



AUSTRALIAN STEEL INSTITUTE

Tax incentives to increase Australian content in major resource projects.



Submission to the Federal Government Tax Summit

by Australian Steel Institute (ASI)

(supported by National Institute of Economic and Industry Research (NIEIR))

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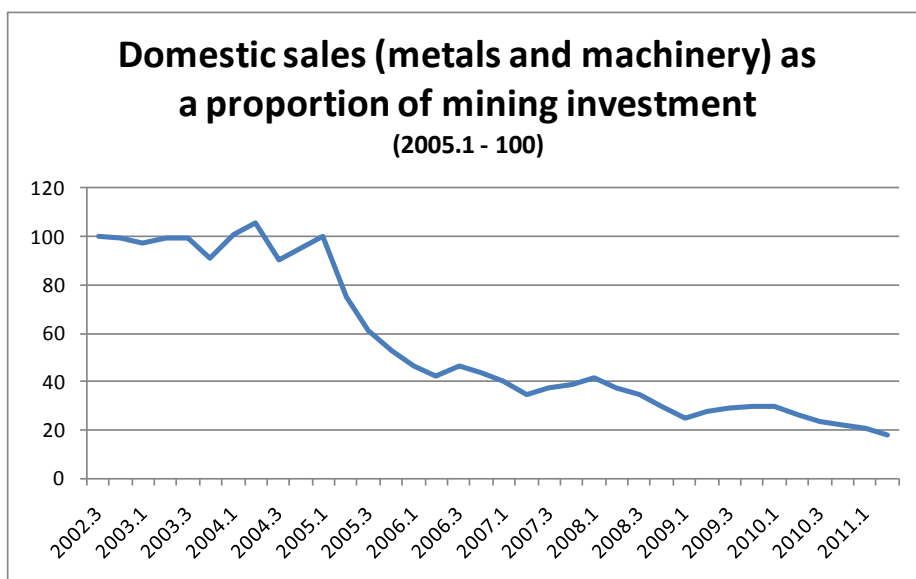
1 Summary

ASI is proposing the Tax Forum consider proposals for tax incentives for proponents of major resource construction projects to increase Australian participation. This would be confined to 'Contestable' Australian content in major projects. The approach would be to offer increased tax concessions and/or resource rent tax (RRT) discounts. This approach is intended to be cost neutral to project proponents and the Australian Government. A tax advantage in the form of accelerated tax depreciation on major project assets for greater use of 'contestable' Australian Content should also be considered. Although the provision of tax concessions may have a revenue cost to the Commonwealth budget, this cost would be more than compensated through the taxes generated by increased levels of economic activity and the benefits of increased employment, retained skills and incomes.

2 Background

In the introduction to the Tax Forum Discussion Paper, *Tax Reform Next Steps for Australia*, the Commonwealth acknowledges the significant disruption being caused by a very tightly confined boom in construction activity associated with an expansion of resource exploitation. The paper says the current peak demand for mineral resources is responsible for "one of the most significant economic shocks in [Australia's] history. Work commissioned by the Australian Steel Institute (ASI) from the National Institute of Economic and Industry Research (NIEIR) confirms that high exchange rates associated with the boom, significant levels of overseas ownership and overseas worker participation in this construction activity as well as the crowding out effects of this massive construction program is having a deleterious impact on other parts of the Australian economy, particularly the steel and metals sector. The Tax Forum Discussion Paper goes on to acknowledge the responsibility of government to "ensure that the living standards of all Australians continue to rise, that we share the benefits of prosperity and do not leave some Australians behind". That is the focus of this paper.

Research by NIEIR shows that the Australian metals, fabrication and machinery sector is not sharing the current investment boom in resource projects. The chart below shows that domestic sales of metals, fabricated metals and machinery has been falling as a proportion of total investment in the resources sector.

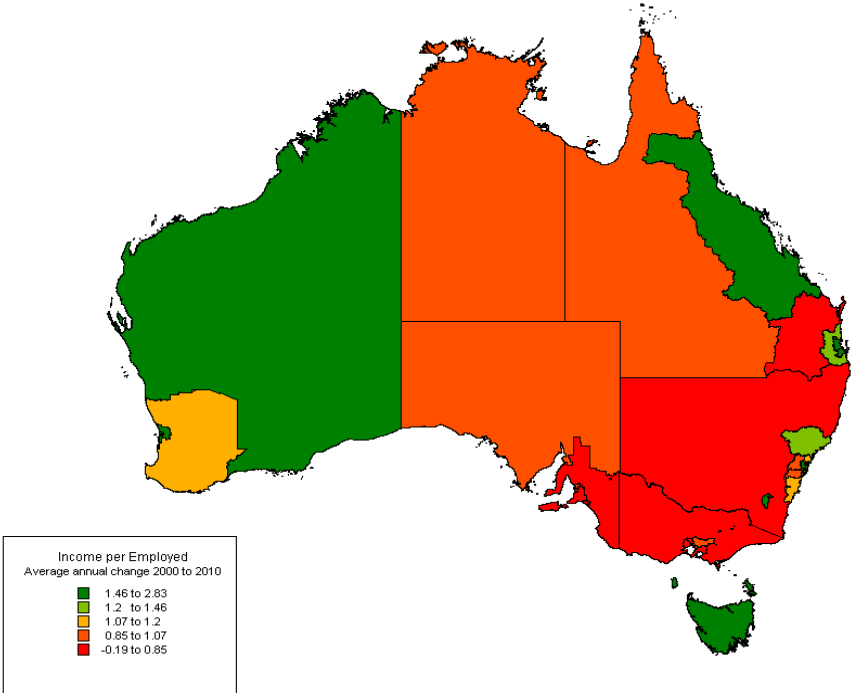


The current high exchange rate is a response to short-term flows of funds largely due to the mining boom. It will last only as long as the boom lasts, but as long as it lasts Australia's non-resources export industries and its non-resource import-competing industries are finding it very difficult to compete. Not only is there an exchange rate penalty, but the resources boom increases costs through high Australian interest rates. As a result, many businesses in the Australian metals and machinery sector are suffering low levels of activity, reflected in retrenchments and under-employment of labour. Businesses are closing, equipment is being idled or scrapped prematurely, business networks are lapsing and skilled personnel are losing their skills by transfer to unskilled work or income support.

