally is quite compact. You find that a mine is a very small area and it is easy to excise. Mining in national parks is quite common around the world. It does not destroy the national park—

Senator HUTCHINS—But it is not as common here.

Dr Moran—It is not as common here, no.

Senator HUTCHINS—And the IPA would like to see a bit more access to the national parks?

Dr Moran—I do not see any reason why we would not have access to national parks for mining. Certainly, if somebody were to say, 'Okay, we'd like to excise that 10 square kilometres but we'll give another 10 square in return,' I think that that would be a reasonable trade off.

Senator HUTCHINS—Do you have any information on who will pay the MRRT, geographically? Will it be mostly Western Australia, where many of the mines are located; Victoria, where many of the big mining companies have their headquarters; or overseas, where a large proportion of shareholders reside?

I do not know if you know that answer. If you would like to take that on notice and respond to us you are most welcome.

Dr Moran—I do not know the answer. I would say it is very unlikely to be Victoria. It seems as though it is much more likely to be where the mining is taking place. I do know it would not be the overseas people because they do not pay the tax. There is a world price—they pay the price.

Senator HUTCHINS—I just wonder if your organisation would be able to take that on notice and reply as soon as possible?

CHAIR—I have got a follow up question to this. The MRRT is supposed to be applied on a project-by-project basis, is it not?

Dr Moran—Yes.

CHAIR—How much iron ore production is there in Victoria or Queensland or New South Wales?

Senator HUTCHINS—Is that a rhetorical question?

CHAIR—It is a rhetorical question perhaps, but I am just following up on Senator Hutchins question. Is it not true that 98 per cent of iron ore production is in Western Australia?

Dr Moran—I do not know but it sounds about right, yes.

CHAIR—If 98 per cent of iron ore production is in Western Australia, how much of the tax on iron ore from the MRRT do you think would come from Western Australia?

Dr Moran—I would assume that. But I think Senator Hutchins is suggesting that it is coming from the companies themselves, located here.

CHAIR—But it is not. It is on a project-by-project basis, isn't it? It is a tax on the resource, isn't it?

Senator HUTCHINS—We might be able to ask Dr Henry.

CHAIR—We will be meeting with Dr Henry on Monday and we will explore that with him further. They have been resisting answering that question. I will be interested to see whether Senator Hutchins will ask that same question of the Treasury secretary.

Senator HUTCHINS—I might be absent.

CHAIR—Dr Moran, thank you for you contribution to the committee. You made a very detailed submission, which we appreciate. We might want to talk to you about the carbon tax at a later stage.

[10.17 am]

ARMSTRONG, Mr Graham T, Senior Associate, National Institute of Economic and Industry Research

MANNING, Dr Ian Geoffrey, Deputy Executive Director, National Institute of Economic and Industry Research

CHAIR—Welcome. Dr Manning and Mr Armstrong, would you like to make a brief opening statement?

Dr Manning—You have our submission. There is not much need to underline anything. On the mining side, we would like to emphasise that, as recently discussed, it is a matter of the price of the sale of state assets and that, to that extent, in referring to resources rent taxation—thought technically accurate, it is a bit of a public relations disaster—you are trying to say, 'We are taxing you for what is in fact a sale of assets.' Our experience with the mining industry has been that it is very good at blowing its own trumpet and therefore very often the benefits of mining are overstated, or at least put in a very favourable light, in that industry's press releases and so forth, so we are simply saying that you should beware of that.

As to resources rent taxation, I think it is just probably a bit too sophisticated. It is a lovely theorem from an economic point of view, but the idea that the states should assist the mining industry with risk management is really probably past its date. The industry actually manages its risks very well indeed, largely in the form of very big multinational companies with a wide portfolio of assets which allows them to spread risk. That being the case, I am inclined to think that a simple ad valorem royalty has a lot going for it and may well be the path of the future. If I were being mischievous I should suggest that the royalty should be stipulated in an overseas currency and, since the US dollar is no longer the king of currencies, we might stick our necks out and make it in yuan—but that is being naughty.

On the carbon-pricing side, we have done a lot more work recently and we have simply emphasised that our recent documents were actually quite critical of Professor Garnaut's report on the grounds that he has underestimated transition costs but, on the other hand, he has tended to forget the spin-off benefits of greenhouse gas abatement, which are in the form of greater production efficiency and also favourable balance of payments effects. Mr Armstrong?

Mr Armstrong—My background is that I am an economist. I started my work in economics in Canada in the 1960s and 1970s, where I was concerned with the mining industry, particularly in northern Canada. When I first came back to Australia in the 1980s I did some work for BHP petroleum on petroleum resource rent tax. Since then I have tended to specialise in energy economics, particularly with respect to electricity and gas, so I have not particularly done any work on resource rent taxes and mining taxes over the last 15 years, but I am familiar with the theories and the developments since then.

My major concern, I suppose, is, with the MRRT and PRRT, the differential impact and also resource misallocation that could come about if you apply different rates to gas and coal. So, as the MRRT is going to affect coal, my concern is that people drawing up the legislation pay a lot of attention to the distortions that might arise by taxing gas in a different way to coal. At the moment, about 80 per cent of Australia's electricity production is from coal—what we call thermal coal as distinct from coking coal; used for steam generation and electricity generation—but, in a climate change environment, we are tending to build many more gas generation plants. If one looks at the generation plants under construction in Australia and committed over the next five years, there is basically only one coal project going ahead and the rest, about 20 or 30, are either gas or renewables, so one has to be very careful in taxing gas and coal differentially, particularly in this very complex environment we have where we are looking at some form of carbon tax or regulation. Of course, it is very uncertain. As one sees many, many times, there is a lot of uncertainty in the electricity generation industry about where they should put their dollars for new electricity generation projects.

For example, coal is produced and can go straight into electricity generation or underground coal gasification. It can get gasification and then it goes into electricity production, or you can have coalmine methane from coalmines, which is used in electricity production. There are a number of mines around Australia. So it is going to be very important to get very clear the distinction between the two regimes and what their impacts could be differentially if coal is going to be taxed differently than gas. That is all I would like to say at the moment, but that is my major concern in my current work: the impact on the electricity industry.

CHAIR—That is a very fascinating argument. I have not heard that raised with us before—the tax differential treatment between gas and coal. I would not mind exploring that a bit. You were involved in the PRRT introduction offshore, were you?

Mr Armstrong—Yes, 25 years ago.

CHAIR—That is really interesting. Offshore at the time—that was of course in Commonwealth waters, wasn't it?

Mr Armstrong—Correct, yes.

CHAIR—And in Commonwealth waters there was no state royalty regime that applied, was there?

Mr Armstrong—No, not that I recall. I would be happy to make my paper available that I did 25 years ago, but that is what it was about at that time.

CHAIR—The point is that, when the PRRT was introduced, for those projects that were subject to PRRT offshore, that was the only resource tax arrangement that was in place, other than company taxes that apply to companies overall.

Mr Armstong—Correct.

CHAIR—There is no state royalty that would apply after that—nothing like that?

Mr Armstong—Not as I recall. Do you recall, Ian?

Dr Manning—No, there is not. It is not constitutional.

CHAIR—In terms of the expansion of the petroleum resource rent tax onshore, under this proposal there will be both a state royalty regime and the tax arrangement at the same time.

Mr Armstong—Yes.

Dr Manning—That is right.

CHAIR—Do you foresee any complications with that?

Mr Armstong—Yes, definitely, unless there is a clear distinction made as to the treatment of gas and coal with respect to electricity generation particularly. That is what I am mainly concerned with.

CHAIR—Let's leave coal to one side at the moment, because coal comes under the MRRT. Let's focus on the PRRT for a moment and we will get back to the MRRT. State royalty regimes will stay in place and PRRT arrangements are proposed to be put in place. Talk us through what is involved with the petroleum resource rent tax in terms of the compliance mechanisms, the administrative processes, the calculations and so on.

Mr Armstong—Unfortunately, it is quite some time since—

CHAIR—Not the detail, the principles.

Mr Armstong—The problem is that under rent taxation in the general economic sense, most super profits or above normal profits are very difficult to define. If you take Victoria, which I am more familiar with, the royalties for coal are for brown coal and they are on a specific basis and have increased to some extent. But, of course, brown coal is different because it really has no use other than in electricity production.

CHAIR—Going back to the PRRT, as I understand it all of the capital costs and exploration expenses can be deducted before you start paying PRRT. Various formulas apply, but you obviously have to be able to demonstrate that you have incurred those costs and there is all that paperwork involved.

Mr Armstong—Correct.

CHAIR—Then you still have the state regime to comply with.

Mr Armstong—That is right.

CHAIR—It is a more complex proposition onshore than it was offshore, isn't it?

Mr Armstong—Yes, you could say that. I am not familiar these days with the Western Australian onshore regime, for example, but that is where it would be really important to look at—

CHAIR—Let me tell you something about the Western Australian onshore regime. They have just decided to reduce royalties because they are worried about a shortage of gas supply domestically and attracting investment in gas production.

Mr Armstong—Yes, and they have put certain bounds on gas for export, restricting a certain amount for the domestic market. There is a very substantial domestic market for gas, of course, for electricity generation in Western Australia, but a lot of it is around Kwinana for the industries there and particularly for alumina production. As distinct from aluminium, which is very electricity intensive, alumina is very gas intensive, so there is a particular need to make sure that there are adequate supplies at a reasonable price. Of course, there has been a lot of debate over the past year on the wholesale price of gas in Western Australia, which has jumped considerably in the last 12 months.

CHAIR—There are petroleum resource rent tax projects offshore. Given the significant deductions that are part of that, it takes many years before they actually start paying the tax, doesn't it?

Mr Armstong—I am not familiar with the details, but it would depend on the field that it applied to—I really do not know. It is very specific, so you might have some fields which are very expensive to develop and others that are less expensive to develop, which would pay it earlier than those that are more expensive to develop.

CHAIR—Treasury and the department have variously told us that it takes between five and 10 years after they start production before they start paying PRRT on these offshore projects. That is because of the significant capital investment involved. Of course, they continue to pay state royalties onshore at the same time. Doesn't it reduce the capacity of individual states to provide incentives for increased gas production by reducing their royalties if the Commonwealth comes over the top with a uniform tax?

Mr Armstrong—It would depend on the resource base that their royalty would apply to. So if they had a considerable resource base, it may not make much difference. In Western Australia basically gas production is offshore although there is some onshore production, but that tends to be dedicated to the domestic market. There may be some competition but not a lot because the offshore tends to go to LNG processors with some coming onshore.

CHAIR—Twenty per cent of it coming onshore.

Mr Armstrong—Yes.

Senator HUTCHINS—In principle, do you prefer a tax on profits or a tax on production and, if so, why?

Dr Manning—In this case I think that for public consumption, to get the principle straight, if it is a sale of a resource then it is not actually even a tax.

Senator HUTCHINS—Yes.

