The Resource Super Profits Tax and the 2010/11 Federal Budget

How the Henry Review and 2010/11 Federal Budget will harm Australia's economic interests

Julie Novak
Research Fellow

June 2010

Institute of Public Affairs
Free people, free society

Contents

Executive Summary

- The 2010/11 federal budget announced a $41 billion deficit for the coming financial year, on the back of a record $57 billion deficit in 2009/10.
- The federal government intends to reduce this multi-year deficit by pursuing the growth-retarding strategy of tax and revenue hikes.
- Government revenues are expected to rise by $93 billion from 2009/10 to 2012/13, on the back of policy decisions such as a 40 per cent Resource Super Profits Tax (RSPT), tobacco excise hikes, an LPG excise, standard income tax deductions, and a tax compliance crackdown.
- The RSPT will be a punitive tax regime that will hurt emerging resource projects that require sufficient return to become a commercially viable proposition.
- The RSPT also undermines the need for capital-intensive mining investors to have certainty and stability in government policy decisions, ameliorating sovereign risks.
- The rationale for a RSPT to correct a 'two speed economy' is fallacious, ignoring the need for scarce labour and capital to move to their most valued uses in the economy. The RSPT will hurt manufacturing and services industries on the eastern seaboard of Australia that are closely linked to mining.
- Mining windfall taxes implemented in other countries have been associated with capital flight of mining investments to safer destinations.
- The government's mining tax plan was inspired by the recently released Henry Review, which in itself is a plan for a significantly higher tax take on Australians into the future.
- Instead of a plan to burden individuals and businesses with new and increased taxes, the Henry Review and the 2010/11 federal budget should have contained plans to: reduce spending; rule out the implementation of the RSPT; and decentralise income taxing powers to the states.

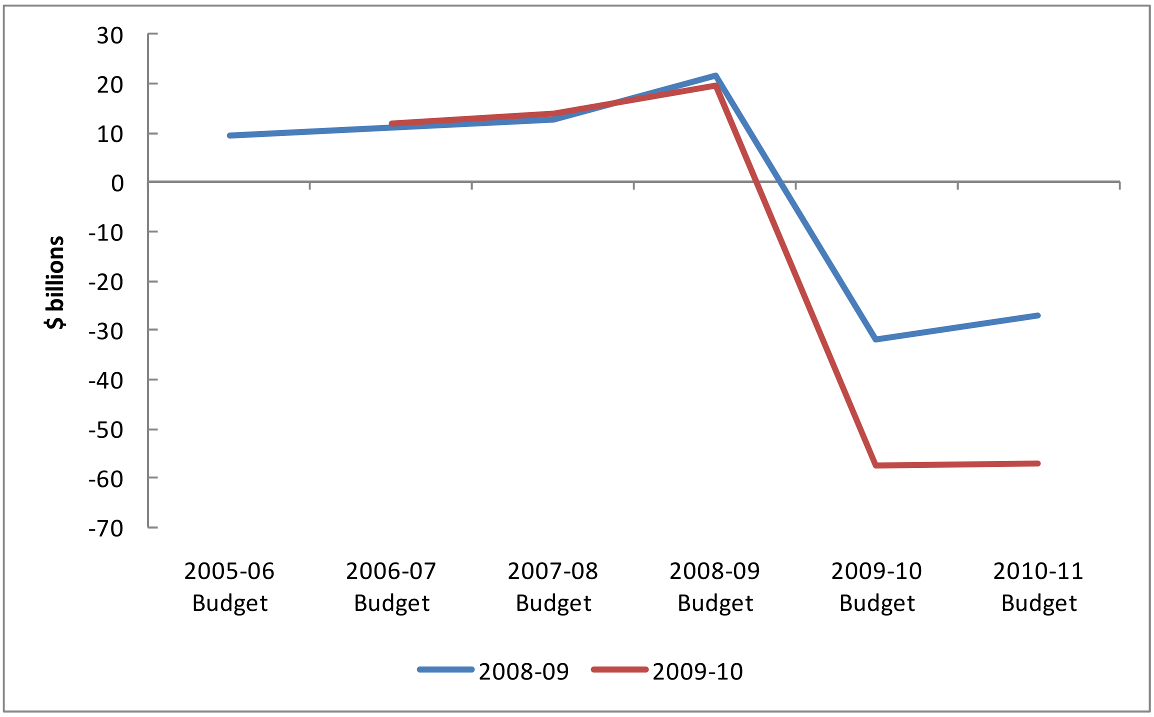
Taxing our way to prosperity? The Rudd government's approach to fiscal management

The Rudd government implemented a host of fiscal and economic policy changes in response to the 'global financial crisis' (GFC) of late 2008.

