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SENATE

SELECT COMMITTEE ON THE SCRUTINY OF NEW TAXES

Reference: Mining taxes

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SYDNEY

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SENATE SELECT COMMITTEE ON

SCRUTINY OF NEW TAXES

Monday, 13 December 2010

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

Senators in attendance: Senators Bushby, Cameron, Cormann and Williams

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

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 5.15 pm

PAPE, Mr Bryan, Senior Lecturer, School of Law, University of New England

CHAIR (Senator Cormann)—I open today's hearing of the Senate Select Committee on the Scrutiny of New Taxes in its inquiry to consider a national mining tax. 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—however, no public servants will be appearing today, so that will not be relevant. I welcome Mr Pape. Would you like to make a brief opening statement?

Mr Pape—Thank you, Mr Chairman and senators, for your invitation to appear before you this afternoon. The terms of reference for this inquiry seem to inextricably link the topics of resource taxation and fiscal federalism. My interest in this proposed minerals resource rent bill—and I understand from the evidence of Dr Henry that it is to be delivered in May next year—is whether the parliament is overreaching its powers under section 114 of the Constitution. Relevantly, section 114 states that the Commonwealth shall not:

… impose any tax on property of any kind belonging to a State.

For the reasons I have published in my written submissions, I am of the view that such a bill would be beyond power. Alternatively, such a bill could be, and in my view would be, seen as interfering with the ability of a state to govern its own affairs. To borrow the words of Justice Starke in the Melbourne Corporation case:

The management and control by the States and by local governing authorities of their revenues and funds is a constitutional power of vital importance to them. Their operations depend upon control of those revenues and funds. And to curtail or interfere with the management of them interferes with their constitutional power.

In my submission I also made reference to the case which Justice Austin of the Supreme Court of New South Wales took to the High Court in relation to superannuation. The High Court held there that the Commonwealth had interfered with the power of the state of New South Wales to administer and govern.

As presently advised, I doubt if a rebate or credit for state royalties, if it were to be allowed against the proposed tax, would be seen as discriminatory so as to offend section 51(ii) or section 99 of the Constitution. But, of course, the difficulty we have in all of this is that the so-called bill is nonexistent and we are speculating as to what in fact the Commonwealth might do.

There are a couple of other matters which I would pause to mention, the first of which is the notion of economic rent. I recently read a 1941 textbook by a very learned economist, Professor Kenneth Boulding, called *Economic Analysis*. This may be helpful to the committee. He said this:

Perhaps the gravest danger facing the legislators who attempt to equalise incomes is that they may destroy a certain amount of productive activity by taking away its rewards. Out of our analysis, therefore, comes a piece of advice to the law-maker: wherever possible attack economic rent. Economic rent we have defined as any payment to the owner of a factor of production in excess of what is required to keep that factor in continuous service. If such an excess is absorbed by taxation or regulation, there will be no diminution in the quantity of the factor supplied; but, if taxation digs deeper than this surplus and attacks the actual supply price of the factor, the quantity supplied will be adversely affected. The advice is good; the difficulty, of course, is to find the economic rents.

I lead to this vexed issue that, if it is lawful, how do you measure it? Mining reeks of what are called uncertainties. I came across a paper recently which may assist. The uncertainties deal with exploration and discovery; testing, proving and assessment; and, finally, the production phase. It was said in relation to Sir Arvi Parbo, the eminent mining engineer of Western Mining Corporation that the first man to address the board in that company was the exploration manager. Exploration makes a mining company tick and Western Mining was said to be the best at that. Sir Arvi Parbo was queried about this and he replied, 'Yes, every board meeting starts with the director of exploration then we go through the operations, production and finance, and so on.' That indicates that mining is a very speculative activity and reeks of uncertainty. Economic rent is a concept which is really based on certainty.

Then we come to this issue of measurement. In a paper published by Robin Boadway and Frank Flatters of the World Bank in 1993, 'The taxation of natural resources', they said, 'We have already made some reference to the fact that rents are virtually impossible to measure as they accrue. To do so requires being able to measure accrued capital costs accurately, including real depreciation, real costs of financing, real capital losses, replacement costs of inventories and the cost of risk bearing.'

I just advert there to some evidence that Mr David Parker of the Treasury gave on thin capitalisation where mining companies have a preference—in fact, lots of companies have a preference—for using debt because they get a tax deduction for it rather than equity. In my submission I say that that is an issue that needs to be dealt with, because it seems on its face that the so-called uplift factor does not recognise on an annual basis the interest which is being incurred. It seems to me that they might spend $100 on capital expenditure and they give it an uplift factor of, say, seven per cent, but that is a once only situation. Rent or interest is an annual charge. If you are there for 10 years, you have 70 per cent worth of interest. Whatever happens, there needs to be some reconciliation with this financing charge.

It seems as though, on one view, the minerals resources rent tax is being used as a vehicle to discourage the use of interest to finance mining projects. That is what you might call an anti-avoidance measure where the other Income Tax Assessment Act has various rules against thin capitalisation. That is a summary of what I put before the committee this afternoon.

CHAIR—Thank you, Mr Pape. On the issue of constitutionality, are you saying that if the federal parliament were to legislate a minerals resource rent tax and an expanded petroleum resource rent tax, as currently proposed, it will be inconsistent with our Constitution on the basis that it is in effect a tax on state property? Is that a fair summary?

Mr Pape—That is correct.

CHAIR—Would your view have been the same or different if we still had the original resource super profits tax, so-called?

Mr Pape—It would still be the same. Super profits were also charged on the state property.

CHAIR—So your view is not influenced by the changes that have been made since?

Mr Pape—That is right.

CHAIR—The reason I ask is that some people have suggested that because the taxing point has been very clearly brought backwards there is not much differentiation anymore between the minerals resource rent tax as proposed and in effect a state royalty. It is very hard to assess profits in the mine game.

Mr Pape—The Northern Territory has a mining royalty tax which is based on an economic rent concept and I do not think it makes much difference there. It is the same situation.

CHAIR—What sanctions are there against the federal parliament passing legislation which is unconstitutional?

Mr Pape—Until the High Court declares it unconstitutional, it is valid.

CHAIR—Essentially, the parliament can pass whatever unconstitutional law it likes. If nobody objects to it, it will stand.

Mr Pape—That is right.

CHAIR—So there is nothing that can be done before a law is passed to test its constitutional validity?

Mr Pape—It may well be that a senator might say, 'My view is that this law is unconstitutional. I believe it would have standing to go to the High Court to run the case that it is unconstitutional.'

CHAIR—Would an individual senator have standing in the lead-up to the law being passed by the parliament?

Mr Pape—I think there is every chance that the individual senator would have that standing because the senator is different from any other person in the community. I say 'a senator', but there are 226 parliamentarians. They are different from any other person because they are legislators.

CHAIR—And have been asked to make a judgment on a piece of legislation.

Mr Pape—Yes. There was a case some years ago where Ms Roxon, the shadow Attorney-General at the time, took a case to the High Court. They did not have to rule on that point, but there were two or three judges—Justice McHugh may have been one of them—who said that she would have had standing. Mr Combet, who was also one of the parties to that case, would not

have had standing because he was President of the Australian Council of Trade Unions at the time.

Senator CAMERON—He was secretary.

Mr Pape—Sorry—secretary.

CHAIR—What you are saying, in effect, is that individual senators would be able to ask the advice of the High Court as to whether—

Mr Pape—They will have to seek a declaration that the proposed bill was invalid—was beyond the power of the parliament to pass.

CHAIR—That might be a way to resolve the question of constitutionality.

Mr Pape—It would probably require a brave senator to do that. In the old days, of course, the position went further. The Governor-General could seek the advice of the High Court in advisory opinions, but that was ruled to be unlawful.

CHAIR—I have a few quick questions about the issue of discrimination between states, which is also prohibited by the Constitution. Treasury, in response to an FOI request, released the Solicitor-General's advice which seemed to point to a number of constitutional issues on the basis that, if individual states have different rates of royalty for the same resource, different royalty credits against the resource, the tax liability for the same resource in different states might end up being different and that could constitute discrimination between states. What is your view on that?

Mr Pape—It would depend upon how the legislation was framed. If the legislation simply said that the Commonwealth would give a credit or a rebate for whatever amount was paid by any mining company in any state, in my view that would not be discriminatory.

CHAIR—I guess the problem the government has is that they have signed a heads of agreement with the three big mining companies which says that all state and territory royalties would be creditable against the resources tax liability. Given that the Commonwealth does not control the level of royalty, if they were to execute that part of the agreement I suspect there might be some issues of constitutionality, would they not?

