26 July 2012

The Secretary
GST Distribution Review
The Treasury
Langton Crescent
PARKES ACT 2600

e-mail: gstdistributionreview@treasury.gov.au

Dear Sir/Madam

Submission to Review of GST Distribution

The Chamber of Minerals and Energy of Western Australia (CME) welcomes the Australian Government's 'Review of GST Distribution' (the Review). CME applauds the thorough consultation process to date, including the July 2011 and December 2011 Issues Papers, and the Panel's resulting March 2012 Interim Report and June 2012 Second Interim Report.

This is CME's submission to the Interim Report and Second Interim Report.

CME and the Western Australian resources industry

CME is the peak resources sector representative body in Western Australia funded by its member companies who generate more than 95% of all mineral and energy production and employ 80% of the resource sector workforce in the State.

The Western Australian resources sector is diverse and complex covering exploration, processing, downstream value adding and refining of over 50 different types of mineral and energy resources.

In 2011, the value of Western Australia's mineral and petroleum production reached $107 billion, accounting for 92% of Western Australia's total merchandise exports and thus representing the majority of Western Australia's 46% contribution to Australian merchandise exports. Furthermore, royalty payments to the State Government totalled $4.9 billion in 2011.

The prospects for future growth are strong, with $1.82 billion invested in minerals exploration in Western Australia in 2011, accounting for 51% of total national investment. This exploration is translating into significant further development, with the value of resource projects either committed or under construction at $166 billion.

Tax Reform and the Review of GST Distribution

Tax reform is an essential function of government, and CME has consistently supported genuine reform of the Australian taxation system and continues to do so to provide for an efficient and effective tax regime.

While CME recognises the GST distribution can be used as a lever to influence tax reform, any reform process must take into account all mechanisms available and include a thorough consultation process with States and industry to achieve the most efficient outcome. CME does not consider appropriate the use of GST distribution as a blunt instrument to enforce tax reform in its own right.

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CME is supportive of a more equitable distribution of GST to recognise, reward, and support State based productivity, protect Australia's international competitiveness, and promote economic stability. The Review comes at an opportune time to help ensure Western Australia has the ongoing financial capacity to maintain the State's economic growth, driven by the resources sector, through timely and adequate investment in significant infrastructure.

In relation to resource taxation measures, CME maintains a strong preference for retention of the current State based royalty regime, administered by the State Government and with revenues flowing to the State. The State has prime responsibility for resource project approvals and the provision of non-privately owned infrastructure. As such, it is imperative the Western Australian Government maintains and receives a dividend for WA resources.

CME does not support GST distribution mechanisms that may discourage the Western Australian Government from independently and efficiently managing their royalty regimes for fear of a reduced GST distribution share, including as a consequence of the interaction between State royalties and the Australian Government's Minerals Resource Rent Tax (MRRT).

For example, it is important the Western Australian Government maintains a suite of policy instruments to effectively manage its economy, Royalties can be adjusted to attract investment or to increase state revenue, to fund services and infrastructure. However, under current the current interaction between State royalties and Federal taxes, this policy is blunted for the key commodities of iron ore and coal.

CME encourages the Australian Government to engage with the Western Australian Government to seek an agreeable outcome to this issue, in the wider context of genuine and consultative State and Commonwealth taxation reform.

Key Concerns with the Current GST Distribution
CME draws the Panel's attention to the following shortcomings of the current GST Distribution.

<u>1. Adequate funds required to fund WA Government investment in infrastructure and project approvals</u>

The policy of horizontal fiscal equalisation, as it is currently practised, does not recognise or support the needs and obligations of the Western Australian State Government to deliver key infrastructure and services and avoid capacity constraints.

The Western Australian Government incurs substantial fiscal costs to develop the State's natural resources which enhance economic growth, for example:

- pro-development economic, legal and regulatory framework, encompassing industrial relations, property rights and environmental management;
- facilitation of land access, development agreements and timely delivery of necessary economic and social infrastructure; and
- provision of research and information dissemination services (e.g. geological surveys).