These included the provision of $900 tax rebate cheques to eligible taxpayers, subsidies for home insulation, capital works on school halls and libraries, and grants to local governments for miscellaneous projects.

Apart from the adverse effects of these policies on Australia's long run productivity growth prospects, the fiscal implications of this significant increase in spending was profound. In response to one quarter of negative GDP growth, recorded in late 2008, the Rudd government plunged the federal budget into a multi-year deficit cycle (Figure 1).

Figure 1: Underlying cash balance forecasts for 2008/09 and 2009/10



2008/09 UCB outcome presented in the 2010/11 federal budget is an actual figure. Other figures are estimates or forecasts.
Source: Commonwealth Budget Paper No. 1, various years.

From an initial forecast in the 2005/06 federal budget papers of a $9 billion surplus in 2008/09, the actual result was a $27 billion deficit. The federal budget turnaround for 2009/10 is even worse, with an initial $12 billion forecast surplus deteriorating into a massive $57 billion deficit.

From a negative net debt position attained by the previous government, Australians are also now burdened with a federal general government sector debt increasing to $94 billion by 2012/13.

Sensitive to the charge that it has recklessly managed Australian public finances, the Rudd government has announced in the latest federal budget that the budget will return to a cash surplus (of $1 billion) as soon as 2012/13. This was compared to a previous forecast of a surplus by 2015/16.

It is possible to discern from the budget papers the process by which the government intends to restore fiscal sustainability. In essence, the government plans to plug the fiscal gap by pursuing the growth retarding strategy of tax and revenue increases.

The available data shows that from 2009/10 (the year of the estimated peak deficit of $57 billion) to 2012/13 (the year in which the federal budget is forecast to return to surplus), general government sector receipts will increase from $285 billion to $378 billion – an increase of $93 billion, or 33 per cent over the period.

In absolute terms expenditure will continue to rise from $339 billion to $374 billion (an increase of $35 billion, or 10 per cent) over the same period, with additional expenditure commitments such as the broadband rollout concealed in the federal budget's contingency reserve.

A major revenue source at the disposal of the government is the corporate income tax, with receipts expected to jump substantially from a global financial crisis affected $53.7 billion in 2009/10 to over $78 billion in 2011/12 (a $24.4 billion - or 45 per cent - increase over the period).

This expected outcome is reliant on assumptions of buoyant economic activity, including a one-in-sixty-year boost in the terms of trade, the strength of which have been questioned by leading economists.[1]

A number of other policy adjustments have been made which is expected to yield further revenues for the federal government:

- A 25 per cent increase in the tobacco excise rate, announced in late April, is anticipated to yield an additional $5 billion in revenue.
- A new excise on liquefied petroleum gas of 2.5 cents per litre from July 2011 and rising to 12.5 cents per litre in 2015, affecting 700,000 motorists.
- The government announced a $500 standard deduction on income tax returns from 2012/13 (rising to $1,000 from 2013/14). The government will be able to claw back additional revenue from those taxpayers who nominate the standard deduction, but have allowable deductions in excess of the standard amounts.
- Efforts by the Australian Taxation Office, supported by federal government funding, to recover at least $1.3 billion in revenue through a tax compliance crackdown.

[1] 'Budget sparks rate rise fears', ABC *Lateline* program transcript, 12 May 2010, http://www.abc.net.au/lateline/business/items/201005/s2896792.htm (accessed 17 May 2010)

Killing the golden goose: The Resources Super Profits Tax

Arguably the centrepiece of the Rudd government's budget is the Resource Super Profits Tax (RSPT), announced prior to the federal budget in response to the final report of the Henry Review.