Dr Manning—Therefore, if it is at all possible, I would like to get the word ‘tax’ out of the vocabulary for this particular item. It also means, of course, that it has to be put in a different category in government accounting. There are strong arguments that revenue from the sale of resources should be devoted to investment in alternative productive capacities—in other words, it should not be just creamed off into the general government budget but kept apart. That also means that, for simplicity and to avoid the opportunities for interesting calculations in the determination of things that are profit based, I have come back towards the old-fashioned ad valorem: by quantity, which is all you need to know, and by an imputed price, which is on the international markets.

CHAIR—The point here, though, is in order to ensure a fair return to the community we have both. We have a sale price for access to the resource, which is the royalty, and we have a profit based tax, which is company tax. So mining companies that exploit resources in Australia pay both, don’t they?

Dr Manning—Yes.

CHAIR—Rather than having, as you describe it, a cost to access the resource, which is the sale price, and a profit based tax, which is company tax, should we have two profit based taxes? That is really the question that the government has asked us to consider. If we have two profit based taxes and you do not make a profit, the community gets no return at all, does it?

Senator HUTCHINS—I’m going to interview you in a minute!

CHAIR—Isn’t it true that if we have two profit based taxes and they don’t have to pay a royalty at all, mining companies would actually get access to the resource for free?

Dr Manning—I think that that has, in fact, occurred in the Northern Territory, where the state royalty regime was profit based.

CHAIR—I have had this discussion with Dr Henry too and he had to concede this point. Don’t profit based taxes also drive behaviour—the way companies structure their affairs and conduct their business, and their business model?

Dr Manning—You are speaking in terms of a dinky-di incentive response or creative accounting. There are opportunities for both. The creative-accounting possibilities for multinational corporations are rather considerable and it is perhaps best not to tempt them. On the incentive side of it, the resources rent tax as originally conceived was in some ways a risk-sharing device whereby if you got below the target profit rate you actually got a refund. On that kind of specification, I do not really think that is necessary, given that the multinational corporations that run the greater part of mining already have perfectly adequate risk management procedures.

CHAIR—Let me ask it in a different way: what incentive is there for mining companies to maximise their profits in Australia, if they are going to be more heavily taxed here than elsewhere, rather than to maximise their profits offshore?

Dr Manning—Their calculations in this respect are extremely complex because they have a lot to do with, for example, their political outlook in different places. It may be that they have access to a resource in a country where they think they may lose that access—a revolution-prone country or whatever—and they want to mine up and get out. In Australia, being a country where you can, to some extent, sit on resources—you do have to keep going at a certain level of activity, otherwise you lose your licence to mine—it is quite possible that they will be warehousing because of political stability, given the opportunities elsewhere if they perceive those to be fleeting.

CHAIR—Royalties are a more certain way of ensuring a definite return to the community than profits, by its taxes, aren't they?

Dr Manning—Yes.

CHAIR—The debate then is about what level they should appropriately be. Because it is irrespective of profits—as you take it out of the ground you have to pay a price for it—it is a more certain return for the community.

Dr Manning—It is more certain except that, as you were talking about with Dr Moran, competition between states means that the state royalty regimes probably do not exhaust the level. State royalties have been, by and large, a bit too low. I found this out when dealing with the land councils in the Northern Territory. We would argue for a little bit extra for the Aboriginal land trusts and it hardly seemed to have any effect on the level of exploration activity.

Senator HUTCHINS—On the issue of taxes—maybe Mr Armstrong would like to join in on my original, simple question—in its recent economic survey of Australia, the OECD said that the proposed level of the MRRT is too low. How would the NIEIR respond that, in light of your comments just then that the OECD said it is too low?

Mr Armstrong—I would like to see the basis for the OECD report. It is very difficult to comment without knowing why they think it would be too low. I do not know. On the question of royalties and the resource rent tax, and that sort of stuff, one distinction between that and income tax is that corporations tax comes under the income tax act and has specific requirements, but royalties or resource rent are basically returns to the owner of the resource. The owner of the resource will set the rate that it wants from that on the basis of, in a sense, how much you can charge without losing that activity. If you keep putting your royalties up, at some point people will not mine or be involved.

Senator HUTCHINS—Earlier, when I was accused by the chairman of doing an editorial—

CHAIR—In a very friendly way.

Senator HUTCHINS—I detailed a number of areas where it does not look like there has been any impact on investment at all, including by small to junior miners.

Mr Armstrong—We have a big advantage in Australia in that our sovereign risk is quite low. The MRRT increases your sovereign risk to some extent. I was recently in Canada—I was not in this field—and it would be interesting to know what my Canadian contacts would have said about this. They would probably think it is a quite interesting development. They will watch it very closely to see if they might do something similar in the future.

Senator HUTCHINS—I am pretty sure that they are looking at it and, as soon as we get it through, they will find a reason to impose it themselves.

Mr Armstrong—The difference in Canada is that they have a much more mature mining industry than Australia. We are not late starters but we are not nearly as mature. If you look at the nickel belt around Sudbury in northern Ontario, it has been there for many years. They have a different operating environment. The owner of the resource will try to take as much as it can from that resource, as the owner of the resource, without putting at risk the activity on which that resource is based. You need to draw a distinction between the return to the owner of the resource and the corporations tax as we have it in Australia, or any other regime.

Dr Manning—As a footnote, the minister for mines in Alberta, who introduced the present royalty regime there, and was excoriated by the industry at the time, is now something of a folk hero.

Senator HUTCHINS—Can I ask again on the OECD report—I know you said you have not—

Mr Armstrong—I have seen a reference to it but I have not read it.

Senator HUTCHINS—It also warned the government against spending the revenue the tax generates and suggested that a special reserve fund should be established. Some have suggested following the Norwegian approach and investing offshore. Would this reduce the effect on the exchange rate and avoid the Dutch disease? Does your group have a view on this?

Mr Armstrong—I will pass to Ian. I am familiar with the Dutch disease argument.

Dr Manning—That is a very real risk here. It is very difficult to determine what determines the exchange rate. It is not behaving according to good economic theories and in fact it moves in contrary directions.

CHAIR—It is not always consistent with good economic theory, is it?

Dr Manning—It depends what you mean by good economic theory.

CHAIR—Good economic theory catches up, doesn’t it, and seeks to explain post the events?

Mr Armstrong—Yes. We are economists of, I think, quite broad thinking, so we would not agree with some of the thoughts put forward by, for example, economists of the Productivity Commission. We are much more liberal.

Senator HUTCHINS—Laissez-faire.

Mr Armstrong—Yes, we tend to take broader approaches to what economics is.

Dr Manning—From our point of view, the Dutch disease is a very real threat. If we have a resources boom which simply results in a high exchange rate, which results in the worst of all worlds, which is serious destruction in manufacturing and agriculture, coupled with a balance-of-payments deficit and accumulation of yet more debt, you can say that it is the curse of resources; it is not a boom at all. Therefore any measure which would change the perceptions of the foreign exchange markets towards minerals prices in setting the Australian dollar exchange rate and make them take less notice of it and tend to put it down would be helpful from a national point of view.

Whether a Norwegian-style corralling of revenue from a resources boom would have this effect on the foreign exchange markets is the weak link in the argument. If that link were there, there would be a lot to be said for that approach. Australia, of course, is a larger country than Norway, and the effect of relatively small amounts of revenue compared to our total foreign exchanges put into a fund may not be all that great. We still, of course, have to remember that the multiplier effects of resource activity are actually diminishing all the time because of the increasing overseas content in the capital investment.

CHAIR—As a result of the deal that Julia Gillard and Wayne Swan did with the big three, they have abolished the mining tax on all resources with the exception of iron ore and coal. What does that do in terms of distorting or not distorting investment decisions and economic activity in those particular industries—iron ore and coal—as compared to the other parts of the mining industry?

Dr Manning—It depends a bit what the states do with respect to their royalties.

CHAIR—The royalties, I suppose, will be all credited so that should not really have any influence.

Dr Manning—No, but what I am then saying is that, if the states actually put up the ad valorem rate on nickel, copper and so forth, you would not necessarily get a switch of effort.

CHAIR—Let us leave the states to one side for a moment, because the only thing we have got in front of us is what the Commonwealth is proposing to do. The Commonwealth, before even introducing it, has abolished the super profits tax on all resources other than iron ore and coal. All other things being equal, what impact is that going to have?

Dr Manning—I think it will be the obvious. In a sense, it is to switch activity to non-iron-ore and non-coal. How far that is a major incentive in view of all the other influences on activity such as price incentives—

CHAIR—So it is hard to quantify.

Dr Manning—Yes.

Mr Armstrong—The major Indian generator and importer of coal into India, Adani, has recently announced an enormous investment in the coal mining industry. They would be aware of the MRRT but, because of the magnitude and quality of the resources, they are going to put a lot of investment in. At its peak, the mine they are developing will be the largest coal mine in

Australia. That has only been announced in the last six months. They would be well aware of the MRRT. So the investment is driven by resources, the infrastructure we have et cetera. The debate over the MRRT has not changed Adani's view on Australian resources.

Dr Manning—An important thing for them is that in Australia they do not have to depend on the Indian railways. Similarly, the Chinese when they invest do not have to depend on the Chinese railways either.

Mr Armstrong—And Ian knows the Indian railways very well.

CHAIR—Can you see a rational reason why the government would have picked iron ore and coal and excluded, for example, uranium?

Dr Manning—If rational, yes: it would simply be that these are large and have had reasonably high price increases. But from an economic point of view—

CHAIR—There is no rational reason why you would pick those as opposed to others?

Dr Manning—No. The only reason would have to do with simple economies of size. You could perhaps argue that the exploration to final production revenue ratio is higher for minerals other than iron ore and coal. For example, to find gold, base metals and so on the investment in exploration is probably a bit higher than for equivalent value of iron ore and coal. But that is the only argument I can think of.

Mr Armstrong—I agree.

CHAIR—How long do you think it would last before a government would add other resources to a mineral resources rent tax once it is in place?

Dr Manning—You are the politicians.

Mr Armstrong—It would have to be seen that the other particular industries are very profitable.

CHAIR—Do you know roughly what the profitability of the uranium industry is in Australia?

Mr Armstrong—I would not have any idea. It varies.

CHAIR—I think it went up about 50 per cent over the last financial year.

Dr Manning—It was terrible in the nineties.

CHAIR—Iron ore was terrible in the nineties too, wasn't it?

Dr Manning—Not quite so bad. The uranium price fluctuated far more. You are quite right.

Mr Armstrong—Uranium went up about 20 times in the nineties, from about $7 or $8 a pound up to, at its peak, about $120 a pound. It has now settled back at about $51 a pound. It depends on when your contracts were drawn up to sell that uranium.

CHAIR—The same happens with iron ore. Between the time the RSPT was announced and the time of the MRRT, the iron ore price came down 30 per cent worldwide. You get these huge fluctuations.

Mr Armstrong—I think the volatility in uranium is probably higher. It has been very significant.

CHAIR—When there is a high price you get a supply response, don't you?

Mr Armstrong—Uranium is very different.

