Mining supplementary submission 2025 Methodology Review

Queensland submission

10 May 2024

Queensland Government

Contact officer:

Matthew Nalder
Principal Treasury Analyst
Economic Strategy
Queensland Treasury
(07) 3035 1818
Matthew.Nalder@Treasury.qld.gov.au

A differential assessment of coal based on prices.

Proposed views sought:

Based on information outlined in the consultation paper, the key questions posed by the Commission are:

- *Does the 2020 Review method adequately capture all material differences in state capacities to raise coal revenue?*
- *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?*
- *If a price band approach is not feasible, do states support an assessment based on the type of coal?*

Queensland position:

Queensland strongly opposes the further disaggregation of the coal mining revenue assessment, including any differential assessment based on coal price ranges, on a range of key grounds, as discussed in detail below.

In particular, the potential change in approach being explored by the Commission would significantly worsen the already substantial issues related to policy neutrality in this assessment.

In fact, this approach would likely result in almost all coal mining revenue being effectively assessed on an actual per capita (APC) basis, despite having several states that receive coal royalties and two states, New South Wales and Queensland, that are major global coal producers and exporters. Any differential assessment as proposed would clearly conflict with the policy neutrality principle in that it would result in each states' assessed coal royalty revenues being driven primarily by their respective policy decisions related to the design of their royalty frameworks.

Importantly, this approach would result in a further redistribution of GST through the HFE system as a direct result of New South Wales' policy decision to impose and retain a flat royalty rate structure, compared with the more economically sound and sustainable progressive royalty rates framework that applies in Queensland. It is this difference in policy approach that has primarily driven differences in the royalties received between the two states during the recent period of high global prices.

The Commission has sought comments on a specific option to change the mining assessment by way of introducing a differential assessment of coal royalties based on specified price bands.

Queensland has several substantial conceptual concerns with this proposed approach, including the specific price bands initially proposed, and has identified a range of significant limitations with the proposal that would likely lead to perverse and inappropriate horizontal fiscal equalisation (HFE) outcomes. The specific concerns with the approach are outlined in detail in this submission.

However, of even greater concern, the proposal raises several key higher-order issues that mean the adoption of any such approach, in isolation of a comprehensive review of the treatment of other mining-related revenues, would undermine the credibility, reliability, consistency and appropriateness of not only the mining assessment, but the Commission's entire 2025 Review outcomes and broader HFE methodology.

In particular, such an approach would:

- be in direct contradiction to the fundamental principle of policy neutrality;

- undermine and disincentivise opportunities for states to implement meaningful policy reforms that are in the national interest;
- add further policy contamination when there is already significant policy contamination in other assessments (in particular, onshore gas revenue); and
- penalise and disincentivise states to undertake economically and fiscally responsible revenue reforms.

As discussed in Queensland's submission in response to the 2024 Update New Issues Supplementary Consultation Paper, the proposed change is inconsistent with the principle of policy neutrality and could have substantially negative and unintended consequences in terms of disincentivising, and undermining the effectiveness of, government policies that are in the national interest.

Queensland's progressive coal royalty rates are specifically designed so that, during periods of high global coal prices when coal companies are making extra-ordinary revenues and profits, all Queenslanders will receive a fair share of the benefits from the sale of the state's natural and limited resources.

Further and most importantly, through the established HFE arrangements, a proportion of revenue is already being redistributed to other states through the 2024 Update and this will continue in future years. As such, **Queensland's coal royalty reforms have improved Queensland and other states' fiscal capacity and budgetary position and have been demonstratively beneficial for the national interest. However, the Commission's proposed change will severely and unfairly impact Queensland for undertaking revenue reform and delivering benefits for not just all Queenslanders, but for people across the nation.**

To the extent that this deters other states from making similar policy changes, this would leave Australians as a whole worse off.

If the Commission ultimately decides to progress with the option of coal price bands, this would add even greater weight to the already compelling case to revise the approach to onshore gas revenue, and adopt, as proposed in its own discussion paper, to treat onshore gas revenue on an equal per capita (EPC) basis.

As outlined in detail in Queensland's Tranche 1 and Tranche 2 submissions, the current treatment of gas revenues is inconsistent with the principle of policy neutrality, given that some other states, despite holding substantial proven and probable gas resources and reserves, have made clear and intentional policy decisions to ban or severely limit gas production (and, therefore, any royalties they can derive from gas).

However, under the current assessment approach, despite their deliberate policy decisions which are limiting their gas royalty revenues, the Commission is assessing these other states as having limited or no gas royalty revenue raising capacity.

Therefore, the Commission is **disregarding the substantial impact of those other states' different policy decisions in their gas assessment** and, as a result, substantially penalising Queensland and rewarding other states in terms of GST redistribution through the HFE system.

As such, the logic and treatment of states' policy decisions underpinning the current treatment of gas (or any other treatment of onshore gas revenues other than on an EPC basis) **is inconsistent with the price band approach being proposed for coal where policy decisions are to be largely incorporated.**

The more granular the assessment, the greater departure from policy neutrality and the greater the risk that the Commission's assessment is actively working against the national interest by disincentivising reform.