In brief, the RSPT will apply a 40 per cent tax to the 'super' profits (calculated as the long term government bond rate) from non-renewable resource projects, after allowing for extraction costs and recouping capital investment.[2] The government intends to commence this tax on 1 July 2012, with revenues anticipated to total $12 billion over the forward estimates.

The government's contention - that the RSPT arrangements may be implemented without adverse consequences for the Australian economy - appears to ignore the circumstances faced by mining sector participants.

In reality, mining investments are typically capital-intensive that involve long gestation periods of a decade or more to realise an operating profit. Mining is also a high risk activity, with investments based on numerous long term economic and financial assumptions such as commodity price levels, production capacity, and expected operating costs.

As noted by Sinclair Davidson, '[m]ining, like all other industries and businesses, relies on entrepreneurial insight for success. Miners do not accidentally or suddenly become wealthy. Like all other businesses they have to forecast future sales, and acquire resources to meet future demand. They need to carefully manage their costs which are often fixed while selling into highly competitive global markets.'[3]

Due to the unique conditions prevalent in mining it is essential that policy institutions, such as taxation settings, remain stable and competitive so as to facilitate long term investments in the sector.

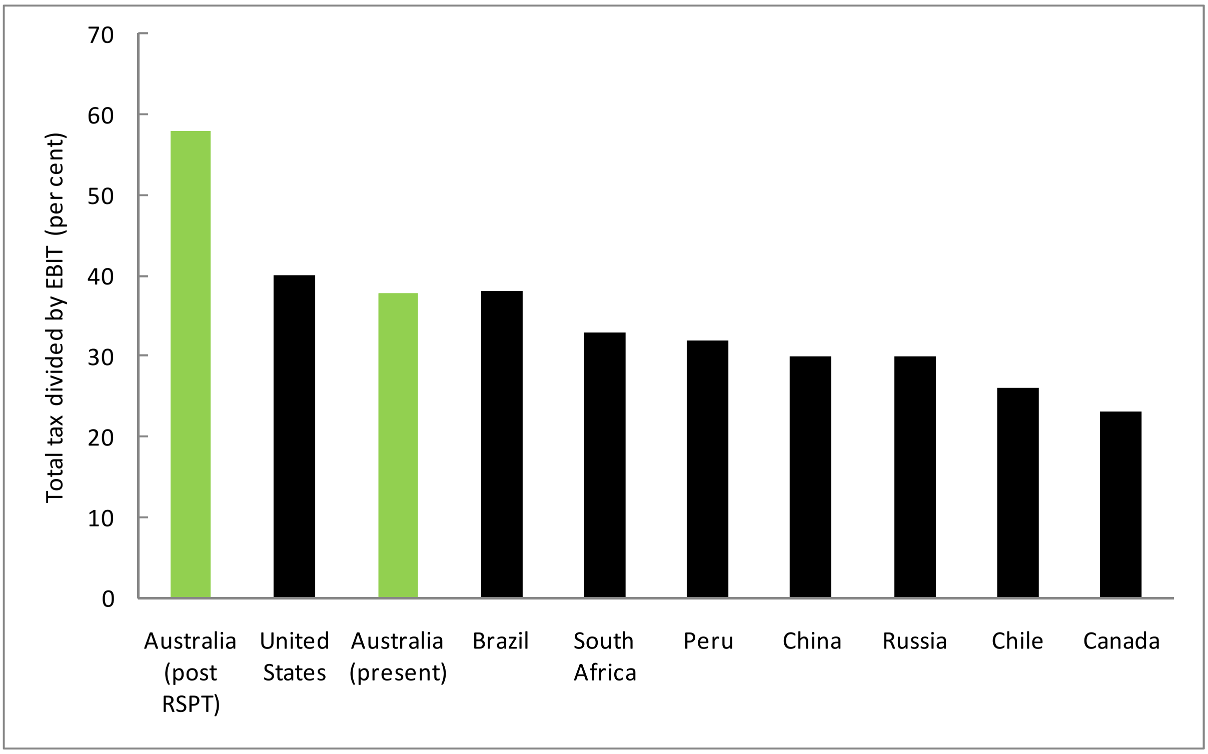
It has been estimated that under the proposed RSPT the effective tax rate for a mining company operating in Australia will be 57 per cent, up from 43 per cent previously. This would place Australia in an uncompetitive tax position compared to alternative mining investment destinations such as the United States (40 per cent effective mining tax rate), Brazil (38 per cent), Chile (26 per cent) and Canada (23 per cent) (Figure 2).