Dr Manning—It is a slow supply response. You can get a quick supply response if the equipment is already sitting in the mine and the capacity is there. As soon as you have to develop new mines, if you have a proven resource that is a three- or four-year time lag. If you really get into the exploration pipeline then that is something like 10 years.

CHAIR—Who do you think owns the actual resource?

Dr Manning—It is the Crown in the right of the states except for offshore, where it is the Crown in the right of the Commonwealth, and with uranium in the Northern Territory, which is the Commonwealth. I am not quite sure of old title in New South Wales.

CHAIR—But it is essentially the property of the states except where it is offshore.

Dr Manning—Yes.

Senator HUTCHINS—It is not a related argument.

Dr Manning—In the United States it is different owing to their different constitutional history where the surface land-holder has rather greater rights.

CHAIR—That was a very clear statement and I am grateful for it. You would then disagree with the government's assertion that it is the property of the Australian people.

Dr Manning—In political philosophy I am hard put to say that the Crown is the property of the people—

CHAIR—Providing it is on a state-by-state basis.

Dr Manning—The Crown in the right of the states represents the people of that state.

CHAIR—Which means that iron ore in Western Australia is not owned by the people of Australia across Australia. Is that the point you are making?

Dr Manning—The people of Western Australia; that is the logic.

CHAIR—We have already established that it is 98 per cent of iron ore production in Western Australia. If there is a tax on iron ore production and you see iron ore being the property of the people of Western Australia, that is a tax on WA, isn't it?

Dr Manning—Provided the amounts are not returned to WA, yes.

CHAIR—Are you aware that there is any proposal to return the amounts to WA?

Dr Manning—I am not aware of any such proposal.

CHAIR—We have got a very bad track record on those sorts of things. The money normally goes east but have never comes back.

Dr Manning—There was a time when money went to WA. Remember it was a mendicant state.

Mr Armstrong—It is also important to note that it tends to go to Canberra and not to the states. A huge problem that I have looked out over the years is that the federal-state fiscal relationships are in serious need of reform yet there is virtually no debate on this issue. That is a very substantial issue. There was a very good article by Tim Colebatch in *Age* about a week ago which clearly sets it out and is the best statement I have seen about it for many years.

Senator HUTCHINS—A substantial amount of infrastructure spending is going to go to the major resource states of WA and Queensland.

CHAIR—Is it? It is a tax that is supposed to raise about $60 billion over 10 years and $2 billion of it is going to supposedly come back to Western Australia over those 10 years. Let us leave that to one side. A final question from me. You sort of say that we should not overestimate the impact of the mining industry on our economy and we should be looking at the contribution to national income rather than to GDP. Isn't it true to say, though, that the contribution of mining to the economy is not just the direct contribution, there is a significant service sector that is attached to it? I would say that in Western Australia most of the economy is in one way or another related to the mining industry.

Dr Manning—And yet it is related to the income generated in the mining industry, so the two remarks are not contradictory. I am saying that you should watch the incomes, not the gross product, because a very large proportion of the gross product goes immediately back overseas in returns to shareholders and in purchases of materials. As you know, mining companies I think pay more for diesel than they pay in wages. That said, the mining industry has provided the basis for development in Australian—not least in the west—of a world competitive mining equipment industry and that should be credited to them. Other services to mining, yes, we also have developed geological assessment and all those kinds of consulting services which we export, again not least from Perth. So those impacts should be credited to the industry.

CHAIR—So do you think it is in our national interest to keep mining strong?

Dr Manning—I think yes, and in fact another reason is that it actually makes good defence policy, because if we were seen to be hogging our resources and not making them available to the resource hungry countries they may look at us with envy. Again, I am in favour of letting the mining industry have its head but subject to environmental, land title and all those constraints.

What we are actually talking about is a fairly small dispute over the division between the sale price and the mark-up which the mining companies get, between the price that we sell the resource and the price that they sell it for on the international market, from which they recoup their various expenses.

Mr Armstrong—I would concur. Australia is in a sense lucky to have such substantial reserves of world-class resources. From the liquids point of view of course we are deficient and we now import about 50 per cent of our petroleum requirements. But, if you look at the rest of the resources, we are very strong and competitive in the world because of the quality of those resources around the country. Western Australia obviously has a very significant resource. Victoria had gold and we have brown coal, which is something of a debate—

CHAIR—It all started off in Victoria, didn't it—the gold rushes?

Dr Manning—Indeed. Australian mining legislation started off in Victoria.

CHAIR—It was the Victorians that built Western Australia.

Dr Manning—Yes, my grandfather was among them. The importance of the mining votes, the diggers, meant that Victorian mining legislation was fairly favourably disposed towards the industry.

CHAIR—Going back, have you got an awareness of the differences in business models in their iron ore operations between BHP or Rio versus FMG, Atlas Iron and BC Iron? Have you got a sense as to where the different business models are?

Dr Manning—No.

CHAIR—Let me ask you a more general question then. Do you think it is appropriate for a government to negotiate the design of a tax with three taxpayers with a particular perspective and exclude everybody else that has a separate interest in the same industry?

Dr Manning—No.

Mr Armstrong—No. I would concur. You need to have consultation and look at all the implications of what you are doing with all the players. I would say that is a general policy.

CHAIR—If a government wanted to introduce a profits based tax—leaving the merits of that to one side—what would have been a better way of going about it?

Mr Armstrong—What you think, Ian?

CHAIR—Should there have been a discussion paper and consultation giving everybody an opportunity to—

Mr Armstrong—Yes. It would be ideal, I would think, to canvass opinions.

CHAIR—That is what happened with the PRRT. You said you were involved in that 20 years ago. To the great benefit of the Hawke government, they consulted, obviously.

Mr Armstrong—As I recall, there were nowhere near the contentious issues raised during the—

CHAIR—It was not dropped on people overnight.

Mr Armstrong—No.

CHAIR—I suspect that is part of the reason.

Dr Manning—One has to add that the lobbying skills of a whole lot of interests have increased substantially since then, and that means that the temperature is higher as the negotiations proceed.

CHAIR—Do you think that it is appropriate for people who are taken by surprise to express their perspective and their views on these sorts of matters?

Dr Manning—I am happy with that—and in fact the widest group of stakeholders possible. Fairly obviously, the agricultural and manufacturing interests who may be hurt by Dutch disease if this actually happens have an interest as well.

CHAIR—Senator Hutchins, are there more questions from you?

Senator HUTCHINS—No, just those. They are interesting lobbyists, that is all!

CHAIR—Some are better than others because some of them get themselves inside the room and close the door behind them and others have to sit outside and look in. People should not get favourable treatment from the government based on whether they can get themselves inside the room or not, I would have thought.

Dr Manning—I do not think so either.

Mr Armstrong—No, I agree.

Dr Manning—It is a democratic principle, I would have thought.

Mr Armstrong—One of the fears about the political process is that it has become too ‘insider’.

CHAIR—Thank you very much for your contributions today.

Proceedings suspended from 10.59 am to 11.47 am

GARNAUT, Professor Ross Gregory, Private capacity

CHAIR—The committee now welcomes Professor Ross Garnaut to the hearing. Professor Garnaut would you like to make a brief opening statement?

Prof. Garnaut—Thank you for inviting me here. I submitted to the committee two papers, One was a public lecture that I gave at the University of Melbourne in May a few weeks after the original government announcement of the resource super profits tax. Some of the points taken from that are being published in an article in the *Australian Economic Review* and I sent a copy of that. They are my two submissions. The submissions focus very much on the concepts, the ideas, of resource rent taxation and that is what I am most qualified to help you with.

Early in my career this was one of the issues that I used to do a lot of work on with my colleague then Professor of Economics at the University of Strathclyde, Anthony Clunies-Ross. I did what used to be thought of and might still be thought of as definitive text on mineral taxation—the *Taxation of Mineral Rents* which was published by Clarendon Press in Oxford in 1983.

CHAIR—Wasn’t Minister Craig Emerson around at the time as well?

Prof. Garnaut—Minister Craig Emerson was a very good PhD student of mine at the time.

CHAIR—He was looking at these resource rent taxes, so we might have a bit of a sense as to where government got their ideas from?

Prof. Garnaut—I do not know. If they got them from Dr Emerson, they got them from someone who is well informed. I make those background points simply to say that my expertise is really on the concepts, on the structures of taxes and the effects of them. I have been very busy on a lot of other things in recent years, so I am not right up to the minute on every detail of the current discussion in Australia, but I can probably be helpful in answering questions on the conceptual issues.

I start from the position that this is a very important issue in Australia. In Australia, more than in any other developed country, the resources sector is a major sector in the economy. Resource rents are larger in this economy than in any other developed country except Norway. A resource rent is potentially a source of taxation that has relatively little distortion of economic activity, so it is a lower cost form of taxation than most of the ways in which we raise taxation.

I also make the point that, under our Constitution where the mineral resources are owned by the Crown, resource rent taxation in one form or another—royalties or profits taxes or in other forms such as the payment of fees—can be regarded as the price a private party pays for receiving a piece of public property, the mineral resources, when it is given exclusive rights to develop them. Those exclusive rights given by government are necessary to give the resource value. If you did not have the government giving some company a monopoly right to develop a mineral resource—for example, a big hunk of iron ore like Mount Tom Price—then you would have a free-for-all, which is what we used to have in things like the gold rushes. So it is economically efficient to give some company a monopoly right to an area and for the government, to stop anyone else mining that, to hand over property rights for that. Resource rent taxation in various forms can be seen as the payment for that exclusive right that is granted by the government to use public property and to exclude other people from using that particular piece of public property.

Resource rent taxation in Australia is complicated by the fact that the mineral leasing powers lie with state governments and, in a compromise way, territory governments and with the Commonwealth only straightforwardly in offshore areas. So if you are thinking of resource rent taxation being a payment for the valuable piece of public property being handed over, it is actually state property that is being handed over. But the Commonwealth also has clear corporation taxation powers. I am not a lawyer but it would seem that this is a case where there are legitimate rights of taxation at the state and Commonwealth level and sorting out the potential for some unproductive interaction has to be an important part of the policymaking process.

The issue is a complex one with many dimensions. I have gone through those dimensions in the book of which you are aware, in quite a lot of articles, in the two papers that I presented to the committee. So maybe it is best for me to be guided by your questions.

CHAIR—Thank you, Professor. Before going into the conceptual issues, I might go to a matter of process because I did note in your submission that you concede that ‘the manner of public disclosure of such a new, large and complex policy was not world’s best practice’. Then you say that should not stop us from assessing the merits. Moving forward from the original disclosure, do you think the process improved after that, when the government decided to sit down with three taxpayers, to the exclusion of the remainder of the industry, rather than to go through a proper, open, consultative process on those concepts that you think may have merit?

Prof. Garnaut—It is best I be straightforward. I would think that the best process—world’s best practice, to which I refer there—would have been for the Henry review recommendations to have been made public and for there to have been a thorough public discussion with everyone with an interest—from a public interest point of view or a business or private interest point of view—putting views on that. I think we would have had a better discussion if it had been done in that way. Obviously, that was not done the first time and it was not done the second time.

