SUBMISSION TO THE NATIONAL COMMISSION OF AUDIT

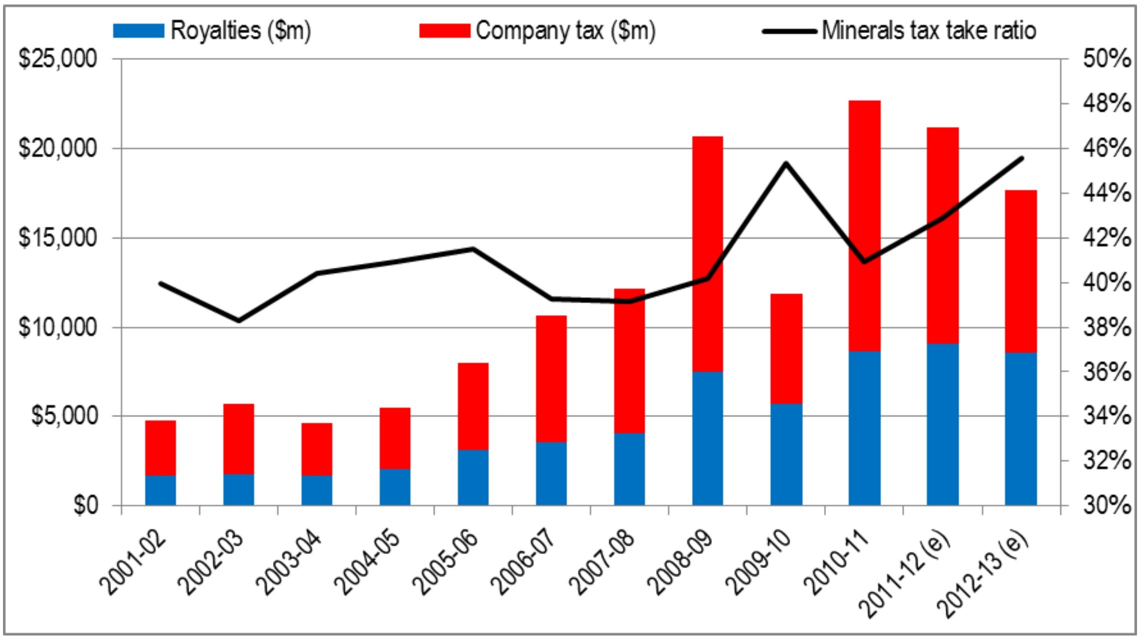
The Minerals Council of Australia (MCA) is the peak industry body of Australia's exploration, mining and minerals processing industry. It represents the minerals industry, both nationally and internationally, in advancing its contribution to sustainable development and to society. MCA member companies account for more than 85 per cent of Australia's annual mineral production and 90 per cent of mineral export earnings.

Australia's minerals industry is a major contributor to national income, investment, high-wage jobs, exports and government revenues in Australia. It operates in a global industry where competition for markets is intense, where investment opportunities abound in other resource-rich economies and where capital, people and technology are highly mobile.

In recent years, the minerals industry has accounted directly for up to 8 per cent of GDP (significantly more when account is taken of related activity), upwards of 20 per cent of business investment and around 50 per cent of national exports. Mineral commodities make up five of Australia's top 10 export earners.

The industry has paid more than $145 billion in Federal company income tax and State royalties since 2001-02, before additional taxes like the carbon tax and the Minerals Resource Rent Tax (MRRT). Deloitte Access Economics estimates the industry's tax ratio has averaged 42.3 per cent between 2007-08 and 2012-13, up from 40.1 per cent over the previous six years. Mining is consistently among the highest taxed industries in Australia according to Australian Taxation Office data, with a net company tax rate well above the average of all industries.

Figure 1: Minerals industry tax take – before MRRT and carbon tax



Source: Deloitte Access Economics estimates: Tax ratio = royalties and company tax / taxable income before deducting royalties

The minerals industry is working to ensure significant and measurable benefits accrue from minerals resource development in Australia in line with community expectations.

