Australian Government

Commonwealth Grants Commission

2020 REVIEW

STATE MINING POLICIES

STAFF RESEARCH PAPER
CGC 2017-04-S

MAY 2017

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BACKGROUND

This staff research paper provides additional analyses of issues raised in Staff Discussion Paper 2017-02-S *The principle of HFE and its implementation*. Its purpose is to provide material States may find helpful in preparing a response to the staff discussion paper.

Commission staff are not seeking State submissions on the issues raised in this staff research paper.

1 One of the Commission's supporting principles is policy neutrality. This principle seeks to ensure that, as far as possible:

- a State's own policies or choices (in relation to the services it provides or the revenues it raises) do not directly influence its share of GST revenue
- Commission methods do not influence State decision making.

2 Policy neutrality was a major consideration in the development of the mining assessment in the last two reviews. In its 2015 Review report, the Commission said it would monitor developments in State mining policies. This research paper reports changes in State mining policies since that review and identifies two circumstances which raise issues about how the Commission develops its mining assessment.

THE 2010 REVIEW MINING REVENUE ASSESSMENT

3 In devising its 2010 Review Mining assessment, the Commission sought to find a balance between measuring States' mining capacity and doing so in a policy neutral way. This was in the context of the policies of one State (Western Australia) accounting for 97% of all iron ore production and 99% of iron ore royalty revenue. The Commission decided to classify the royalties raised from all minerals into two groups to mitigate the influence of State policies on the royalties raised from the production of any one mineral. It said its approach achieved an appropriate balance between equalisation and policy neutrality.

4 The two groups were royalties raised from minerals with high royalty rates and royalties raised from minerals with low royalty rates. The Commission classified:

- oil and gas, bauxite, lump iron ore and export coal to the high (royalty rate) group
- the remaining minerals, including iron ore fines and domestic coal, to the low (royalty rate) group.

5 The composition of the groups was not fixed. A mineral could move between groups if its royalty rate changed.

6 While the Commission considered the assessment might ideally be based directly on profit levels, it was unable to overcome the data deficiencies to allow it to make such an assessment.

Removal of iron ore fines concession

7 Shortly after the 2010 Review, Western Australia announced it would remove a concession applying to around half of iron ore fines production in the State. From 1 July 2010, it applied the standard rate of 5.625% to all fines production, up from the concessional rate of 3.75% that applied to the operations of BHP Billiton and Rio Tinto.

8 As part of the development of its 2011 Update report, the Commission considered whether to move fines to the high group. It concluded a better equalisation outcome was achieved by leaving fines in the low group, but said it may move minerals between groups if States changed royalty rates.

9 The Commission subsequently received 2011 Update terms of reference, directing it to leave iron ore fines in the low group.

Increase in iron ore fines royalty rate

10 In its 2011-12 Budget, Western Australian announced it would increase its royalty rate on fines. A first increase took effect from 1 July 2012 and a second from 1 July 2013. After the second increase, its rate on fines would align with its rate on lump iron ore (a high group mineral).

11 Terms of reference for the 2012, 2013 and 2014 Updates instructed the Commission to leave iron ore fines in the low group.

12 The Commission's mining revenue assessment was one of the areas considered by the GST Distribution Review.[1] The Panel considered the major issue with the assessment was the potential for a State to lose more in GST revenue than it gained from an increase in its royalties. This could happen when a mineral moved from the low rate group to the high rate group (potentially such as for iron ore fines). The Panel's view was that this appeared to be a perverse and inappropriate side-effect of the two-tier mining revenue assessment.[2]

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1 The GST Distribution Review was established by the Commonwealth Treasurer in May 2011, comprising a Panel including Messrs Brumby, Carter and Greiner. The Panel provided its Final Report to the Treasurer in October 2012.

2 GST Distribution Review, Final Report, October 2012, page 111.

THE 2015 REVIEW MINING REVENUE ASSESSMENT

13 In the 2015 Review, the Commission again considered the balance between measuring States' mining capacity and policy neutrality. It decided to separately assess the minerals that individually redistributed material amounts of GST revenue and to assess the remaining minerals in one group.[3]

14 The Commission said mining was an area where it had to balance competing supporting principles. It chose a mineral by mineral approach because it concluded policy neutrality was not the only issue and it believed a mineral by mineral approach provided a better reflection of States' underlying mining revenue raising capacity.