There are significant and specific conceptual and methodological issues with the proposed price bands approach that need to be considered including:

- Price bands for coal cannot be considered and treated the same as for Land tax or Transfer duty.
- Confidentiality concerns and limitations related to royalty returns and data.
- Unfair redistribution reflecting lack of policy neutrality.
- Any retrospective change penalises Queensland for already enacted policy decisions, which were made based on long established HFE methodologies.
- A lack of appropriateness of proposed price bands in the context of effective royalty rates

This submission proposes that, if the price band approach was to be further considered, a less flawed approach would be to align any bands with effective royalty rates rather than 'headline' marginal rates. This approach would be more logical and aligned with how progressive coal royalty rates actually work in practice and would help mitigate some of the methodological and HFE limitations identified.

Further, given the violations of policy neutrality that result from disaggregation by price ranges, if an approach aligned more with effective rates as outlined in this submission was to be adopted, the resulting distortionary impacts on HFE should also be further mitigated through adoption of the following complementary adjustments:

- Consistent with the approach proposed by the Commission in its earlier 2025 discussion paper, applying a 50% discount on all coal royalty revenue due to the impact of a policy change in a 'dominant state'; and
- To reduce the substantial and unfair retrospective impact of any change, that the adoption of any differential assessment based on price bands only be applied from the assessment of revenues in the 2025-26 single year onwards, rather than being applied retrospectively in the assessment of previous year's revenues.

Finally, the consultation paper proposes that, if price ranges are not considered a viable approach, the Commission may further consider a split between different coal types, as was previously raised by the Commission as part of the 2024 Annual Update.

As outlined in detail in Queensland's previous submission, there is a long list of reasons why this is not feasible, highly inappropriate, and particularly problematic option, that would contradict sharply with key HFE principles, including 'what states do'.

Overall, given the substantial nature of these risks and concerns, consideration of alternative options to the broader treatment of mining related revenues are clearly warranted.

As outlined in Queensland submissions under previous reviews, as well as the Tranche 1 submission as part of this review, Queensland proposes that the total aggregation of all royalties and revenues across the mining assessment should be re-considered as a priority.

Queensland continues to advocate for a greater degree of aggregation in the mining assessment with the view that this provides a superior method of achieving HFE while striking a more appropriate balance between the supporting principles.

The risk in disaggregating the Commission's assessments in this area, including any move to more granular assessments, is that they are actively working against the national interest.

The 2025 review offered the Commission and states the opportunity to explore how the mining assessment, as a whole, should operate and resolve these issues in a more comprehensive way.

Queensland is firmly of the view that the mining assessment with its mineral-by-mineral methodology is already too disaggregated, which is leading to significant and very real policy

neutrality concerns. Further, additional disaggregation such as adoption of the proposed price bands for the coal assessment, accentuate these concerns and increase the likelihood that the Commission's assessment is actively working against the national interest.

Therefore, Queensland considers the Commission should use the remaining months before the draft report is released to seriously re-consider its commitment to the mineral-by-mineral approach in the mining revenue assessment, and rather than attempting to move towards even further disaggregation, consider options to move to a more aggregated assessment.

This would, in Queensland's view, most appropriately capture states relative fiscal capacities from mining related revenues, while also addressing many of the real and legitimate concerns that have been raised with the current and proposed assessment methodology.

This submission outlines in further detail Queensland's response to the Commission's consultation paper.

Detailed discussion of issues related to the potential change.

Issue 1. Exacerbating the lack of policy neutrality

A key principle of HFE is that assessments need to be policy neutral. In particular, the Commission's own paper discussing the impact of state revenue policy decisions and HFE, states clearly that:

> *"The Commission's policy neutrality principle seeks to ensure state policy choices have minimal effect on its assessments and, in turn, the assessments have minimal impact on state policy choices."*

If the Commission introduces further disaggregation of the coal revenue assessment by price range, which would primarily be designed to capture differential impacts of Queensland's progressive rate structure versus New South Wales' flat rate structure, this would represent a significant and material departure from policy neutrality.

This proposed change, should the Commission decide to enact it, would ensure that individual states coal mining revenue policy choices have a material impact on the mining revenue assessment. This is an inevitable and inappropriate consequence of a more granular mining assessment.

In effect, this would result in an individual state's coal royalty revenue policy equating to average national royalty policy, leading to Queensland's revenue policy driving the assessment. This means that any such change would be clearly moving further away from the key HFE principle of policy neutrality.

Such a change would also retrospectively incorporate policy decisions already made and implemented by Queensland in 2022-23, as well as impacting on assessed GST shares prior to the current policy change, with the single year relativity in 2021-22 (before the additional progressive tiers were introduced) affecting 2025-26 three year average relativities.