Mr Pape—There may not be, in the sense that the various states could increase their royalties so that there was very little mineral resource rent tax—because they would have to give a credit for that amount. If you are adverting to the possibility that the Commonwealth said, 'We wish to cap the amount of credit or rebate,' so that, for example, mining company X paid royalties of $100, and the Commonwealth said, 'That is excessive. We will limit Western Australia to $50 and Queensland to $30,' that would be discriminatory, in my view.

CHAIR—If the government said that the credits for royalties are as they are at the moment and that we would not be crediting future increases, and the effect of that in Western Australia was that the refund was $50, for want of a better example, and in Queensland the refund was $100, what would be the status of that?

Mr Pape—That is the very essence that I just put to you. It seems to me that that is capping the credit, or the rebate, and on that basis it would seem discriminatory.

CHAIR—If a particular national tax targeted one state more than others, in terms of the amount of revenue raised from that particular state, is there a point when that becomes discriminatory or is that acceptable, as long as it is a law that has general application?

Mr Pape—So long as it has general application. For example, it would be discriminatory if they said, 'All mining companies north of the Tropic of Capricorn will be taxed at a certain rate and those below the Tropic of Capricorn will be taxed at a lesser rate.' That would be discriminatory.

CHAIR—If you have a resource like iron ore production of which 97 or 98 per cent takes place in Western Australia—it has already been said that not much of the tax will be raised on coal—most of the tax will come from iron ore. As 97 to 98 per cent of iron ore production takes place in Western Australia, does there come a point where the tax becomes discriminatory against Western Australia?

Mr Pape—No. As Chief Justice Gleeson once said, 'Taxes can be unreasonable to the nth degree. Unreasonableness is not a disqualification for a tax.'

CHAIR—If the Commonwealth were to impose a tax on all companies within 100 kilometres of the western coastline?

Mr Pape—That is a different thing. You are now splitting Western Australia into geographical areas, and you are discriminating between those within 100 kilometres of the coast and those in other parts. It would be discriminatory if you did that.

CHAIR—One of the battles that has been going on, and we have touched on it, between the three big miners would be the deal with the government relating to the treatment of state and territory royalties. Miners are of the view that all means all and that the reference in their agreement to all state and territory royalties includes future increases in royalties. The government thinks it does not include future increases, only those in place at the time of the announcement or of any scheduled increases at the time of the announcement. I have some questions around all of that. Can the Commonwealth in any way, shape or form prevent states from imposing royalties or increasing them as they see fit?

Mr Pape—I do not think so.

CHAIR—You do not think so or are you pretty sure?

Mr Pape—That would be interfering with the way in which the states administer it. Any state can charge or do whatever it likes in relation to royalties because it is their property.

CHAIR—When you say that you do not think so it sounds as if there is a bit of equivocation.

Mr Pape—No, perhaps I will withdraw that. In my view a state can impose whatever royalty it liked. If it wanted to impose a royalty of 100c in the dollar it could.

CHAIR—And there is nothing the Commonwealth could do under the Constitution to stop that?

Mr Pape—When one is dealing with the Constitution there may well be some trade in commerce or export power that they might be able to impose in relation to that.

CHAIR—Do not give them any ideas.

Mr Pape—That is the point. You are virtually inviting me to solve their problem.

CHAIR—The *Australian* last Friday quoted mining industry sources as suggesting that:

… the federal government will need to threaten Western Australia with lower infrastructure funding as a deterrent to raising royalty rates again.

Can the federal government do that?

Mr Pape—That is not a legal issue; that is a political issue.

CHAIR—Can they legally do that?

Mr Pape—Legally, they cannot. There are grants how one organises the relationship of financing states through section 96. They may well decline to give certain grants. The grants are discretionary and there is no requirement for the Commonwealth to give the grant. They can, in fact, discriminate on section 96 grants. They can give grants to one state in preference to another state.

CHAIR—Yet, when Dr Henry gave evidence to our committee and said that the Commonwealth could use its appropriation power to stop the states from increasing their royalties, you made an additional to the committee to say that the Commonwealth was expressly prohibited from doing so and that that was clear now.

Mr Pape—That is right. That was dealing with the so-called misnamed section 81 appropriation power. That is where the Commonwealth appropriates money for the purpose of the Commonwealth. In the case that I unsuccessfully took last year, the High Court held on that issue, which is the Commonwealth's primary argument, seven-nil, that the appropriations power was not a spending power and they also rejected the submissions of the states of Western Australia, South Australia and New South Wales on the same point.

On the appropriations power situation, that issue is dead. The Commonwealth has used that power for the Roads to Recovery legislation, regional partnerships, Mr Albanese's bike tracks and AusLink. There are a whole range of things that the Commonwealth has used the spending power for, and that is no longer—in my view—available to them.

CHAIR—Dr Henry suggested before our committee that the Commonwealth could use its appropriation power to stop the states from increasing their royalties. As far as you are aware, that power does not exist.

Mr Pape—That does not exist. He may well have been adverting to the grants power under section 96, being charitable.

CHAIR—Going back to the issue of Commonwealth powers to direct states about the existence of or increases to state royalties, would your answers be the same or different if it was in relation to territories?

Mr Pape—Territories are in a different situation, because the Commonwealth can control territories. That is a different issue. Discrimination only applies to states under 51(ii) and section 99.

CHAIR—If I were to summarise your evidence to us today, I would say that you have a very clear view that the minerals resource rent tax and the expanded petroleum resource rent tax as they are currently proposed would be unconstitutional because they are taxes on state property. You also think that there would be work arounds as far as the potential for discrimination between states is concerned, although there are some question marks around what would happen to the credits for future royalty increases if they were in effect capped by the Commonwealth and if the Commonwealth on that basis gave different rebates to projects in different states. That could constitute discrimination.

Mr Pape—Yes. That would be discriminatory.

CHAIR—Is that a fair summary of your evidence today?

Mr Pape—Yes.

Senator CAMERON—I must say that I am a babe in the woods when it comes to constitutional law.

Mr Pape—You have a lot of friends, Senator.

Senator CAMERON—I am sure. Let us go back a step. Senator Cormann diverted you from looking at how this problem could be resolved. How can this problem be resolved under the Constitution?

Mr Pape—The easy way is for the Commonwealth to just allow a full credit for the royalties. That is the sticking point. I would think that what the Commonwealth would try and do would be to give a rebate for the full amount, because that forms part of the assessment—in my view, that would be the preferred way of doing it. Once you start what I might call capping, that is when you get into difficulties. Then you are saying, 'In Western Australia, we cap it at 70 and somewhere else we cap it at 30 or 20.' You are starting to discriminate then. That is the difficulty. That may well be insoluble.

Senator CAMERON—You averted to the High Court decision in relation to the corporations law. The federal government would be entitled to place a tax on corporations, wouldn't it?

Mr Pape—Yes. It might be that the solution is not to do a minerals resource rent tax, because you have a vehicle in the Taxation Act to just put the rates up.

CHAIR—Company tax.

Mr Pape—Alternatively, if you really want to do it—and I sent a letter to the editor of the *Financial Review* about this—both in the First World War and the Second World War this country had an excess profits tax based on the profits of corporations. It was at a 10 per cent rate or similar. That is another simple way of doing it. This comes back to a point that I made earlier on about it being a question of measurement. It seems to me that this is going to take a great deal of work to compute. You want something which is simpler. In many ways, I was surprised that they do not go the excess profits tax way. In fact, in that letter I suggested that they dust down those two pieces of legislation.

Senator CAMERON—This is all hypothetical, as is the bill, because we do not have a bill before us. Hypothetically, if the government did say, 'We are going to put a tax—no matter what it is called—on mining companies who are making excess profits,' which is the word you used, do you accept that there are some excess profits out there in the mining industry?

Mr Pape—I do not know if there are excess profits. How do you measure excess? It is like any government. It could say, 'We're going to tax corporations involved in industry X at 30 per cent. We are going to tax corporations involved in industry Y at 45 per cent.' There is no problem about that at all.

Senator CAMERON—As distinct from the actual way through this issue, there are ways, in your view, that would not offend the Constitution and that would allow the Commonwealth to get a fair share of the mineral resources wealth of this country back to the Commonwealth.

Mr Pape—Yes, and you have a corporations tax staring you in the face.

Senator CAMERON—There have been long debates in this committee on horizontal fiscal equalisation. Is that a principle that you support?