Once an industry is dismembered, it is very difficult to put it back together again. This is because the business networks have been destroyed, the equipment scrapped and the skills dispersed and/or depreciated by lack of practice. The expectation that scrapped industries will spring back into life as soon as the resources boom is over and the exchange rate subsides is unrealistic, the more so because investors will have learnt from their current experience and will be unwilling to invest in Australia because of the risk that the exchange rate will again spike upwards and destroy their investments. All of this is well explained in Paul Cleary's recent book *Too Much Luck*.

In abstract theory, the capital and labour released from declining sectors should transfer to the booming sector. However, this is not possible for embodied capital, while it is not practicable for labour, due to partly to skills mismatches but largely to geography. NIEIR estimates that the resource construction boom is confined to five per cent of local government areas (LGAs) with significant spin-off into perhaps a further 10 per cent. Workers resident in the remaining 85 per cent of LGAs, including the majority of workers with skills related to metals and machinery, can only participate in the boom if they abandon their homes, their family ties and their mortgages. Most are understandably reluctant to do so.

Income per employed - average annual change 2000 to 2010



The Tax Forum Discussion Document acknowledges that: “When labour force participation is lower than it could be, not only is the economy’s output below potential, but the rest of the community has to pay higher taxes in order to fund transfers.” ASI shares this concern and believes increasing the participation of Australian industry in the resources boom should be a key priority for Government. It believes the Tax Reform process can be complementary to addressing this issue. We do not believe that tax reform should be used to subsidise inefficient industries. Only that Tax Reform be used in a way that is complementary to other initiatives being proposed by ASI to create a ‘level playing field’ where efficient Australian companies can compete during a period of artificially high exchange rates and crowding out in the non-resource industries and areas of Australia. Again as the Discussion paper says: “Taxes affect the level of investment, where investment and workers go in the economy, and how they are used.” We believe Government should consider the long run implication of the current boom and the danger of Australia sacrificing its non-resource tradeable sectors for short-term gain of a massive investment boom. The NIEIR report *‘Maximising Australia’s Resources Boom...’* has shown that the benefits of the current boom has been overstated because of a focus on GDP rather than Net National Product or net returns to Australian citizens of the boom.

One of the three key elements of the Government’s approach to tax reform is *Reform to make the economy stronger*. The Discussion Paper says: “There are many ways that reform can make the economy stronger. Taxes impact on many incentives: to work, to save, or to invest. Taxes need to be designed to reward hard work and improve international competitiveness at the same time as generating the revenue required to deliver the quality services the community needs.” ASI shares that view. It has developed a set of proposals aimed at ensuring Australian companies increase their participation in the boom and thereby become more directly linked into the global economy and the industries that service the global resources industries. The tax measures proposed are intended to overcome the short term disadvantages that reduce their ability to win work from the resource developers.

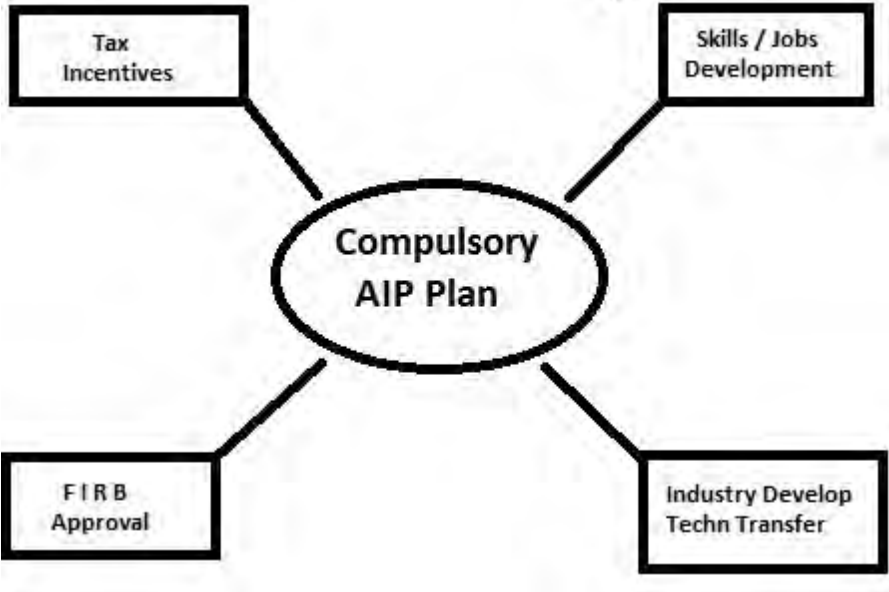
3 ASI Proposals

The ASI wants to stimulate Australian Industry participation through the development of a “Major Projects Industry Participation Scheme”. Refer <http://steel.org.au/policy-position-paper> .The ASI is aware of Governments’ responsibilities in line with WTO guidelines and does not propose any form of mandates or other conditions that would contravene WTO guidelines or principles. Under the proposed arrangements, all companies or Government agencies seeking development approval for new resources or infrastructure projects in excess of \$100m in Australia, including those requiring FIRB approval or seeking EPBS, will need to enter into the Scheme. This will require the development of an Australian Industry Participation Plan, similar to the one in current use by AusIndustry. These AIPP’s will be compulsory and form an integral part of the approvals process, similar to and treated with the same importance as current Environmental and Indigenous / Land Rights approvals.

The key to the success of this scheme will be the criteria that are set and the reporting, audit and follow-up structures put in place to ensure that it happens. These industry development plans will require major project owners and their contractors (at various levels) to meet a number of criteria prior to obtaining approval to develop the project and/or invest in a project in Australia. Plans should be re-evaluated during various stages of the project including FID, FEED, sub-contract works and construction.

The proposal links to requirements of the Foreign Investment Review Board in that prospective investors must agree to the use of the 'Major Projects Participation Scheme' and the use of AIP Plans. It will reinforce the clear distinction between Investment in a project and the supply to a project and that these should be mutually exclusive. The proposal includes a review to align with other resource rich countries rules on foreign investment. The proposal also has a skills development component in that major Project proponents would work closely with DIISR and the DEEWR to take advantage of all Government Skills programs including the recently announced 'National Workforce Development Fund'. They would Coordinate with Skills Australia to ensure the enhancement of the skills required to support major projects into the future. Plans for skilled Australian jobs and apprenticeships would be embedded within the AIP Plan.

