NSW Treasury

2025 Review – NSW Submission

Mining revenue supplementary consultation (Coal)

May 2024

Acknowledgement of Country

We acknowledge that Aboriginal and Torres Strait Islander peoples are the First Peoples and Traditional Custodians of Australia, and the oldest continuing culture in human history.

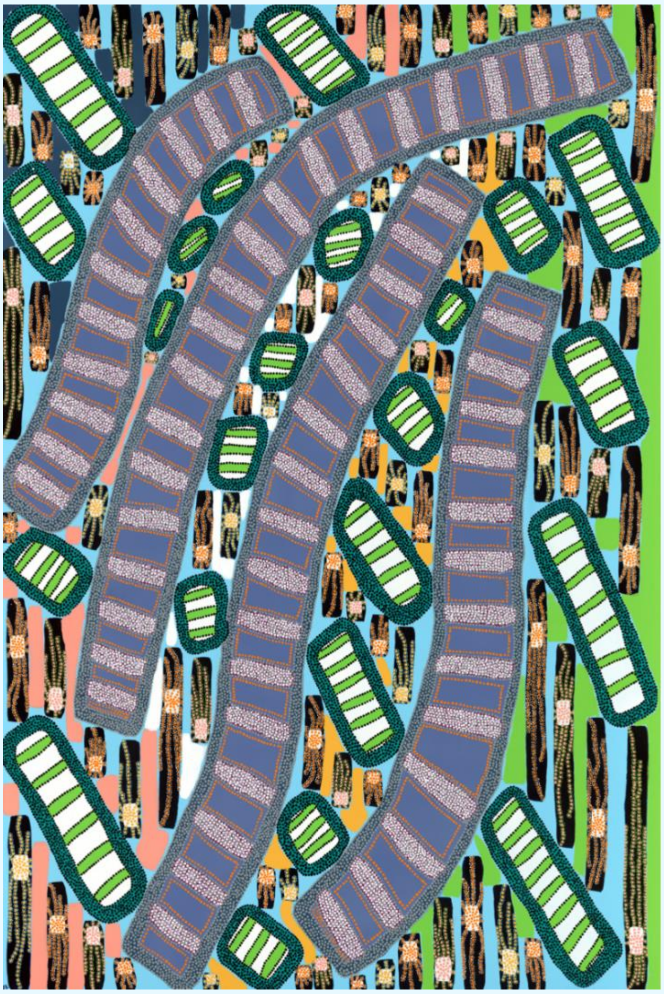
We pay respect to Elders past and present and commit to respecting the lands we walk on, and the communities we walk with.

We celebrate the deep and enduring connection of Aboriginal and Torres Strait Islander peoples to Country and acknowledge their continuing custodianship of the land, seas and sky.

We acknowledge the ongoing stewardship of Aboriginal and Torres Strait Islander peoples, and the important contribution they make to our communities and economies.

We reflect on the continuing impact of government policies and practices, and recognise our responsibility to work together with and for Aboriginal and Torres Strait Islander peoples, families and communities, towards improved economic, social and cultural outcomes.

Artwork:
Regeneration by Josie Rose



2025 Methodology Review – Supplementary Consultation (Coal)

1 Context

- In measuring the revenue raising capacity of jurisdictions, the Commission firstly quantifies the revenue base of each jurisdiction and then applies a national average tax rate to that revenue base.
- Where jurisdictions apply a progressive rate of tax and this results in significant additional revenue, the Commission divides the measured revenue base into price bands and applies the national average tax rate for each price band to determine the revenue raising capacity of jurisdictions. Such an approach is used for stamp duty and land tax revenue assessments.
- Property prices are, on average, higher in NSW than in other jurisdictions. Given this, and the application by states of a progressive rate of tax to property transfers, a price band approach increases the assessed revenue raising capacity of NSW by around $800 million per annum.
- Coal resources are unevenly distributed across jurisdictions with most coal concentrated in NSW and Queensland. Additionally, the majority of coal sold by Queensland is higher grade metallurgical coal compared with NSW which sells lower grade thermal coal. Since June 2005, the metallurgical coal price has been, on average, 1.8 times the price of thermal coal. Given the difference in price of thermal and metallurgical coal and differences in resource endowment, the average price of coal sold by Queensland is significantly higher than for NSW.
- NSW applies an ad valorem coal royalty rate depending on the type of mining operation[1], while Queensland applies a progressive rate of tax based on the price the coal is sold. Given its progressive rate structure, Queensland applies a higher royalty rate to its relatively higher value coal resources.