As such, this change would have substantial consequences in terms of the impact of the Commission's treatment of previous policy decisions (i.e. to raise appropriate returns to the people of Queensland for the state's valuable natural resources during periods of high coal price) that were implemented cognisant of the Commission's longstanding approach to the GST treatment of coal.[1]

[1] Noting that this mineral-by-mineral approach is already a breach of the policy neutrality principle and is opposed by Queensland.

Other states, in a different context, have also previously raised concerns that the Commission's approach to revenue assessments is influencing policy decisions and resulting in economic inefficiencies.

In particular, New South Wales stated as part of their previous submission to the Productivity Commission into HFE:

> *"[The Commission's] approach can distort state decisions to alter their tax mix to enhance economic efficiency and minimise deadweight losses."*[2]

The outcomes of any such split of coal prices would be inconsistent with the policy neutrality principle under which no single state's revenues should impact the assessment and that the assessment should not impact states' policy decisions.

- The proposed change would effectively result in Queensland's policy settings driving the overall assessment outcomes.
- The proposed change is also not fit for purpose in the sense of ensuring the Commission's relativities are practically useful for States to incorporate into their budgets, as the change would result in substantial impacts on GST outcomes, in particular for Queensland, thereby impacting on State budgets which have already been set over forward estimate years based on the long-standing and clear methodology applied to coal royalties.
- Any disaggregation of coal royalties in this way will simply ensure that specific policy choices in New South Wales and Queensland each have a material impact on the mining revenue assessment.
- In effect, enacting this proposed change would effectively create an APC assessment for both Queensland and New South Wales, with an individual state potentially having all coal, or the vast majority of coal, in any specific price band.

As such, the proposed approach would result in no recognition of states' *actual* capacity to raise revenue, with the assessment based purely on the policy differences between the two states.

More broadly, as discussed further below, in addition to delivering outcomes that are clearly inconsistent with HFE, the implications of such a change will reverberate throughout the entire architecture of HFE, highlighting substantial inconsistencies with the approach currently applied to other key assessments, in particular gas royalties.

Issue 2. Detrimental impact on policies in the national interest

From a national interest perspective, Queensland's new coal royalty tiers introduced in the 2022-23 State Budget, represent one of the most important and consequential state revenue reforms for many decades.

Their introduction has ensured that, during periods of high global coal prices when coal companies are making extra-ordinary revenues and profits, that all Queenslanders will receive a fair share of the benefits from the sale of the state's natural and limited resources.

Further and most importantly, through the established HFE arrangements, a proportion of revenue is already then redistributed to other states through the 2024 Update and this will continue in future years. As such, Queensland's reforms have delivered benefits for the vast majority of Australians.

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[2] NSW Treasury 2017. *NSW Government Submission: Productivity Commission Inquiry into Horizontal Fiscal Equalisation.*

Therefore, Queensland's coal royalty revenue reforms have improved *other* states' fiscal capacity and budgetary position and have been demonstratively beneficial for the national interest.

However, the Commission's proposed change will severely and unfairly penalise Queensland for undertaking revenue reform and delivering benefits for Australians across the nation.

Consistent with the arguments outlined in Queensland's submission as part of the 2024 Update, the proposed change (including the potential precedent it could set or uncertainty it could create related to potential future changes to other assessment methodologies), could have substantially negative and unintended consequences in terms of disincentivising, and undermining the effectiveness of government policies that are in the national interest.

Importantly, royalties are critical revenue policies that are in the national interest. They are specifically designed to ensure that Australians (including in the states where specific resources are located), receive a reasonable and appropriate return on the valuable and limited natural resources owned by the people in order to fund essential public goods, infrastructure and services.

In particular, Queensland's new progressive coal royalty tiers were designed to collect material revenue only in exceptional circumstances, when coal prices were at high levels, to ensure a fair return to the people of Queensland in times when coal producers are receiving extraordinary revenues and profits.

As highlighted in Queensland Government ministerial statements, the "new progressive royalty tiers will ensure that the people of Queensland also receive a fair share of those windfall proceeds."[3] Furthermore "this change has been specifically designed to ensure a share of windfall profits while still protecting companies should coal prices go down." [4]

The existing coal assessment methodology applied by the Commission already ensures that a proportion of additional royalties raised in any given state during periods of high prices is redistributed over time to other states and territories through the GST system. This ensures that other states and territories also benefit from the increased royalties derived from the use and sale of the countries' limited and valuable natural resources.

The nature of the proposed change, including the potential retrospective nature of the change to the assessment approach, is likely to lead to substantial uncertainty in the context of states considering such important policy decisions that are in the national interest.

It will reduce the incentive to pursue such policies that are designed to rightfully and appropriately protect the interests of the citizens who own the natural resources.

By disincentivising consideration of potential policies that are in the national interest, this would ultimately reduce the benefits flowing to all Australians.

Issue 3. Adding further policy contamination when there is already significant policy contamination in other assessments (in particular, onshore gas revenue)

The proposal put forward by the Commission exacerbates Queensland's growing concerns around the judgment-based application of important supporting principles like policy neutrality.

While the Commission's primary focus is to ensure that the principle of HFE is met, the impact of policy decisions by states which affect their fiscal capacity cannot be overlooked in this process.