More specifically for the purposes of the Tax Review, the proposals put forward by ASI include some tax incentives for proponents to increase Australian participation. This would be confined to 'Contestable' Australian content in major projects. The approach would be to offer increased tax concessions and/or resource rent tax (RRT) discounts. This approach is intended to be cost neutral to project proponents and the Australian Government. A tax advantage in the form of accelerated tax depreciation on major project assets for greater use of 'contestable' Australian Content should also be considered. Analysis by NIEIR, discussed below, indicates that, although the provision of tax concessions initially have a revenue cost to the Commonwealth budget, this cost would be more than compensated through the taxes generated by increased levels of economic activity and the benefits of increased employment and incomes. The relationship between elements of the ASI proposals is illustrated below.



This approach is not inconsistent with the approach the Government has previously taken with the Minerals Resource Rent Tax where it linked the tax to create benefits for industry in other sectors and parts of the country. The Discussion Paper says:

Revenue from the Minerals Resource Rent Tax will enable a cut in the company tax rate to 29 per cent and a phasing down of Interest Withholding Tax for financial institutions — making our economy stronger and making Australia a more attractive place to do business.

ASI believes this proposal is consistent with the objective of making the Australian economy stronger and making it a more attractive place to invest in other non-resources sectors. It further believes this approach is consistent with the objective of Tax Forum with the Government has said needs to recognise the following:

- the Government's commitment to fiscal discipline, which means that ideas that have a budget cost need to be funded;
- the impact that the tax and transfer system has on labour force participation, saving and investment decisions;
- that shifting the tax burden or tax mix from one base to another needs broad community consensus; and
- the key economic, social, demographic and environmental challenges and opportunities facing Australia.

In particular, we believe this action is necessary if the tax system is to support the economy of "a developed nation with a significant resource base alongside well-developed manufacturing and service sectors". If this set of actions is not taken, NIEIR research shows Australia may well not have a well developed manufacturing sector in five or 10 years time.

4 Economic rationale

This section explores the costs and benefits of strategies to increase local content in resource construction projects from the metals, fabricated metals and machinery sector. It is divided into three segments, namely:

- (i) the taxation revenue implications of increased local content;
- (ii) the macroeconomic benefits of enhanced local content; and
- (iii) the net benefits of enhanced local content with particular focus on net taxation revenues.

The argument rests on the case made by NIEIR that the current resources expansion is causing substantial crowding out of domestic production which results in under-utilisation of resources, both capital and labour, in many parts of Australia. It explores ways in which these under-utilised resources could be brought back into production, with obvious benefits to Australian employment and incomes.

The core finding is the Commonwealth Government has the ability to enhance local content and expand economic activity to achieve very large benefits, not only in the short term by increasing local spinoff from resources construction but in the long term by preventing plant closures. Even better, the proposed actions are budget-neutral.

The regional implications and the impact on unemployment rates are described in the full NIEIR report available from ASI. Refer <http://steel.org.au/nieir-report/>

4.1 Tax incentives

The tax incentive approach discussed in this paper propose tax concessions and/or resource rent tax (RRT) discounts based increased local content where this additional content involves increased costs compared to foreign sourced products. The concessions/discounts would be designed to partially or fully compensate for the additional costs.

Table 2, in the attached appendix, uses a large scale (\$43 billion) 100 per cent foreign owned LNG project to illustrate the cost of the incentives involved. The local content for a major offshore LNG project is approximately 25 to 30 per cent (*Tim Toohey GSJBW report, 15 Feb, 2010*). The table shows the revenue cost of using either an accelerated depreciation

loading or a discount to the RRT to maintain the same internal rate of return on the project given an assumed range of additional costs incurred by switching from imported to local content.

Case one will be explained in detail in order to demonstrate how to interpret the table. The underlying base case includes local content at its 'natural' or competitive level of 25 per cent. In case one the policy objective is to increase local content by 10 percentage points, where this is assumed to incur a 10 per cent cost differential. For a \$43 billion project this would increase the local content from say \$10.8 to \$15.1 billion. The cost penalty is 1 per cent of the overall project, or \$430 million, which brings total investment outlay to \$43,430 million.

In the base case the real internal rate of return on the project (depreciation, interest and profit after taxes) is 7 per cent per annum. In order to maintain the same internal rate of return with the higher cost penalty, a depreciation loading of 10 per cent would have to be given to the project. If the standard allowable depreciation rate was 10 per cent per annum the project would have to be allowed a depreciation rate of 11 per cent per annum, which would allow the project to be written off quicker and earlier.

The foregone Commonwealth taxation revenue is 1.4 per cent for the base case revenue in undiscounted terms and 3.1 per cent in discounted terms. The difference is due to the relatively high loss of taxation revenue in the early years when the depreciation loading instrument is used.

Case four deals with the same 10/10 example but employs a different tax concession: a discount to the 40 per cent RRT rate. In the 10/10 case the discount that would need to be applied to the RRT rate is 4.5 per cent, or a rate reduction of 1.8 percentage points. The foregone revenue in both discounted and undiscounted terms is around 3.5 per cent. In undiscounted terms, this is approximately double the revenue loss when the depreciation loading instrument is used. The reason for this is that as the project would not be paying RRT until the middle of the 2020s at the earliest and therefore would require a larger proportion of tax revenue offsets past the mid-2020s to offset the lack of tax benefits to the project developers in the early years of the project.

The other cases are an approximate linear adjustment from the 10/10 case. Thus, for Case three or the 10/30 per cent case, where a 30 per cent cost disability is assumed, the depreciation loading has to increase to 34 per cent or approximately three times the loading for the 10/10 case, while the discount for the RRT is 14 per cent, again three times the 10/10 case discount.

The same approximate linearity is in evidence for the larger local content cases. For Case 13 or the 30/10 case, a 33 per cent increase in depreciation loading is required, compared to 10 per cent for the 10/10 case.