Mr Pape—That is really a political situation; it is not a legal one. It is a matter for the Grants Commission how you share the income around Australia. I will try and answer that question. Horizontal fiscal equalisation is one aspect of it. The other one is vertical fiscal equalisation, where in fact the Commonwealth at the present time is raising something like 82c in the dollar of all taxation in the country. The Commonwealth is the dominant taxing force in the country. But, on the other side of it, to come back to horizontal fiscal equalisation, roughly 90 per cent of the physical assets of this country—that is, the roads, the railways, the hospitals, the universities, you name it, except for defence assets—are state assets. We have probably the worst case of vertical fiscal imbalance in the world. You have an extraordinary situation where the Commonwealth is attempting to run activities which it is in many ways, in my view, not tooled up to do, yet the states have got control of those assets which are closest to the people.

Senator CAMERON—This is something that has been happening for many years now, isn't it?

Mr Pape—It is a legacy of the Second World War. I can remember a story about Sir Robert Garran, the great constitutionalist. He was at some premiers' meeting. He was doodling away and he wrote something down on a piece of paper—and he was talking about the states vis-a-vis

the Commonwealth—that went something like this: 'We thank you for the offer of a cow but we cannot milk. Please keep the cow and do the milking for us.' That is the point. The states do not want to have the odium of raising taxes.

Senator CAMERON—They could have just had a barbecue. That would have saved the milking! There are always ways around things, aren't there. How would you describe yourself? You are a federalist.

Mr Pape—If you want a description, I am constitutionalist. That is why I took that case to the High Court. It was not because of the tax bonus; it was because the Commonwealth had overreached its power and it just so happened to be that the tax bonus case was what Sir Anthony Mason used to say was a suitable vehicle to run the argument, because I had standing. Normally, no-one else would have had standing. So was a unique situation. From my perspective, the great thing that came out it was what I call the Garran doctrine. Sir Robert Garran was a great advocate of using Commonwealth power through the section 81 appropriation, which effectively ripped the Constitution up. The Commonwealth was using section 51—and that is political parties of all persuasions—in these terms:

The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth …

Full stop. Which is virtually—as you know better than I do—the Westminster unitary system.

Senator CAMERON—I want to come to this issue of good governance. If states are not prepared to apply good governance in terms of royalties, and we can see that royalties are all over the place in different states—and good governance is a clear Constitutional concept; it is legally in the Constitution—when can the Commonwealth intervene to ensure good governance?

Mr Pape—Legally it cannot. It is a political decision. If the people of the various states say to their respective governments, 'We don't want royalties to be this high,' and the Commonwealth say, 'We think—

Senator CAMERON—But people do not do that. Mining companies do that.

Mr Pape—They may not—whatever.

Senator CAMERON—People do not do that.

Mr Pape—They elect a government which administers the state, and the state has certain responsibilities.

Senator CAMERON—But, under the Constitution, haven't the states got responsibilities for good governance?

Mr Pape—Yes, under their own constitutions they have responsibilities.

Senator CAMERON—I am talking about states not applying good governance in the national interest. I know this is the issue that gets you a bit activated from time to time, but isn't the national interest important, and isn't the national interest consistent with good governance?

Mr Pape—You raise a very good point, and I am glad you did. That is the great problem which Sir Owen Dixon adverted to in the entry in my submission: the Commonwealth parliament has limited powers.

CHAIR—Thank God for that.

Mr Pape—There are certain things which it can and cannot do. An example is education. In the Constitution, you will not find the word 'education'. You will not find anything about universities. So what do you mean by good governance? Sir Garfield Barwick and Sir Harry Gibbs, former Chief Justices, would say: just because something might be in the national interest, it does not mean it attracts Commonwealth power. I have no doubt that is unpalatable to a great many people. But it is what it is. You asked me where I stand. I am a constitutionalist. I am not a member of a political party. I have been a member of a political party, but all of the political parties, in my view, have disavowed the Constitution.

Senator CAMERON—How do you get good governance, then, if the states refuse to govern in the national good?

Mr Pape—The people of those various states elect people who subscribe to what you might call good governance—somebody else might take a different view. It is a matter for the people of the respective states to do that. One of the tragedies of this whole issue is that the states, irrespective of political colouring, have, like Lord Nelson, put the telescope to the blind eye. They should have, many times, been to the High Court and challenged these situations. Somebody like me, one in 22 million people, should not have to go to the High Court and risk everything for a constitutional principle.

Senator CAMERON—So basically, if a state government refuses to act in the national interest—

CHAIR—The states have to act in the states' interests, by definition—

Senator CAMERON—Just let me finish, Chair. I did not interrupt you and I would appreciate you not interrupting me.

CHAIR—You did, actually.

Senator CAMERON—Well, do not interrupt me.

CHAIR—I am chairing this meeting, Senator Cameron.

Senator CAMERON—Well, do not interrupt me.

CHAIR—Senator Cameron, I am chairing this meeting.

Senator CAMERON—Well, do not interrupt me—

CHAIR—Senator Cameron, I am the Chair—

Senator CAMERON—Your chairing will be much easier if you do not interrupt me.

CHAIR—Senator Cameron, you asked your question and I will keep chairing the meeting.

Senator CAMERON—Well, good luck to you. Mr Pape, if a state does not act in the national interest, you say, basically, we have to wait to get a judgment on that until there is an election—we might have to wait for three or four years. Is that correct?

Mr Pape—They are political decisions. They are not legal issues; they are political issues, and that is a matter for the people of the respective states.

Senator CAMERON—What about the grants power? How could that be used? Could that be used to overcome section 96?

Mr Pape—It may well be and, of course, that is one of the problems of the grants power at the present time. In August I did a paper for the Samuel Griffith Society in Perth and in it I raised the issue of what is called 'executive federalism'. That is the operation of the COAG Reform Fund. Normally, section 96 speaks of money being granted to the states. It says:

... the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.

What we have at the present time is the executive of the Commonwealth and the executives of the various states working out what those terms and conditions are. All it says about the appropriation from the COAG Reform Fund is that there has to be an agreement in writing. It does not allow the parliament to evaluate or even assess what those terms and conditions are. My submission is that the parliament has abdicated its powers to the executive in making these current grants under the COAG Reform Fund. Building the Education Revolution is probably an example.

Senator CAMERON—What about trade powers?

Mr Pape—That could be a possibility. You can do lots of things because export—

Senator CAMERON—Because the mining industry is predominantly exports. So the guts of the federal government would have some constitutional power in terms of trade.

Mr Pape—Yes. You might license people to export iron ore under certain terms and conditions.

Senator CAMERON—And that they pay a certain tax to the Commonwealth government?

Mr Pape—It could be. That would be going back to before the Second World War, when you could not even export iron ore from Australia; you had to have a licence to export it.

Senator CAMERON—There are always ways and means.

Mr Pape—Sure.

Senator CAMERON—The Constitution is a complex document with lots of history in terms of its application, but there are always new ways of trying to deal with it.

Mr Pape—I am not here to try and do the Solicitor-General's job for him—but no doubt.

Senator CAMERON—You are not doing a bad job. In terms of royalties, you are simply here to talk about the constitutional issue; you are not here to argue about royalties. But have you got a view as to whether or not royalties are being effectively implemented in each state?

Mr Pape—I would have no idea about that.

Senator CAMERON—So you are doing this purely from a constitutional approach.

Mr Pape—Yes. I am not particularly concerned about the merits of the issue. I am more concerned about the constitutionality of it.

Senator CAMERON—We have had other views saying that the government's MRRT is constitutional. That could be an argument. There are always arguments in law, isn't there?

Mr Pape—Absolutely.

Senator CAMERON—Thank you very much.

CHAIR—Just going back to the proposition of whether or not we have a proposal before us: the proposal must be sufficiently specific because it was included by the government in its budget with a $12 billion revenue attached to it and then the revised version of $10½ billion revenue attached to it. So we do have a specific proposal before us, don't we?

Mr Pape—Yes. But you do not know how that was calculated in.

CHAIR—We do not know what the underlying assumptions are, no, because the government is trying to keep those secret. But we do know the parameters of the tax as it is supposed to apply, because there is the heads of agreement and so on. Just going back to your proposition: the discussion you have just had with Senator Cameron was on how one could circumvent the problem of royalties credits. That does not in any way impact your assessment that the MRRT and the expanded PRRT as currently proposed are in fact taxes on state property, though.

Mr Pape—All this is just another way of saying, 'This gate has been shut; we're just exploring any other gates which might open to the Commonwealth into a field of taxation.'

CHAIR—So what you are saying is that, if the government wanted to tax the mining companies, they could use the corporations power and increase company tax and other things.

Mr Pape—They could use the taxation power. All they have to do is turn around and say a defined mining company will pay 40 per cent tax.

CHAIR—But of course that is not what they are proposing. Rather than dealing speculatively with what the government may do, I am interested in what the government is currently proposing to do. So as far as you are concerned the MRRT and expanded PRRT, as they are currently before us, are taxes on state property?