CHAIR—We are now in a position where we are trying to assess the merits or otherwise. We have got the policy transition group process going with very narrow terms of reference and prescriptions that it has to be revenue neutral and it has got to respect the main features of the tax. Do you think that the policy transition group process is adequate to ensure that there is a proper discussion of the merits of specific features of the tax, so it gives enough flexibility for the government to properly take on board the public interest as well as the various stakeholder interests?

Prof. Garnaut—My views on policy process are well enough known for it to be no surprise for me to say that I think that a complicated public policy issue like this will be handled better if there is widespread public discussion of it. But that process that is going on now involving some consultation will not be the whole of the process. The process that you are going through is part of the process. What I would hope is that through all of the various ways in which this will be discussed we can get all of the important interests, especially public interests, properly represented in the discussion. But if all there was for us was the process as described, that would not be enough. Fortunately, there are some other—

CHAIR—So the policy transition group process on its own is not enough?

Prof. Garnaut—No, I think that the processes of this committee and of parliamentary discussion and the public discussion that could go on around whatever comes out of the transitional process are all important to good policymaking.

CHAIR—You mention in your submission when the petroleum resource rent tax was introduced for offshore production. That was a much more inclusive and lengthy process of public discussion, wasn't it? You were involved at that time to some degree?

Prof. Garnaut—I was not involved in government. I was involved because Anthony Clunies-Ross's and my ideas were really what were being embodied in the policy proposals. So I took an interest in it, of course. I see that whole policy process as including the public discussion of ideas early in the process, of which there was quite a lot and you have mentioned Craig Emerson's work. There were quite a number of economists discussing these issues publicly and that was part of a wider public discussion. The government followed that up with a white paper for discussion. So, yes, there was quite a long process last time.

CHAIR—But this time, of course, the government has negotiated the design of the tax with three individual companies who have got a particular business model—and these are the BHPs, Rios and Xstratas—and they have excluded the FMGs and the iron ore ones and all of the other companies who in fact had a different business model. Can you see why those companies that were excluded from that tax design process feel aggrieved and why they think that BHP, Rio and Xstrata were given a competitive advantage?

Prof. Garnaut—I will make a more general response. I think that the public interest would be well served by a wide discussion in which the interests of particular companies are legitimate, so we can hear their voices but we need a wider public voice. And there is a very big public interest in this question; it is not just that of BHP and Fortescue and the other mining companies. So I hope that we will get enough public discussion.

CHAIR—I totally concede that point—there is a wider public interest question which has to be discussed—but I have a lot of discomfort with the Australian government negotiating a tax and the design of the tax with three companies, excluding the public, the parliament and other competitive stakeholders and not being prepared to share any of the information. What is your view? When the RSPT was announced, it was announced that there was $12 billion in revenue, and then it was going to be $10½ billion under the MRRT. The assumptions were changed. The original tax would have raised $24 billion; now the exchange rates have changed it is $7½ billion. There has been a lot of moving around in revenue estimates before the tax has even been introduced. Do you think that the government should be more transparent around the assumptions they are using so that we can have proper public debate about the impact of the tax on the budget, on the economy and on the public interest in general?

Prof. Garnaut—I agree that this is such an important issue that we would all benefit from wide discussion of effects on the budget and the economy, and I hope we will still get some of that.

CHAIR—But it is difficult to have wider discussion if we have not got the information, isn't it? The people who were on the inside of the room have the information, but the public at large do not have the information. We, the parliament, have tried to get hold of the information. Do you think it is legitimate for the government to keep secret the commodity price, production volume and exchange rate assumptions that they have used to estimate the revenue from the tax?

Prof. Garnaut—I think best practice is to be as transparent as possible on all of these things.

CHAIR—Do you think the design of the minerals resource rent tax matches up better with the idea of a resource rent tax, or was the RSPT in your view a better tax in terms of the way you have assessed the structures of these taxes in the past?

Senator HUTCHINS—And in terms of your comment on royalties as opposed to the tax as well, Professor.

Prof. Garnaut—Okay. This is not unrelated to your earlier comment, Chairman, but I am not aware of every detail of the new proposal that is necessary to form an authoritative assessment, because in these matters some quite arcane things can have a very big fiscal effect. I do not know anything that the readers of Australian newspapers do not know, so—

CHAIR—Let me be more specific.

Prof. Garnaut—Can I answer—because you have both asked questions.

Senator HUTCHINS—I asked you about the coalition's royalties and MRRT—

Prof. Garnaut—From an economic efficiency point of view, a profits based tax—or even better a cash flow based tax—like the MRRT or the resource super profits tax has many advantages over specific and ad valorem royalties. That drove the Commonwealth towards use of profits based taxes and the resource rent tax in offshore areas for petroleum. Back in history it even, in the end, led the Bass Strait joint venture partners to ask if they could come under the regime, because at the time mineral rents were judged to be very high in the Bass Strait. Under successive governments from both sides of politics, royalties rose to very high levels—in some fields around 85 per cent—and they have the effect of making it unprofitable to fully extract the mineral resource, whereas a profits based tax or, especially, a cash flow based tax does not have that effect. So there is a general superiority of the profit based taxes over the ad valorem and specific royalties from an economic efficiency point of view.

CHAIR—On that point, though, we had evidence earlier that in the Northern Territory, for example—where they have profit based royalties as well as paying company tax, which is a profit based tax—there are circumstances where the people in the Northern Territory do not get any return at all from the extraction of a non-renewable resource, because if there is no profit then the miners do not pay company tax and do not pay a price for the resources they extract.

Isn’t a state royalty the only certain way for the community to get a certain return for the extraction of non-renewable resources?

Prof. Garnaut—It is more certain but if there is no profit from mining a mineral resource then there is no economic rent.

CHAIR—If there is no capacity for profit should there be any ongoing extraction at all? If a butcher cannot pay the price of his raw material he is not going to be able to run his business. If a restaurant cannot pay for the produce because they are not making enough money to run their restaurant they are not going to be able to run the restaurant. If a mining company cannot pay the cost of the resources that they are purchasing from individual states should they be able to continue to extract that resource without a return to the community? Or should we wait until it maybe becomes profitable again when prices go up for that return to continue?

Prof. Garnaut—There is always uncertainty about future prices and therefore about profitability. It is sufficient to leave judgments about that to the private sector. I do not think there is a general policy problem in receiving no revenue from a mine that turns out to have no profit. One can go through the economics of that and show overall that it will be part of a favourable outcome. That will be balanced by other cases where mines are more profitable than expected and in which the public revenues will get a higher proportion.

No mining company will enter the production of a mine in the expectation that it will get no profit, obviously. Its expectations would be disappointed for some reason or other if it does not make a profit. There are economic advantages in not placing a tax burden on it in those circumstances. The analogy with the butcher, I think, would be closer if we were considering putting a specific duty on some of the butcher’s inputs—

CHAIR—That goes to the person who is selling the product. Resources, as you mentioned earlier, are the properties of the states and it is the states on behalf of the people in those states who sell those resources, for royalties, to those mining companies. A butcher would buy it in a private market but the principle is the same. Why is it appropriate for this sort of tax to be applied to iron ore and coal but not to uranium, nickel or gold? Is there an economic argument in favour of picking those two resources and excluding others?

Prof. Garnaut—There is no economic reason. If two mines are equally profitable, are the same size, take the same length of time and the same amount of exploration to bring into production there is no economic reason to tax iron ore more heavily than uranium, for example.

CHAIR—So why do you think the government has picked them? I am not asking you to second-guess the government but what would be a public policy reason to pick iron ore and coal instead of some of the other resources?

Prof. Garnaut—That really is better directed at the government, because all I can do is second-guess the government.

CHAIR—Is it fair to say, then, that it is an arbitrary choice?

Prof. Garnaut—I think that is fair to say. In the public discussion there has been some suggestion that these happen to be very large and very profitable activities at the moment, but not every iron ore mine is large and profitable, and not every other kind of mine is small and unprofitable. So yes, I think you would be struggling to find an economic justification for the distinction.

CHAIR—I will again pursue this argument around state property and Commonwealth taxation powers. The Commonwealth does have corporation taxation powers and they impose company tax, and at present the states are imposing royalties. One of the distinctions between this mineral resources rent tax and the super profits tax is that the government have said that they want to bring the taxing point as close to the mine gate as possible. What has been said to us by mining companies and others is that when you extract it out of the ground it is hardly worth anything. The value comes in when you can take it to port and add value to it along the way. So the question is: when does a minerals resource rent tax that is applied as close to the extraction of the resource as possible become, in effect, a royalty rather than a profits based tax?

Prof. Garnaut—These are the difficult questions of administration. The closer you go to the mine gate to apply the tax, the more you have to attribute costs to the process whereby you get from there to a place where the resource has an independent market value. You do have an independent market value once you put something on a boat, because there is a global market for sea freight and for the final product. It is a question of the simplicity and straightforwardness of administration whether it is better to value the product at the first point at which the resource is independently saleable or at the mine gate. If you do the latter, then you will have to attribute a transport cost and therefore a return on investment, so you have to go through an additional process to calculate the resources rent tax.

CHAIR—So by calculating the resource rent tax that way you have got to go through a whole series of calculations and you have got to apply a whole series of processes and assumptions in order to essentially come up with a construct rather than what is a verifiable profit as such.

Prof. Garnaut—Yes. Well, you can do that on the basis of very clear principles and, if you have got very clear principles, it will lead you to a result. But, yes, you do have to go through that construction.

CHAIR—In the Henry review the resource rent tax proposal was based on the proposition that it would replace state royalties and the resource super profits tax initially was going to refund all royalties because the states were going to abolish royalties. But there is a limit to how much state royalties will be credited; any increases will not be credited and anybody not subject to the MRRT will continue to have to pay royalties. This is becoming rather complex, isn’t it?

Prof. Garnaut—My memory—and I might be wrong, because, as I mentioned, I am losing lots of things and this is not one of the main ones—is that the original Henry proposal capped the reimbursement of state royalties—

CHAIR—I think that was a conditional government proposal. I think the Henry proposal actually envisaged that a resource rent tax would replace royalties altogether. The problem the federal government had is that, because they wanted to introduce it quickly rather than going through a lengthy public consultation process they did not have agreement from the states to abolish royalties. In fact to this day, they have not spoken to the state government in Western Australia, for example, about any of this. So it goes again to the matter of process.

Going back to the question I wanted to ask earlier, about whether the MRRT is better or worse than the RSPT: one of the features of the MRRT is that it has removed the risk-sharing component that the RSPT included—having a share of the 40 per cent in profits but then taking on 40 per cent of the losses. That is what the government proposed as part of the RSPT, which is a Brown tax concept. What is the impact of this on the pace of new mining developments or incentives to pursue risky projects?