4.2 Enhanced local content: The macroeconomic benefits

Given that increased local content can be provided using factors of production which are unemployed in the base case, the macroeconomic benefits can readily be calculated using input-output tables and inter-regional trade flow matrices. Table 3 shows the macroeconomic benefits from a 15 percentage point increase in local content from this large scale offshore LNG project. (A 15 per cent benchmark is selected to allow interpolation to 10 percentage points and 20 percentage points, as is considered below.)

A 15 percentage point increase in local content for a \$43 billion project gives a GDP benefit of \$6.5 billion over four years, or \$1.6 billion for one year. The results in the table are for a

one year average. The \$1.6 billion GDP benefit is distributed over the metals and machinery industries in accordance with the resource industry's current pattern of demand. The distribution is also reflected in the pattern of decline in imports in Table 4.

Table 3 shows that the annual benefit to GDP at factor cost is \$1.6 billion in 2009 prices, with an employment increase of 14,000. The increase in our preferred indicator – net national product – is less, but still substantial at \$1.3 billion a year over the four years of enhanced resources construction. The total tax revenue increase for all sources is \$376 million or \$1.5 billion over four years.

Of interest is the \$3bn increase in the capital stock in productive use. This is the capital equivalent of the increase in employment. It represents the notional value of capital which is idle or under-utilised in the base case but is brought into production in the policy case. This is likely to be spread over a large number of enterprises where the capital stock is currently less than fully employed. Up to \$30 to \$40 billion of existing capacity in the economy may well benefit from enhanced local content.

Table 4 shows the distribution of the employment gains across all industries. It is worth noting that half the increase in employment, or 7,000, is in the tertiary sector. Due to (Type II) multiplier effects, for every one employment position created in metals and machinery, one additional employment position is created in the tertiary sector. Once again, as shown in the NIEIR report, these additional positions can be filled largely, by currently under-employed labour. If the Australian metals and machinery sector could increase its share of the total metals and machinery sector contribution to resources expenditures by 15 percentage points, then this would divert \$2.6 billion of orders to local suppliers who, even on a very narrow definition of the Australian metals and machinery sector capable of supplying the resources sector have excess capacity capable of supplying products of at least \$1.5 billion annually. The \$2.6 billion increase would represent an increase in total Australian industry local content of 2.3 percentage points.

Table 1 estimates the benefit as per the structure of the economy in 2008-09. This has a higher impact on local production for the metals and machinery sector. The benefits would increase if, as seems likely, the domestic supply chain would strengthen and the increased local content was seen to be sustainable. In the years ahead, as demand shifts towards high import content LNG projects, the increase in local content will be required simply to maintain the absolute contribution of the local MM sector to resource expenditures at a stable level.

Table 1

	15 percentage point increase in MM sector's share of resources expenditures	Comment
Direct employment ('000) – MM sector	10.0	If the increase was deemed to be stable the import content of local production would decline, potentially increasing benefits by up to 20 per cent.
Indirect employment ('000)	12.7	Would increase if the direct employment benefit increased from a decline in import content of local production.

Gross product at factor cost (2009 \$ billion)	2.6	As above.
Tax revenue (2009 \$ billion)	0.6	As above.
Welfare savings	0.2	As above.

At this point the case might be considered made. An opportunity exists to increase Australian incomes by employing currently under-employed labour and capital. However, it should be remembered that the benefits shown in Table 4 apply only during the construction phase of the resources boom, whereas the cost of the tax concessions required to compensate the resources industry for the increase in local content runs out for decades. Fiscal prudence demands a more complete account of the costs and benefits.

4.3 Enhanced local content: A net assessment

The task here is to combine the preceding sections to provide an empirical framework for evaluating the impact of enhanced local content. Table 5 commences this process. This table shows a more detailed time profile of the Commonwealth taxation revenue streams underlying the revenue results given in Table 2. The table summarises the year by year results into:

- (i) the construction phase – 2011-2014;
- (ii) the first half of the production period – 2015-2024; and
- (iii) the second half of the production period – 2025-2035.

The results are in terms of difference from the base case which has a “natural” local content of 25 per cent.

Not every case in Table 2 is included in Table 5. However, a reasonable range is provided. The first case is the 10/10 case or 10 per cent local content enhancement with a 10 per cent cost disability. For the 10/10 case, with the depreciation loading, the total loss of revenue is \$845 million in 2009 prices, of which \$824 million is foregone in the first half of the production period. For the RRT discount instrument the loss of revenue is \$2.1 billion, of which the bulk is foregone over the second half of the production period. Only \$172 million is foregone over the first half of the production period.

Table 6 uses the results from Table 3 to obtain total taxation revenue from enhanced local production over the construction phase. For the 10/10 case this comes to \$1.1 billion. For the 10/30 case the total additional taxation revenue from each source is \$1.3 billion. This will be higher than in the 10/10 case because of the higher “real” expenditures in the domestic economy because of the higher cost. The same logic applies to the other cases shown in the table.

The short-term entry in Table 5 reflects the case where there is no ongoing benefit from the enhanced local content. Domestic production is expanded during the construction phase matched by an equal contraction when investment winds down. However, where significant crowding out occurs in the base case, leading to permanent loss of capacity, additions to local content are likely to have the effect of keeping some capacity operating so that it is still there when the elevated resources investment phase ends and exchange and interest rates return to sustainable levels, rendering the plant profitable again on a long-term basis. In this case the benefit from enhanced local content over the construction phase will last as long as

plant that otherwise would have closed during the construction phase continues in production. The long term entry assumes that the plant continues on to 2035, while the half life assumes that the plant closes at 2024. If the plant continues on for the life of the LNG plant then the total undiscounted taxation revenue from all sources is \$6.9 billion, all as a result of the initial enhanced content. For the half life case it is \$3.9 billion.

Of course, the relationship between enhanced local content and maintenance of capacity in operations is uncertain, but the one to one relationship assumed in Table 6 is likely to be, on average, conservative. This is because, as noted previously, the steel sector appears to be operating at approximately 50 per cent capacity. Assume that the threshold criterion for continued operation of a plant is that it maintains a capacity utilisation rate of 55 per cent for the last four years. If the plant is currently operating at 50 per cent and under a strategy of increasing local content, assume the plant receives additional orders of 5 per cent of capacity enabling it to maintain production at 55 per cent capacity utilisation for four years. If this does not happen then the plant will close around 2013 or 2014. After 2014, if the resources boom starts to abate and exchange rates and interest rates fall, the plant may well be able to operate at 55 per cent or above for many years from 2014 on even though enhanced local content orders fall to zero.