Mr Pape—I believe so.

CHAIR—In terms of how one could obtain advice or a declaration from the High Court, you mentioned that individual senators could have standing to pursue this. What about the Senate as a whole? If the Senate passed a motion seeking advice on whether a particular piece of legislation is constitutional or not, would the High Court have to pursue this?

Mr Pape—That is an interesting point. Presumably that would be done in the name of the President of the Senate. In my view—

CHAIR—The President would have to foreword it, but the President does not have any view on the merits of issues passed by the Senate.

Mr Pape—In my submission, I think you would need a senator to run the case. You need to have standing, and what makes a senator different from me, for example, is that the senator has to make a decision as to which way he or she is going to vote. The argument there is just as Ms Roxon had in the case that I mentioned earlier on.

CHAIR—It is not a very satisfactory situation, though, that the parliament may be asked to consider legislation which is in fact unconstitutional without having some sort of authoritative settlement as it makes that decision.

Mr Pape—You are touching on ground where Mr Hughes, Prime Minister of Australia back in 1910, amended the Judiciary Act to provide for advisory opinions. In 1920, I think, the High Court said, 'That is not a matter,' and they said that this advisory opinion was unconstitutional. So the problem that you have just adverted to has been longstanding.

CHAIR—But it has never been resolved.

Mr Pape—It has never been resolved.

CHAIR—So we are in a situation now where governments of either persuasion could bring things to the parliament which are in fact unconstitutional, and the parliament as it votes on them is not aware—

Mr Pape—The person who has standing to do it is the Attorney-General.

CHAIR—But the Attorney-General of the government that seeks to do something that might be unconstitutional has hardly got the interest to pursue it.

Mr Pape—Precisely, and that fell from Chief Justice Gibbs. It was Harry Gibbs who said that you are not going to get the Attorney-General to go along and say, 'The piece of legislation that I've just drafted is unconstitutional.' What you really need is a state.

CHAIR—So there are two phases. There is the phase before a piece of legislation is passed and then there is the one after it has been passed. Before it is passed, if an individual senator—or individual member, for that matter—pursues the matter in the High Court, what happens to the legislation before the parliament?

Mr Pape—You would want a stay of proceedings. But the High Court may take the view, 'Let the parliament decide it,' because until they have something definitive they do not have anything firm.

CHAIR—Yes, but what about, as you have said, the individual members and senators who have to make a decision?

Mr Pape—It could be that after it has been passed—and this is not answering your question, but it is a solution to the problem—a senator could move a bill to rescind it and take that to the High Court.

CHAIR—But you have the same circumstances. If you have a bill then you still do not have a final resolution of it.

Mr Pape—That is right.

CHAIR—So, after it has been passed, would individual members of parliament still have standing to pursue that in the High Court?

Mr Pape—No, I don't think so.

CHAIR—They have lost their standing. So essentially the only window of opportunity you have is up until the time that it is actually passed into law.

Mr Pape—Yes. You are inviting somebody in the Senate or in the House of Representatives to be what I call the constitutional censor.

CHAIR—There should be a more systematic process in place, to be honest, that has to go through checks and balances. Surely one of the most stringent tests before something can get passed into law is whether it is consistent with the Constitution.

Mr Pape—You will see in the Water Act—an example of recent legislation passed by the parliament——a reference in one of the sections to the various constitutional provisions which were relied upon to support that legislation. So the parliament is aware of that issue. But that is legislation that I might call uncontentious. Where you have something contentious—the minerals resource rent tax—it means that somebody has to step up. I am not saying they are going to be successful, but that is the avenue and by taking—

CHAIR—Presumably it is an expensive exercise?

Mr Pape—In a situation like that—and bear in mind it is in the public interest—each party would pay its costs and perhaps the Attorney would have to agree to indemnify the senator for taking the action to test it. The High Court might turn around and say, 'That is a backdoor way of getting a hypothetical opinion.'

CHAIR—Okay. Thank you very much, Mr Pape, for your contribution to the committee.

[6.02 pm]

CHAIT, Mr Louis Alan, General Manager Business Analysis and Planning, Xstrata Coal

FREYBERG, Mr Peter, Chief Executive, Xstrata Coal

McCARTHY, Ms Cassandra, Group Manager Government Relations and Climate Change, Xstrata Coal

CHAIR—I welcome Mr Freyberg, Ms McCarthy and Mr Smith to the hearing. Would you like to make an opening statement?

Mr Freyberg—If I can. Thank you very much for having us here. If I could quickly advise the committee that Mr Dominic Smith is unable to join us. Mr Louis Chait is here with us. Mr Smith is overseas unfortunately and could not make it. I would like to make some very brief introductory remarks if I may.

Xstrata are a global, diversified mining business that has grown quickly since 2001, establishing a meaningful position in seven major commodity markets—copper, thermal and coking coal, and ferrochrome, nickel, platinum and zinc. In that time, Xstrata have gone from an initial market capitalisation of $500 million to over $60 billion today, with operations and projects spanning 19 countries and employing over 65,000 people worldwide. Xstrata in a relatively short time have developed a global resource base and are well positioned to participate in the rapidly expanding global commodity market. Our business continues to deliver on a good track record of operational excellence, project delivery and sustainable development. Our company are a significant employer, taxpayer and investor in Australia with existing operations and committed projects in coal, copper, nickel and zinc, employing over 12,300 Australians. Over the period 2002 to 2009, Xstrata's effective tax rate was over 40 per cent. Between 2002 and 2009, Xstrata generated $44 billion in revenues from its operations in Australia, but over the same period has spent or invested $45 billion into Australia, meaning that we have invested more into Australia than the revenue that we have generated.

In addition to our economic contribution, Xstrata has been recognised by the global Dow Jones Sustainability Indexes as mining sector leader for the fourth consecutive year and recognised this year as a super sector leader for basic resource industries. This recognises our strong commitment to sustainable development and triple bottom line approach. Xstrata also continues to dedicate one per cent of our global pre-tax profit towards our corporate social involvement program which supports a range of community and regional development initiatives.

The history and chronology of events related to the resource super profits tax or RSPT and the announcement of the MRRT has been well documented and I do not wish to prolong proceedings by reiterating points previously made by other parties involved. However, I have three observations I would like to offer to the committee today in relation to the RSPT and tax reform more broadly.

The first is that genuine consultation is critical for major public policy reform. Xstrata acknowledges that it is the role of the Australian government to develop and need public policy reform and the role of parliament to give effect to these policies in legislation. However, true reform cannot be achieved in a vacuum and must include meaningful engagement with all stakeholders so that policy objectives, impacts and consequences are transparent and fully understood by all parties. We are committed to establishing a transparent and cooperative dialogue with the Australian government and other stakeholders in relation to public policy development. As you would be aware, when the resource super profits tax policy was announced, Xstrata was very concerned about the lack of consultation with industry about the RSPT to accurately gauge the impact of this tax reform on not only new projects but also existing projects in Australia.

Australia has traditionally enjoyed significant investment in the resource sector due in large part to a reputation of transparency, stability and certainty. Unfortunately, this reputation was put at risk with the announcement of the RSPT. Perhaps the most damaging aspect of the RSPT was that it introduced an element of sovereign risk for investors in Australia which did not previously exist. It was only after publicly voicing these concerns that Xstrata, along with BHP Billiton and Rio Tinto, was invited to participate in discussions with government around a range of features of the RSPT and their impacts.

Since the announcement of the mineral resource rent tax, MRRT, and the formation of the Policy Transition Group, Xstrata is pleased that a more formal consultation process has been put in place which has provided an opportunity to discuss specific issues in greater detail. Xstrata supports a continued role for the PTG as a consultation vehicle for stakeholders. We also support thorough road testing of the proposed PTG recommendations to government with industry prior to the reporting being formally submitted to government.

The second point that I would like to raise is that companies, markets and investors will respond to uncertainty or perceived sovereign risk. Xstrata takes a number of factors into account when determining investment decisions. Effective tax rate including royalties is an important part of calculating the NPV of projects or return on investment along with other components such as geology, cost of inputs, capital costs and access to infrastructure and so forth. Like any other business there is a finite amount of capital available for investment and so prospective projects from around the world are ranked and prioritised. In this context Australian projects must compete for investment capital with other projects in different geographies. Xstrata had a number of concerns in relation to the proposed RSPT. These included the retrospective nature of the tax, the high level of the total tax which made the Australian resource sector less competitive, and the fact that a material change to the tax rate could be imposed in the absence of thorough consultation.