15 In its report, the Commission said it intended to retain its mineral by mineral structure until the next review. However, if there were a major change in circumstances — such as another mineral becoming material or one of the material minerals becoming immaterial — it would exercise its judgment on whether equalisation would be improved by changing the structure of the assessment.

16 The mineral by mineral approach avoids most of the GST Distribution Review Panel's policy neutrality concerns over the two-tier structure. It is still possible for a minor mineral to move from the residual group if there was a big enough increase in legislated royalty rates to make it material.

MONITORING STATE MINING POLICIES

17 In its 2015 Review report, the Commission said it would monitor State mining policies:

- to ensure its mineral by mineral assessment was not influencing State behaviour
- to check whether other minerals, such as coal seam gas, became material, requiring a change to the minerals separately assessed
- to ensure the revenue base it observed with respect to say, coal seam gas, is consistent with average policy.[4]

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[3] The individually assessed minerals were iron ore, coal, gold, onshore oil and gas, copper, bauxite and nickel.

[4] Report on GST Revenue Sharing Relativities, 2015 Review, Volume 1, page 12, paragraph 30.

Has the mineral by mineral approach influenced State behaviour?

Changes in mining royalty rates since 2013-14

18 Information on royalty rates was obtained from State budget documents and Western Australia's *Overview of State Taxes and Royalties*.[5]

19 There has only been one royalty rate change since 2013-14. New South Wales had a concession on petroleum royalty rates where the rate was nil for the first five years, increasing from 6% to 10% over the following five years. It ceased its concession on 1 January 2013.

Changes in mining policies since 2013-14

20 In September 2015, New South Wales amended its *State Environmental Planning Policy (Mining, Petroleum Production and Extractive Industries) 2007*, which sets the legal framework for assessing projects relating to its mineral and energy resources. It repealed clause 12AA which required the consent authority to consider the relative significance of a resource and the economic benefits of developing the resource.[6]

21 States also changed their mining policies in relation to minerals that are the subject of bans or moratoriums. At the time of the 2015 Review, there were bans or moratoriums on three minerals:

- Uranium mining was banned in New South Wales and Victoria. It was permitted in Queensland, Western Australia, South Australia, Tasmania and the Northern Territory.
- New South Wales had a ban on unconventional gas mining within 2 kilometres of existing and future residential areas and in the Upper Hunter equine and viticulture industry clusters.
- Western Australia had a ban on coal mining in an area 230 square kilometres around the Margaret River township.

22 Since the 2015 Review, the following changes have taken place:

- Queensland (in 2015) and Western Australia (in 2017)[7] have reinstated bans on uranium mining.
- Victoria (in 2017), Tasmania (for five years from 2015) and the Northern Territory (in 2016) have imposed moratoriums or bans on unconventional gas

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5 See the Western Australian Treasury website (www.treasury.wa.gov.au/Treasury/Publications/State_Taxes/).

6 Under clause 12AA in Part 3 of the Act the significance of the resource was to be the consent authority's principal consideration.

7 The new government will allow three uranium mines approved by the preceding government to proceed. See the ABC website (www.abc.net.au/news/2017-03-27/uranium-mines-will-be-allowed-to-proceed-labor-minister-confirms/8389622).

mining. Victoria (in 2017) also imposed a five year moratorium on onshore conventional gas mining.

23 Commission staff will continue monitoring State mining policies and royalty rates over the course of the 2020 Review.

24 There is no evidence the mineral by mineral approach has influenced State behaviour. There were no legislated rate changes like those observed after the 2010 Review. The only change was the removal of a concession.

Policies in relation to coal seam gas

25 The Commission said it would monitor developments in coal seam gas (CSG). CSG production is currently assessed in the onshore oil and gas component.

26 Table 1 shows the differing State policies in relation to CSG. Currently around one fifth of onshore oil and gas royalties relate to CSG production. It is unclear the extent to which, if at all, the Commission's mining revenue assessment influenced States' introduction of bans on coal seam gas (CSG) development.