- The Bureau of Resources and Energy Economics has found that average weekly household incomes in Australian climbed by almost 40 per cent over the period described as the Millennium Mining Boom (2002-03 to 2011-12).
- Research by KPMG has shown that across nine mining regions the industry has helped to boost incomes, attract families and reduce unemployment at a faster rate than for non-mining regions.
- Based on a survey of 25 Australian mining companies, consultants Banarra conclude that the minerals industry spent an estimated $34.7 billion on community infrastructure projects, local suppliers and other community-related activities in 2011-12.

The imperative for reform

After a remarkable decade of growth, the global minerals industry is in a more constrained and demanding phase—the so called mining boom has shifted, and arguably more acutely than expected, to a new phase of supply competitiveness, far more so than any material easing in demand for minerals and energy.

The super cycle of growth has well and truly transcended the traditional boom bust commodity cycles to a "new normal", with inherent cyclical volatility around the longer term growth trajectory, as markets invariably correct as they overshoot either side of the demand and supply axis.

But there is more substance in the underlying fundamentals of this global and industry structural adjustment than there is risk in the cyclical volatility.

To suggest the so called mining boom is over is to misread the current rather sudden cyclical downside volatility as changes to the underlying fundamentals of mining's long term growth trajectory, and to misjudge the significant prospective gains from future investment and export growth that is heavily dependent upon addressing the critical and urgent policy challenges confronting Australia.

In this changing global competitive dynamic, Australia is increasingly found wanting, more vulnerable to competition for human and capital resources and market share, especially from the resource rich emerging economies.

We've been complacently "dining out" on our natural endowment, our traditional low cost competitive strength, and an unprecedented growth in investment, and the increase in national prosperity from the strongest terms of trade in 150 years.

This complacency born of a false sense of security aided and abetted by the politics of envy and class warfare has spawned:

- an unashamedly regressive shift in economic policy towards the redistributive than the productive side of the economy, and
- an emerging protectionist sentiment notably in workplace arrangements, excessive and soft regulation, new taxes without tangible dividend, industries assistance, and an antipathy to foreign investment, skills and enterprise.

In effectively denying the virtues of the preceding decades of open market reforms, the Australian economy is in structural deficit in just about every key economic indicator:

- The Commonwealth Budget will be in structural deficit for at least the next decade.
- Gross external debt is burgeoning driven by run of current account deficits and budget deficits.
- The exchange rate is unnecessarily high, supported, inter alia, by poor fiscal and external debt fundamentals.
- There is an unsustainably high resilient cost structure reflecting underlying structural cost escalators in energy, labour, construction and material inputs and transport.
- Operating costs have all but doubled since 2006. Worse still our rate of increase is nearly twice that of the globe in coal and base metals and more than twice for iron ore.
- Increased labour costs are more of a function of capacity to pay than productivity offsets.
- Australian operations have been pushed into the higher end of the global cost curve, even before factoring in declining ore grades.
- Capital intensity is at unprecedented and uncompetitive levels - that is, the capital costs per unit of output.
- Australia's productivity performance – labour and multi-factor – is declining. Multi-factor productivity (labour and capital) has dropped by more than a third over the decade of the boom – falling at an average annual rate of 4.5 per cent - even when adjusted for the capital lag effect and resource depletion, our performance is poor compared to like-jurisdictions such as Canada.
- There is entrenched depressed business confidence. Business confidence is usually highly elastic and Australia's sovereign risk standing has deteriorated markedly. We are increasingly regarded as an unreliable place to do business. As determined by the complex of natural endowment and public policy factors our standing is slipping relative to other resource rich jurisdictions.
- Enduring capacity constraints in social and physical infrastructure remain structural impediments in some circumstances and will recur when demand exceeds the supply curve as it inevitably will. These constraints include project approvals; export corridors; energy and water; skilled labour; and remote social infrastructure.

While much of the capacity for change is within the control of companies in recovering their competitive position by reducing costs and improving productivity, if they are swimming against the tide of poor public policy this becomes a deadweight to their efforts and ultimately fatal.

Governments must provide the right policy framework for companies' confidence to invest, to be competitive and to grow. To remedy this will similarly require structural change. Australia must recharge the batteries of market oriented economic reforms, releasing the brakes to economic growth, social progressiveness and environmental stewardship. Key among them is restoring long term fiscal sustainability. [1]

The case for fiscal reform is strong.