---

[2] The RSPT will operate in parallel with state and territory royalty regimes. The federal government will provide a credit to companies for royalties paid to state governments following the introduction of the RSPT. Commonwealth of Australia, 2010, 'Fact Sheet: Resource Super Profits Tax', http://www.futuretax.gov.au/documents/attachments/10_Fact_sheet_Resource_Profit_Tax_Final.pdf (accessed 14 May 2010).

[3] Sinclair Davidson, 2008, 'The 'mining boom' myth', *IPA Review* 60 (5) (November): 31-32.

Figure 2: Total effective mining tax burden under RSPT



Source: Citigroup Global Markets, 2010, 'Henry Tax Review - It looks bad, but is it really?', *Citi Metals and Mining*, 2 May.

In addition, the inherent riskiness of mining investments implies that the cost of capital to fund projects are usually well above the long term bond rate.[4] This implies that the RSPT represents a punitive tax regime that will particularly affect emergent resource projects that require substantial returns to become a commercially viable proposition.

Support for the RSPT has been predicated, in part, on the need to prevent the re-emergence of the so-called 'two speed' economy – with the resource states of Western Australia and Queensland growing strongly on the back of an improved terms of trade, with an attendant reallocation of capital and labour favouring lucrative mining projects in those jurisdictions, while the 'rust belt' southern states of NSW, Victoria and Tasmania languish in the growth and production factor attraction stakes.[5]

This proposition ignores the complex interlinkages across industries and locational space. Mining provides critical support to industries including metal fabrication, machine construction and repair, transportation, carpentry, plumbing, welding and other manual services.

People in these associated industries may work on a contract basis with mining companies, repatriating some of their incomes to family members living in other towns or states. A considerable proportion of mine workers operate on a 'fly-in, fly-out' basis from capital cities and major regional centres, with beneficial flow on effects for other areas that are far flung from mining sites.

[4] Judith Sloan, 2010, 'Mining tax concocted in La-La Land', *The Age*, 7 May.

[5] For example, the Deputy Governor of the Reserve Bank of Australia, Ric Batellino, was reported to have recently stated that 'from the viewpoint of the whole Australian economy, the best thing that could happen is for one of the big projects to fall over' against the context of easing capacity constraints in the face of an impending mining boom. John Kehoe, 2010, 'RBA deputy governor rejects miners tax threat', *The Australian Financial Review*, 11 May.

The corporate headquarters for a host of major Australian mining companies are based in eastern states, with the in-house logistical services (for example, accountancy, corporate governance, legal and regulatory affairs) providing an important source of white-collar employment in non-resource jurisdictions.

The attainment of economic efficiency requires that resources flow freely to their best valued uses, and thereby to more profitable industries. A diminution of economic activity in the mining heartland as a result of the RSPT will inevitably flow through to other regions of Australia in the form of lower economic growth and fewer job opportunities.

As attested by the experience of various countries in recent years, the implementation of mining windfall taxes is commonly associated with the flight of capital to safer, lower taxing nations:

- Mongolia introduced a 68 per cent windfall profits tax on gold and copper in 2006, at thresholds significantly below going market prices. The tax led to a reduction in exploration activity, an increase in smuggling of the affected metals, and falling share prices of numerous mining companies.[6]
- New Zealand introduced special levies for coal and oil production that subsequently induced capital flight for more than a decade following the repeal of the taxes.[7]
- Papua New Guinea introduced an Additional Profits Tax on the Bougainville copper mine project in the 1970s. In response to a sustained reduction in the country's share of global exploration investment, the government abolished the tax in 2003. The tax was reintroduced in 2008 for a major liquefied natural gas project.[8]

While other factors – such as the integrity of the legal framework, and the degree of security over tenure – impinge on the location of mining activities around the world, the anecdotal evidence presented above suggest that higher mining taxes are associated with the 'capital flight' of mining investments to more hospitable business environments.