Xstrata initiated a systematic review of all its pending Australian development projects to determine the impact of the RSPT. One of the findings of that review clearly indicated that, if the RSPT were implemented, some of these projects would no longer be economically viable. Xstrata's decision to suspend expenditure on the Wandoan coal project and the Ernest Henry underground copper project in Queensland was as a result of the above review. The impact of the RSPT eliminated the net present value of the Wandoan coal project almost entirely. It substantially reduced the value of the Ernest Henry underground project to the point where continued investment could no longer be justified. The decision was made that we should not

spend $500 million of our shareholders' money on these projects. In the case of Wandoan this effectively put a further $6 billion of investment at risk. Expenditure commitments already made by Xstrata, such as the completion of land purchase contracts, continued. Following the announcement of the MRRT and the signed heads of agreement, Xstrata has since resumed both of these projects. The EHM project resumed and the Wandoan coal project resumed its feasibility study.

The third point I would like to make is that the RSPT was bad policy. With particular reference to taxation reform, Xstrata believes that the following principles should be used to guide policy development. Consultation: genuine tax reform should be developed as part of an open, informed, transparent and timely dialogue between the government and other stakeholders. Prospectivity: changes should apply to new projects only. Applying new rules retrospectively it is a breach of investors' trust and raises legitimate concerns that government will change the rules again in the future. International competitiveness: any tax reform must ensure that the resource sector remains competitive. Resource base: any new tax must be based on the value of the resource in the ground and not include capital investment made by companies to add value to the resource, such as investment in infrastructure. Differentiation: each resource commodity has a different cost structure and this should be considered when adding any new tax. Any tax should be levied on primary resource value only. Certainty: in order to take the risks involved in making substantial long-term capital investment, companies need certainty that the tax rules will not change arbitrarily during the life of the operation. If boards of directors perceive the level of uncertainty or the risk is too high, capital will be invested elsewhere.

Xstrata participated in verbal discussions with Treasury officials regarding certain input assumptions in their modelling. We directed Treasury officials to publicly available data related to thermal and semi-soft coal prices and volumes. We do not know to what extent, if any, that information was used in further modelling work carried out by Treasury. In discussions with government, the companies reiterated on several occasions that the design features of the MRRT were a collected package of interrelated measures or levers. For the MRRT to be successful, all of the elements of the heads of agreement need to be delivered. On the treatment and crediting of state royalties, it was made very clear by Xstrata, BHP Billiton and Rio that our understanding was that all state royalties would be credited under the MRRT. The wording of the signed heads of agreement was quite specific for that reason. From Xstrata's perspective, all means all. We have subsequently sought board approval for up to $3 billion of investment on projects in Australia since July based on the strength of the signed heads of agreement. This is a key design feature for Xstrata that is directly linked to our ongoing competitiveness, and any indication that the government may deviate from the agreed approach will require Xstrata to re-evaluate investments once again. Xstrata is currently considering a project pipeline of between $15 billion and $20 billion in Australia. The ability of the government to deliver on the signed heads of agreement for the MRRT, providing greater certainty and a stable fiscal regime, will be a key driver in future investment decisions for Xstrata in Australia.

With that brief summary, I welcome questions from the committee.

CHAIR—Thank you very much, Mr Freyberg. Before we get into it, are you in a position to table your opening statement for the benefit of the committee and perhaps the media in the room?

Mr Freyberg—The committee can have a copy of that. I do not think we have a copy at hand.

Ms McCarthy—Not at the moment, but we can arrange for a copy.

CHAIR—We may be a able to make a copy.

Mr Freyberg—I am not sure it is in a form that is easily copied. It has some notes on it. We will send one.

CHAIR—Mr Freyberg, Xstrata, was very critical—and we have just gone through some of the issues—of the lack of proper process which led to the announcement of the original so-called resource super profits tax. It was suggested that there was no consultation or appropriate testing of design features. Do you think the process which led to the development of the minerals resource rent tax and the expanded PRRT, which you were a party to, was a good public consultation process?

Mr Freyberg—We were invited to participate in a process by the government. We did participate. Within our deliberations, we put forward ideas about how this could affect the whole sector. It certainly manifested itself in, for example, the $50 million starting point for small businesses. The process did involve discussion with significant industry players, both Australian and foreign based, and we think it was a great improvement on what was initially done.

CHAIR—It was an improvement from your point of view, I guess, because the government, as you say, sat down with you. But essentially the government sat down with three taxpayers and designed a tax with much broader application behind closed doors with all other stakeholders and the public at large excluded. It was not really an open and transparent process, was it?

Mr Freyberg—We think that there was certainly a rapid move towards creating a level of certainty, at least, whereas previously there was a high level of uncertainty. The government decided to involve three major players that were involved in iron ore and coal and they made it clear that they felt those were the two important commodities. I am not going to comment on whether it was good or bad; it was a huge improvement on the previous process.

CHAIR—From your point of view, but can you understand why the smaller and mid-tier mining companies feel aggrieved because they were excluded from the process at the time when it mattered? You mentioned the policy transition group process, but that hardly focuses on the fundamental design features; it really just deals with some implementation issues and has some severe restrictions around it, doesn't it?

Mr Freyberg—We have heard comments made by other members of the industry. At the end of the day, the government invited us to participate in a process. I think we had to participate in that process and we felt that the outcome was a great improvement on the RSPT.

CHAIR—Do you think the minerals resource rent tax as it is proposed now is a sound tax which complies with all the principles that you have set up? Or did you go into the negotiation trying to get the least flawed deal you could possibly get?

Mr Freyberg—Prior to being invited into this process we said that we were prepared to sit down at any stage and participate in discussions around tax reform. We put down various principles that we felt had to be met and the MRRT goes a very long way to achieving those principles—in particular, the fact that the issue of retrospectivity was addressed, the fact that it was more competitive and the fact that at last a degree of consultation had occurred.

CHAIR—You mention tax reform. Of course, when the Henry review began this was supposed to be a profit based tax which would replace production based royalties, which were seen as inefficient and having a distorting impact on investment and production decisions. But the MRRT does not abolish or replace state royalties, does it? As David Parker from Treasury has told us, it is a top-up tax rather than a replacement tax. Is this still tax reform?

Mr Freyberg—Certainly a new tax is being levied. It is over and above royalties. The fact that it is a change in the tax regime makes it reform of some type. The royalties essentially stay at a minimum level and obviously are on an ad valorem basis, so there is an element of ad valorem and an element of profit based tax now.

CHAIR—At the beginning and the end of a project's life, where there is most distortion—if one thinks there is distortion from royalty payments—royalties will continue to be payable and will in effect not be refundable, will they?

Mr Freyberg—There are issues with refundability towards the end and there are certain distortions. We are obviously waiting to see the process of the PTG, but I think at least the principles that have been laid down in the MRRT and the heads of agreement as it was signed are a significant improvement on what we saw under the RSPT.

CHAIR—We have now a signed copy of the heads of agreement. There is a very clear sentence in there which says that that all state and territory royalties would be creditable against a resources tax liability. There is obviously some dispute about that between the government and the three other parties that designed the deal. How confident are you that 'all' includes future increases in state and territory royalties?

Mr Freyberg—For us the statement 'all royalties' is very clear. We would not have signed the agreement had we thought it was ambiguous. One of the big subjects discussed during the consultations was the issue of sovereign risk. The fact that the spectre of sovereign within the Australian resource sector had now been opened up made us argue the point that, given that this was an increase in tax, we needed certainty for the future and hence argued for the point of all royalties being credited. This went a very long way to addressing the sovereign risk issues that we were concerned about, particularly with reference to investments we want to make in the future.

CHAIR—So this was not just an incidental discussion; it was a significant focus of the discussions with the government.

Mr Freyberg—The discussions were comprehensive on a number of issues: retrospectivity, sovereign risk, royalties and so forth. We saw the heads of agreement as a complete set of criteria against which the MRRT needed to be detailed.

CHAIR—Was the discussion comprehensive on the point of the meaning of 'all state and territory royalties will be creditable against any resources tax liability'?

Mr Freyberg—I do not know what your definition of 'comprehensive' is. It was part of the discussions, as much a part as many of the other parts were. Was it belaboured? I do not know that it was. It was certainly part of the discussions.

CHAIR—You said that if it had not been clear in your mind that all states and territories being creditable meant all, you would not have signed the agreement.

Mr Freyberg—It was a very important aspect for us.

CHAIR—So if that had not been clear you would not have signed the agreement.

Mr Freyberg—I do not believe we necessarily would have, no.

CHAIR—That was what you said earlier. When were you advised by the government that they had changed their mind or that they had changed their interpretation on this point?