The MCA supports the National Commission of Audit's mandate to conduct a "thorough review of the scope, efficiency and functions of the Commonwealth Government" with a view to achieving efficiency and productivity improvements across all areas of Commonwealth expenditure. In Pre-Budget submissions over many years, the

[1] A more detailed outline of the economic, social and environmental performance of Australia's minerals industry, as well as the industry's policy priorities, are provided in the MCA's Policy Brief to the 44th Commonwealth Parliament – attached to this submission

MCA has advocated a comprehensive review of Commonwealth expenditure, while noting that more permanent reforms are likely to be needed for long-term fiscal sustainability.

Over the last decade, mining-led growth in Commonwealth revenues arising from a period of sustained high terms of trade led to a significant weakening in budget discipline. Economic modelling firm Macroeconomics estimates commodity boom windfall revenues contributed around $160 billion to the Commonwealth Budget bottom-line between 2003-04 and 2011-12.

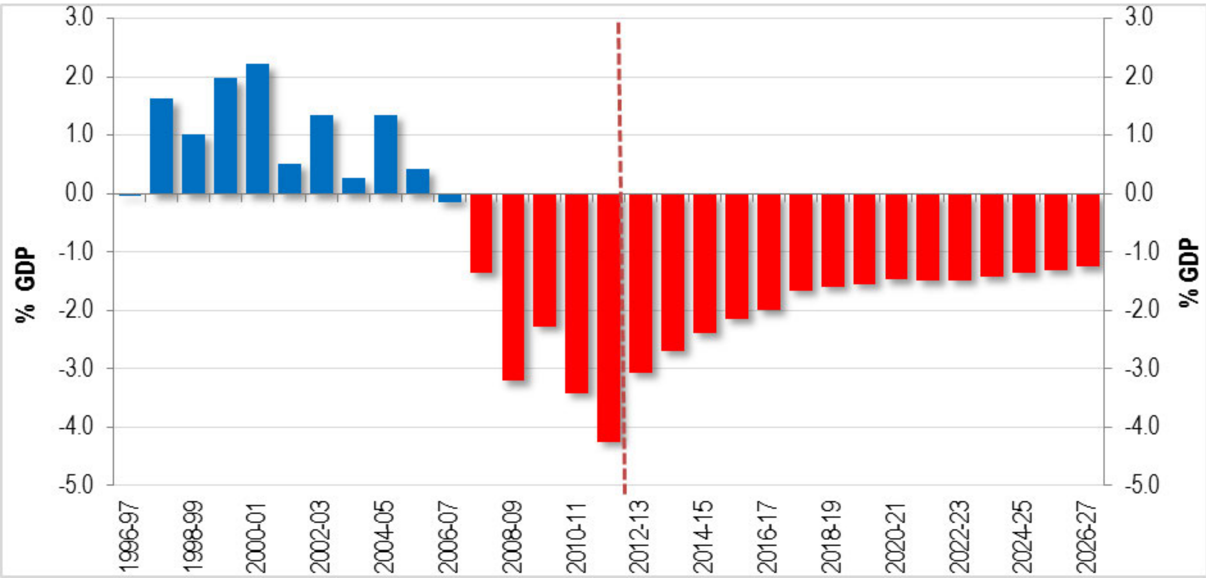
These windfall gains were used to support higher spending and to fund successive rounds of personal income tax cuts. Further deterioration in Australia's fiscal settings resulted from the Global Financial Crisis, the legacy of which is a higher Commonwealth spending base. The sharp drop in mineral commodity prices in the last two years has exposed further the structural weakness in the Commonwealth budgetary position.

Notwithstanding current below-trend growth in the economy, long-term budget repair is essential given the Commonwealth's structural budget deficit and looming fiscal pressures. There has been a significant deterioration in the Commonwealth's structural budget balance since the mid-2000s.