This is critical in the mining assessment, where state policies have a significant impact on state revenues, especially for gas.

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[3] Queensland Parliament, Record of Proceedings (Hansard) – 23 June 2022, Sitting Date | Queensland Parliament

[4] Queensland Parliament, Record of Proceedings (Hansard) – 23 June 2022, Sitting Date | Queensland Parliament

A comparison between the gas and coal mining categories of the mining assessment highlights a disregard for policy neutrality across multiple different policy issues and inconsistent treatment of State policies.

As highlighted in substantial detail in Queensland’s Tranche 1 and Tranche 2 submissions, states such as New South Wales and Victoria apply specific, deliberate policies that prohibit or limit development of a gas industry and the raising of revenues in those states (despite having substantial resources). However, the current assessment methods continue to assess these states as having no (or very limited) revenue capacity.

This severe policy contamination substantially penalises Queensland and rewards the other states in terms of GST redistribution.

Meanwhile, under the coal mining assessment, the Commission is proposing to change the current methodology to specifically capture and reflect differences in state policy frameworks, in particular, Queensland’s policy decision to increase its mining revenue through changes to Queensland’s royalty tiers.

Both assessments should be policy neutral. For gas this would be achieved through an EPC assessment and for coal by either aggregating minerals, or at least not making the existing situation worse, and maintaining the current coal assessment.

If the Commission pursues the proposed change to the coal revenue assessment without substantially revising the gas revenue assessment there will then be two very large assessments where the Commission's treatment of revenue is not policy neutral, to the substantial detrimental of Queensland’s GST share.

Meanwhile, the Commission would be rewarding states who have made clear and deliberate policy decisions to limit or prohibit their potential revenues, either through policies to ban or limit development and production of key resources, or in designing their royalty frameworks to limit the potential revenues to the state even during periods when producers are making extra-ordinary returns and profits.

Issue 4. Penalises and disincentivise states from undertaking appropriate revenue reforms

There is a substantial reputational risk to the overall HFE framework if this change is made.

Such an outcome would set an inappropriate and damaging precedent that the Commission *could* and *will* make future judgements at any point that effectively penalise states for their policy decisions.

Meanwhile, enacting this proposed change would lead to substantial uncertainty for states around the ultimate revenue impacts and GST treatment of any potential future reforms, and create an environment which disincentivises meaningful state policy reform with any material revenue implications.

Ultimately, this will reinforce state's dependence on Commonwealth grants and potentially less efficient revenue streams to deliver essential services, exacerbating the current vertical fiscal imbalance, and reducing the likelihood that states will independently pursue meaningful and appropriate revenue reform.

To the extent this does impact on or disincentivise consideration of potential policies that are in the national interest, this would ultimately reduce the benefits flowing to Australians.

In addition, the proposed price band approach would reward states that primarily produce thermal coal (which tends to be sold at lower prices) and penalise states that primarily produce higher quality coal used in steel making. This tilting of the playing field in favour of thermal coal is at odds with supporting transition to a low carbon economy.

Dominant state and a 50% discount

In the Commission's tranche 1 mining consultation paper as part of the current methodology review, it was noted that there are policy neutrality concerns when a state is a dominant producer of a mineral and changes its royalty rates. The Commission outlined how, in these instances, the change in revenue for the state will largely be offset by a change in its GST distribution, which could act as a disincentive for the dominant state to make policy decisions impacting on its royalty rate.

The Commission also outlined its preferred definition of what a dominant state should be, i.e. a state would only be considered to be dominant if the size of the difference between the state's revenue base share and its population share is greater than 50%.

In the tranche 1 consultation paper, the Commission defined this for Queensland as having a share of the national production of any specific mineral greater than 70%. At that time, given the prevailing and longstanding treatment of coal in the mining assessment, Queensland would not have been considered as a dominant state for coal under that definition.

The Commission proposed that where a state is classed as dominant, and the state changed its royalty rate, 50% of the change in royalties from the policy change would not be included in the Commission's assessed revenue calculation.

In Queensland's response to the consultation paper Queensland did not agree with the approach, given that the proposed arbitrary definition of a dominant state would have excluded Queensland as being considered a dominant state for coal. As indicated in Queensland's submission at that time, this outcome highlighted concerns about the appropriateness of this proposed approach, and the arbitrary high threshold, in fully addressing policy neutrality concerns.

However, given the potential material change to the coal revenue assessment methodology now being considered, Queensland could now likely be a dominant state in specific coal price ranges if this approach was adopted, even using the Commission's proposed high threshold for defining a dominant state.

Given the substantial further erosion of the policy neutrality principle if a differential assessment based on price ranges is adopted, Queensland now considers it is appropriate that the proposed dominant state adjustment be applied alongside any proposed price range method change, to appropriately recognise Queensland as the dominant state for coal.

While application of the Commission's dominant state discount proposal does not fully address the broader substantial concerns around policy neutrality, it would at least go some way to mitigating the substantial issues relating to this key HFE principle in the context of the proposed change to the coal royalty assessment.