The important point, however, is that additional orders equal to 5 per cent of capacity can generate additional production up to ten times the orders received under enhanced local content rules. At the other extreme, some of the plants which receive additional orders from enhanced local content may be expected to continue in production irrespective of whether they receive the additional orders or not. Nonetheless, given the current state of the steel sector, the one to one assumption of Table 6 is likely to be conservative. If the resources construction boom continues and nothing is done to raise current levels of capacity utilisation in the steel industry, large segments of currently remaining capacity will be closed within a few years.

The potential cost of the closure can be seen from the results in Table 7. This table incorporates the net impacts on Government revenue from Tables 2 and 6. It also has estimates of the cumulative non-discounted increase in GDP at factor cost from the enhanced local content. Table 7 has considerable detail because of the need to consider two policy instruments to enhance local content, depreciation loadings and RRT discounts.

The short life cases will be considered first. For the 10/10 case, both total undiscounted and discounted net tax revenue is positive for a total cumulative gap given at factor cost of \$4.7 billion in 2009 prices. For the 10/10 case with the RRT loading, the gap gain will be the same but the undiscounted cumulative Government revenue impact will now be negative \$1 billion. The discounted tax revenue outcome is positive. Until 2024, the cumulative taxation revenue gain is positive by almost \$1 billion. This correlates with the depreciation loading case where there is only a \$100 to \$200 million cumulative taxation revenue gain by 2024.

The short-term 20/10 case also looks attractive. The 20/20 case for the RRT discount also looks attractive for Governments with a medium-term focus on revenue. The same conclusion applies to the 30/10 case. This would represent the case where Governments had a pessimistic view of long run fossil fuel prices from both the demand and supply perspective and were quite willing to give large discounts to future RRT rates in return for short-term revenues on the grounds that commodity prices may well be such that the RRT revenue that is being given away might not be collected in any case.

For both the half and full life cases there is either a large increase in net taxation revenues or at least a small increase. The only exception is the 10/30 case for the half life assumption and the RRT discount instrument.

For half life and full life cases the gains are large in terms of the cumulative undiscounted gap. The cumulative increase ranges from \$16.6 billion for the half life 10/10 case to nearly \$90 billion for the full life 30 per cent local content case. These increases are generated at no actual cost to taxation revenue.

The data in Table 7 can also be interpreted as showing the very large costs of not doing anything in terms of enhanced local content. If, for the 20/20 case, failure to implement enhanced local content results in the closure of plants over the next one to five years, the cumulative cost to GDP will be around \$36 billion if the plant would have remained in production until the mid 2020s and \$64 billion if the plant would have gone on operating until 2035. The cost to Government revenue from Table 5 would range from \$8 to \$15 billion in undiscounted terms.

5 Additional public policy issues

5.1 Reciprocal obligation

If Government confines itself to short term arguments the upper limit of ambition would be the 20/10 or 20/20 case. However, if plant is at risk of closure the longer term cases become relevant. In terms of these cases, the upper limit would be determined by the scale of the plant at risk if nothing is done. However, beyond a 15 to 20 per cent cost disability complementary policies of reciprocal obligation would be desirable. By this is meant that in exchange for enhanced local content local plants with relatively high cost disabilities would be required to satisfy the criterion that they are reasonably expected to be profitable in a post resources boom environment. If that is not the case a complementary investment program would have to be put in place to ensure long-run profitability. The same requirement would have to be satisfied by firms where the capital stock is nearing the end of its expected life. These firms would also be required to undertake an investment upgrade to ensure that the plants could keep operating beyond the early 2020s.

5.2 The impact of a longer resources boom

This analysis assumes that a more normal environment begins to prevail over the second half of this decade. However, what if this is not the case and the "abnormal" economic conditions extend to 2020? Then the policy would need to continue. The cost to revenue would be greater but not enormously so compared to the benefits. The additional costs can be based on the results of Table 5. For another few years the additional undiscounted revenue costs for another five years would be between \$2 and \$4 billion to lead in a cumulative GDP gain at factor cost of (conservatively) between \$35 and \$54 billion. The longer the boom the higher will be the risk of plant closure and the higher the benefit multiplier from enhanced local content during the construction phase. However, the longer the boom lasts the greater the importance of reciprocal obligation responses from the policy beneficiaries. For example, along with plant upgrades there would need to be agreed benchmarks where for a given exchange rate the cost disability declines over time. For example, a cost disability of 20 per cent for a given US\$/A\$ exchange rate would be expected to decline to 15 per cent by 2015 and 10 per cent by 2020. This would mainly be achieved by plant upgrade and modernisation expenditures required to extend the plant life.

5.3 The deemed exchange rate

The costs of the enhanced local content would also be reduced if the “natural” local content was set on the basis of a deemed, rather than the actual, exchange rate. A reasonable deemed exchange rate would be the PPP rate plus, say, 10 per cent, which would give some benefit to the project developers. Such a policy would increase the “natural” or competitive local content and reduce the tax incentives required for further increases in local content.

5.4 The Norwegian precedent

This analysis demonstrates the basic arithmetic of why the Norwegian strategy for avoiding the Dutch Disease was so successful. The strategy outlined here is different in that it protects capacity already in place. The Norwegians obtained their benefit multipliers by building additional capacity to meet a short-term demand increase from local content enhancement while ensuring that the capacity installed was of sufficient quality to be competitive in the absence of local content support. This meant that even in a stable resource investment profile the next round of local content orders would create additional capacity as the capacity that was previously put in place to sustain previous local content orders was now being used for exports and/or import replacement elsewhere in the economy. After 30 years of this positive dynamic Norway created an economy able to survive a steadily contracting resource sector as its oil runs down. For Australia, in contrast, the best that can be hoped for is success in simply keeping what is already in place unless a dramatic change in policy aspirations is achieved.

5.5 The institutional policy framework

The Norwegians set up a development authority to assist countries to maximise the benefits from resource development by maximising local content from resource development using their domestic template. The agency is the Norwegian Agency for Development Cooperation (NORAD). The focus of the NORAD assistance, in terms of maximising local content, is on the procurement process and the appropriate decisions that need to be made. In Australia an agency would need to be set up with the objective of maximising local content from resource development both in terms of the construction phase and production stage.