Prof. Garnaut—I described in my public lecture at the University of Melbourne the Henry review proposals as an ‘elegant response to a complex problem’. I did draw attention to concerns I had had about the Brown tax when I was assessing all the different ways you would tax royalties. The Brown tax is only neutral if the private parties have confidence that whatever the scale of their losses they will be paid by the government.

One can imagine some circumstances, especially if there are differences of views across the parliament and the chance of a change of government, where an investor would not feel certain that if it made a very large investment and, unfortunately for the company and for the community, it made a loss that it would not be fully reimbursed. So, the questions about the neutrality of the Brown tax are all about perceptions of the certainty with which you will get the cash.

CHAIR—Which then comes into the political domain as to whether public opinion would tolerate governments bailing out big mining companies.

Prof. Garnaut—That is a dimension of it, to which I drew attention in the discussion of these matters in the seventies and early eighties.

There is an additional complication in the version of the Brown tax that was proposed by the Henry review, and that is that the cash payments were not made immediately when the negative cash flows were incurred. They were somewhat delayed through two processes. Firstly, instead of negative cash flows being partially reimbursed immediately, there was in effect a depreciation regime. So there was some delay in the reimbursement. Secondly, even when the period of delay had passed there was not reimbursement in cash, it was in the form, effectively, of a government bond. That raised an additional question of certainty about whether the payment would actually be made in the future. It would not only be contingent on political circumstances but also because ‘in the future’ is contingent on the circumstance as well. There was also a question about whether recoupment of the costs of delayed payment at the Commonwealth’s borrowing rate did properly reflect the cost of capital. So there were these quite important questions that needed to be debated about the original Henry proposals.

CHAIR—The proposal of the RSPT said that it did not distort incentives for investment. Does the MRRT distort incentives to pursue new projects? What is going to be the impact on investment incentives of having it apply to iron ore and coal and not to other resources?

Prof. Garnaut—Again, bear in mind that I do not know all the details of the MRRT so I am speaking conceptually. But let us make it more concrete; let us talk about the sort of tax you have got for offshore petroleum, which in some ways is the prototype for the PRRT.

CHAIR—Except that there are no state royalties offshore.

Prof. Garnaut—Yes, apart from that complication. But abstracting from that issue—and it is a very important issue—let us just look at the structure of the tax.

The resource rent tax in the form of a petroleum resource rent tax does not have the problem that the Brown tax has, that you have to have faith that the government will pay up a large amount of money, and it does not raise that question about the appropriate rate of interest on delayed payment.

It raises another question: what is the appropriate discount rate that you should apply to negative cash flows before the tax comes into existence? It will not be possible to get that precisely right, but if it is set broadly right, as I think it is under the PRRT, then it will be less distorting than other forms of taxation. And if you have it broadly right it will be relatively undistorting in relation to new investment decisions. Companies will know that they will not pay anything until they have the whole of their investment back, with a rate of return substantially in excess of the return on riskless investment. They do not pay anything extra until then.

That has the effect of compressing the dispersion of the probability distribution of the outcomes. That has the effect of reducing risk for the company, and so it is therefore a way in which you can raise taxation with a minimal effect on investment decisions. You cannot say it has no effect.

Senator HUTCHINS—Professor Garnaut, I have just a few questions. Do you have a view on how successful resource rent taxes have been overseas?

Prof. Garnaut—Resource rent taxes come in many forms. Even the royalty is a form of resource rent taxes. Taken across the whole range, they have been very large sources of revenue in quite a few countries—not unimportant in Australia. Generally the resource rent tax in the form that Anthony Clunies Ross and I propose—in the form of the petroleum resource rent tax and I understand in the form of the MRRT—have, where they have been applied, tended to be stable and consistent with a healthy expansion of the minerals sector. That seems to have been the case with our petroleum resource rent tax in offshore areas.

Senator HUTCHINS—Is the $50 million threshold too high or too low?

Prof. Garnaut—There are some details of the way that will operate of which I am not—

Senator HUTCHINS—Would you mind taking that on notice.

Prof. Garnaut—Okay.

Senator HUTCHINS—Is the 22½ per cent rate too low as the OECD argues?

Prof. Garnaut—If you have the other parameters of the tax right, you could have a higher rate of tax without having a large distorting effect on investment. Cash flows of 22½ per cent are of course a very much lower imposition than a similar imposition on the value of production, and on many mines that 22½ per cent will apply to a relatively small cash flow because it will only apply to the cash flow after recruitment of the whole investment, with a rate of return that is not high enough to attract investors. So 22½ per cent sounds higher than it will seem if you apply it in practice to a lot of outcomes. But in general one could say that a 22½ per cent tax is not too high. And it could be higher without distorting investment. There is some trade-off between the rate of tax and the rate of return you allow before you apply the tax. If you have a higher rate of return, you might want to err in the direction of allowing a high rate of return, given that there are issues of judgment involved in setting the rate of return.

Senator HUTCHINS—The OECD in its recent review of the Australian government warned the government against spending the revenue the tax generates, and they suggested that a special reserve fund should be established. Some have suggested it should follow the Norwegian approach of investing offshore. Would this reduce the effect on the exchange rate and avoid the Dutch disease? Do you have a view on the effectiveness of special reserve funds?

Prof. Garnaut—I like to see this as part of a more general story of how we handle temporarily large revenues, above what one might think of as long-term average revenues, that come with a boom. I have been worried about the level of total expenditure in Australia—investment plus private consumption plus government expenditure—since the early stages of the current resources boom in 2005. I have actually been saying since 2005 that we should have been running bigger budget surpluses by sparely spending the revenue.

CHAIR— At least then we would have budget surpluses. That is a long history. We have not had one under this government.

Prof. Garnaut—I would qualify my general view for the circumstances of the great crash of 2008 and aftermath, Senator. There were circumstances there where, if we had tried to maintain a balanced budget then or a budget surplus, we would have sent the economy into recession. But, with the exception of that period, since 2005 we should have been running higher budget surpluses. The fact that we are spending the money as we go along, and still doing it, means the general cost level in Australia is rising more than it would otherwise. It means that other tradable goods industries are becoming less competitive. It means that parts of the economy other than the resources sector are not finding it easy to gain access to capital, given total capital availability in the Australian economy is to some extent limited. I set out some of these issues in a presentation I gave to the Australian Academy of Technological Sciences and Engineering last week.

The question about a special fund is whether it is easier to run bigger budget surpluses if you have a separate fund—politically easier. There is no reason in principle why you cannot run bigger budget surpluses through a boom like we have had without such a fund, but probably it is easier if you are making quite transparent the stabilisation purposes of the fund and putting some money aside.

CHAIR—The Future Fund?

Prof. Garnaut—I think the Future Fund probably made it easier for the government to run that bit of the surplus at that time, yes.

Senator HUTCHINS—What about the benefits of, say, a cut in the company tax rate? You were just talking about the uneven benefits through the economy, so I wonder if you would like to comment on that for us.

Prof. Garnaut—There was some discussion in the Henry tax review of the advantages of a higher rate of resource taxation, part of which would fund lower rates of company tax more generally. The general theoretical position of the Henry review on that was that there were economic advantages in taxing income from resources and other fixed factors of production and reducing the burden on parts of the economy where resources are mobile. Speaking purely from a theoretical point of view, in the current circumstance of our economy there would be advantages in shifting the balance of taxation from the general run of competitive business and more onto businesses operating in the resource sector and in other monopoly enterprises.

Senator HUTCHINS—You would be aware that at this stage the Commonwealth is looking at the benefits of this scheme going into increased infrastructure spending, superannuation savings and cutting the company tax.

CHAIR—And reducing the deficit?

Senator HUTCHINS—What sort of advantage do you see from that? Is that going to have a flow-on effect to the economy?

Prof. Garnaut—I think in current circumstances—again, I am just talking analytically or theoretically—to have a higher rate of tax on the resources sector that is funding a lower rate of tax on other sectors in general would reduce pressure on those other sectors, which are under very great pressure at the moment. They have quite extraordinary pressure, actually.

CHAIR—You are saying the resources sector should help the rest of the economy: let’s have less taxation on all other parts of the economy funded by the resources sector. That is essentially what you are saying?

Prof. Garnaut—Yes, and that is an idea from the Henry review. I think there is something to be said for that. But in current circumstances in Australia I would be cautious about spending all the revenue anyway because I am worried that right through this boom, now for five years with the exception of the financial crisis, we have been spending too much and that has made—

CHAIR—But most of the money to be raised by the mining tax is going to be spent, isn’t it?

Prof. Garnaut—Yes, but my understanding is that that expenditure is still subject to the two per cent per annum expenditure growth constraint.

CHAIR—That is about getting to surplus; to have a two per cent expenditure restraint from record levels of spending, at crisis levels, is not a very challenging expenditure restraint.

Prof. Garnaut—Yes.

Senator HUTCHINS—Superannuation is going to be savings, isn't it?

Prof. Garnaut—Superannuation is a contribution to savings—

CHAIR—Will the mining tax increase superannuation funds?

Prof. Garnaut—I have explained that I have not tried to follow every detail—

CHAIR—I think Senator Hutchins is being very disingenuous because he knows that the mining tax will not be funding increased superannuation savings.

Prof. Garnaut—Let me make the general point again, this is an extraordinary boom. I think we would be in a less risky position as a national economy if on average we had been running bigger budget surpluses through this boom. What that is doing to the competitiveness of the other sectors is creating some problems for the future.

Senator HUTCHINS—Geographically, who do you think will be paying the MRRT? Will it be mostly Western Australia, where many of the mines are located, or Victoria, where many of the big mining companies have their headquarters, or overseas, where a large proportion of the shareholders reside?

Prof. Garnaut—In the end it will be mostly shareholders who carry the cost, and for mining companies where a majority of shareholders are overseas there will be a significant burden on them. Of course the proportion of foreign ownership varies quite a lot across the Australian mining sector.

CHAIR—The MRRT is supposed to be applied on a project by project basis, which means you can geographically isolate it. You mentioned earlier there is no economic reason why you would pick iron ore and coal and not the other resources—and 98 per cent of iron ore production happens to take place in Western Australia. Dr Henry has conceded that most of the MRRT revenue will come from iron ore and not from coal, because of the way the MRRT and state royalty credits interact, so coal is going to be a comparatively smaller proportion. Is it fair to pick a resource for what is an arbitrary reason, as you have described, when 98 per cent of that resource is located in one state? It is a national tax being essentially targeted at one state.

Prof. Garnaut—I said something about federal-state financial relations in the public lecture I gave. If the tax is a good one and it happens that the burden lies mainly in one or another state, I do not think the distributional issue is important. But I do think there are very big federal-state financial relations problems with two aspects of the arrangements. One is horizontal fiscal equalisation—this is a big subject in itself. I think it is very important for Australia that we come to grips with that. I say in the paper that that provided a disincentive for the states putting in efficient taxation arrangements of their own. Under the horizontal fiscal equalisation, if they took the big effort that was necessary Western Australia would lose most of the revenue anyway.