The majority (around 70%) of the mining royalties raised in Western Australia that could be invested in services and infrastructure to help Western Australia attract labour and private sector capital are instead redistributed to other States.

CME recognises the need to understand the types and cost quantum of large infrastructure projects to support economic growth, and the nexus between government and private funding. CME's State Growth Outlook Study, first undertaken in 2009 and 2011 and currently being updated for release in quarter four of 2012, provides an integrated view of the State's growth profile in people, energy, and water. The 2012 study will also focus on the key growth enablers of air transport and associated aviation infrastructure, and ports.

CME is confident the 2012 study's results will provide an up-to-date picture of forecast resource projects, and the key economic and social infrastructure required to enable them. CME will be pleased to provide a copy of the report to the Panel and the Treasurer later this year.

Ahead of CME's State Growth Outlook Study 2012, CME draws the Panel's attention to the following key Western Australian infrastructure requirements:

Oakajee Port and Rail

Significant resource sector investment is occurring in the Mid West region of WA, in particular as part of the emerging magnetite iron ore sector.

Iron ore is a high bulk relatively low value (per tonne) product requiring substantial infrastructure to move the product from mine site to port. Considering capacity at Geraldton Port is limited, a new deepwater port at Oakajee, capable of handling Cape Size ships, is therefore fundamental to the development of the Mid West's emerging iron ore industry.

It is vital the Western Australian Government has the funds to finance its share of the total Oakajee infrastructure project in a timely fashion.

Esperance Port and Common User Facilities

Esperance Port will be a critical element of the supply chain for the emerging iron ore sector in the Yilgarn area, while at the same time meeting the needs of established nickel and other industries – many of which have expansion plans. CME welcomes the State and Australian Government's investment in the Esperance Port Access Corridor Project, but further investment in the port capacity and operations is needed if the region's development potential is to be reached.

This will require strategic government investment, a clear framework for facilitating private investment, and surety that the Western Australian Government has funds to contribute.

Perth Airport

In 2011, the resource sector's workforce in Western Australia was estimated to be 101,000 with approximately 50% employed on fly-in fly-out (FIFO) rosters. This number will increase as new projects commission and existing activities expand. By 2020, the Western Australian resource sector will employ approximately 127,000 people, with over 50% employed on FIFO arrangements.

The resources sectors' paramount concern is safety, therefore fatigue management policies require that shift changeovers for operational workers occur at 6am and 6pm. This drives demand for workers to fly into and out of Perth at times coinciding with peak periods (approximately 5.30am to 7.30am and 4:00pm – 6:00pm on week days) of aircraft movements at Perth Airport.

Consequently, a safe and efficient aviation sector and road network linkages to Perth Airport with appropriate airport infrastructure is a key enabler to support resource sector and wider economic growth. Perth Airport is a central hub for FIFO activity and it is critical that the associated infrastructure can accommodate this growth, particularly around peak periods.

CME encourages the State and Australian governments to expedite the Gateway WA project as a high priority to improve access to and around Perth Airport. Further, significant congestion is being experienced at Perth Airport in the terminals and on the runway, aprons, and in the airspace. Accordingly, Perth Airport Corporation's re-development plans must continue to progress and initiatives to improve air space management must be fast tracked.

However, the incremental improvement initiatives above may not deliver the capacity to adequately manage the peak periods into the future. The potential need for a third runway to support peak periods is emerging as a key infrastructure consideration to enable the forecast ongoing increase in peak period aircraft movements.

2. Overly penalises economic performance

CME believes fiscal policy should reward productivity and economic growth. Under the current policy of horizontal fiscal equalisation, this is not the case.

Specifically, by increasing royalty rates, Western Australia could lose more in GST grants than it gains in royalty revenue. Conversely, by reducing certain royalty rates, it could gain more in GST than it loses in royalty revenue – but to the detriment of all other States.