The agency would advise governments during the approval process for a given project of the strategic value of the project, in part by:

- (i) assessing the impact on resource requirements during the construction stage; and
- (ii) the NNP/GDP and NNP/investment ratios for the production stage.

This would form the basis of the rules for local content that would apply if approval was granted, namely:

- (i) the setting of a deemed exchange rate if required for bid evaluation – the less strategic value a project the more likely a deemed exchange rate would be adopted;
- (ii) a maximum acceptable domestic cost disability margin;
- (iii) the extent to which a domestic cost disability margin is to be compensated for and how it is to be compensated; and
- (iv) determining the potential maximum level of local content by project segment.

Once approved the agency would have responsibility for:

- (i) communicating well in advance to local companies the contracts available for bid;

- (ii) working with local suppliers to maximise their competitiveness in their bids; and
- (iii) monitoring the bid process for the contracts included in the potential local content segment of the project to.

Reference documents referred to in this report were:

1. *'Maximising Australia's Resources Boom...'* - Independent economic report by NIEIR (refer weblink <http://steel.org.au/nieir-report/>).
2. *'Major Projects Industry Participation Scheme'* - ASI Policy Proposal (refer weblink <http://steel.org.au/policy-position-paper>) .
3. *'Too much Luck'* – Book by Paul Cleary (refer weblink - <http://www.penguin.com.au/products/9781863955379/too-much-luck-mining-boom-and-australia-s-future>)
4. *GSJBW Economics Report, 15 February 2010* – Tim Toohey.

Table 2 The trade-off between cost disability, tax warranties and a given internal rate of return: Large scale offshore LNG project

	Additional local content (%)	Cost differential (%)	Depreciatio n loading (%)	Resource rent tax discount (%)	Undiscounted Commonwealth tax revenue foregone (\$% of case)	Discounted Commonwealth tax revenue foregone (6% discounted) (% of base case)
Case one	10	10	10	–	-1.4	-3.1
Case two	10	20	21	–	-3.2	-6.3
Case three	10	30	34	–	-4.9	-9.7
Case four	10	10	–	4.5	-3.5	-3.6
Case five	10	20	–	11	-7.8	-7.7
Case six	10	30	–	14	-10.5	-10.5
Case seven	20	10	21	–	-3.3	-6.4
Case eight	20	20	45	–	-6.6	-12.5
Case nine	20	30	79	–	-9.7	-18.3
Case ten	20	10	–	9	-7.3	-7.0
Case eleven	20	20	–	21	-14.3	-14.1
Case twelve	20	30	–	33	-21.8	-21.3
Case thirteen	30	10	33	–	-4.9	-9.6
Case fourteen	30	20	78	–	-9.5	-18.1
Case fifteen	30	30	109	–	-14.5	-25.2
Case sixteen	30	10	–	12	-10.5	-10.5
Case seventeen	30	20	–	33	-21.8	-21.3
Case eighteen	30	30	–	58	-33.8	-32.3

**Table 3 Increased local content from mining investment: Annual impact on national economic indicators – large scale offshore LNG project
15 percentage point increase in local content on \$43 billion project over 4 years**

National aggregates		
GDP at factor cost	\$2009m	1615.6
Mining gross product at factor cost	\$2009m	108.4
Non mining gross product at factor cost	\$2009m	1507.2
Gross local product at factor cost	\$2009m	1163.2
Net local product at factor cost	\$2009m	1018.5
Total employment - full time equivalent	'000	14.0
Household consumption expenditure at basic values	\$2009m	528.2
	index – per cent	
Per capita household consumption expenditure	change	0.1
	index – per cent	
Capital stock	change	3044.8
Factor productivity - net national product		0.0
Household income Formation		
Net national product at factor cost	\$2009m	1354.6
Wages and salaries	\$2009m	961.6
Mixed income	\$2009m	116.9
Interest received dividends	\$2009m	93.8
Disposable income	\$2009m	739.8
Government revenue		
Household direct taxes	\$2009m	198.1
Enterprise direct taxes	\$2009m	94.5
Indirect taxes	\$2009m	82.8
Total	\$2009m	375.5

**Table 4 Increased local content from mining investment: Annual impact on national industry indicators – large scale offshore LNG project
15 percentage point increase in local content on \$43 billion project over 4 years**

	Gross output (2009 \$m)	Imports (2009 \$m)	Supply (2009 \$m)	Employment (‘000)
Sheep	2.5	0.0	2.5	0.02
Grains	3.6	0.0	3.6	0.01
Beef cattle	6.5	0.0	6.5	0.05
Dairy cattle	3.5	0.0	3.5	0.02
Pigs	0.9	0.0	0.9	0.01
Poultry	2.0	0.0	2.0	0.01
Other agriculture	12.4	1.1	13.6	0.07
Services to agriculture, hunting & trapping	3.3	0.0	3.3	0.01
Forestry and logging	1.8	0.1	1.9	0.01
Commercial fishing	1.9	0.2	2.1	0.01
Coal	12.1	0.0	12.2	0.01
Oil and gas	25.7	16.6	42.3	0.01
Iron ores	18.3	1.8	20.0	0.01
Non-ferrous metal ores	117.6	47.8	165.4	0.13
Other mining	16.9	2.9	19.8	0.04
Services to mining	17.5	0.1	17.6	0.05
Meat and meat products	15.1	0.7	15.8	0.05
Dairy products	11.3	1.2	12.5	0.02
Fruit and vegetable products	3.6	2.0	5.6	0.01
Oils and fats	1.5	1.0	2.4	0.00
Flour mill products and cereal foods	6.0	0.7	6.8	0.01
Bakery products	4.8	0.7	5.5	0.04
Confectionery	3.7	1.1	4.7	0.01
Other food products	9.1	3.5	12.6	0.02
Soft drinks, cordials and syrups	4.5	0.3	4.8	0.01
Beer and malt	4.0	0.6	4.6	0.01
Wine, spirits and tobacco products	4.5	2.8	7.3	0.01
Textile fibres, yarns and woven fabrics	0.7	1.9	2.7	0.00
Textile products	1.7	3.1	4.8	0.01
Knitting mill products	0.9	1.2	2.1	0.00
Clothing	2.3	5.7	8.0	0.02
Footwear	0.5	1.8	2.3	0.00
Leather and leather products	0.6	1.5	2.1	0.00
Sawmill products	3.8	1.1	5.0	0.01
Other wood products	6.8	1.8	8.6	0.04
Pulp, paper and paperboard	1.5	3.1	4.6	0.00
Paper containers and products	4.5	1.2	5.6	0.02
Printing and services to printing	15.5	1.3	16.8	0.07
Publishing, recorded media, etc.	14.1	2.8	16.9	0.06
Petroleum and coal products	27.1	15.3	42.4	0.01
Basic chemicals	16.7	18.9	35.7	0.01