CHAIR—I was interested to read that part of it. So the way the Commonwealth Grants Commission process works at the moment, if Western Australia for example puts up their royalties on something, or even another state, their GST revenue just continues to go down. So, really, there is no incentive for a state to become less competitive in terms of attracting investment, just to send the money over to other parts of Australia anyway. Is that what you are saying?

Prof. Garnaut—Yes. It is hard work to put in place an efficient taxation regime, and there is not much incentive for a state government to do that and to take criticism for it if it is going to lose almost all of the revenue.

CHAIR—So do we have to revisit that whole Commonwealth Grants Commission process from a public interest point of view, to make sure that taxation arrangements, federal-state financial relations, are as efficient as possible?

Prof. Garnaut—That is my own view, and it has been for quite a long time. I think it is a big problem of our Federation. I have only mentioned one problem, the horizontal fiscal equalisation, but these days—and this has been happening gradually on both sides of politics for a long time—almost every state function has been turned into a joint function by tied grants, so there are really no purely state functions where states take full responsibility for what they do. I think that is the source of dreadful inefficiencies in our Federation.

CHAIR—To be fair, when you are responsible you should be responsible for both the revenue—

Prof. Garnaut—That is right, or else there should be clear lump-sum payments to handle vertical fiscal imbalance that do not—

CHAIR—Like the GST going to the states.

Prof. Garnaut—If the GST went to them on a lump-sum basis—but, unfortunately, it goes through the Grants Commission process.

CHAIR—And that distorts all of that again.

Prof. Garnaut—In my view it does, yes.

CHAIR—I think that is a very sound view. You talked about the PRRT before. Of course it was applied offshore, where there were no state royalties. The proposition is that it now be extended onshore. Why was the PRRT not extended to the onshore areas when it was introduced in the 1990s?

Prof. Garnaut—Simply because of the complexities of federal-state financial relations. There was a lot of discussion at that time about the advantages of profit based royalties like the PRRT and some of the states and territories moved in that direction. Western Australia did it for the Barrow Island onshore oilfield. The Northern Territory introduced a variation on the PRRT theme. From memory, South Australia went a bit in that direction with Roxby Downs, but I would have to refresh my memory to be sure. There were some adjustments in what the states did at the time but the reason the Commonwealth did not come onshore then was the complications of federal-state relations.

CHAIR—So the Commonwealth then had corporate knowledge of the complexities from the federal-state financial relations point of view of introducing a PRRT onshore, given the state royalty dynamics and, for that matter, an MRRT. Wouldn't you expect that, before the government proceeded with something like this, there would be active engagement with state and territory governments about the merits or otherwise of this tax as opposed to the current arrangements? Wouldn't you expect that there would be a discussion over a certain period of time rather than just having it dropped not just on the mining companies but also on the state and territory governments and the public at large?

Prof. Garnaut—I have no idea what discussions took place, but world's best practice would suggest there was careful discussion of these matters.

CHAIR—The WA Treasury, which appeared before this committee, told us in July that there had been no discussions, and they told us again last week that, even since the middle of July, there has not been any meaningful discussion at all about any of these matters. They still do not know how the MRRT is supposed to interact with state royalties. But I think you have answered the question to the extent that you think that, under world's best practice, the government should have engaged with those governments as well as with everybody else. You would not have any views or understanding about the likely revenues from the MRRT across individual commodities and things of that nature?

Prof. Garnaut—No. I do not know whether that is because I have not looked for all the information that is available or because it is not available.

CHAIR—I just thought I would check. Thank you so much for your contribution to the committee; it was most interesting.

Prof. Garnaut—Okay, good to be with you.

[12.39 pm]

HOGAN, Ms Lindsay, Senior Economist, Resource, Energy and Trade, Australian Bureau of Agricultural and Resource Economics, Bureau of Rural Sciences

MORRIS, Mr Paul, Deputy Executive Director, Australian Bureau of Agricultural and Resource Economics, Bureau of Rural Sciences

CHAIR—The committee now welcomes representatives of ABARE-BRS to the hearing. Mr Morris and Ms Hogan, would you like to make a brief opening statement?

Mr Morris—Yes, thank you. We have passed a copy of our opening statement to the secretariat—I will read that as passed to them.

Firstly, thank you for the opportunity to talk to the committee, today. The Australian Bureau of Agricultural and Resource Economics-Bureau of Rural Sciences, ABARE-BRS, is a professional, independent research bureau within the Australian government Department of Agriculture, Fisheries and Forestry. ABARE-BRS receives funding from the Australian government Department of Resources, Energy and Tourism to undertake economic research on the minerals and energy industries. We have also received funding from other agencies and organisations on specific projects related to minerals and energy issues.

Our role in resource taxation has been to provide economic analysis and information as an input to the consideration of resource tax options by the Australian government and others. Our work on resource taxation extends back to 1989 when, as an input to the Australian government's consideration of extending the petroleum resource rent tax to the Bass Strait fields, ABARE released two research reports: *Mineral taxation and risk in Australia* by Hinchy, Fisher and Wallace in 1989 and *Crude oil taxation under uncertainty: a simulation study* by Hogan and Thorpe in 1990. We have published a number of papers on resource taxation since that time, the most recent of which we have highlighted in our two submissions to the committee. Our submission to the committee on 21 October contained three research outputs that were published by ABARE on approaches to taxation in the minerals and petroleum industry in 2007, 2008 and 2010. The three research outputs are: *Mineral resource taxation in Australia: an economic assessment of policy options*, *International minerals taxation: experience and issues* and a chapter in the book titled *The taxation of petroleum and minerals: principles, problems and practice*.

We provided a second submission to the committee on 17 November, to formally advise the committee of the release on 28 and 29 October of a report, *Non-renewable resource taxation in Australia*, which is by Hogan and McCallum in 2010. That was commissioned by Treasury as an input into Australia's future tax system review—the AFTS review. From an economic perspective, the extraction of non-renewable resources by the mining industry creates economic rent, which is profits in excess of those that would normally be required for a company to invest in the industry. We believe that mineral resources in Australia are an asset owned by the

Australian community and that collection of the economic rent represents a return to the community from allocation of exploration and production rights to private investors. These rents have traditionally been collected by federal, state and territory governments through a mix of arrangements.

The ABARE-BRS report to the AFTS review panel reviewed the alternative forms of resource rent collection and considered the extent to which the full rent from minerals projects had been collected by governments. As you are aware, the two main applied forms of resource rent collection are rent and profit based measures, such as a petroleum resource rent tax, and output based measures, such as royalties per tonne of production. Profit based taxes are relatively efficient measures that result in revenue varying according to market circumstances and tend to reduce distortions to industry based decision making that would otherwise be created by output based measures. However, profit based taxes tend to be more complex to apply and result in variable revenue streams for governments. Output based taxes tend to provide greater government revenue stability and administrative simplicity. A key concern with output based royalties is the risk that governments collect an inadequate share of the resource rent during periods of relatively high industry profitability—for example, due to relatively high commodity prices, such as in recent years.

The estimates which were presented in the ABARE-BRS report to the AFTS review panel indicated that there is likely to have been a substantial shortfall in actual resource taxation revenue compared with potential revenue, particularly in the period 2000-01 to 2006-07, which was the latest period we assessed in the report. This shortfall may have amounted to around $28 billion over the seven-year period. Given Australia’s considerable demonstrated economic resources and continuing strong global demand for minerals, future resource rents and, hence, resource taxation potential are likely to be substantial. It should be noted that we have not evaluated the specific details of the alternative tax arrangements that may be applied in practice. We would be happy to answer any questions the committee may have on the work we have done in this area.

CHAIR—Thank you very much. Just going through your opening statement you said it is believed that mineral resources in Australia are an asset owned by the Australian community. They are not really are they because, according to the Constitution, onshore resources are actually assets owned by the states?

Mr Morris—The statement we were making is a general statement referring to the Australian community whether that is represented by the state governments or the Commonwealth government rather than necessarily differentiating between whether it is state or Commonwealth.

CHAIR—Do you think the people in New South Wales own the iron ore resources in the Pilbara?

Mr Morris—We do not make a judgment on that. In an economic sense it is an issue of equity and a determination by governments as to who actually owns a resource whether it be a water resource or a mineral resource. It is—

CHAIR—It is not just determined by government; it is actually determined by the Constitution. According to the Constitution, resources are a matter for the states. The reason I am asking is that your statement is entirely consistent with the political assertion made by the current government and the Treasurer. He is trying to run the argument that they are resources owned by the Australian people. That is one of the key features of the argument that is currently taking place. I was surprised to see that you would have adopted that sort of language as an independent research bureau. I will just make that point.

Mr Morris—We were not trying to make a constitutional law point; we were just making a generic point.

CHAIR—But it is relevant to the debate though. It goes to the question as to whether these sorts of resource rent arrangements are appropriately applied at a national level or at the state level. Of course, at a national level we have corporations taxation, company tax and so on and at a state level we have royalties. I just thought I would explore that with you.

Senator HUTCHINS—This is not a point to raise with public servants.

CHAIR—It is the Public Service who make the point in their statement.

Mr Morris—We were not trying to make a particular point of view on that. We were referring to the Australian community whether it be New South Welshmen or Western Australians or Australians as a whole—it was a generic statement.

CHAIR—Profit based taxes tend to be more complex to apply and result in variable revenue streams for government. We have certainly seen the variable revenue streams because the budget estimates would have gone to $24 billion once the assumptions were changed for the successor tax, the MRRT. There was $10½ billion and that has gone to $7.4 billion because of changes in exchange rates so that point is borne out even before the tax has been introduced because there have been significant fluctuations. Given the great variability in revenue streams for governments under profit based taxes like the MRRT, is it important to have a clear understanding of the assumptions that are used when you estimate the impact of these sorts of taxes?

Mr Morris—Very much so. Obviously, in looking at the future and what revenue stream might be possible, you need to take into account the likely prices, the likely production and the cost of production if you are using a profit based tax as well as government decisions about the actual operating parameters of the scheme. Clearly all of those—

CHAIR—And exchange rates.

Mr Morris—Yes, exchange rates. If you are looking at prices in Australian dollars then clearly exchange rates are going to have an important role once you convert those back into Australian dollar terms. Of course, most of minerals and energy are traded in currencies other than Australian dollars so it can be quite important.

CHAIR—So the only way you can properly assess a mining tax revenue estimate such as that from the MRRT is if you have a clear understanding as to what your commodity price, production volume, production cost, exchange rate assumptions are going to be assuming that government settings for the time being remain equal?

Mr Morris—If you are trying to assess the revenue stream then, clearly, it will depend on all the factors I have just mentioned.

CHAIR—But if you do not know these factors, you would not be in a position to scrutinise the credibility of any revenue streams would you?

Mr Morris—It would not be that much different from, say, a royalty—looking at the revenue stream from a royalty—other than that there are a few extra factors in a resource rent tax. Royalty streams tend to be dependent on what is happening to future prices as well, because most of them are based on value. So this is more complex, as we have indicated here, because you are not only looking at what might happen to future prices, which is a key area of variability, but you are also looking at costs and other things as well.