In the Australian context, a number of mining companies have already announced their intentions to shelve or defer their operations in response to the RSPT (Box 1), with significant implications for the future development of the sector.

---

[6] James M. Otto, 2007, 'Competitive Position of Mongolia's Mineral Sector Fiscal System: The Case of a Model Copper Mine', http://www.nambc.org/docs/Dr.%20James%20Otto%20--%20Mongolia%20Competitive%20Tax%20Report%20%202007.pdf (accessed 14 May 2010); World Growth International, 2008, *Taxation and Mining in Mongolia*, http://www.worldgrowth.org/assets/File/World_Growth_-_Taxation_and_Mining_in_Mongolia_-_English.pdf (accessed 14 May 2010).

[7] Letter to the Editor, *The Australian*, 12 May 2010.

[8] World Growth International, Ibid.

Box 1: Mining sector participant reactions to Resource Super Profits Tax

Mining companies with significant operations, existing or potential, in Australia have announced that they are reassessing selected resource projects in anticipation of a higher tax burden and lower sectoral rates of return.

On 10 May the Xstrata Copper North Queensland Division announced the suspension of its $30 million, three-year copper exploration project in the Mt Isa and Cloncurry area. The chief operating officer, Steve de Kruijff, stated 'the proposed tax has introduced great uncertainty about the potential impact on the economics of developing resources into viable operations in Australia.'

Santos recently announced it would defer for up to six months a decision on whether to build a $15 billion liquefied natural gas plant in Gladstone, Queensland.

Other companies, such as BHP Billiton, Rio Tinto and AngloGold Ashanti, indicated that they were reviewing the status of selected projects in light of the Rudd government's RSPT announcement.

US based company Peabody Energy recently reduces its takeover bid for Queensland coal entity Macarthur Coal, citing the RSPT as a factor in reducing the value of its offer.

Fortescue Metals Group chief executive Andrew Forrest recently stated that 'the proposed introduction of an unfair tax on mining profits will force companies to pursue offshore projects,' while Rio Tinto chief executive Tom Albanese expressed concerns 'about the inclusion of existing businesses and the arbitrary nature of the 40 per cent tax rate.'

News of the proposed introduction of the RSPT also led to almost immediate falls in share prices for major mining stocks.

Source: Andrew Fraser and David Nason, 2010, 'Santos joins big mining's tax revolt', *The Australian*, 7 May; Dennis Shanahan, 2010, 'Labor states back big mining companies on resources profits tax', *The Australian*, 11 May; Dennis Shanahan and Jennifer Hewett, 2010, 'Mining delays 'not all bad': Treasury', *The Australian*, 13 May; 'Paying off Canberra', *The Wall Street Journal (Asia edition)*, 13 May 2010; Xstrata, 2010, 'Xstrata Copper's North Queensland Division announces the suspension of its regional exploration program', News release, 10 May.

The notion that the RSPT is necessary to obtain a 'fair' return on the extracted natural endowments that the community 'owns' needs to be challenged if Australia is to avoid backsliding into outright property rights expropriation commonly associated with developing countries.

Mining companies routinely invest billions of dollars in exploration, build their own infrastructure to bring their products to port, and then compete on volatile world commodity markets as price takers.[9] This requires not only the combination of scarce capital and labour resources, but the application of entrepreneurial flair and ingenuity.

In exchange, it is reasonable that miners anticipate a reasonable financial return on commercially viable projects to justify their substantial investments. A punitive tax on legitimately acquired returns sends a worrying signal that Australia is closed for business not only in mining, but in other sectors of the economy that stand to enjoy success on their own terms.

[9] 'The Rudd Mining Grab', *The Wall Street Journal (Asia edition)*, 4 May 2010.

The Henry Review

The Rudd government's budget plan for new and increased taxes is heavily drawn from the 1,072 page final report of the Australia's Future Tax System Review (Henry Review), commissioned to examine the Australian taxation (including federal, state and local taxes) and transfer system.