**Table 4 Increased local content from mining investment: Annual impact on national industry indicators – large scale offshore LNG project
15 percentage point increase in local content on \$43 billion project over 4 years
(continued)**

	Gross output (2009 \$m)	Imports (2009 \$m)	Supply (2009 \$m)	Employment (‘000)
Paints	2.4	0.9	3.3	0.01
Medicinal and pharmaceutical products, pesticides	3.9	6.6	10.5	0.01
Soap and detergents	1.6	0.8	2.4	0.00
Cosmetics and toiletry preparations	0.4	1.7	2.1	0.00
Other chemical products	3.0	2.0	5.0	0.01
Rubber products	1.9	5.2	7.1	0.01
Plastic products	12.0	6.0	18.0	0.04
Glass and glass products	6.3	2.1	8.4	0.02
Ceramic products	1.1	2.6	3.7	0.01
Cement, lime and concrete slurry	5.8	0.3	6.1	0.01
Plaster and other concrete products	2.4	0.1	2.5	0.00
Other non-metallic mineral products	1.6	0.5	2.1	0.01
Iron and steel	422.1	-155.2	266.9	1.00
Basic non-ferrous metal and products	283.8	-23.8	260.0	0.17
Structural metal products	155.8	-103.4	52.3	0.26
Sheet metal products	47.2	-31.2	16.0	0.07
Fabricated metal products	259.2	-218.7	40.5	1.13
Motor vehicles and parts, other transport equipment	81.6	-37.6	44.0	0.29
Ships and boats	10.6	-8.6	1.9	0.01
Railway equipment	10.7	-5.0	5.7	0.01
Aircraft	66.3	-46.3	20.0	0.09
Photographic and scientific equipment	29.8	-16.9	12.9	0.11
Electronic equipment	65.9	-28.2	37.7	0.34
Household appliances	33.1	-22.0	11.2	0.06
Other electrical equipment	112.5	-56.8	55.7	0.34
Agricultural, mining, etc. machinery	296.5	-283.0	13.5	1.18
Other machinery and equipment	322.6	-270.5	52.2	1.23
Prefabricated buildings	1.3	0.0	1.3	0.00
Furniture	5.0	3.6	8.6	0.04
Other manufacturing	8.0	4.9	12.9	0.02
Electricity supply	73.3	0.0	73.4	0.10
Gas supply	8.5	0.0	8.5	0.02
Water supply, sewerage and drainage services	18.9	0.0	19.0	0.05
Residential building	6.9	0.0	6.9	0.01
Other construction	11.1	0.0	11.1	0.02
Construction trade services	57.3	0.0	57.4	0.30
Wholesale trade	178.1	0.7	178.8	0.60
Wholesale mechanical repairs	2.8	0.0	2.8	0.01
Other wholesale repairs	16.2	0.0	16.2	0.03

**Table 4 Increased local content from mining investment: Annual impact on national industry indicators – large scale offshore LNG project
15 percentage point increase in local content on \$43 billion project over 4 years
(continued)**

	Gross output (2009 \$m)	Imports (2009 \$m)	Supply (2009 \$m)	Employment (‘000)
Retail trade	106.7	0.9	107.6	0.93
Retail mechanical repairs	24.4	0.0	24.4	0.34
Other retail repairs	1.3	0.0	1.3	0.02
Accommodation, cafes and restaurants	56.7	5.6	62.3	0.40
Road transport	59.5	1.4	60.9	0.29
Rail, pipeline and other transport	15.6	0.8	16.5	0.07
Water transport	5.9	1.2	7.1	0.01
Air and space transport	20.1	6.5	26.6	0.05
Services to transport, storage	60.5	0.2	60.7	0.16
Communication services	72.2	1.3	73.5	0.22
Finance	152.2	1.3	153.5	0.38
Ownership of dwellings	0.0	0.0	0.0	0.00
Other property services	145.7	1.3	147.0	0.22
Scientific research, technical and computer services	76.8	3.7	80.6	0.42
Legal, accounting, marketing and business management services	97.2	5.0	102.2	0.43
Other business services	79.8	2.0	81.9	0.42
Government administration	9.0	0.0	9.0	0.07
Defence	0.2	0.0	0.2	0.00
Education	31.8	1.4	33.3	0.31
Health services	27.7	0.7	28.4	0.26
Community services	3.4	0.0	3.4	0.05
Motion picture, radio and television services	18.3	1.4	19.7	0.05
Libraries, museums and the arts	4.1	0.2	4.3	0.04
Sport, gambling and recreational services	19.8	0.6	20.4	0.11
Personal services	11.2	0.2	11.4	0.18
Other services	12.6	0.0	12.6	0.10
Total	4151.5	-1087.4	3064.1	14.04

Table 5 The taxation revenue implications of enhanced local content: The case of a large offshore LNG project

	Enhanced local content (%)	Cost disability (%)	Instrument	Construction period – 2011-2014 (2009 \$m)	First half production period – 2015-2024 (2009 \$m)	Second half production period – 2025-2035 (2009 \$m)	Total undiscounted	Total discounted (6%)
Case one	10	10	Depreciation loading	0	-824	-22	-845	-650
Case two	10	10	RRT discount	0	-172	-1891	-2063	-727
Case two	10	30	Depreciation loading	0	-2776	5	-2771	-1974
Case two	10	30	RRT discount	0	-517	-5613	-6130	-2109
Case three	20	10	Depreciation loading	0	-1726	-200	-1926	-1341
Case three	20	10	RRT discount	0	-345	-3724	-4069	-1412
Case four	20	20	Depreciation loading	0	-3708	-152	-3859	-2615
Case four	20	20	RRT discount	0	-689	-7660	-8349	-2845
Case five	30	10	Depreciation loading	0	-2709	-182	-2892	-1995
Case five	30	10	RRT discount	0	-517	-5613	-6130	-2109