Analysis for the MCA by Macroeconomics finds that despite some improvement over the forward estimates period, the Commonwealth is projected to be in structural deficit by more than $30 billion (2 per cent of GDP) in 2016-17. On this analysis even if Australian Governments manage to restrain spending for around a decade, there will still be a structural deficit of 1.2 per cent of GDP in 2026-27.

To strengthen the Australian Government's medium-term fiscal policy framework, the MCA recommends the Australian Government report a measure of the structural budget balance in Budget documents to provide both policy makers and the public with a realistic assessment of the underlying position of the Budget.

Figure 2: Structural Budget balance projections



Source: Macroeconomics

The means by which fiscal repair is achieved has a major bearing on growth, investment and job creation.

The sustainability of fiscal settings and the efficiency of individual budget measures help to support consumer and investor confidence, to ensure governments do their job cost-effectively and, ultimately, to assist rising living standards. The MCA recommends that the long-term focus of efforts to close the fiscal sustainability gap should be on spending restraint, not higher taxes.

Growth in Commonwealth spending as a share of GDP has outstripped economic growth in Australia over the past 50 years. As a result, Commonwealth spending as a share of GDP has risen from 17.5 per cent in the 1960s to 25.5 per cent in the 2000s, while the tax burden has risen from 19.1 per cent of GDP to 24.9 per cent of GDP. Since 1990-91, trend real spending growth has exceeded 4 per cent per annum, accelerating in the 2000s funded by windfall tax revenues generated by the Millennium Mining Boom.

The reality is that each period of significant budget repair in the last four decades has culminated in a higher share of tax receipts to GDP. The challenge going forward is ensure greater emphasis is given to tight control on government spending as the dominant vehicle for achieving long-term fiscal sustainability as higher taxes impair investment decisions, acting as a barrier to growth.

In this context, the practice in recent years of portraying expenditure cuts and revenue increases both as "savings" obscures the critical fact that the means of by which fiscal sustainability is pursued has a major bearing on incentives for growth, investment and job creation.

Sound fiscal policy has both macroeconomic and microeconomic dimensions. It should be guided by a medium-term framework that supports sustained economic growth with low inflation. It should also promote higher productivity by fostering a stable investment climate with competitive taxation arrangements while providing appropriate market signals to ensure factors of production (labour, capital, technology etc.) flow to where they are most highly valued.

Without long-term budget reform, Australia remains exposed to another global financial shock at the same time as poor quality spending undermines national productivity and living standards. The MCA therefore supports the strong focus of the National Audit Commission on improving the quality of Commonwealth expenditure. This should not be a one-off exercise in finding savings. It should be the starting point for development of a roadmap for fiscal sustainability and lead to lasting reforms to Australia's fiscal strategy and institutions.

Pro-growth reforms to Commonwealth expenditure are both necessary and achievable.

A research for the MCA by Dr Stephen Anthony of Macroeconomics – *A roadmap for fiscal sustainability* – has outlined the in detail why a review of the Commonwealth's spending base is long overdue and a number of "pro-growth" reforms as part of a wider productivity agenda. A central theme of this work is that:

> *… effective fiscal rules can guide budget behaviours around a sustainable benchmark, provided that benchmark is properly specified and clearly identified. The combination of transparency and high-quality information can assist political acceptance of the need for budget discipline, without removing necessary fiscal flexibility.*

Undertaking a full-scale sustainability review of all Commonwealth spending programs using performance benchmarks is a logical first step. All existing spending programs should be evaluated employing a "zero base" approach – in other words, assess the merits of all programs from the first dollar, no matter how long they have been in place. Benchmarks should assess the efficiency and effectiveness of programs, with the Department of Finance given a mandate to conduct cost-benefit analysis on all new policy proposals above a certain threshold.

An important transparency reform would be for the Australian Government to introduce a new Budget Paper (Budget Paper No. 6) to report estimates and actual outcomes for all government spending by portfolio. This document would provide additional discipline by ensuring meaningful programs linked to the budget appropriations framework are in place, with performance measures based on value for money criteria.

The thrust of these and other reforms is to identify effective performance benchmarks and to employ transparent, high-quality public reporting frameworks. A copy of Dr Anthony's Monograph is included as part of this MCA submission.

Minerals Council of Australia
26 November 2013