If the price bands method change is applied retrospectively, for consistency, the dominant state discount approach should also be applied retrospectively up to the 2022-23 single year.

Although Queensland would likely be dominant in only one value range, it is likely that most additional revenue raised from the policy changes is from this value range. As such, any additional revenue raised because of Queensland's new progressive coal royalty tiers should be assessed as 50 per cent EPC.

Specific issues and concerns with proposal outlined in the Commission's consultation paper

In addition to the higher-order issues outlined above caused by any proposal to differentiate coal revenues based on price ranges, Queensland has identified a range of limitations and risks specific to the option outlined by the Commission.

The remainder of this submission discusses the specific questions posed by the Commission and outlines a range of key methodological issues and concerns identified by Queensland.

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

As outlined in previous submissions, both as part of this review and the previous 2020 review, Queensland does not support the current mineral-by-mineral approach to the mining assessment, given that it is not policy neutral and unfairly penalises Queensland and other mining states. **The more granular the assessment the greater the departure from policy neutrality and the greater the risk the Commission's assessments are actively working against the policy neutrality supporting principle and the national interest by disincentivising reform.**

The mineral-by-mineral approach does not effectively capture differences in state capacity, rather it creates an almost APC assessment for most minerals and overestimates the revenue capacity of states with above average mining production. As such, the limitations of this method prevent or disincentivise states from undertaking policy reform, disincentivise states from raising more own-source revenue, and act against policies that are in the national interest.

Given the fundamental issues in the mining revenue assessment, Queensland has previously proposed, and continues to strongly recommend that the most appropriate approach would be for a full aggregation approach (across the entire mining assessment) to be applied to this assessment. This would offer a more appropriate balance between HFE and the supporting principles, including policy neutrality.

However, if the Commission is not willing to adopt a full aggregation of the mining assessment, Queensland considers the existing methodologies as they apply to coal, deficient as they are, are more fit for purpose and more aligned with HFE outcomes than alternatives (including any differentiation by arbitrary price ranges or coal type) which are even more disaggregated, less fit for purpose and clearly less policy neutral.

Do states support a differential coal assessment based on price bands?

Queensland strongly opposes a differential coal assessment based on price bands. The use of any price bands will create additional policy neutrality issues in an already highly policy contaminated assessment. This will further push mining toward an APC assessment under which Queensland is penalised for making policy reforms that are in the national interest.

There are several, very significant issues with the conceptual case for the Commission's consideration of price value bands being introduced into the coal mining revenue assessment. These include:

1. Conceptual differences between price bands in the context of coal and land tax or transfer duty.
2. Confidentiality issues caused by low numbers of observations across price bands.
3. Unfair redistribution impacts reflecting a lack of policy neutrality.
4. The retrospective nature of the proposed change exacerbating any impacts.
5. An aggregation of minerals provides a better reflection of State's fiscal capacity.

The following section of the paper explores these key issues in greater detail.

1. **Price bands for coal cannot be considered and treated the same as for Land tax or Transfer duty.**

The Commission's paper indicates that it is exploring a differential assessment based on the price producers receive on the basis that this is similar to the approach used for the land tax and transfer duty assessments.

However, the way that commodity prices and markets work is substantially different to the prices and values applicable to property and land.

The price of key commodities, in particular coal, is highly volatile, and can fluctuate significantly over a price cycle including over the course of days, weeks, months or years. In comparison, land and property values move more consistently in an upward direction over time.

Further, there are consistently large numbers of individual landholdings and property transactions across all value ranges and states, regardless of any fluctuations in average land or property values.

As a result, the application of value bands in the land tax and transfer duty assessments result in a large number of transactions and land holdings from all states in each of the value bands, which means there is an appropriate blending of the tax bases and the revenue policy settings from all states. **This allows for a meaningful measure of average policy and a policy neutral outcome.**

In stark contrast, for coal, given the prices received by all producers move up and down in line with global prices, and given the limited number of companies producing coal in various price ranges in many periods, there will often be very few observations to enable any effective blending of different states revenues and tax bases. **This <u>does not</u> allow for a meaningful measure of average policy that is policy neutral.**

2. **Practicality issues, in particular data confidentiality.**

Queensland's Revenue Office, and other states' similar bodies, are bound by strict legislative confidentiality requirements that prohibit the disclosure of any personal confidential information about a taxpayer.

As such, as highlighted by the Commission in its paper, disaggregating the coal mining assessment into price bands is likely to raise substantial confidentiality issues, given it will result in a small number of producers within each band in many years, with the application of more and narrower bands significantly increasing the likelihood and incidence of this occurring.

Therefore, to address these confidentiality requirements, it would be necessary in most years to combine data across multiple price bands.

This is particularly prevalent in both lower and upper end bands, with the extent to which blending of data across bands is required likely to change over time, as data within different bands needs to be combined based on relevant prices within different periods.

