

AN ECONOMIC ANALYSIS OF THE GNWT'S APPROACH TO THE MINING REGIME FISCAL REVIEW

SUMMARY OF DRAFT FINDINGS

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Context

- The GNWT is proposing to “adopt a benefit retention approach to economic development.” This includes “maximizing benefits from development while maintaining competitiveness.”
- ITI has stated that “re-imagining of our government’s fiscal framework around royalties is one that deserves a comprehensive, collaborative, multi-phased approach.”
- ITI commissioned the PWC study entitled “Tax and Royalty Benchmark: Mining in the Northwest Territories” based on Two Ducks report methodology.



Terms of Reference for Review

1. Is the GNWT maximizing benefits from resource extraction?
2. Does the GNWT fiscal and regulatory structure maximize value for NWT residents and future generations?
3. Is the proposed approach by the GNWT to review this fiscal and regulatory regime comprehensive?
4. Will the proposed approach accurately assess whether the benefits of resource wealth are being maximized for the GNWT, NWT residents, and future generations?



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Our Experts and Our Commitment

- Level the playing field with industry experts:
 - Use experts with decades of industry experience.
 - Economists, modelers, lawyers, engineers.
 - Use industry methods – cash flow analysis.

- But no conflict of interest:
 - We work with governments and communities.
 - We never work for oil, gas or mining companies.



Methodology – Report Sections

1. Gap Analysis of the PWC Tax and Royalty Benchmark
2. Preliminary Government Revenue Analysis
3. Preliminary Revenue Risk Analysis
4. Conclusions and Recommendations

Caveats

- Desk study working from public domain information
- No information on other studies ITI may be planning



PWC Report – Tax and Royalty Benchmark

- ToRs – assess the tax and royalty competitiveness
- Replicate the methodology of a previous 2008 study
- Two hypothetical mines – diamond and base metals
- Analyze direct taxes, indirect taxes and total costs
- Assess different levels of profitability – IRR
- Provide an assessment of “fair return”



PWC high Level Findings

- NWT mining fiscal regime is among the most competitive in the world and in Canada.
- The return that NWT receives is in line with other jurisdictions in Canada and is therefore fair.
- It is high capital and operating costs that make the economics challenging for mining companies.
- Lowering royalties and taxes would not help encourage mining investment, while developing energy and transportation infrastructure would.