Mr Freyberg—I do not recall the exact date, but we became aware when certain statements were made that the government had problems with it. Just going back to the previous question, I should emphasise that one of the reasons that we were concerned about it being all royalties was the fact that shortly after 2 May, when the RSPT was announced and the date was set as all royalties up to that date or all scheduled royalties or announced royalty increases that were going to be made, there was an announcement within the Northern Territory about a royalty increase. That made us very conscious of the fact that, even within a reform tax, there was still a sovereign risk issues relating to the royalties. We went into this more than concerned about the fact that if you solved the RSPT problem the royalties could still pose a problem for future projects.

CHAIR—Did you become aware of the problem, as you describe it, after the election or before?

Mr Freyberg—It was not a problem until we heard statements being made. I do not recall the exact date—

CHAIR—Was it after or before the election?

Mr Freyberg—I am not sure.

CHAIR—Because the agreement that you entered into with the government—

Mr Freyberg—It was after.

CHAIR—And the agreement that you entered into with the government, where the very explicit and clear statement was made, was before the election. That was on 2 July.

Mr Freyberg—Yes, it was on 2 July.

CHAIR—So you have made decisions since 2 July on the strength of that agreement around investment. You have made decisions on $3 billion worth of projects.

Mr Freyberg—Correct.

CHAIR—Can you talk us through how that is relevant to the $3 billion worth of projects?

Mr Freyberg—As the head of Xstrata Coal, I took projects to the Xstrata board, including the Ulan West project in August and the Ravensworth North project that was announced last week in London. Each project is close to $1½ billion. Obviously when we recommend to our board that we would like to build new mines we have to table the economics, and within the economics are details relating to the tax structures that will affect those businesses. Given the fact that there is a heads of agreement signed by the Australian government saying what the tax structure will be related to the MRRT and royalties, we took that as an affirmation that that would be the tax structure going forward. Hence that information or that document informed our decision making for those two projects.

CHAIR—If that is now not going to be the tax structure moving forward, what does that mean for those projects approved since 2 July?

Mr Freyberg—Personally I do not understand why it would change, because there was a signed agreement, but should the tax structure change we will review as we did in the past. If there is a significant change to the tax structure or to the risk regime, it is incumbent upon us to review our investment decisions in the light of that.

CHAIR—You said that between 2002 and 2009 your effective tax rate was about 40 per cent.

Mr Freyberg—Over 40 per cent.

CHAIR—What will it be if the MRRT is law, as you understand the heads of agreement to work? What will be your effective tax rate?

Mr Freyberg—I believe it is in the order of 45 per cent.

CHAIR—How does that compare from an international competitiveness point of view?

Mr Freyberg—Tax relative to other countries varies. Some are higher; some are lower. But tax, as I said earlier on, is only one factor in a suite of issues that we look at. You have different geologies, different infrastructure costs and different costs of inputs in the different geographies. We look at each one of those and each one of the geographies.

CHAIR—So, even though there is no explicit decision to increase royalties into the future, you would be concerned about the open-ended exposure to increase.

Mr Freyberg—Very much so. There was a view prior to RSPT that tax and royalty regimes in Australia were relatively stable. The RSPT resulted in a potential very significant and material increase in tax overnight. As such, suddenly the concept that there is a possibility of these types

of volatile tax decisions makes us, I guess, concerned about risk, not just on RSPT but on royalties going forward if they are not locked in as per the heads of agreement.

CHAIR—Have you got advice as to whether you could enforce the heads of agreement in a court of law or is it essentially just a statement of intentions?

Mr Freyberg—It is a statement signed by some very senior people within the government. On that basis, we have taken it as that is the way that the policy and the tax legislation will be developed.

CHAIR—Where is that discussion at with the government now?

Mr Freyberg—We have participated in the PTG process. The PTG is more concerned about the details of implementing what is on the heads of agreement and is not about renegotiating the policy per se. We have had input. We understand that there will be some findings coming out later this month from the PTG. As I said in my opening statement, we are hoping that they are actually going to come back to industry and road-test those ideas before they submit their final report to government.

CHAIR—Given that the Prime Minister, the Minister for Resources and Energy, the Treasurer and so on have made statements saying that 'all' does not necessarily mean all and that future increases are not meant to be included, it is not really an issue that the PTG can resolve for you, is it? It is a matter that would have to be resolved at that level, isn't it?

Mr Freyberg—It is a matter that has to be resolved, but it does bring a new level of concern, or sovereign risk issue, to the table—that an agreement that is entered into and signed by the government of the day can be then revisited and questioned.

CHAIR—What is signed before the election can be revisited after the election. I think that is what you find.

Mr Freyberg—At the end of the day, investors will have to take a view on the risk associated with their investments. Whether it is the mining sector or other sectors, issues such as taxation policy are very important and stability around those policies and the way the government implements agreements that were reached through consultation is very important. I would like to think that this heads of agreement, although the government have expressed the fact that they have some difficulties, will ultimately be implemented the way it should be implemented.

CHAIR—Revenue estimates for the mining tax have bounced around quite a bit. The original RSPT was said to be $12 billion and then there were changes in commodity prices and other assumptions to facilitate the MRRT. We were told the original tax would rise to $24 billion. Did the government get it wrong with their original assumptions?

Mr Freyberg—I do not know what their original assumptions were. We pointed them in the direction of public information. At the end of the day, I cannot comment on their projections. I do not have an insight to it. It is something that Treasury does.

CHAIR—So you directed them to publicly available information. You did not provide them with market sensitive commercial in confidence information?

Mr Freyberg—We pointed them to public information.

CHAIR—Would you be able to point the committee to the same public information?

Mr Freyberg—There are entities that look at supply and demand, volumes and potential factors that influence price going forward. They are relatively well known. I do not know that want to advertise here in an open forum the ones that are used.

CHAIR—Fair point. Would you have any problem if the government and the Treasurer were to advise this committee in a private setting about the publicly available information that you directed the government towards?

Mr Freyberg—I would not have a problem with that.

CHAIR—Thank you very much. We have had evidence from a number of witnesses—Dr Henry and others—that most of the mining tax revenue will in fact be generated by iron ore production rather than coal, and that is on the basis of the interaction between state royalties and the MRRT, were essentially you are going to get credited. The gap between state royalty payments and the MRRT liability is smaller for coal than what it is expected to be for iron ore. I see that you are nodding. Is that your expectation?

Mr Freyberg—That is my understanding, but we are not an iron ore producer within Australia.

CHAIR—But do you have some expectation of how much of the mining tax revenue would be generated from coal?

Mr Freyberg—No, I did not.

CHAIR—But you would have an understanding of how much mining tax Xstrata will pay?

Mr Freyberg—We do have internally but it is not something we discuss commercially. You personally mentioned that prices are volatile, so how much tax we think we will pay is a commercial issue but it is only an estimate anyway.

Senator CAMERON—Did you attend the discussions leading up to the signing of the heads of agreement?

Mr Freyberg—Yes, I did.

Senator CAMERON—All of them?

Mr Freyberg—There were a number of discussions happening on several occasions. I do not believe I was at 100 per cent of the talks.

Senator CAMERON—Can you remind me of what you said about the discussion around the detail of the word 'all'. You said there was not a great deal of discussion on it.

Mr Freyberg—Frankly, I do not recall the exact detail around it. A document was developed amongst the parties, it was reviewed and there were discussions. As I have pointed out to the chair, one of Xstrata's concerns was that, shortly after the RSPT was announced, there was a royalty increase in the Northern Territory. That, I think, had raised everybody's concerns that any agreement needed to encompass the risk of royalty increases.

Senator CAMERON—There was no debate about the definition of the word 'all'?

Mr Freyberg—I do not believe there was a debate around the definition of the word 'all'.

Senator CAMERON—We have heard evidence from Rio Tinto that every clause and every word was extensively discussed.

CHAIR—I have to correct you there. They did not say 'every word'.

Senator CAMERON—Every clause?

CHAIR—They said they went through every paragraph, not every word.

Mr Freyberg—I think that is exactly correct. Every paragraph was gone through. And I repeat: we were concerned about royalty increases.

Senator CAMERON—I have written a few agreements in my time, I must say—industrial agreements, not agreements like this—but this is more akin to an agreement between the parties; it is not a legal document. Why didn't you say 'all current and future state and territory royalties will be credited'?

Mr Freyberg—Because, frankly, all is all.

Senator CAMERON—No, it is not.

CHAIR—So all is not all?

Senator CAMERON—Not from my perspective. You could say 'all current'.

CHAIR—It does not say 'all current'.

Senator CAMERON—Chair, I did not interrupt you. When you get a bit edgy you should just bite your tongue for a minute and let me get on with my questions.

CHAIR—As long as you ask a sensible line of questioning.

Senator CAMERON—I think I am doing that.

Mr Freyberg—As I said, for us the word 'all' is pretty all encompassing.