Table 6 The gross taxation revenues from enhanced local content (2009 \$m)

	Enhanced local content (%)	Cost disability (%)	Instrument	Construction period – 2011-2014 (2009 \$m)	First half production period – 2015-2024 (2009 \$m)	Second half production period – 2025-2035 (2009 \$m)	Total undiscounted	Total discounted (6%)
Case one	10%	10%	Short term	1101	0	0	1101	998
			Long term	1101	2753	3029	6883	3604
			Half life	1101	2753	0	3855	2651
Case two	10%	30%	Short term	1302	0	0	1302	1180
			Long term	1302	3254	3579	8135	4259
			Half life	1302	3254	0	4556	3134
Case three	20%	10%	Short term	2203	0	0	2203	1997
			Long term	2203	5507	6057	13767	7208
			Half life	2203	5507	0	7709	5303
Case four	20%	20%	Short term	2403	0	0	2403	2178
			Long term	2403	6007	6608	15018	7864
			Half life	2403	6007	0	8410	5785
Case five	30%	10%	Short term	3304	0	0	3304	2995
			Long term	3304	8260	9086	20650	10813
			Half life	3304	8260	0	11564	7954

Table 7 Net taxation revenues from enhanced local content (2009 \$m)

	Enhanced local content (%)	Cost disability (%)	Instrument	Term	Construction period – 2011-2014 (2009 \$m)	First half production period – 2015-2024 (2009 \$m)	Second half production period – 2025-2035 (2009 \$m)	Total undiscounted	Total discounted (6%)	Total undiscounted GDP at factor cost (\$b)
Case	10%	10%	Depreciation loading	Short term	1101	-824	-22	256	349	4.7
Case	10%	10%	Depreciation loading	Long term	1101	1930	3007	6038	2954	29.6
Case	10%	10%	Depreciation loading	Half life	1101	1930	-22	3009	2002	16.6
Case	10%	10%	RRT discount	Short term	1101	-172	-1891	-962	272	4.7
Case	10%	10%	RRT discount	Long term	1101	2581	1138	4820	2877	29.6
Case	10%	10%	RRT discount	Half life	1101	2581	-1891	1791	1925	16.6
Case	10%	30%	Depreciation loading	Short term	1302	-2776	5	-1469	-794	5.6
Case	10%	30%	Depreciation loading	Long term	1302	478	3584	5364	2285	35.0
Case	10%	30%	Depreciation loading	Half life	1302	478	5	1785	1159	19.6
Case	10%	30%	RRT discount	Short term	1302	-517	-5613	-4828	-929	5.6
Case	10%	30%	RRT discount	Long term	1302	2737	-2034	2005	2150	35.0
Case	10%	30%	RRT discount	Half life	1302	2737	-5613	-1575	1025	19.6
Case	20%	10%	Depreciation loading	Short term	2203	-1726	-200	277	656	9.5
Case	20%	10%	Depreciation loading	Long term	2203	3781	5858	11841	5868	59.2
Case	20%	10%	Depreciation loading	Half life	2203	3781	-200	5783	3962	33.2
Case	20%	10%	RRT discount	Short term	2203	-345	-3724	-1866	585	9.5
Case	20%	10%	RRT discount	Long term	2203	5162	2333	9698	5796	59.2
Case	20%	10%	RRT discount	Half life	2203	5162	-3724	3641	3891	33.2

Table 7 Net taxation revenues from enhanced local content (2009 \$m) – continued

	Enhanced local content (%)	Cost disability (%)	Instrument	Term	Construction period – 2011-2014 (2009 \$m)	First half production period – 2015-2024 (2009 \$m)	Second half production period – 2025-2035 (2009 \$m)	Total undiscounted	Total discounted (6%)	Total undiscounted GDP at factor cost (\$b)
Case	20%	20%	Depreciation loading	Short term	2403	-3708	-152	-1457	-437	10.3
Case	20%	20%	Depreciation loading	Long term	2403	2300	6456	11159	5248	64.6
Case	20%	20%	Depreciation loading	Half life	2403	2300	-152	4551	3170	36.2
Case	20%	20%	RRT discount	Short term	2403	-689	-7660	-5946	-667	10.3
Case	20%	20%	RRT discount	Long term	2403	5318	-1052	6669	5018	64.6
Case	20%	20%	RRT discount	Half life	2403	5318	-7660	61	2940	36.2
Case	30%	10%	Depreciation loading	Short term	3304	-2709	-182	412	1000	14.2
Case	30%	10%	Depreciation loading	Long term	3304	5551	8904	17758	8817	88.9
Case	30%	10%	Depreciation loading	Half life	3304	5551	-182	8672	5959	49.8
Case	30%	10%	RRT discount	Short term	3304	-517	-5613	-2826	886	14.2
Case	30%	10%	RRT discount	Long term	3304	7743	3473	14520	8703	88.9
Case	30%	10%	RRT discount	Half life	3304	7743	-5613	5434	5845	49.8

CONCLUSION

Under the arrangements proposed, unique opportunities will be opened up to stimulate local demand, help alleviate some of the crowding out impacts from resources boom and maintain and enhance important Australian capability and capacity.

The ASI calls for the Government Tax Forum to consider the proposals contained within this submission and move quickly to implement them as the industry is in urgent need of greater demand and there is a large pipeline of major project work underway right now.

There is a clear and urgent imperative for Government leadership and whole-of-government approach ,backed up by a range of policy measures proposed herein, to address the dire plight of our industry which is caused by lack of demand. Government has the responsibility to stimulate the economy in sectors being crowded out by the resources boom. The ASI is proposing a very effective and immediate stimulus plan to stop the export of real jobs and production offshore. Every dollar spent offshore is a dollar not being spent in stimulating the Australian economy.

Further information on the Australian Steel Institute can be found by following the following web-link.

www.steel.org.au

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