2 Separating the coal assessment

The Commission asks:

- Does the 2020 Review method adequately capture all material differences in state capacities to raise coal revenue?

- As outlined in our previous submissions[2], NSW Treasury believes the current assessment for coal royalties fails to broadly measure the fiscal capacity of states to raise revenue.
- The average price of coal sold in Queensland is significantly higher than in NSW due to the higher quality of coal mined in that state. At its simplest, this reflects Queensland's endowment and sales being primarily higher-grade metallurgical coal compared to NSW's endowment and sales being primarily lower grade thermal coal.
- NSW Treasury estimates of the average price of coal sold in New South Wales and Queensland are shown in Table 1-1. Queensland figures have been derived based on export coal prices and

[1] NSW distinguishes between open cut, underground and deep underground mines.

[2] NSW submissions to the 2024 Update and Tranche 2 Submission to the 2025 Review.

volumes published by the Commonwealth Department of Industry, Science and Resources and using similar data for export and domestic coal for New South Wales. It should be noted that 2022-23 saw thermal coal prices spike due to various global factors, disrupting the normal relationship between average price of coal sold by each state.

Table 1-1: Average Coal Prices ($AUD per Tonne)

	NSW	Qld	% Difference
2019-20	$101.48	$156.58	54.3%
2020-21	$86.78	$115.93	33.6%
2021-22	$250.20	$329.53	31.7%
2022-23	$356.71	$337.52	-5.4%

Source: NSW Treasury estimates

- While the existing methodology for assessing the revenue raising capacity of jurisdictions from coal royalties captures the higher average price of coal sold in Queensland, it does not capture the impact on the revenue raising capacity of states due to the application, on average, of progressive royalty rates.
- As shown in our Tranche 2 submission, Queensland's higher value royalty tiers apply almost exclusively to metallurgical coal. For that reason, the vast majority of additional revenue attributable to its expansion of royalty tiers is generated from metallurgical coal.

3 Assessing coal using price bands

The Commission asks:

- Do states support a differential coal assessment based on price bands?
- Are the proposed 3 price bands sufficient to appropriately capture differences in state capacities to raise coal revenue?

- New South Wales has previously argued that the Commission should adopt separate assessments for metallurgical and thermal coal. We acknowledge that this approach involves several practical data difficulties as state royalties are determined based on the price at which coal is sold, rather than on the basis of the quality of the coal sold. Nevertheless, we do contend that it is reasonably possible to overcome these difficulties.
- However, in accordance with the principle of 'what states do', adopting a similar approach to assessing royalty revenue raising capacity as that adopted for stamp duty and land tax has intrinsic merit and would more accurately assess the revenue raising capacity of jurisdictions.
- The Commission and other states have raised a number of issues with the application of a price band approach.

Data Availability

- Queensland has raised the issue that distinguishing between metallurgical and thermal coal sales is not possible for various reasons. We believe the Commission's proposed price band approach overcomes all the objections of this nature raised by Queensland.
- Coal royalties are based on the value of coal sold with various allowable deductions. To accurately assess required royalty payments, states must collect tonnages of coal sold and the

price at which this coal is sold. In the case of Queensland, price data is critical as it applies a progressive rate of royalty based on the price at which coal is sold. Queensland also publishes large amounts of mine specific coal volume data.

- We can confirm that New South Wales can provide coal tonnages, the value of coal sales and royalties collected by price band.