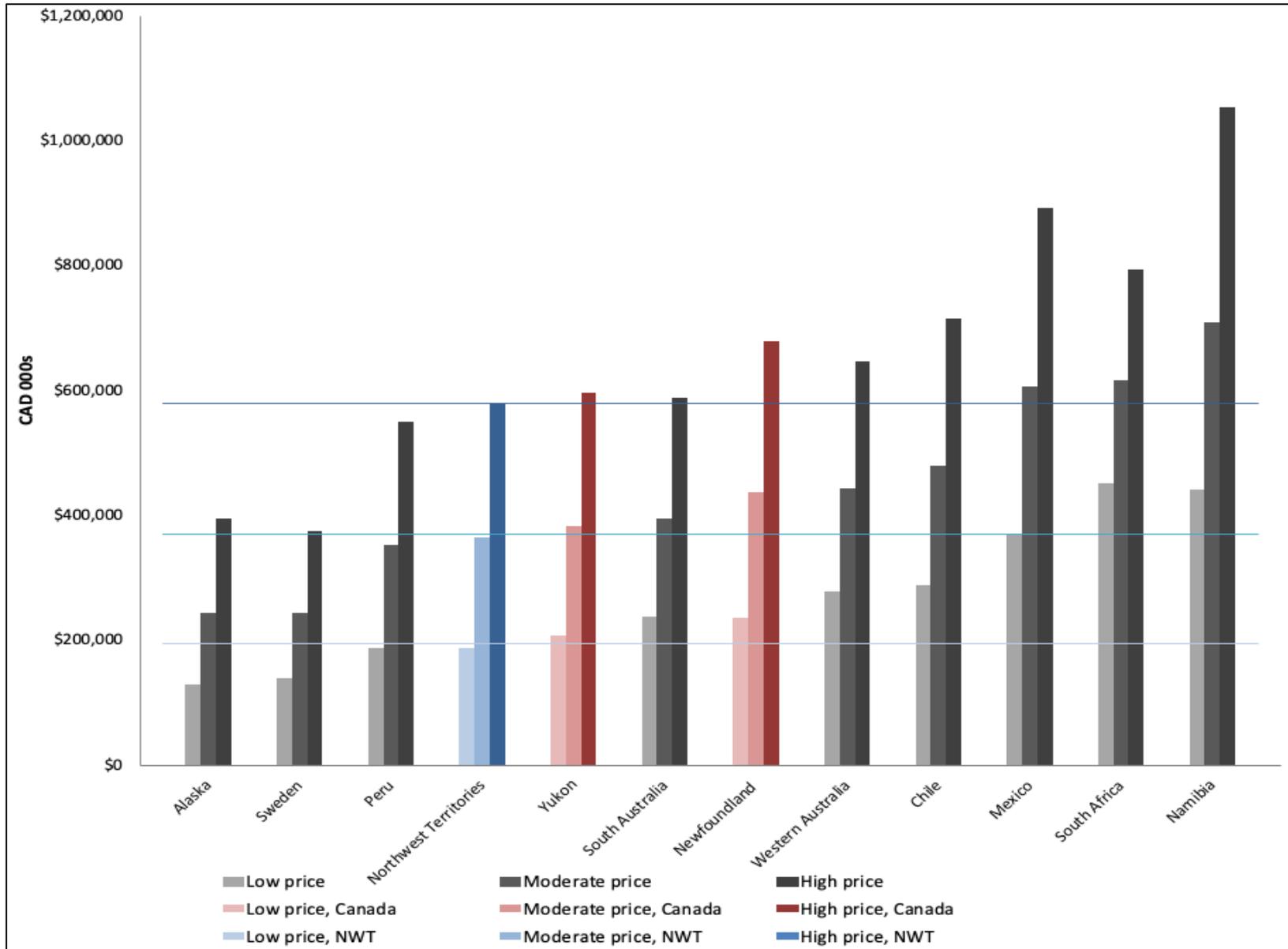


Gap Analysis – Limits of the TORs

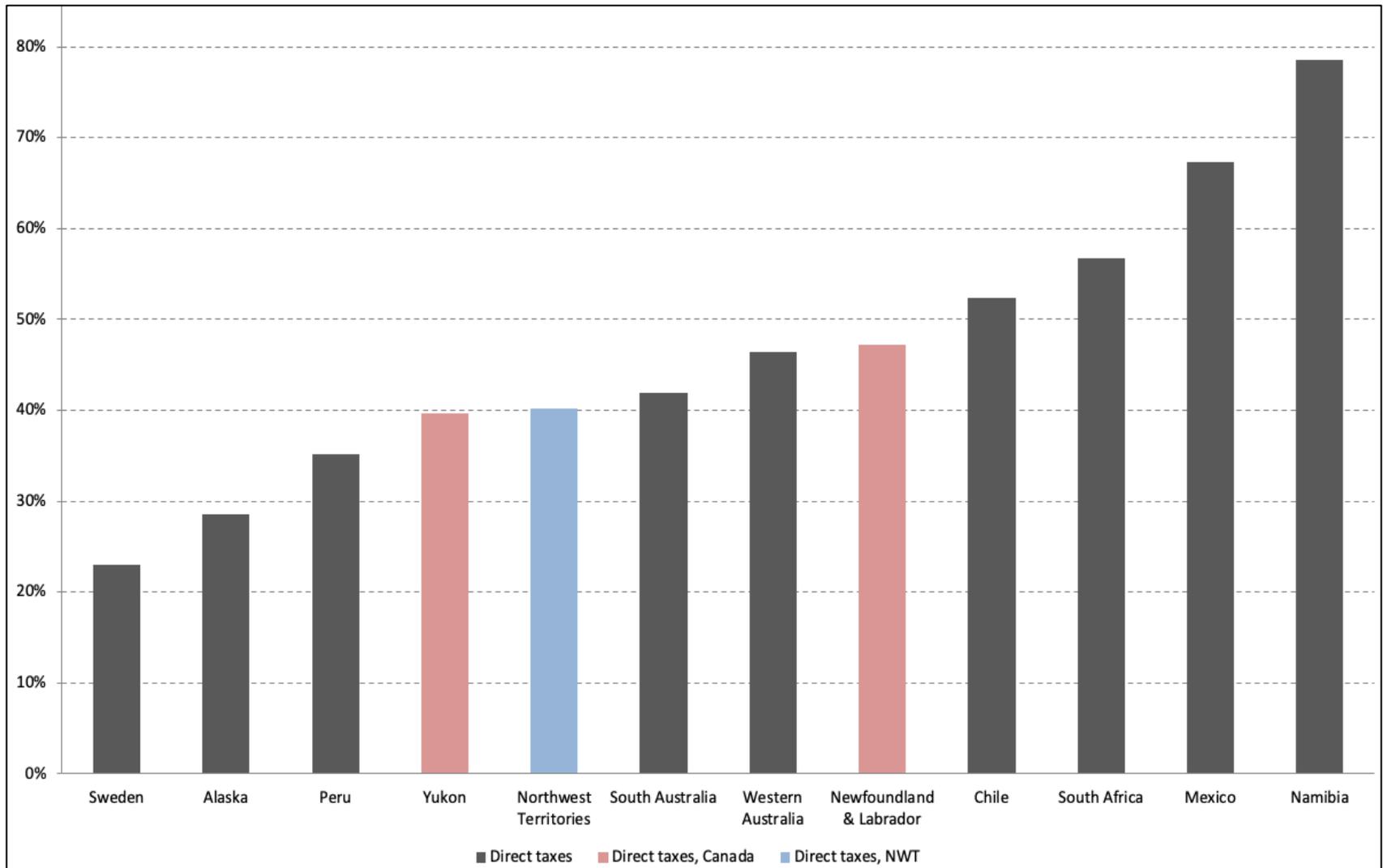
1. Benchmarking study examining payments to governments as a “cost” to companies and a potential barrier to inward investment.
2. Selection of comparators with emphasis on US and Canada – jurisdictions known to have among the lowest government take in the world.
3. Limited attention to analyzing the fiscal regime from the perspective of government revenue generation: fiscal instruments and core metrics.
4. No assessment of “net benefits” to the NWT.



PWC Selected Rankings – Large Diamond Mine



Government Take – Large Diamond Mine



Revenue Analysis – Fiscal Instruments

- NWT Royalty – a tax on mine profits
 - Graduated rate based on mine output 5%-14% (over \$45m)
 - Assessed on mine output with most mine costs deducted
- Corporate Income Tax – a tax on company net income
 - Federal tax rate of 15% applies to all mines in Canada
 - Provincial/territorial rates of 11.5% (NWT) to 16% (NS)
 - Assessed on net income, revenues less expenses
 - Accelerated depreciation rear-loads government revenues