Table 1 State policies in relation to coal seam gas

State	Policy
New South Wales	Freeze on CSG exploration and development. Buyback of licences. Narrabri gas project environmental impact statement lodged.
Victoria	Ban on onshore exploration for unconventional gas and hydraulic fracturing. Ban on conventional drilling until 2020.
Queensland	No restrictions. CSG makes up more than 90% of the State's natural gas supply.
Western Australia	Currently no restrictions, although the new government said it would ban fracking across large parts of the Southwest.
South Australia	No restrictions. Liberal opposition announced a policy for a 10 year fracking moratorium in the State's Southeast.
Tasmania	Ban on fracking. There is no onshore gas activity and no proposal for any.
Northern Territory	Independent scientific review. Moratorium on fracking.

Source: The Australian, Wednesday 8 February, 2017, page 11.

Have other minerals become material?

27 There is no evidence that another mineral has become material enough to be separately assessed.[8]

[8] In its 2015 Review report, the Commission said it would monitor the minerals that are not separately assessed. It would test whether any of them had become sufficiently large to warrant being separately assessed. Compared with the existing assessment, a separate assessment of a mineral would need to change at least one State's GST shares by $30 per capita to be considered to be material.

28 A separate assessment of CSG is not currently material. Queensland's 2016-17 Mid-Year Fiscal and Economic Review projects its petroleum royalties (which include CSG) to increase from $36 million to $250 million over the next five years. Commission staff will monitor the materiality of separately assessing CSG.

29 Royalties from uranium mining are around $11 million per annum and are assessed in the Other minerals component. A separate assessment is not currently material.

Is the revenue base consistent with average policy?

30 In the 2015 Review, the Commission said its mineral by mineral approach was consistent with average policy. Nevertheless, there are two cases of constructing the average policy that it may revisit as part of the next review:

- when a State dominates a tax base
- when a State prohibits a tax base being accessed.

When a State dominates a tax base

31 When a State dominates the tax base for a mineral, its legislated rate practically becomes the mineral's effective rate and the State's actual revenue virtually becomes its assessed revenue. The implication is that there may be a negative incentive for the State to increase its royalty rate and a positive incentive for it to decrease its rates so as to affect its GST share.

When a State prohibits a tax base being accessed

32 At times, State governments impose bans or moratoriums on exploration and mining. States mostly cite environmental reasons for imposing a ban.

33 In the 2015 Review, States were assessed to have no capacity in relation to any banned activity. This is consistent with treating bans on environmental grounds as average policy. In the 2017 Update, Queensland said bans in other States meant it was being penalised for permitting CSG production. Western Australia also made a similar claim. The existing moratoriums and bans do not currently have a material effect on the relevant State's assessed mining capacity.

34 As part of the 2020 Review, the Commission will reconsider what average policy is in the case where exploitation of a mineral is banned in a State. This could involve the Commission estimating the missing capacity, assessing no capacity for the State that bans a mineral (the current approach) or assessing no capacity for any State for the banned mineral. In considering this issue the Commission will need to balance the competing supporting principles of policy neutrality and fiscal capacity. The issue would become more pressing if an existing moratorium or ban were to become material.

CONCLUSION

35 In its 2015 Review report, the Commission said it would monitor State mining policies:

- to ensure its mineral by mineral assessment was not influencing State behaviour
- to check whether other minerals, such as coal seam gas, became material, requiring a change to the minerals separately assessed
- to ensure the revenue base it observed with respect to say, coal seam gas, is consistent with average policy.

36 The mineral by mineral assessment does not appear to have influenced State behaviour. There have been no legislated royalty rate changes, although New South Wales did remove a concession.

37 None of the minerals included in the Other mineral component have become material enough to be separately assessed. However, Queensland has forecast a big increase in its royalties from CSG. Commission staff will continue to monitor developments in this area.

38 The Commission said that the mineral by mineral approach was consistent with average policy. Nevertheless, there are two cases of constructing average policy that it may revisit as part of the next review:

- when a State dominates a tax base
- when a State prohibits a tax base being accessed.