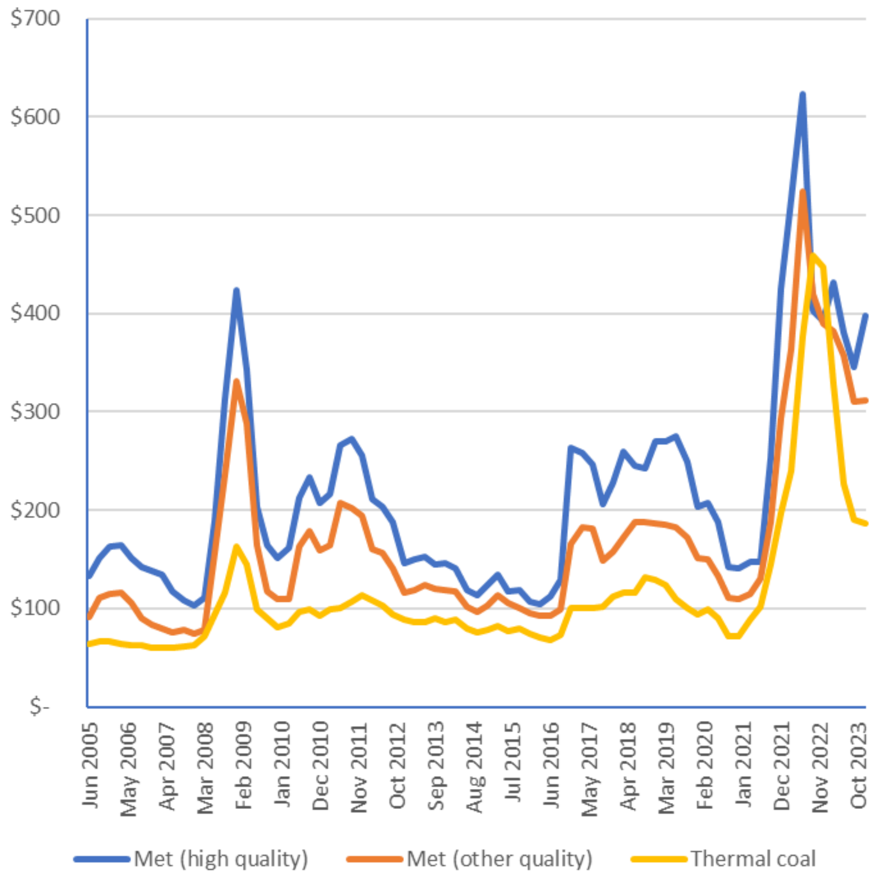
Confidentiality

- It has been argued that the provision of coal data to the Commission by price band is likely to reveal commercial-in-confidence data for specific private sector operators. We believe this concern is overstated. In 2022-23, Queensland reported tonnage data for 45 export mines. It could also be expected that each of these mines would have multiple sales contracts at varying prices. Given this, the provision of deidentified data to the Commission by Queensland should be possible without revealing commercially sensitive data.
- Furthermore, individual mining operation data will be aggregated by states into the Commission's price bands. Currently the Commission is proposing three bands, which provides little scope for data identification. We believe this is also the case where price bands are considerably narrower than proposed in the Consultation Paper.
- Finally, the Commission has processes in place for other assessments that deal with data confidentiality issues and involve non-disclosure of certain data elements within the Commission's Simulator. This is currently the case for elements of the Mining assessment.

Dominant State Effect

- Concerns have been raised that a price band approach runs the risk that data for one price band will be sourced from only one state (dominant state effect). Where this is the case, the assessment for that price band defaults to an Actual Per Capita assessment. The Commission's proposed three-price band approach minimises this potential problem by adopting wide price bands.
- However, we are concerned that the volatility of coal prices creates difficulties for the three-price band approach. For example, between December 2016 and September 2019, both metallurgical and thermal coal fell within the same price band ($100-$300). During this period, the average price of metallurgical coal was twice the price of thermal coal. Despite this material price difference, the three-price band approach would have defaulted to the current assessment approach. In such circumstances, the proposal put forward by the Commission would have failed to measure differences in the underlying taxable capacity of New South Wales and Queensland under a progressive royalty rate framework.
- Figure 1-1 provides historical data for coal export prices since June 2005. This data clearly shows the likelihood that thermal and metallurgical coal will often fall within the same price bands proposed by the Commission, even if there are significant differences in price.