The report claims that 'the reform vision is estimated to be broadly fiscally neutral, after taking into account the net fiscal gain from the estimated increase in national output.'[10] Such a design for a tax reform package is a classic pea-and-thimble trick of orthodox public finance, whereby some taxes are downscaled or abolished outright to be replaced by alternative taxes with potentially higher revenue yields.

A host of largely state based imposts (payroll tax, stamp duties, insurance taxes, mining royalties, and some taxes on the ownership and use of motor vehicles) are slated for abolition by the Henry Review, with the federal corporate income tax rate reduced to 25 per cent (and still above the rates of Asia-Pacific competitors such as Hong Kong and Singapore).

In its place the Review recommends that governments establish taxes within four broad tax bases (personal and business incomes, private consumption and economic rents). Some of the new and increased taxes proposed by the Henry Review include:

- A uniform resource rent tax, applied at a rate of 40 per cent, to onshore non-renewable resource projects;
- A broader land tax base to incorporate all forms of land;
- A destination based 'cash flow' tax imposed by the Commonwealth, with revenues to be disbursed to the states;
- A regime of variable congestion pricing on road networks;
- Indexation of the federal fuel excise to the CPI;
- Taxation of all alcoholic beverages of a volumetric basis, with effective tax rates on some products increased in accordance with their higher alcohol content;
- A 'substantial' increase in tobacco excises, and indexed to wages instead of CPI;
- Ensuring that gambling taxes 'are focused on recouping economic rent generated by government restrictions on the supply of gambling services or are being used efficiently to impose such restrictions,'[11] and the elimination of gambling tax concessions;
- Removal of certain tax concessions for not-for-profit organisations, and raising the gift deductibility threshold for the purpose of income tax; and
- Removal of grandfathering arrangements relating to assets acquired before the commencement of capital gains tax.[12]

The Review also recommended that the government proceed with a further investigation into the merits of wealth taxes.

To be sure, the Rudd government has released a statement ruling out some of the more politically charged

[10] Australia's Future Tax System Review Panel, 2009, *Australia's future tax system: Report to the Treasurer*, Commonwealth of Australia, Canberra, p. 76.
[11] Ibid.
[12] Ibid, p. 80-106.

tax base broadening proposals, such as a land tax on the family home.[13] However, as the official response to the Henry Review made clear, governments can readily cherry pick from, and in some cases redefine, the 138 recommendations to raise additional revenue from taxpayers.[14]

Like the 1975 Asprey Review and the 1985 Tax Summit before it, the intention of 2010 Henry Review is that it is built to last. The spectre of long term fiscal deficits in the face of population ageing led the Treasury Secretary to remark earlier this year that 'it would be prudent to plan on the basis that the tax system will have to generate revenues to meet substantially larger fiscal costs.'[15]

Should policymakers have insufficient appetite to roll back spending by the 'demographic state,' including allowing the more efficient private sector to deliver more services to the aged, the Henry Review might provide future governments with avenues to impose new taxes upon relatively fewer people of working age.

Even if it were no part of the Review Panel's intention the Henry Review is likely, in practice, to inspire an increase in the size of the Australian public sector into the future, with all the attendant inefficiencies and losses of economic liberties involved.

[13] The Hon Kevin Rudd MP and The Hon Wayne Swan MP, 2010, 'A tax plan for our future', Media release, http://www.futuretax.gov.au/documents/attachments/100502_stronger_fairer_simpler_a_tax_plan_for_our_future.pdf (accessed 17 May 2010). On the other hand, the government does not favour the removal of the Medicare Levy.

[14] According to the government's response to the Henry Review (outlined in the statement 'Stronger, Simpler, Fairer: A tax plan for our future'), the net fiscal effect is to *increase* revenue (including from the RSPT) by about $3.2 billion over four years.

[15] Ken Henry, 2010, 'Changing Taxes for Changing Times', Address to the Australasian Tax Teachers Association Conference, http://www.treasury.gov.au/documents/1714/PDF/Australasian_Tax_Teachers_ATT_Speech.pdf (accessed 17 May 2010), p. 10.

What was missing from the Henry Review and 2010/11 Federal Budget?