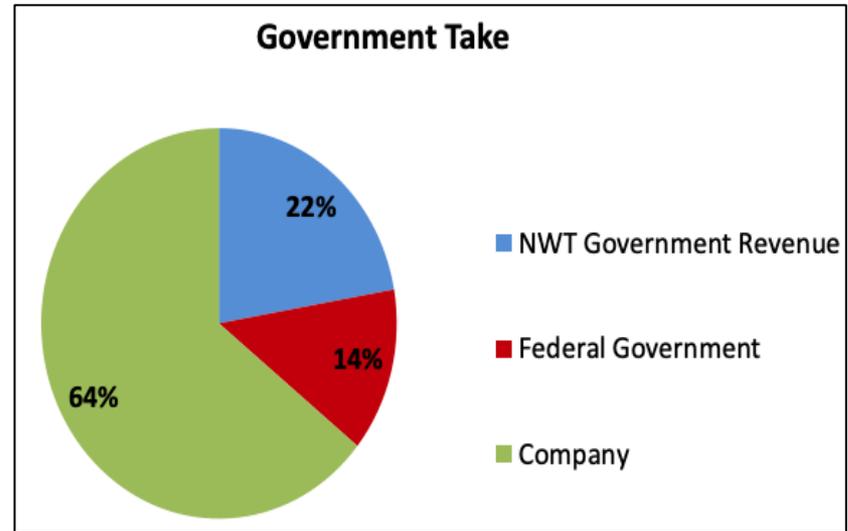
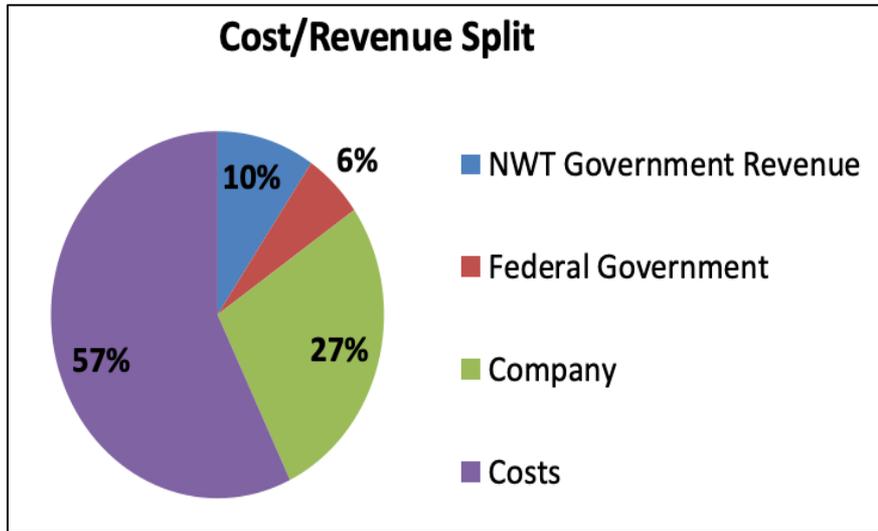


Developed Large Diamond Mine Model

- Discounted cash flow models are the main tool to analyze mining fiscal regimes for companies and also for governments.
- PWC models provide answers to many important questions that were not part of the ToRs
- We have recreated the large diamond mine model used in the PWC report.
- Used the model to conducted a preliminary government revenue analysis