More generally, around 90% of royalties from an increase in the value of mining production in Western Australia is redistributed to other States. Western Australia is in essence being penalised for economic growth through a reduction in GST grants.

In recent decades, Western Australia has been a net donor of resources to the Commonwealth budget, at the expense of timely and strategic investment in infrastructure and services, including roads, ports, energy, water, and town development to support the State's considerable economic growth now and into the future. More recently it has also been a net donor of GST to other States.

Returns from resource projects, secured through the State fully underwriting project cost and risk, are being redistributed to other States through both mechanisms. An example of this is the cost to the Western Australian Government of enabling the establishment of the North West Shelf gas project.

Currently, there is considerable Government investment required in the Mid West region of Western Australia to enable the development of valuable, albeit infrastructure, energy, and water intensive, magnetite iron ore projects. Up-front Government investment in common user infrastructure such as energy networks and common user port facilities, i.e. the Mid West Energy Project and Oakajee respectively, is urgently required.

With such heavy investment, the Western Australian Government faces an opportunity cost in the short term whilst a critical mass of users is achieved, and the longer term risk that the asset will never be fully utilised and costs fully recovered.

3. Barrier to structural adjustment and labour mobility

The current fiscal equalisation policy is inhibiting the free flow of labour and capital across regions and industries to where they will be most productive.

By delivering equitable Government service delivery in every State, regardless of local economy and workforce participation, the policy of horizontal fiscal equalisation provides no incentive for people to move to areas of economic growth. This is a key concern for Western Australia's resource sector which is facing significant shortages of skilled labour that could potentially be eased via skilled domestic migration. For example, CME's State Growth Outlook Study forecasts the workforce required for growth plans in the resources sector is expected to reach a peak of almost 119,500 persons in 2012 – some 43,800 (58%) above the 2009 sector workforce of approximately 75,600.

4. Complexity, bias and lack of transparency

The current process is complex, considering over 110 measures, which can detract from transparency. The outcomes of the fiscal equalisation process can also be biased to what can be more readily quantified. Assessments of States' relative 'needs' considered to be of lesser reliability are often discounted – despite the fact that the assessments are just as likely to under-estimate as to over-estimate needs. Other areas of differential needs are not assessed at all, including infrastructure to support future economic growth.

Recommendations
CME submits the following recommendations for the Panel's consideration:

- Transition to an equal per capita (EPC) share of GST distribution, with the Commonwealth Government directly funding any subsidies to smaller States (including from the fiscal dividend it will reap from reform of the GST distribution), in a way that appropriately balances equity and efficiency considerations. This will place Western Australia in a stronger position to support national economic growth and help address concerns 1, 2, and 3 above.

- Consideration in the short term of discounting mining revenue assessments to enable and incentivise States to develop, properly price and efficiently use the benefits of their resources. As per the previous recommendation, this will place Western Australia in a stronger position to invest in projects and initiatives to support resource sector growth and help address concerns 1 and 2 above.

- Limit annual falls in States' GST 'relativities' or grants. This will help address concerns 1, 2, and 3 above, as well as increasing stability in State budgets.

- States to be able to agree among themselves on a GST distribution outcome, i.e. on how their aggregate share of the GST pool is allocated (while not affecting outcomes for non-participant States). This will help address all concerns above by potentially leading to a more effective GST distribution that is responsive to changing circumstances.

- The need for simplified methods based on broader indicators of underlying differences in States' relative needs. This will help address concern 4 above.

Conclusion
CME looks forwards to the Panel's final report to the Treasurer in approximately October 2012. CME hopes to remain involved in helping the Panel form its recommendations. If you would like to explore CME's views further, please contact James Edwards, Manager – Economics and Taxation, j.edwards@cmewa.com or (08) 9220 8534.

Yours Sincerely

Reg Howard-Smith
Chief Executive