A genuine commitment to smaller government

The scope of the terms of reference for the Henry Review was limited to issues of taxation policy design. Importantly, the terms of reference also insisted that the Review's recommendations not presume a smaller general government sector.[16]

When it is recognised that government revenues and spending are two sides of the same fiscal coin the orthodox public finance presumption of efficiency gains through tax base broadening are substantially weakened. As once explained by Australian public choice theorist Geoffrey Brennan:

> *the broadening of the tax base makes it easier for the government to raise additional revenue, and ... government will in the long run adjust to this greater ease by increasing its total claim on resources. Suppose one believed, however, that the resultant increase in government spending would involve substantial waste, or would yield to taxpayers lower benefits than they would have received if they had spent the proceeds privately. Then even if there were gains in terms of more neutral choices among private goods to be obtained from broadening the tax base, these would have to be set against the efficiency losses attributable to the expansion of public spending.*[17]

In other words, the Henry Review represented a lost opportunity to advocate an unambiguously low taxation future that would constrain the ability of governments to engage in spending misadventures of the like witnessed during the aftermath of the GFC.[18]

The 2010/11 federal budget similarly failed to lay out a meaningful, effective platform conducive to smaller government. On the revenue side, as discussed above, the Rudd government has devised a concoction of discretionary tax and revenue hikes that, in combination with rosy economic assumptions, is supposed to deliver a return to surplus budgeting.

The government has also touted its previously announced 2 per cent cap on real spending growth as an instrumental factor in delivering an expected federal budget surplus in 2012/13.

---

[16] The terms of reference also specify that the recommendations be consistent with the federal government's tax-to-GDP commitments. As explained by former ministerial advisor David Alexander, 'before the election Labor's promise was to "not increase taxation as a proportion of gross domestic product." But the government's new formulation, as expressed by Kevin Rudd … is to "ensure that the level of taxation remains lower on average than the level we inherited in 2007-08." … The pre-election tax level that was promised as a hard upper-bound limit has morphed into an average-level limit with no timeframe, thereby allowing for large increases in tax.' While the Henry Review was finalised prior to the reformulated tax-to-GDP objective, the policy revision nonetheless provides additional leeway for the government to significantly increase its revenue take. David Alexander, 2010, 'Be prepared for a fatter, big-taxing government', *The Australian*, 16 April.

[17] Geoffrey Brennan, 1987, *The Case Against Tax Reform*, Australian Institute for Public Policy Critical Issues No. 7, p. 21-22.

[18] In an important contribution to the debate over the effectiveness of stimulus spending, Sinclair Davidson adjusted information published in the budget papers that show, contrary to Treasury assertions, a statistically insignificant relationship between the size of stimulus packages by nations and growth forecasting errors. Sinclair Davidson, 2010, 'Did the stimulus work?', *Catallaxy* blog, 13 May, http://catallaxyfiles.com/2010/05/13/did-the-stimulus-work/ (accessed 18 May 2010).

However the purported adherence to the spending cap is in fact based on a series of arithmetical and other fiddles buried deep within the fine print of the budget papers. Two cases in point include:

- The treatment of the deferral of the Carbon Pollution Reduction Scheme (CPRS). The government has removed the fiscal effects of the CPRS from the forward estimates, but has allowed up to $30 billion in household and industry compensation under the Scheme to be spent elsewhere.
- The treatment of the National Broadband Network (NBN). Spending under the NBN is being treated as an 'equity investment' contained within the budgetary contingency reserve, that does not appear in the operating statements of the budget.[19]

It should also be recognised that the spending cap applies to the average of total general government sector expenditure, allowing a host of program spending items to grow in excess of the cap.

The federal budget papers reveal that items that would require further cost constraints in 2012/13 include carers' income support (12 per cent), defence support (9 per cent), assistance to states for public hospitals and health care (8 per cent), seniors' income support (8 per cent), and Medicare services (6 per cent).

There is an abundance of empirical evidence demonstrating that government taxing and spending should remain as low as possible if nations are to sustain economic prosperity and individual freedoms.[20] With the Henry Review having been released in recent weeks, now is an opportune period for the Rudd government to proceed with a comprehensive audit of Commonwealth expenditure activities identifying potential savings to be pursued by current and future governments.