CHAIR—Yes, but my question goes to the information that we have to have in front of us in order to be able to assess the revenue estimate. The context of it is that the state government in Western Australia creates royalties, which are also sensitive to variations in commodity prices—they are ad valorem. Those royalties are also sensitive to variations in exchange rates, so the WA government publishes those assumptions in their budget papers. But we are now discussing a situation where the estimated mining tax revenue has gone up and down significantly, consistent with what you said in your opening statement, but none of us have access to information about the commodity price, production volume and exchange rate assumptions that were used by the government in that revenue estimation. I gather that your organisation has actually provided some of the input to the commodity price and production volume assumptions used by the government. Is that right?

Mr Morris—As a government commodity forecasting agency, we produce and publish, on a quarterly basis, our forecasts of commodity prices, including commodity prices for the minerals and energy sector. We do that quarterly—four times a year. In three of those quarters—June, September and December—we publish forecasts for one year ahead, while in March we provide forecasts going out five years. On the question of the transparency of our forecasts of commodity prices, production volumes, export numbers and so forth, and our exchange rate assumptions: that is all out in the public domain. We cannot really comment on whether the Treasury has used those assumptions or whether they take those into account and use a whole lot of other forecasts they might have access to in coming up with their price forecasts. I can only comment—

CHAIR—I understand. I can comment, because Dr Henry has given evidence to us which you may or may not have reviewed. Are you aware whether your March 2010 forecasts—the five-year forecasts that you publish—were used for the purposes of estimating the revenue of the RSPT? I believe that that is what happened.

Mr Morris—Those forecasts may have been used. As I say, we publish those; anyone can use them. We provide those to the Treasury, so they would have had access to that information, the same as everyone else.

CHAIR—Have you provided anything to Treasury that was not published? Is it the case that everything that you have provided to Treasury has been published?

Mr Morris—I believe so. The report that had not been published was the one that came out on 28 and 29 October. That was a report done in the context of the Henry tax review.

CHAIR—We will not worry about that at the moment, because we are looking at the deal on the minerals resource rent tax that was done on 2 July. Your report in October would not have been relevant for that. The forecast you publish in March is a five-year forecast?

Mr Morris—Correct.

CHAIR—And your forecast in June is a one-year forecast?

Mr Morris—Correct.

CHAIR—Is it fair to say that the March forecast is more reliable over the longer term? What are the differences? What are the differences between your five-year forecast and your one-year forecast?

Mr Morris—We do not publish five-year forecasts every quarter because they are a longer term forecast. We think it is not sensible to be looking five years ahead every quarter, whereas it is sensible—because things do change quite a bit from quarter to quarter—to look one year ahead and modify our forecasts. That is why we only produce those five-year forecasts once a year in March.

CHAIR—Which ones are the better forecasts to use for budget estimates purposes—for forward planning over the four-year cycle?

Mr Morris—It is really up to Treasury what forecasts they use. All I can say is that, as of March, we have put out a five-year forecast. We put out a revised set of forecasts for one year ahead in June. Those June numbers are not available for the budget, which comes out in May, so if they are using our forecasts then it would obviously be the March ones rather than the—

CHAIR—In the budget, yes, but in June, if they were to use your June forecast, they would only really be able to use it for one year ahead, not for an extended period. Is that right?

Mr Morris—We only produce a forecast for one year ahead. How they use those forecasts is up to them.

CHAIR—I am intrigued because, between the end of April 2010 and the end of June-early July 2010, which is the period between when the RSPT was settled down and the MRRT was negotiated, spot prices in the iron ore market went down by 30 per cent. There was not any evidence of significant improvements in the commodity price outlook for iron ore, yet the government were telling us that they had significantly upgraded their commodity price forecasts. We are finding it very difficult to get to the bottom of where they got the information from. Can you comment on that?

Mr Morris—Between March and June we substantially upgraded our numbers, our forecasts. It depends what period you are talking about. Our March forecast came out very early in March, and the June forecast came out in the middle of June. We did have some discussions with Treasury about our forecasts just before they came out—a few days before—

CHAIR—Before the MRRT came out?

Mr Morris—No, before our forecasts came out.

CHAIR—In April or in June?

Mr Morris—In June. As I say, a few days before the forecasts come out quite often we will have a conversation with Treasury just to give them some advance notice as to where we are going. We did have a conversation with them and with the Department of Resources, Energy and Tourism just before they came out. So they had the numbers a little bit in advance. But those numbers were the ones that we eventually published in June.

CHAIR—In June, you say, it is for one year, and that is for the period when there is no tax, because the tax is only supposed to come into effect in 2012. You gave them a forecast in March which goes over five years and covers the whole forward estimates period. You gave them a forecast in June which covers the period 2010 to 2011. Surely your June forecast is completely irrelevant to a tax that applies from 2012-13 onwards.

Mr Morris—Relevance or otherwise is a question for them to answer. We provide the forecasts as I say—five-year forecasts in March, one-year forecasts in June. The base was a lot higher for the next few years because there was quite an increase in—

CHAIR—But you do not know, because you have not done that, have you?

Mr Morris—Not yet, no.

CHAIR—This is an important question. What is the most recent ABARE forecast for commodity prices that covers the period 2012-13, 2013-14?

Mr Morris—That is the March 2010 forecast.

Senator HUTCHINS—Thank you very much for coming along today. That paper was from you, Ms Hogan?

Ms Hogan—Yes.

Senator HUTCHINS—In the third-last paragraph, you estimate—I will just shorthand it—that ‘we may have had a shortfall of $28 billion over this seven-year period.’ Can you tell us what you mean by that? How would that have been collected? What have we lost? What have overseas shareholders got that could have come to Australia?

Mr Morris—Let me start off and then I will hand over to the expert who has worked on this for 20 years or so. That number comes out of the report that went into the Henry tax review, so that was a calculation based across the range of mining industries that we believe a tax could have been applied to—so the full range of them. It was looking at a hypothetical Brown tax being applied at a rate of 40 per cent. It looked at what the net cash flow from industries over that period was, and then if you applied a 40 per cent Brown tax to the industry what sort of revenue you would have got. We then compared that to the revenue that was actually earned over that period, and that gives a difference of about $28 billion. Would you like to add anything to that, Lindsay?

Ms Hogan—If you want some clarification, I can discuss that a little bit further. If you have copies of the report, I can actually refer you to a table in the report.

Senator HUTCHINS—What page are we looking at?

Ms Hogan—In fact, there are two pages that are relevant. On page 49 we have calculated, in present value terms, the actual resource tax payments for the period from 2000-2001 to 2006-07. On page 49, at the end of table 5.10, we provide that data. We will stick to the aggregate numbers. For example, in that seven-year period, actual resource tax payments amounted to $39 billion. We have the break-up, if you are interested, for oil and gas, coalmining, metal ore mining and those combined. But we will stick with total mining. So $39 billion is the actual resource tax payments. If I can refer you to page 52, table 5.11, we have this hypothetical Brown tax. There are similar results as to whether you have this hypothetical Brown tax—

CHAIR—The Brown tax is a tax, like the original RSPT, where the government covers the downside risks as well as the upside risks. The Brown tax is covering the losses as well as taking a share of the profits. I see you nod. That is what a Brown tax is. That is the academic description of a Brown tax.

Ms Hogan—I think the RSPT is somewhat more complex and was based on the allowance for corporate capital—the ACC approach—which actually is a different approach to allowing offset for year capital expenditures. A Brown tax is essentially a silent partner.

CHAIR—That is right.

Ms Hogan—As a company invest in capital, the government will pay upfront, say, 40 per cent of the capital and then it is on a net cash flow basis. It is like a silent partner.

CHAIR—When you say ‘silent partner’ you are saying the government is exposed to the risk and will take a share in the profits without having any influence on the decision making by that company?

Ms Hogan—Absolutely, and it is in the same time period, which is a very important point. So, in the very initial period, for example, if a company spends $10 billion in capital, the government will put in 40 per cent of that upfront.

CHAIR—Which is highly questionable.

Ms Hogan—That is quite different to the allowance for corporate capital. There are some definitions on page 19 in a box there. That is quite an important distinction.

Mr Morris—Just to clarify: I think I was agreeing to a different thing to what Ms Hogan was disagreeing to. I was agreeing to the proposition that a Brown tax actually involves both bearing losses and profits.

CHAIR—Which is what I was saying. That is exactly my point.

Mr Morris—What you were disagreeing with was whether that was a correct characterisation of the RSPT.

Ms Hogan—There is risk sharing in all of these rent based arrangements.

CHAIR—There is no risk sharing in the MRRT, is there?

Ms Hogan—I cannot comment. We have not been asked to work on the MRRT. But in general there is risk sharing in the resources rent tax.

CHAIR—That is the whole point. That sharing of risk is one of the features that has been taken out of the MRRT. We had that discussion in Perth the other day. Senator Cameron was trying to suggest that Brown taxes were successful everywhere. The Brown tax feature—which is the risk-sharing bit—is the one feature that has been removed out of the MRRT, but not the RSPT.

Ms Hogan—The way a resources rent tax gets around that is to accumulate those losses at some threshold rate and that will be offset against the future profit. A resources rent tax can be designed so there can be different characteristics in terms of the extent to which there is risk sharing. For example, if there is a failed exploration project, one of the characteristics of sharing the losses is that the exploration costs from a failed project can be offset against the profit of a successful project. So you can start to introduce risk sharing in a more subtle way under a resources rent tax. It does not have to involve cash payouts, as would be the case under a Brown tax. There are advantages of rent based taxes. There are slightly different design characteristics that need to be thought through.

Senator HUTCHINS—Were you trained by Professor Garnaut?

Ms Hogan—Actually, I did not have any lectures with Professor Garnaut, but I have certainly read a lot of his papers.

CHAIR—You are much too young for that!

Mr Morris—I think most economists as a matter of principle would say that a resource rent tax is a preferred form of taxation over—

Ms Hogan—On efficiency grounds.

Mr Morris—On efficiency grounds.

Ms Hogan—On page 49 are the actual resource tax payments. On page 52 we now have this hypothetical Brown tax, which is simulating a silent partnership arrangement. The results are very similar to a resource rent tax. At the very bottom there you will see that the total mining sector would have paid $67 billion over that time period. So the $28 billion is simply the difference between $67 billion and the $39 billion. That is where the $28 billion tax revenue shortfall comes from. So it is really comparing what actually happened with a hypothetical efficient arrangement with a tax rate that is similar to the PRRT.

Senator HUTCHINS—Can you outline the recent statistics released about future mining investment? I understand you have just done a paper on that. We have some doom and gloom people over in Perth that this is not going to happen—that there is no more investment going on.

CHAIR—I don't think they said 'no more investment'. I think they said the long-term impacts of this tax are going to be bad.

Senator HUTCHINS—We will put you in the witness box in a minute.

Mr Morris—Every six months we do a report on the minerals and energy major development projects.

