Section 22

From: Short, John [mailto:John.Short@originenergy.com.au]
Sent: Thursday, 15 April 2010 2:15 PM
To: Barrett, Chris (Treasurer's Office); McDonald, Hamish
Subject: RE: Modelling of tax mix switch proposal involving the introduction of a broad based RRT
Importance: High

Chris & Hamish,

As discussed some weeks ago, I recently commissioned work from KPMG Econtech on a tax mix switch proposal involving the introduction of a broad based RRT to fund the replacement of existing royalties and a 5 percentage point cut in the company tax rate. I significantly extended the breadth of this work following our meeting - which has, unfortunately, caused considerable delay in completion of the attached report. However the report now also provides modelling results for a number of sectors and all States, as well as national results (ie, it is no longer confined to the national picture, the mining industry and the key resource States of WA and Queensland).

Origin Energy is not proposing such a tax policy change. In fact, we strongly oppose the introduction of a broad based RRT for the reasons spelt out below. We are also strongly of the view that the taxing entity should remain the State, not the Commonwealth.

The scenario modelled by KPMG Econtech was developed by Origin based on public comments over the last 15 months by Dr Ken Henry, Dr Greg Smith and David Parker.

The aim of the work was to understand what would be the impact of such a scenario (1) under traditional long run equilibrium economic analysis (which we would expect Treasury to have undertaken) and (2) when what I would regard as more realistic assumptions - with respect to the issue of international mobility of capital and whether a perfect RRT could be designed - were used.

Origin is particularly concerned that traditional economic analysis assumes perfect international mobility of capital and that a perfect RRT can be introduced - and that advocates of a RRT therefore maintain that the introduction of a RRT will not have any adverse impact on investment and activity in the mining industry and, thus, the overall economy.

Virtually by definition, advocates of a RRT can claim that the introduction of a RRT will deliver substantial welfare gains for the general community - although they often fail to acknowledge that (1) there are substantial difficulties in designing a RRT that only taxes economic rents, (2) these benefits will take some time to eventuate (5-10 years), (3) the introduction of a RRT can have significant adverse impacts on individual projects with major consequential negative economic and welfare consequences in the years immediately following the introduction of a RRT and that (4) the tax changes could result in negative sovereign risk effects which could prove negative for future investment in Australia (and not just the resources sector).

The analysis carried out by KPMG Econtech demonstrates that traditional analysis of a tax mix switch policy involving the introduction of a broad based RRT would significantly overstate the national welfare and economic benefits - by around 50% in relation to key national results, and considerably higher levels of overstatement in some areas.

Although the tax mix switch scenario modelled would produce net welfare gains, when the 2 key assumptions used in traditional long run equilibrium economic analysis (listed above) are relaxed, the tax mix switch scenario would deliver (over the long term; ie, 5-10 years) an annual per capita welfare gain of only $98 - ie, a per capita welfare gain of less than $2 a week.

Looking at this within a risk/reward framework, this potential (long term) gain of less than $2 a week is very small when compared against:

1. The risks associated with the design of a RRT (especially when it is recognised that there are considerable difficulties in setting an appropriate uplift factor for a RRT given the major differences in investment risks between different commodities within the resource sector - and even within commodity groupings (especially gas)).

2. The negative potential impacts of a RRT on specific projects in the years immediately following the introduction of a RRT.

3. The prospect of a negative sovereign risk effect of the introduction of a RRT, especially if the initial design features did not guarantee 100% grand fathering for existing projects; any negative sovereign risk response by existing and potential investors would not necessarily be limited to the resources sector.

Traditional long term economic analysis by definition does not measure the impacts of points 2 and 3 immediately above - and, thus, traditional economic analysis would further overstate the potential gains of a tax mix switch proposal involving the introduction of a broad based RRT.

I would also note that even though the tax mix switch scenario modelled involves a major cut in the company tax rate (from 30% to 25%), the modelling results show that the tax policy changes would not be beneficial for the manufacturing and tourism sectors and would not be beneficial for Victoria, SA and Tasmania.

Origin Energy therefore strongly opposes the introduction of a broad based RRT.

We do not believe that the potential gains would outweigh the significant economic risks attached to the introduction of a broad based RRT.

We are also strongly of the view that the taxing entity should remain the State, not the Commonwealth - as this would maintain the incentive for State Governments to work with resource companies to ensure that economic and social infrastructure necessary for the full development of resource projects was appropriately provided by this level of government.

I would be available to meet with you over coming days to discuss the significant findings of this report.

I will also forward - under cover of a separate email - a report by Ernst & Young on the current Petroleum RRT, with this report clearly demonstrating that the PRRT would not be an appropriate starting point for the design of a broad based RRT because of the considerable complexities with the current PRRT regime.

Should you wish to contact me on these matters, my mobile number is 0428 683 438.

Best regards,

John Short

Based on more realistic

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