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Commissioners

Australian Government
Productivity Commission

Dear Sir/Madam,

Productivity Commission Inquiry into Horizontal Fiscal Equalisation

Rio Tinto welcomes the opportunity to make this submission to the Productivity Commission's inquiry into Australia's system of horizontal fiscal equalisation (HFE) which underpins the distribution of GST revenues by the Commonwealth to states and territories.

Rio Tinto in Australia

Rio Tinto is a leading global mining and metals group that focuses on finding, mining, processing and marketing the earth's mineral resources. We have been in business for more than 140 years and remain focused on the long term.

Our Australian mining operations are located in Western Australia (iron ore, diamonds and solar salt), Queensland (coal and bauxite), the Northern Territory (uranium and bauxite) and NSW (coal). We also operate alumina refineries in Queensland and the Northern Territory (currently curtailed) and aluminium smelters in Queensland, NSW and Tasmania. Australia is home to around half of Rio Tinto's global assets. We directly employ more than 20,000 people across Australia. We are one of the largest private sector employers of Indigenous Australians, who make up around 8 per cent of our Australian workforce.

Rio Tinto is the second largest producer of iron ore in the world, with most of our production in Western Australia. In the Pilbara, Rio Tinto operates the world's largest integrated portfolio of iron ore assets. This system comprises 15 mines, four independent port terminals, more than 1700km of the largest privately-owned heavy freight railway in Australia, and supporting infrastructure, all linked by our Operations Centre in Perth.

Rio Tinto contributes considerably to the Australian economy each year, through employment, supplier contracts, investment, taxes and royalties and dividend payments to investors. In 2016 alone, Rio Tinto contributed A$21 billion to the Australian economy, including A$11.3 billion spent with Australian businesses and A$5.9 billion paid in salaries and wages.

Since 2000, we have invested close to A$40 billion in Australia through capital expenditure and acquisitions. Between 2009 and 2016, we have invested A$28 billion in our Pilbara mines and infrastructure growth, increasing production by more than 50 per cent and expanding port operations to 360 million tonne capacity.

Rio Tinto is one of Australia's largest corporate taxpayers. Over the five years from 2012 to 2016, Rio Tinto paid A$28 billion in taxes and royalties in Australia. Our iron ore business paid approximately A$15 billion in state royalties to the Government of Western Australia over the past decade, with a further community investment contribution in excess of A$323 million.

Raising Australia's prosperity

Rio Tinto is supportive of policies that promote Australia's long-term economic growth potential and benefit all Australians. This inquiry represents an opportunity to raise Australia's future prosperity by better aligning the HFE system to support productivity, efficiency and economic growth across all jurisdictions. Ultimately, all Australians benefit from a strong, growth-oriented economy that delivers higher productivity, higher living standards and, in turn, revenue to governments sufficient to meet necessary public services.

Rio Tinto recognises that Australian jurisdictions differ in their revenue raising capabilities and funding obligations, and that there is a need for a system of fiscal equalisation that enables all jurisdictions to provide a comparable standard of services to its people. However, there is strong evidence that the current HFE GST distribution mechanism lacks a sound policy rationale that would safeguard the fairness objectives of fiscal equalisation, while ensuring that Australian jurisdictions face appropriate incentives to promote economic development, not least in relation to energy and resource development.

Perverse incentives

A necessary foundation for an efficient, equitable and sustainable HFE mechanism is a clear definition of the objectives and intended outcomes of the regime, taking account of the need to balance equity considerations, incentives for states to develop their economies and stability in state public finances. Under the current framework, the Commonwealth Grant Commission (CGC) would appear to have given undue weight to redistributing jurisdictions' GST revenues, and less priority to ensuring jurisdictions are incentivised to make the most of their capabilities, including natural resource endowments. As a consequence, jurisdictions that have adopted growth-enhancing policies supportive of resource development are effectively penalised, while jurisdictions that have restricted such activities are rewarded.

There is ample evidence that the growth in Australia's natural resources sector has conferred significant benefits on all Australians, and that it will continue to do so given the right policy settings. Research prepared by Deloitte Access Economics for the Minerals Council of Australia and released in March 2017 estimates the total contribution of the broad mining sector (including mining services and technology) at around 15 per cent of the Australian economy in 2015-16. The sector supports more than 1.14 million, or one in 10 full-time positions, jobs across the country.[1] A GST distribution mechanism which discourages policy initiatives that build on Australia's strong comparative advantage in mineral resources is therefore not in the longer term interests of Australians.

Recent outcomes of GST distributions have tended to reinforce the view that jurisdictions are penalised for embracing policies that support economic development. In the 15 year period from 2003 to 2017, the GST distribution transferred $50 billion between states as a result of the mining assessment. Around $41 billion of this revenue was sourced from Western Australia due to the expansion of mining activity in that state.

In 2016-17, Western Australia will receive $1.9 billion in GST funding, down from $2.5 billion in 2001-02. Every other state and territory GST allocation has more than doubled over this period. Between 2001-02 and 2016-17, Western Australia's share of the total

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[1] Deloitte Access Economics, 2017. Mining and METS: engines of economic growth and prosperity for Australians, Report prepared for the Minerals Council of Australia.

GST revenue pool has fallen from 9.5 per cent in 2001-02 to 3.3 per cent in 2016-17. Over the same period, Western Australia's population has increased by 36 per cent.

One of the main drivers of GST distribution is the mining revenue assessment which will distribute around $6 billion in 2016-17. While all states and territories in Australia continue to reap the economic benefits of mining, there are very material differences in the policies of different jurisdictions when it comes to developing their natural resources.

Western Australia has adopted policies that are supportive of resource developments, as evidenced in its high ranking (9 out of 104) in the Fraser Institute's Annual Survey of Mining Companies (Table 1). Other Australian jurisdictions are ranked significantly lower than Western Australia, and all but one have slipped in the global rankings.

Table 1. Policy Perception Index – Mining

	Global ranking				
	2012	**2013**	**2014**	**2015**	**2016**
New South Wales	27/96	37/112	41/122	51/109	66/104
Northern Territory	17/96	20/112	23/122	21/109	22/104
Queensland	32/96	28/112	33/122	32/109	36/104
South Australia	19/96	15/112	17/122	20/109	21/104
Tasmania	51/96	34/112	49/122	34/109	32/104
Victoria	33/96	31/112	37/122	43/109	42/104
Western Australia	16/96	8/112	12/122	8/109	9/104

Source: Fraser Institute, Annual Survey of Mining Companies 2016, https://www.fraserinstitute.org/studies/annual-survey-of-mining-companies-2016

An alternative approach

An HFE GST distribution mechanism that places undue emphasis on redistribution without also encouraging economic development does not serve Australia's longer term interest. Rio Tinto therefore supports reforms that serve to change the balance of incentives towards a framework that recognises and incentivises jurisdictions that adopt growth-oriented policies for future development.

Rio Tinto supports the recommendation of the Minerals Council of Australia that the Productivity Commission consider the approach adopted in Canada of discounting assessed mining revenues in the GST distribution calculations. Discounting assessed mining revenues is consistent with the CGC's current approach to aspects of its calculations, and would mitigate some of the adverse incentives that currently exist. Such a reform could be supported by 'safety net' provisions to limit short-term financial impacts on individual jurisdictions through an appropriate transition period.

If you would like to follow up on any matters raised in this submission, please contact John Kunkel, Chief Adviser Government Relations (Australia)

Yours sincerely,

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