This adjustment to the data would need to be undertaken by state revenue offices, who would be unable to disclose the extent to which this has occurred (as disclosing that information would likely in itself, breach confidentiality requirements), thereby resulting in states and the Commission having no clear visibility or understanding of the extent to which the data reflects actual price outcomes and royalty impacts within each proposed price band.

This significant limitation could undermine perceptions of the reliability and rigour of the price band approach in determining a meaningful differential assessment of revenue capacity based on the proposed price bands.

Given these challenges, Queensland cautions that should a price band approach be adopted, it would need to be sufficiently structured with wider bands as Queensland proposes later in this submission, to maintain confidentiality and limit volatility over time. This would also reduce the need to, on an ad-hoc basis combine data across ranges due to confidentiality reasons, while also meaningfully reflecting the differences between price bands.

This issue, including Queensland's suggestions regarding appropriate price bands to mitigate this risk, is discussed in further detail below.

3. Unfair redistribution reflecting lack of policy neutrality.

The Commission acknowledged in the 2024 Update Supplementary New Issues Consultation Paper that a disaggregated assessment for coal revenues has only become material for a period of time because of the increase in Queensland coal royalties during the recent period of high global coal prices. The Commission also acknowledged that this increase was in part due to the recent change in Queensland's royalty regime through the introduction of new progressive royalty tiers.

Queensland Treasury considers that the majority of the additional redistribution from introducing a differential assessment based on coal price ranges during periods of high prices will likely reflect the impact of Queensland's additional progressive royalty tiers. This reflects the fact that the new progressive royalty tiers introduced in the 2022-23 Budget were specifically designed to only impact during periods of high prices and, therefore, the impact of the proposed differential assessment based on price ranges would be substantially less in the absence of the new tiers.

As such, this method change clearly appears to reflect the Commission making a specific decision to structure the assessment in response to Queensland's policy reform. **The impacts of this redistribution would penalise Queensland for enacting a reform that has benefitted Australians across the nation.**

As a result, the proposed approach based on price ranges in effect would provide a permanent budgetary benefit to New South Wales at the direct expense of Queensland, purely as a result of differences in the effective royalty rates generated by Queensland's progressive royalty tiers compared to New South Wales' ad valorum fixed-rate policy.

New South Wales has recently legislated an increased fixed-rate royalty levy for coal. Ironically and inappropriately, this means that at lower prices, this will further exacerbate the material negative impact on Queensland of a differential assessment by price ranges.

This reflects the fact that, under New South Wales' new rates, it is estimated that Queensland's effective royalty rate will be lower than New South Wales' effective rate until coal prices reach above $200 per tonne.

As prices increase to high levels, the progressive nature of Queensland's royalty tiers increases the effective rate above the effective royalty rate in New South Wales. This is entirely appropriate given that, during periods when coal prices are high and coal producers are making extra-ordinary returns and profits, the people of Queensland should also receive a higher return on their limited and valuable natural resources.

A consequence of these policy differences means that during periods of low prices, Queensland will have a below-average effective royalty rate and will, therefore, be assessed as having a higher fiscal capacity than actual royalties collected. **This anomaly raises further substantial concerns in terms of policy neutrality given that Queensland's new progressive coal royalty tiers were introduced on the basis of deliberately not increasing royalties at lower price ranges to avoid impacts on production.**

Meanwhile, at high prices, this will amount to an effective APC treatment of the revenue raised at these higher prices, further increasing Queensland's assessed fiscal capacity relative to New South Wales.

In addition, the proposed price band approach would reward states that primarily produce thermal coal (which tends to be sold at lower prices) and penalise states that primarily produce higher quality coal used in steel making. This tilting of the playing field in favour of thermal coal is at odds with supporting transition to a low carbon economy.

In contrast, given the price tiers proposed would be specifically designed to differentially assess higher quality, higher priced coal, this would substantially penalise Queensland given its coal production is primarily hard coking and other forms of higher quality coal used in steel making, which will continue to be a critical input to industrial production and activity globally for decades and is also essential to support the ongoing transition to renewables.

4. Timing - any retrospective change penalises Queensland for already enacted policy decisions, which were made based on long established HFE methodologies.

The consultation paper describing the proposed change did not indicate when it might come into effect if it was to be progressed.

However, were this to be implemented retrospectively, this change would substantially impact on the outcomes of previous policy decisions (i.e. to raise appropriate returns to the people of Queensland for the state’s valuable natural resources during periods of high coal price) that were implemented on the basis of the Commission’s longstanding approach to the GST treatment of coal.[5]

States need to be able to rely on the assumption that Commission assessments will not be altered materially because of their policy decisions and reforms. This assumption provides stability and reliability in the relativities used in budget processes, which in turn affects state funding decisions.

For this reason, Queensland considers that any retrospective application of this method change is highly inappropriate and would produce significant and unfair budgetary pressures for the state.

While Queensland strongly maintains that there should be no method changes that materially disadvantage states because of their policy decisions, any retrospective application of the assessment would further exacerbate the penalisation and uncertainty for states.