Senator HUTCHINS—What is the name of that paper? And if we could have a copy of it sent to the secretariat.

Mr Morris—I will answer the question and then I will hand it over to you, because I possibly may need to refer to it. This comes out every six months. The latest one was released yesterday, which is our normal schedule. It lists all of the projects that we are aware of that have either been recently completed, are advanced—and by advanced we mean they are either firmly committed or under construction—or are proposed but are as yet not fully committed or are not under construction.

CHAIR—With the advanced ones, do they all have final investment decisions?

Mr Morris—Yes, they are quite firmly committed. The ones that we are very confident are going to proceed.

Senator HUTCHINS—Do you have the major investment announcements there? Do you list them?

Mr Morris—In this publication we do not have the list, but on our website we provide the full listing of all the projects that we have actually included in here, and there are over 300, I think, in total that are actually listed. It hopefully lists all of the ones that we have come across and that we are aware of and that have been proposed or are underway. If you find there are not any there let us know and we will put it in the April edition. But, certainly, that is the intention.

In the most recently published report on recently completed projects we reported on 25 major projects that have been completed, which were valued at about $8.2 billion. That included five energy projects, the largest of which was Rio's Queensland Clermont open cut thermal coal mine. There were 10 mineral mining projects. The largest was Rio Tinto's Hammersley iron ore project in WA. There were nine infrastructure projects of which the largest was the Newcastle Coal Infrastructure Group's expansion of the Newcastle terminal. And there was one mineral processing project, which was a pigment plant in Kwinana. That number of completed projects, in terms of the number, is the highest number since October 2007, although the capital cost was lower than our previous listing and the average for the previous eight years. On that front there were a high number of projects but the capital cost was slightly lower than previously.

We also reported on advanced projects. As I said, these are the projects which are committed or already under construction. We reported on 72 projects in that category, and the value of those projects was a record $132.9 billion, which was a 21 per cent increase on those commitments from April. So there has been quite an expansion in the number of advanced projects since that period. That included 26 energy projects, the largest of which is Gorgon's LNG project. There were 25—

CHAIR—Gorgon has been announced since the MRRT—that is not quite right, is it? The Gorgon LNG project was announced some time ago. Kevin Rudd was still Prime Minister when that was announced.

Mr Morris—These are not new announcements; these are a listing of advanced projects that—

CHAIR—But a project like Gorgon has been on the books and was announced in a pretty advanced stage some time ago. What you are saying is that you have put it on the list since we—

Mr Morris—No, sorry, I am not saying that at all.

CHAIR—You are just saying all of the ones that have been put on the list since April. That is essentially suggesting that it has not been impacted by this tax announcement.

Mr Morris—Let me repeat what I said or perhaps, if I said it incorrectly, correct the record. The 72 projects which are advanced is a cumulative list. It includes things committed and under construction—not just since April but the whole list of projects that are actually in that category. The total value of the stock of projects in that category is $132.9—

Senator HUTCHINS—But none of them have stopped. They are continuing.

Mr Morris—These are all the ones that are continuing.

CHAIR—There are two FMG ones which have been delayed.

Mr Morris—If you want to refer to the full list of projects on our website and ask questions about any specific project on there, please let us know; we are happy to answer that. Of the 72 projects, there are 26 energy projects, 25 mineral projects, 15 infrastructure projects and six mineral—

CHAIR—Is this a Dorothy Dixer, is it?

Mr Morris—No, not at all. Because this report came out yesterday—

Senator HUTCHINS—You anticipated we might ask about it.

Mr Morris—you have probably seen in the press that there are quite a number of—

CHAIR—It is just that I see you have some handwritten notes for the answer in response to Senator Hutchins's question. I thought it seemed very coincidental.

Mr Morris—We have not spoken in advance. This is to help me when the media or anyone asks questions on this issue. You have probably seen quite a bit of media coverage of this report. It does attract a lot of interest whenever it is published because of the importance of the industry.

CHAIR—You mentioned early that economists prefer MRRT type taxes because they are more efficient. I am just looking at your opening statement again. You said, 'Profit based taxes tend to me more complex to apply and result in variable revenue streams for government.' And we have already seen how much fluctuation there has been from $7.4 billion to $24 billion for the current proposal that is on the table. Then you say, 'Output based taxes'—that is, royalties—'tend to provide greater government revenue stability and administrative simplicity.' Furthermore, if I can add to that bit, 'royalties also provide a certain return to the community whereas profit based taxes of course only provide a return if you have a profit.' How does that coincide with your belief that economists prefer the efficiency of MRRT type taxes?

Mr Morris—Essentially it is a distinction between administrative simplicity and streams of revenue versus what an economically efficient outcome for society is in terms of taxation regimes. In an economic sense a rent tax, which varies depending on the profitability of the industry, including being potentially zero when profits are zero or negative, is actually a more efficient way to ensure that you are getting the optimal level of mineral and energy development in Australia over time. That is the distinction. In an efficiency sense for society over the long term, a resource rent tax will give you a better, more socially optimal level of mineral and energy activity over time. If you are more interested in a more stable revenue stream for government and administrative simplicity then a royalty will provide that.

CHAIR—If there are zero profits there is zero return to the community. We have a profit based tax, which is company tax, but at the moment it is combined with state royalties. What if both of them were profit based taxes, with the Australian sport of seeking to minimise tax? Is part of your economic thinking to make allowance for taxation driving behaviour?

Mr Morris—Let me start, and then you can jump in, Lindsay. I think it is important to think of this in terms of what the long-term socially-optimal outcome is.

CHAIR—How is it going to drive behaviour over the long term?

Mr Morris—Over time, sure. At any point in time in any year, profit, for an individual company or even for the industry as a whole, might be very low or zero. But, over time, that industry will only remain in existence if it is getting at least a normal rate of return on its investment in that industry. So, over time, you would expect that there would be at least some normal rate of profit; otherwise, the industry would go out of business.

We know that different mining ventures have different cost levels, which are a reflection of the quality of the ore or the ease of extracting it and so forth. Those factors are what really drives the economic rent, or the resource rent, in the industry. So we know that, over the long term, there will be differentials between mining ventures—those levels of rent—and that those rents can be taxed from the industry without affecting the overall level of investment.

CHAIR—If it does drive behaviour—I mean, profit is, to a degree, an artificial construct; you have to take into account costs of production, and there are all sorts of deductions that happen along the way. You can manage your books, your accounting. I mean, even with this tax you have the market valuation mechanisms versus the book valuation mechanisms—all the different calculations that take place. There has got to be a lot of scope to game the system with a view to minimising profits, whereas, with state royalties, it is what it is. If it is 7½ per cent of the value of iron ore then if iron ore prices go up it is still 7½ per cent of the value of iron ore, and that is the end of it, whereas with profit there is an inherent value. Economic theory might assume that everybody behaves in an economically rational way, but when taxation is involved it gets a bit more complex than that, doesn't it?

Mr Morris—It does, and we have said that. Clearly, a profit based tax is a more complex way of collecting it. But, in the long run, you are going to have a more efficient mechanism. The problem with a royalty based tax is that, when you do have very low profit or when industry is struggling, you are still actually taxing them during those periods and, potentially, having quite a negative impact on their longer-term viability through doing that.

CHAIR—But the way you are putting it is based on the premise that we have only got a profit based tax and no state royalty. What we will be ending up with, though, are company taxes, a profit based tax in the MRRT, and state royalties as well. Your argument is on the basis that state royalties do not exist at all. We will end up with both. We will end up with the state royalties, the MRRT and the company tax. Does that make it simpler, or does it make it more complex?

Mr Morris—Clearly, having different tax regimes does create some issues for industry in terms of their—

CHAIR—It makes it more complex.

Mr Morris—It is a complex world and it is quite complex for them in terms of how they look at those various things—

CHAIR—But, compared to the status quo, is it more or less complex?

Mr Morris—Clearly, as we have said, compared to a royalty, a resource rent tax is more complex. I mean, it is—

CHAIR—Sorry; Senator Hutchins has to ask a question, and we are running out of time as well.

Senator HUTCHINS—This is dealing with profit. At the committee's public hearing in Perth, representatives from the Association of Mining and Exploration Companies claimed that, over the last two or three years, the profitability of the mining industry has been slowly eroding. On your figures, do you agree with that statement? Do you contest it? Do you have a view, or is it something you would like to take on notice?

Mr Morris—Profit is the difference between revenue and costs. It seems that the information on the cost side of the industry is not readily available and has not been readily available in the last few years. In our report here we report information up to 2006-07, partly because of the timing of when we did this report but also partly because that was when information was readily available. So we do not have very good information on what has happened to costs in the last three or four years.

However, if you look at the revenue side of things, at what has been happening to prices and production, that has been increasing quite dramatically, driven particularly in the last few months by the increase in world prices of many of our mineral products. So you would expect on that basis, unless there has been some dramatic increase in costs in the meantime, that there should still be very strong profitability in the industry.

CHAIR—Do you expect the supply response to start having an impact on prices over the medium to long term? The companies that Senator Hutchins was just talking about are saying that in four to five years they expect prices to come off on the basis that there will be supply response from around the world.

Mr Morris—Yes, that is right. That is a normal expectation that you would have as a forecaster as well that with the very high prices that we have got at the moment there would be, in effect, more marginal projects which would come on stream at those prices and that would tend to have an impact on prices over the longer term.

Ms Hogan—I just quickly make the point that 10 years ago we were very concerned about the negative impact on the state and territory arrangements—mainly state arrangements—of output based royalties on industry investment and production decisions. Ten years ago we were in the middle of a major downturn and that really highlighted the negative effects of a total reliance on output based royalties to collect some share from the extraction of, if you like, community resources. In particular, it hits the low-profit mines more, so they are more likely to shut down or be put into a care-and-maintenance mode et cetera. But they are also regressive, so you will still have some higher profit mines and they are paying a much lower share of the rent in terms of resource taxation, so they are regressive.

I also refer you to an IMF conference paper and a subsequent chapter that we worked on, where we highlighted that in fact some of the Canadian provinces have now developed these hybrid systems. The main difference there—there can be variations—is that the one government can introduce an output based royalty in addition to a profit based royalty to basically balance the strengths and weaknesses of the different approaches.

CHAIR—More taxes!

Ms Hogan—It balances those, so you can reduce the output based royalty and that is really up to government judgment as to whether they like a smooth revenue flow. When they do that they tend to be giving up significant resource rents with the higher profit mines, and that is the main downside.

CHAIR—Picking up on this, though, if we had had a profit based tax 10 years ago when the market was down, there would have been a significantly lower return to the community at that time through a mineral resource rent tax. So when the government asserts that in order to get a fair return for the community from a non-renewable resource, it is a less reliable return through a profits based tax than through a royalty on production.

Ms Hogan—The community is sharing the risks with the private sector, absolutely. What I really want to point out is that these hybrid systems are out there.

CHAIR—It was a very interesting discussion. Thank you very much for your contribution to the committee.

Committee adjourned at 1.23 pm