Senator CAMERON—It could be 'all current', couldn't it?

Mr Freyberg—No.

Senator CAMERON—Why?

Mr Freyberg—Because previously under RSPT there was clarification that all was not all. It did not go to all. It said 'royalties up until that date and any scheduled royalties'. That wording was obviously absent from this agreement; it said 'all royalties'.

Senator WILLIAMS—All state and territory royalties.

Senator CAMERON—So you do not believe it should have said 'all future royalties'?

Mr Freyberg—No. All meant all.

Senator CAMERON—All does not mean that at all. All can be qualified. It can be all current, it can be all future, it can be all past. All does not mean what you are saying it means.

Mr Freyberg—That is your opinion, but I think that is wrong. I was in the room. I sat there and the parties discussed all royalties. The fact that we are having this debate now suggests that perhaps the government is having a problem with that. The reality is that I have not heard the government—

Senator CAMERON—Let me be clear: this is my questioning; this is not the government's questioning. I am a senator on the committee and I am entitled to ask questions. I am not asking the questions for the government; I am asking the questions for myself.

Mr Freyberg—I can tell you my opinion. My opinion is that the parties that entered into that agreement understood at that point in time that all was all and it referred to existing and future. The reason I believe that is that under the RSPT there were qualifications as to what royalties were—pre 2 May, post 2 May and any scheduled royalties. The absence of that wording, and the simplification—the fact that it just said 'all'—meant all.

Senator CAMERON—So that means that if the Queensland and Western Australian government want to massively increase royalties—

CHAIR—Or the New South Wales government.

Senator CAMERON—Are you finished? You can ask these questions; let me ask mine. If the Queensland government or the Western Australian government want to massively increase royalties then that comes out of the tax take of the Commonwealth. That is what you are saying?

Mr Freyberg—The definition of the way that the MRRT is formulated says that all royalties are creditable. So you have to look at how that is ultimately implemented.

Senator CAMERON—So you are saying that is past royalties and future royalties?

Mr Freyberg—Correct.

Senator CAMERON—Existing royalties?

Mr Freyberg—All royalties.

Senator CAMERON—But 'all' can be qualified, can't it?

Mr Freyberg—I do not believe it was qualified and I do not believe there was the intention to qualify it.

Senator CAMERON—You may not believe it, but the factual position is that 'all' can be qualified. It is not an end in itself; it can be qualified, can't it?

Mr Freyberg—I sat in the meetings, and in the end the clauses put in 'all'. I believe I have answered as clearly as I can.

CHAIR—I am going to intervene here as chair. Senator Cameron has asked you, Mr Freyberg, whether that can be qualified. I ask you a variation of that question. In the agreement that you have signed, is the word 'all' qualified—that is, is there any mention that 'all' means 'all current' or any—

Mr Freyberg—There was no qualification and, as such, we believe it to be all encompassing.

CHAIR—Thank you.

Senator CAMERON—Are you saying, Mr Freyberg, that if future royalties are not included then you will not invest in Australia?

Mr Freyberg—We will take a view as to risk. Our industry and the markets we operate in have a very high level of risk, whether it is related to geology, commodity pricing or other inputs such as costs and capital. As we have seen over recent times, there is no certainty in commodity prices. We try and manage those risks as best we can, and we have to take a view on those risks. If a project gets a certain return but we think that return is at risk because of policy changes to do with tax or royalties and we believe that risk to be high, that affects our decision making.

Senator CAMERON—Isn't this what Professor Garnaut calls in his submission 'rent seeking'?

Mr Freyberg—There are royalties paid on resources already that are mined.

Senator CAMERON—But you have a vested interest in this, and your vested interest is served by threatening not to invest in the future, isn't it?

Mr Freyberg—We do not threaten; we simply make business decisions in the interests of our shareholders whilst remaining a company that is really concerned about how we operate in the community and about providing stable jobs and contributing to the community that we operate in. We do not threaten; we make business decisions.

Senator CAMERON—But you do get a return. It is not a one-sided equation. It is not all jobs or all investment; it is profitability as well, isn't it?

Mr Freyberg—It is not a one-sided equation. We operate for the purpose of providing a shareholder return. At the end of the day, it is their money that is invested, and we have to do that responsibly.

Senator CAMERON—Xstrata has had returns in Australia that are reasonable, good returns.

Mr Freyberg—We have reinvested everything that we have made back into Australia, into building new mines, creating new jobs and making contributions to the community.

Senator CAMERON—Because there is an expectation you will make further profits from that investment.

Mr Freyberg—We are growing our business.

Senator CAMERON—Sure.

Mr Freyberg—At the moment that we perceive the risk to be too high or that the tax rate gets to a level where it becomes unattractive to invest, we do not invest.

Senator CAMERON—Have you heard of the phrase 'pattern bargaining'?

Mr Freyberg—I have heard of the expression.

Senator CAMERON—I have just witnessed pattern submissions from the mining companies. Your submission is almost word for word the submission from Rio and BHP. Did you sit down with them before making these submissions?

Mr Freyberg—The industry sits in many forums and has discussions. As you would be well aware, in each state and at a country level there are organisations where the mining companies work together. This is not just limited to the mining sector.

Senator CAMERON—So it was agreed that you would come and put these submissions; there was a collective agreement that you would come and put these submissions?

Mr Freyberg—No, we—

CHAIR—To be fair, this committee asked Xstrata and BHP if they were willing to appear.

Mr Freyberg—Yes, we were invited to come.

Senator CAMERON—I know you were invited to come. I am asking: did you have discussions with the mining companies or the Minerals Council prior to making your submission?

Mr Freyberg—We have continuous discussions with the industry about issues that are important to the industry.

Senator CAMERON—Including your submission?

Mr Freyberg—I have not discussed my submission with anybody.

Senator CAMERON—Well, how come it is nearly word for word?

Mr Freyberg—Because there are a lot of common factors in the industry they were looking as well as the principles. Given the fact that we sat together in Canberra and discussed those issues and the principles with the government, that has not changed since we were in Canberra.

Senator CAMERON—You say you sat and discussed these issues. So that discussion resulted in common submissions in relation to the key priorities for you which are consultation, retrospectivity, international competitiveness, the resource base and differentiation.

CHAIR—They were in a meeting with your government, Senator Cameron.

Senator CAMERON—Chair, I do not want to hear you in this. I am asking Mr Freyberg so do not interrupt all the time.

CHAIR—I might conclude this form of questioning.

Senator CAMERON—Do not be so rude. Be a good chair.

CHAIR—This is now becoming repetitive, Senator Cameron.

Senator CAMERON—It is not becoming repetitive, and I would ask you to have a look at the *Hansard* and consider what you have just said. Mr Freyberg, I am asking you the question about your submission here today on consultation, retrospectivity, international competitiveness, resource base and differentiation. Was that an agreed position that all the mining companies would put to this inquiry?

Mr Freyberg—Put to this inquiry?

Senator CAMERON—Yes.

Mr Freyberg—The answer to that, Senator, is no. Those were principles that we established in discussions in the industry when the RSPT came up. In an attempt to clearly articulate an industry position around issues which concerned us without having discussions with other parties—it is a pretty straightforward conclusion to come to—around retrospectivity are absolutely critical. The fact that we have invested billions into this country and then to suddenly have a tax imposed on us that takes away all of the cash generated by those investments in a very

short time after we have made them is highly problematic. I do not need to discuss that with BHP Billiton or Rio to get to that conclusion.

We had discussions in industry where we outlined some basic and fundamental principles and, I think, reached general consensus. Those principles prevail to this day. If five years from now there is a discussion on tax, Senator, I think we will probably have the same principles about the Australian resource sector needs to be competitive. If you have a tax rate that starts in total together with royalties to approach 58 per cent, given the fact that infill costs are high here and logistics are complicated within Australia, it is likely that the resource sector will not be competitive.

Senator CAMERON—The principles are not just the same; the threats are the same about disinvestment.

Mr Freyberg—Senator, I will not comment on the word 'threat' because we simply make business decisions.

Senator CAMERON—The threat is, 'If we don't get our way on the tax here we will invest overseas.' I suppose there are other issues that you have to consider when you make decisions to invest overseas such as tax, availability of skills, logistics, quality of the ore or the coal, the infrastructure capacity, the nature of the government. There are lots of decisions that you have to deal with. Do you have investments in Africa?

Mr Freyberg—We certainly do, Senator.

Senator CAMERON—Where are your investments in Africa?

Mr Freyberg—We have investments in South Africa and we recently acquired an Australian business which has investments in Mauritania in West Africa.

Senator CAMERON—Do you have discussions with the Mauritanian government?