As such, if the Commission chooses to proceed with this proposed change, it should only be enacted from the single assessment year of 2025-26 onwards (thereby being initially incorporated into the three year average assessment from 2027-28 onwards) and should not be used to assess revenue retrospectively in single assessment years prior to 2025-26.

This is critical given that the policy impacting on revenue in those previous years was introduced based clearly on the understanding and cognisant of the longstanding approach applied by the Commission in assessing coal royalties, with that increased revenue having subsequently been committed to critical expenditure to support essential service delivery and infrastructure investment across regional areas of Queensland.

5. An aggregation of minerals provides a better reflection of states' relative fiscal capacity.

There are substantial conceptual issues with any move to a price range based differential assessment, or other attempts to further disaggregate the coal revenue assessment. Queensland strongly considers that any further review of this assessment by the Commission should take a more aggregated and strategic approach based on achieving better overall HFE outcomes.

[5] Noting that this mineral-by-mineral approach is already a breach of the policy neutrality principle and is opposed by Queensland.

As highlighted in previous Queensland submissions, Queensland does not support a mineral-by-mineral approach and continues to maintain that aggregation of minerals in the mining assessment provides a superior HFE outcome and strikes a better balance between 'what states do' and policy neutrality.

The mineral-by-mineral approach does not capture differences in state capacity, rather it creates an almost APC assessment for most minerals, thereby overestimating revenue capacity in states with above average mining production in relation to specific minerals.

These assessment methods pose a barrier to states in undertaking policy reform, disincentivise states from raising more own-source revenue, and act against policies that are in the national interest.

An aggregated approach to the mining revenue assessment offers greater policy neutrality compared to a mineral-by-mineral method, addressing issues of dominant state influence stemming from the disparate distribution of minerals.

This approach better reflects a state's fiscal capacity by mitigating biases from individual state policy settings. For instance, combining assessments for minerals like iron ore and coal would diminish the impact of any single state on the average royalty rate used to determine state revenue-raising abilities across mining-related revenues, thus reducing disincentives for states to adjust royalty rates, including policy decisions in the national interest, and lessening the policy impact of any single state on the assessment.

The Productivity Commission's 2018 report on HFE criticized the lack of policy neutrality in the current mining assessment method, citing adverse incentive effects. According to the report:

"In sum, there is a large potential for the HFE system to discourage efficient taxation and extraction of (some) minerals. Indeed, the mining assessment has always thrown up problems, due to the dominance of select minerals and particular States, and has been subject to significant change in methodology over the years. Over time, the disincentives for major tax reform and the efficient taxation of minerals could have a material cumulative impact on the economy and wellbeing."[6]

The Commission itself has previously suggested, as part of the 2020 methodology review, that adopting an aggregated approach could alleviate these issues. Queensland maintains that this aggregated method remains the most appropriate option for the mining revenue assessment.

Are the proposed 3 price bands sufficient to appropriately capture differences in state capacities to raise coal revenue?

Queensland does not support the proposed price bands outlined in the paper and considers the conceptual logic underpinning them is flawed.

As outlined in the Commission's paper, these proposed bands have been determined based on the legislative 'headline' marginal rates that apply in Queensland.

However, basing price bands around these rates reflects a misunderstanding of how in effect the progressive royalty rates operate. The legislative rates should not be the basis for the setting of assessed fiscal capacity, given they are marginal rates that only apply to the portion of the price over and above the relevant threshold.

[6] Productivity Commission, Inquiry Report – Horizontal Fiscal Equalisation, released May 2018, https://www.pc.gov.au/inquiries/completed/horizontal-fiscal-equalisation/report

For example, if coal prices are A$302/t, a very high price by historical standards, the 40 per cent tier will only apply to the $2 portion. In reality, at a price of A$302/t, Queensland's effective rate is only 16.66 per cent.

Therefore, any setting of price bands should be based on consideration of *effective* rates.

Based on analysis undertaken by Queensland Treasury of the effective rates applicable under Queensland's progressive rate tiers, an alternative set of price bands are proposed, which better align with effective tax rates.

- Up to $200
- Over $200

These price bands would be more closely aligned with the differences between the effective rates in Queensland and New South Wales, particularly considering the legislated increase in New South Wales' fixed-rate royalty. As the conceptual case for this proposed change is partly based around a divergence in revenue capacities between states, a price band structure based around differences between states' effective rates rather than legislated rates makes more conceptual sense.

New South Wales' legislated increase of coal royalties from 1 July 2024 will increase New South Wales' royalty by 2.6 per cent, up to 10.80 per cent for open cut mined coal. A flat royalty applies to all coal produced, regardless of price of coal. This will mean that the effective royalty rate in New South Wales will be higher than the effective royalty rate in Queensland up to a value of approximately $200.

As such, the lower proposed tier would assess coal revenue where Queensland's effective royalty rate is lower than New South Wales and the higher royalty rate will assess where Queensland's effective royalty rate is higher than New South Wales.