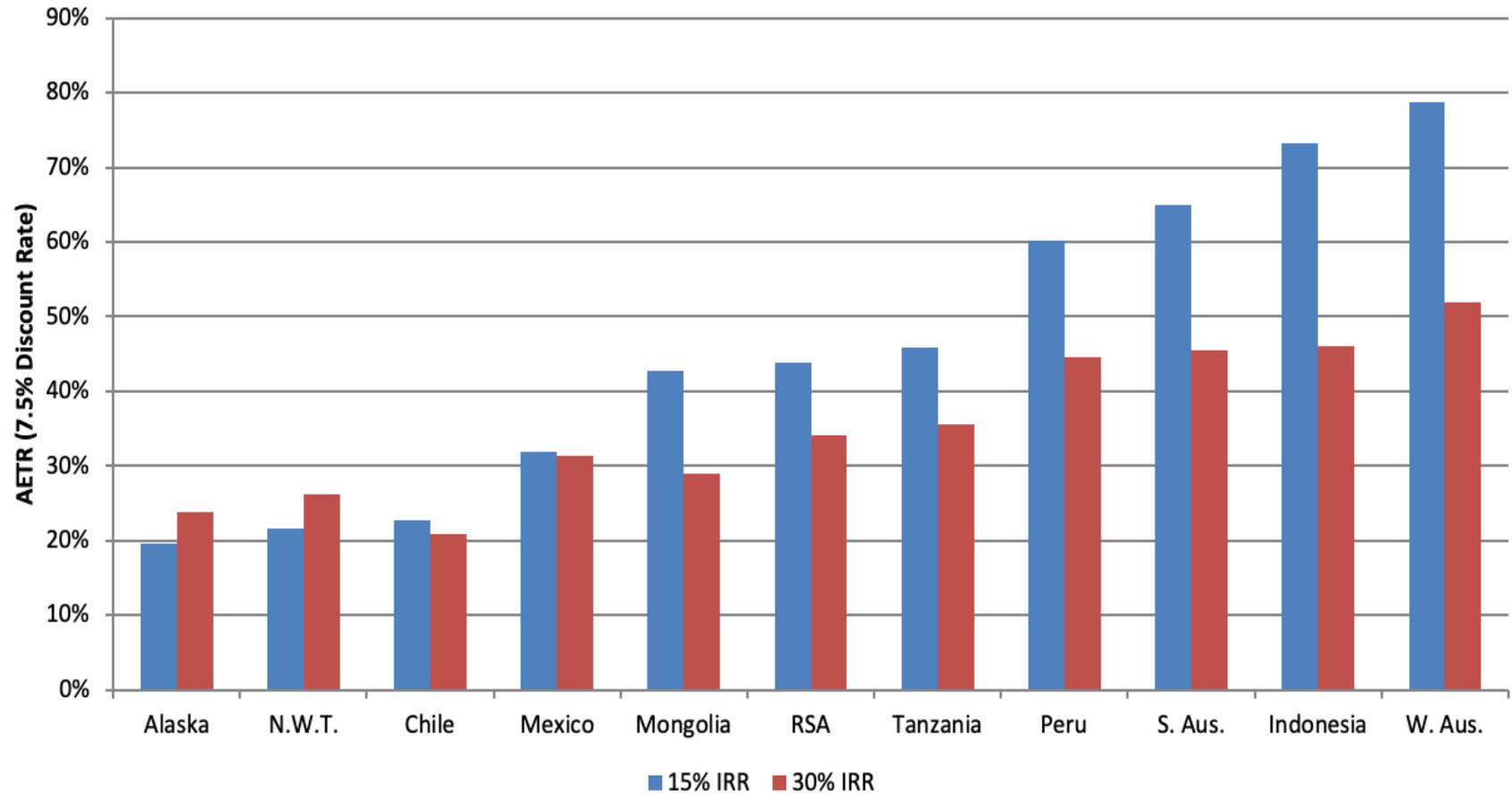


Cost/Revenue Split and Government Take



- Results shown for large diamond mine at IRR = 15%
- Costs account for nearly 60% of revenues
- After costs, government gets 36%, NWT gets 22%