Mr Freyberg—Yes, Senator.

Senator CAMERON—What resources does the Mauritanian government have to discuss tax? What is their Treasury department like? Is it well resourced?

Mr Freyberg—I am not going to comment on how well resourced their department is. All I will say is that, when we look at investing in countries around the world—and we have investments in 19 countries, some in Africa, some in South America, obviously here in Australia, New Caledonia and so forth—we look at the level of stability that we expect to get in terms of fiscal type issues, like tax and royalties and so forth, and we understand what changes have happened historically, the nature of the decisions the governments have made and whether or not we should be concerned about big changes in the future in those sorts of policies. Then we make investment decisions on our perception of risk.

Senator CAMERON—Was Xstrata part of the discussion with the Minerals Council about moving from a royalties based system to a profit based system?

Mr Freyberg—There were discussions within the MCA, and Xstrata is a member of the MCA, yes.

Senator CAMERON—And you supported moving from a royalties based system to a profit based system?

Mr Freyberg—I think we recognised, together with others, that there are certain advantages in a profit based system. I would comment, though, that all of the advantages and disadvantages of profit based and ad valorem have to be considered and a view has to be taken, when people formulate tax policy, as to those implications. I think this committee has heard some of those implications from some of the other people that have presented here.

Senator CAMERON—What is the tax system in Mauritania?

Mr Freyberg—There is corporate tax and there is a royalty.

Senator CAMERON—So it is an ad valorem tax; it is not profit.

Mr Freyberg—There is a tax and ad valorem royalty.

Senator CAMERON—Did you ever put it to the Mauritanian government to go to a profit based tax?

Mr Freyberg—I would not comment on that.

CHAIR—The Mauritanian government's tax arrangements are not the subject of this inquiry. Senator Williams.

Senator CAMERON—Chair, I would like the witness to be able to finish. I will also come back to a point of order in terms of the question.

Mr Freyberg—We have just acquired that business, and we took a view in terms of tax issues in that country. We have, as I said earlier on, operations in many countries. I could quote to you, for example, discussions around tax reform in South Africa, where there were several years of consultation around the royalty system to be implemented there when they developed the minerals legislation in that country. That resulted in a satisfactory outcome for all parties and a royalty that is currently being imposed on industry. That is the difference with the RSPT, which was a policy statement that was made without consultation. There are comparisons elsewhere in the world as to consultations that have resulted in tax reform that has been acceptable to all parties involved.

Senator CAMERON—My point of order is this, Chair. You indicated to me that I could not go down the path of that question, and yet, with Rio Tinto, that question was put in an even more detailed way, and Rio Tinto have agreed to come back with details of the tax and royalties situation in countries overseas. I am just saying to you that it is not appropriate and not acceptable for you to rule out a question like that at this hearing when you did not do that at a previous hearing.

CHAIR—On that point of order: there was no discussion between Rio Tinto and this committee about discussions or otherwise with the Mauritanian government. It is now up to Senator Williams.

Senator WILLIAMS—Thanks, Chair—

Senator CAMERON—I have a point of order.

CHAIR—There is no point of order.

Senator CAMERON—You don't know what my point of order is.

CHAIR—You have made it. Senator Williams has—

Senator CAMERON—I have got a point of order, Chair, and you must deal with it. Those are the rules.

CHAIR—What is your next point of order?

Senator CAMERON—My point of order is that you cannot determine what questions are put and you cannot tell me that Mauritania is not appropriate to discuss. That is not appropriate.

CHAIR—On that point of order: it has got to be relevant to the terms of reference, and my ruling is that it is not. I now pass on to Senator Williams.

Senator WILLIAMS—Thank you, Chair—

Senator CAMERON—That shows the bias that—

Senator WILLIAMS—Senator Cameron, it is my turn—

Senator CAMERON—Is it?

Senator WILLIAMS—Will you shut up?

Senator CAMERON—No. If I have got a point of order, I will have a point of order. That will be the case. I will not be bullied by you or anyone else.

Senator WILLIAMS—Mr Freyberg, just taking it back to the minerals resource rent tax heads of agreement:

All State and Territory royalties will be creditable against the resources tax liability but not transferable or refundable.

That is signed by you, Mr Peever from Rio Tinto, Mr Kloppers from BHP, the Prime Minister, Ms Gillard, the Treasurer, Wayne Swan, and Minister Martin Ferguson. Will you please take on notice the definition of the word 'all' and come back to us with that? Look it up in a dictionary or whatever.

Mr Freyberg—I will do that.

Senator WILLIAMS—I say that because obviously some around here have problems with that definition, so you might clarify that.

Mr Freyberg—I will do that.

Senator WILLIAMS—That would be great. Obviously this is an important part of this heads of agreement. Are you now in a situation to say to the minister, 'We don't know about future royalties and increases'? Are you now getting to a state where you lack trust in this government?

Mr Freyberg—We deal with the government on a very regular basis. I remain confident that an agreement such as this will be delivered. I truly do. An agreement was reached in good faith. A lot of work was put into it. I understand the ultimate implementation and the details around it can be complex, but I remain confident that the government will deliver on this.

Senator WILLIAMS—Thank you.

CHAIR—Mr Freyberg, you are a multicommodity, multiproject, multinational company. According to this proposal there would be a new mining tax, a top-up tax, imposed on iron ore and coal. You do not have any iron ore production in Australia.

Mr Freyberg—In Australia, no; not as a primary product, no.

CHAIR—Essentially, your interest in all of this is the MRRT as it applies to coal.

Mr Freyberg—Correct.

CHAIR—So how does this top-up tax, which is the MRRT, impact on your investment decisions vis-a-vis other commodities or other projects in other jurisdictions?

Mr Freyberg—Sorry, in other jurisdictions?

CHAIR—You are a multinational, multiproject, multicommodity company. You have only one commodity in Australia so you do not really have any—

Mr Freyberg—We have other commodities in Australia. We mine copper, we mine nickel and we mine and produce zinc in Australia as well.

CHAIR—I will rephrase the question. How will this additional tax on coal impact on your investment decisions on other commodities in Australia and perhaps on investment decisions for projects around the world?

Mr Freyberg—If we intend to make an investment decision pertaining to a project in Australia, we look at all of the issues that I have mentioned before, including fiscal stability, and take a view on that. If we believe that there is a disproportionate risk and that risk could make this project unviable then we will make a decision on that basis.

CHAIR—How will an additional tax on coal impact on your investment decisions? Will it make other commodities and other projects—

Mr Freyberg—We would look at projects on a project-by-project basis.

CHAIR—Projects for other commodities could now become more competitive in attracting investment.

Mr Freyberg—I think each project is looked at on the merits of itself and—

CHAIR—If there is an increase in tax for only one commodity—it is not applied to other commodities—will that have any impact at all?

Mr Freyberg—Capital is not unlimited but if a project is robust enough, whether it be in coal or in another commodity, we will make a decision around that project. But obviously increases in tax on coal may make some coal projects less attractive.

CHAIR—This is a final question from me. Senator Cameron asked you about your preference or otherwise for a profit based system as opposed to a royalty based system. The MRRT is not a profit based system, is it?

Mr Freyberg—The MRRT has an element of being profit based but there is obviously the interaction with creditable royalties.

CHAIR—There is an interaction with creditable royalties and there is also an interaction with creditable but non-refundable royalties, isn't there?

Mr Freyberg—Yes.

CHAIR—Even if all state and territory royalties turn out to be creditable, they will not all be refunded, will they?

Mr Freyberg—There is the potential that they will not all be refunded.

CHAIR—Supposedly one of the key drivers for tax reform in this area, as promoted by Dr Henry, was to avoid distortions in investment decisions at the beginning and at the end of a project's life. At the end of a project's life, however many credits you accumulate, given those credits are not transferable between projects, you will never be able to get a refund, will you?

Mr Freyberg—Ultimately there is potential for that, but some of the details are still being worked through in the PTG process.

CHAIR—This is why David Parker from Treasury has described this as a top-up tax rather than a replacement tax. It is not a profit based tax replacing royalties; it is profit tax on top of royalties. That is right, isn't it?

Mr Freyberg—I hear what you are saying.

CHAIR—Thank you very much for your contribution to our committee hearing.

Mr Freyberg—Thank you very much for the opportunity. I would like to put on the record for Senator Cameron that Xstrata does not threaten. We run a very professional business. We have been recognised as being the leader in sustainability in the mining sector globally. Part of that relates to transparency in the way that we deal with people—employees and communities. Hence the word 'threaten' is something that I have a bit of a problem with, Senator. I just thought I would put that on the record.

CHAIR—I think you have made that point. Thank you very much for your contribution.

Committee adjourned at 7.01 pm