Figure 1-1: Historical Coal Prices – June 2005 to December 2023



- In addition, under the proposed three-band approach, small changes in coal prices would result in significant changes in the assessed revenue of states. For example, changes in the price of thermal coal from $99 to $101 per tonnage will have a huge impact on GST relativities, as this would move both thermal and metallurgical coal into the same price band.[3] Under this scenario, the new assessment for coal royalties would again default to the existing assessment.
- To avoid this outcome, the Commission could use narrower price bands. This would avoid the likelihood of thermal and metallurgical coal falling within the one price band. It would also reduce the impact of a change in price, such as the $99 to $101 per tonnage example outlined above. However, too narrow price bands increase the risk of the dominant state effect coming into play.
- On balance, we believe that the three-price bands proposed by the Commission in the Consultation Paper places too much weight on avoiding the dominant state effect and too little weight on assessment stability and fiscal equalisation. We note that the current Mining assessment is not designed or structured to avoid dominant state issues.
- Based on historical price data, the need to avoid small changes in coal prices having a disproportionate impact on GST relativities, and minimising the risk of the dominant state effect, we propose that the Commission adopt price bands in $50 increments up to at least $500.

[3] Assuming the average historical relationship, metallurgical coal prices under this scenario would increase from $178 to $182.

4 Alternatives to the price band approach

The Commission asks:

- If a price band approach is not feasible, do states support an assessment based on the type of coal?

- Whatever approach the Commission adopts for assessing the revenue raising capacity of states from coal royalties, it must recognise that coal sold at a higher price is, on average, subject to higher rates of tax. The Commission has identified this can be achieved through:
  - Splitting the current coal assessment between metallurgical and thermal coal, effectively capturing the price differential which has averaged a ratio of 1.8 during the period since June 2005.
  - Adopting a price band approach to the current coal royalty assessment.
- Both approaches have merit, although on balance we believe a price band approach is more practical and more closely mirrors 'what states do'.

An Alternative Approach

- Should the Commission believe that the $50 price band approach proposed by NSW creates too many data confidentiality concerns and too great a potential for the dominant state effect to come into play, an alternative approach could be considered.
- Under this alternative, a two-step assessment approach would be adopted whereby the value of coal production and royalties collected would be split into only two categories.
  - The value of coal sold <u>above</u> the average price for the assessment year, and
  - The value of coal sold <u>below</u> the average price for the assessment year
- This approach would have a number of advantages:
  - Avoiding any risk of divulging commercially sensitive data,
  - Removing the sensitivity of the assessment to small changes in coal prices, and
  - Future proofing the assessment should there be large changes in coal prices during the 5-year application period of the 2025 Review.
- Under this alternative approach, all states would provide to the Commission the total volume and value of coal sales in a financial year. The Commission would advise the states of the average price at which coal had been sold for the financial year, derived from this state data. States would then be requested to split the value of coal sold and the associated royalty revenue into coal sales that were above and below the average sale price of coal for the year.

5 Concluding Comments

- NSW Treasury believes the current approach to assessing the revenue raising capacity of states should be revised to take account of the significant differences in the quality and price of coal sold by various jurisdictions.
- To achieve this, we believe a price band approach is preferable. However, the broad price bands proposed by the Commission in the Consultation Paper will fail to achieve fiscal equalisation as both metallurgical and thermal coal will frequently fall within the same price band, despite

significant difference in the price for these coals. To overcome this problem, we propose price bands in $50 increments up to at least $500.

- We have also proposed an alternative two-price band approach which should be considered by the Commission if concerns regarding dominant state effects using narrower price bands are believed to be great. This approach has several other advantages including being less data intensive, overcoming any confidentiality concerns, and being responsive to possible significant future changes in coal prices.
- Under either scenario, states must already have the data that would be required for an assessment, as it is necessary to effectively operate state royalty schemes. New South Wales can readily supply the relevant data. In the unlikely event that the data cannot be provided by other states, it can be reasonably approximated by reference to publicly available data.

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