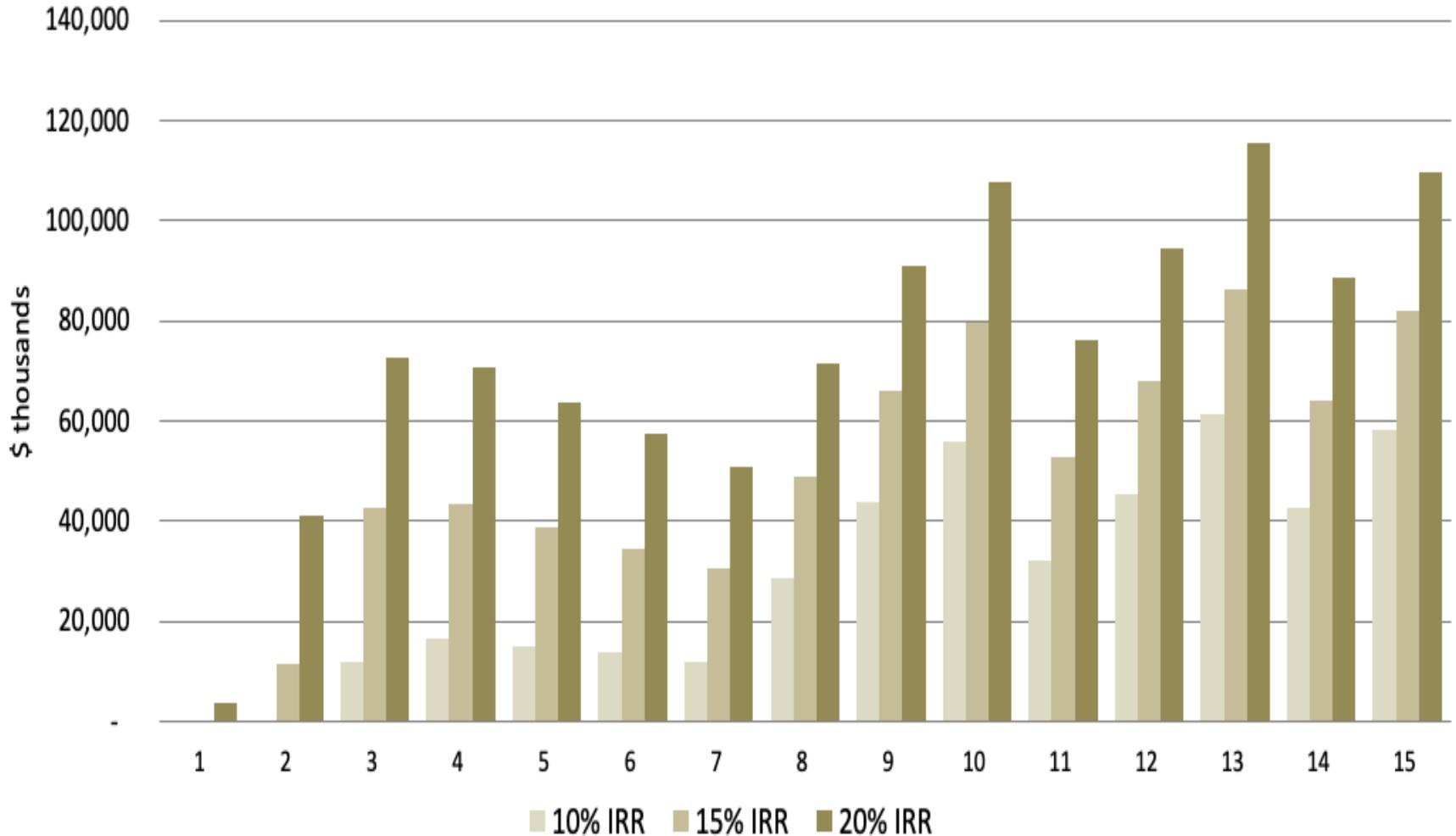
Consistent Finding that NWT Take is Low



NRCan 2011



Timing of Government Revenue



Preliminary Revenue Risk Analysis

- Economic models generate theoretical revenues
- Government revenues in practice normally fall far short of initial expectations even controlling for prices
- This can be the result of cost over-runs where capital and operating costs are higher than expected.
- It can also be the result of company tax optimization (Base Erosion and Profit Shifting or BEPS)
- BEPS risks are significant for the NWT given that both the royalties and tax are “profit sensitive”