Given the Commission's proposal is partly based around a divergence in revenue capacities between states, which reflects differences in royalty policies, Queensland proposes that any assessment using tiers have only two categories, aligned with the two price ranges in which one state has a higher effective royalty rate than the other. This assessment would still not be policy neutral and would still unfairly redistribute GST, however, is preferable to the Commission's proposed price ranges.

If the Commission decides that two prices ranges is insufficient and does not adequately assess policy differences, the following price ranges could be considered:

- Up to $200
- $200-$400
- Over $400

Again, a $200 to $400 price range better recognises how Queensland's progressive coal royalties work compared to the proposed $100 to $300 price range based on headline rates.

Furthermore, analysis undertaken by Queensland Treasury also indicates that, if the proposed price ranges outlined in the Commission's paper were introduced, this would effectively create an APC assessment of coal revenues.

In specific years when prices are high, Queensland will be dominant in the proposed $300 and over price range while New South Wales will be dominant in the $100 to $300 price range, thereby creating an effective APC assessment for the vast majority of coal revenue in Australia.

As such, the proposed price ranges would simply become an assessment of these two states' policies rather than their fiscal capacity.

Based on Queensland Treasury estimates, the alternative broader price bands proposed by Queensland above would help partially address this issue, by ensuring that **there is a substantial amount of Queensland and New South Wales coal revenue and tax base captured within the broader price bands of up to $200 and over $200.**

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

Queensland strongly opposes any assessment based on types of coal, consistent with our position on this issue clearly outlined in detail in Queensland's 2024 Update Supplementary New Issues submission.

Additionally, the Commission indicating that they could potentially disaggregate estimates of metallurgical and non-metallurgical coal royalties using publicly available data from the Department of Industry, Science and Resources raises major concerns given the inadequacy of the data approach and the lack of data related to royalty returns.

As per the previous submission from Queensland as part of the 2024 Update, this approach is not feasible or appropriate for a range of reasons, including:

- Inconsistency with the Commission's mineral-by-mineral approach and previous decisions made in relation to separate assessments of minerals.
- Inconsistency with the fundamentals of geology and nature of coal mining, production and use – coal is a combustible sedimentary rock mainly composed of carbon, and there is no clear distinction between what is classified as metallurgical coal and what is classified as thermal coal.
- Inconsistency with the 'what states do' principle – the majority of states do not levy royalties by coal type. In NSW and Queensland in particular (where value of production makes up the vast majority of the national total), coal royalty rates apply to both thermal and metallurgical coal.
- Policy neutrality and contamination – as with the price range distribution approach, separately assessing metallurgical and non-metallurgical coal creates an effective APC assessment for both, with Queensland dominant in metallurgical coal and New South Wales dominant in non-metallurgical coal. This will result in these states' policies driving the entire assessment.
- Detrimental impact on policies in the national interest – this would disincentivise states from changing revenue policies in the mining assessment, even if they are in the national interest. It would also undermine states' capacity to independently make mining policy decisions.

As was discussed at length in the 2024 Update Supplementary New Issues submission, there are substantial data limitations which make any disaggregation approach inconsistent with key HFE principles, in particular the principles of practicality and fitness for purpose. This is for a variety of reasons, including:

- Coal royalties are not calculated separately for metallurgical and thermal coal and the type of coal (metallurgical or thermal) is not relevant for the calculation of coal royalty. As such, there is no data collected on the type, quality, or rank of coal on which a royalty is being paid. Furthermore, in a return period, a producer may be liable for both private and state royalty. Private coal royalty is also not separated in any way by coal type in royalty returns.

- The gross value of coal includes a mix of different qualities and types of coal. The royalty rate is determined by the average price per tonne and is based on a mix of different qualities, types, or ranks of coal. The calculation of the average price per tonne also includes variable input prices (e.g. freight and insurance costs), the value and volume of coal disposed of or used, and deductions such as port operating costs and non-refundable capital contributions for the building of port infrastructure, which further prevent any estimation of the volume of production or value of royalties from metallurgical and non-metallurgical coal.
- Even if coal could be disaggregated by type (which, as discussed above, it cannot), the ultimate use of various types of coal can vary over time depending on changes in demand for various types of coal.
- For example, in 2022, when thermal coal prices reached record highs, producers of lower quality 'metallurgical coal' switched their product into 'thermal coal' markets to benefit from the higher prices, given this type of coal is substitutable for lower quality coal for the purpose of power generation. As such, there is no clear distinction between metallurgical and non-metallurgical coal, preventing any accurate or reliable estimate of coal disaggregation.

As the Commission was informed in the 2024 Update Supplementary New Issues submission, Queensland cannot provide or estimate the value of production or royalty revenue for metallurgical or non-metallurgical coal in the state.

Queensland has severe concerns about the Commission's suggestion of using publicly available data from the Department of Industry, Science and Resources to estimate this split.

While the consultation paper lacks sufficient detail to understand how this split could be achieved and the reliability of this data source, given the issues presented above, Queensland contends that it is almost certain that this data would be highly unreliable and not fit for purpose in any GST assessment, let alone one which results in such significant movements in GST.

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