Quantification of Plausible Revenue Risks

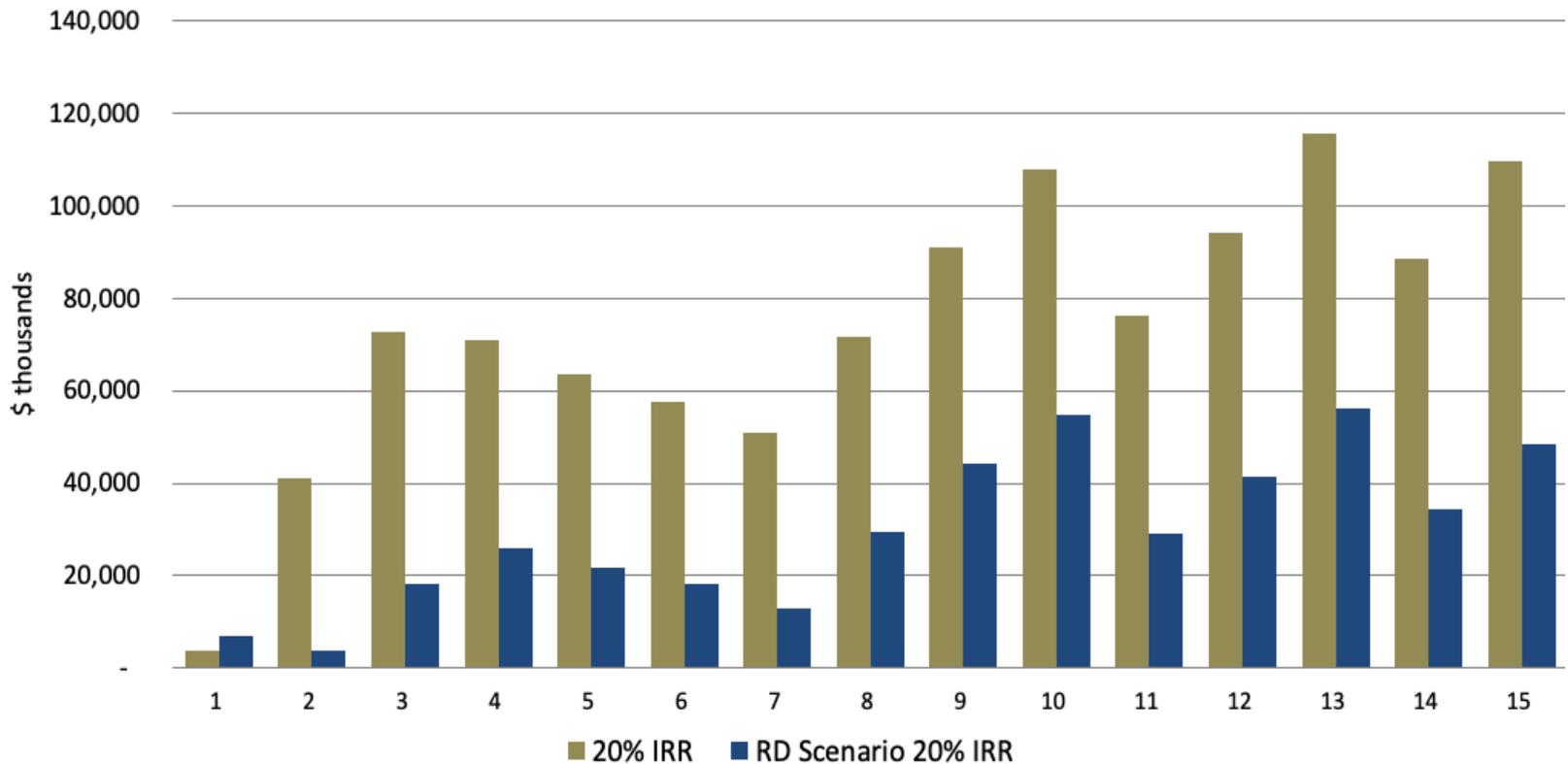
Base Case – Large Diamond Mine @ 20% IRR

- + Capital costs exceed original estimates by 30%
- + Operating costs exceed original estimates by 20%
- + Diamond marketing charges at 3%
- + Exploration costs at NWT mine site at \$10mil/year for 10 years
- + Exploration costs outside of the NWT at \$50 million
- + Historic tax loss carry-forward from outside NWT at \$50 million
- + Debt finance costs at 65% debt and at 8% interest
- + Removal of assumption of revenue inflation at 2% per annum



Impact of Risks on Government Revenues

	Government Revenues	NWT Revenues
PWC @ IRR of 20%	1,779,340	1,115,779
Revenue Risk Impact	722,212	445,663



Question	Response
Is the GNWT maximizing benefits from resource extraction?	No – the government take for mining is among the lowest in Canada and in the world.
Does the GNWT fiscal and regulatory structure maximize value for NWT residents and future generations?	No – although the PWC report does not conduct this kind of analysis, a preliminary review indicates that revisions to the fiscal regime could increase value.
Is the proposed approach by the GNWT to review this fiscal and regulatory regime comprehensive?	No – a comprehensive review would include (1) an assessment of performance of the fiscal regime since devolution, (2) a thorough potential government revenue analysis (3) an assessment of net revenue benefits (TFF).
Will the proposed approach accurately assess whether the benefits of resource wealth are being maximized for the GNWT, NWT residents, and future generations?	In addition to a benchmarking study, the other three areas of analysis would need to be completed in order to assess whether benefits of resource wealth are being maximized.

Are Mining Revenues Important?

Does the GNWT believe that maximizing government revenues from the mining sector is an important policy objective?

"Mining taxes are obviously one part of it, but the value for us are the jobs, are the indirect economic benefits that come from the jobs." (Ontario Mines Minister, 2015)



Recommendations

1. Analyse Fiscal Performance since Devolution
2. Implement Government-led Revenue Transparency
3. Conduct a Review focused on Government Revenue
4. Analyse the Net Revenue Benefits for the NWT
5. Expand First Nations' Economic Benefit Sharing



Thank You / Masi