Allowing Australia to succeed on the international economic front: No new mining taxes

The country’s future prosperity is too important for mining - arguably Australia's most pivotal sector in an increasingly integrated global economy - to be placed at risk in order to mop up the fiscal spills of its stimulus packages.

Industry sources have noted that mining enterprises already make a significant contribution to the revenue collected by governments.

Over the past decade Australian mining companies paid $80 billion in company tax and royalties - approximately the size of the six month federal fiscal stimulus programs rolled out during 2008/09. Since 2004/05 it has been estimated that the expansion of mining activities have delivered an additional $334 billion to the Commonwealth Government alone.[21]

---

[19] Terry McCrann, 2010, 'Treasurer Wayne Swan's hidden $50bn', *Herald Sun*, 13 May.

[20] A number of recent surveys have been published that examine the relationship between fiscal activities and economic performance. See, for example, Dennis C. Mueller, 2003, Public Choice III, Cambridge University Press: Cambridge; and Daniel J. Mitchell, 2005, "The Impact of Government Spending on Economic Growth", Heritage Foundation Backgrounder, http://www.heritage.org/Research/Reports/2005/03/The-Impact-of-Government-Spending-on-Economic-Growth (accessed 18 May 2010).

[21] Minerals Council of Australia, 'Resources Super Profits Tax: Key Points', http://www.keepminingstrong.com/resources.ashx/MediaResources/6/ReleaseFilePdf/36AAD20517E9F6602713D96AE46E3D40/MCA_Keep_Mining_Stro198D44.pdf (accessed 18 May 2010).

For the reasons outlined above, the federal government should not proceed with a new, exorbitant mining tax that risks the future development of the sector.

The role of state and territory governments in the taxation of mining activities also should not be overlooked in the broader picture. As a preliminary paper by the Henry Review Panel indicated, there currently exists a multiplicity of royalty arrangements (Table 1).

Table 1: State and territory mining royalties

Jurisdiction	Mineral	Royalty
All states	Generally	*Ad valorem* royalty, generally ranging between 2.5 and 7.5 per cent of the value of mine output
All states	Certain low value commodities (e.g., clay, sand)	Specific royalty (amount per tonne)
Queensland	Coal	Base rate of 7 per cent of value. Additional 3 per cent applies to value over $100/tonne
Tasmania	Most minerals	Hybrid arrangements comprised of *ad valorem* and profit based royalty
Northern Territory	Most minerals except petroleum	Profit based royalty

Source: Australia's Future Tax System Review Panel, 2008, *Architecture of Australia's tax and transfer system*, Commonwealth of Australia, Canberra.

While the inter-jurisdictional variation in royalties (and prospective increases recently announced by resources states) presents a legitimate cause for concern for the mining sector, it is important to note that there is nothing precluding the states from imposing more efficient, low rate royalties on the profit derived from the sale of onshore natural resources. This option was not actively explored by either the Henry Review or the federal government in its initial response.

Such profit based royalty arrangements can already be investigated by states pursuant to the objective of reducing the overall burden of taxation upon the mining sector.

A plan to decentralise taxing powers, and revitalise the Federation

It has long been understood that our excessive vertical fiscal imbalance (VFI), or the discrepancy between taxing powers and expenditure activities across levels of government, has led to an increasingly dysfunctional Australian federalism.

The insufficiency of decentralised revenue powers in Australia tends to blur political accountability of public sector financial decisions, particularly at the state and local levels. One of the chief manifestations of this is the intergovernmental 'blame game' - where the Commonwealth can blame the states for inefficient services delivery, all the while that states blame the Commonwealth for a lack of financial assistance to rectify services inefficiencies.

The Henry Review acknowledged that state and territory governments need a degree of fiscal autonomy to function well. This would promote public accountability for spending decisions by premiers and chief ministers, improve the relative efficiency of public service provision and enhance state fiscal discipline.

However, the final report of the Review proposed in effect a substantial diminution of state fiscal autonomy. In one of the surprises to come from the report, it was suggested that states abolish their payroll taxes, often seen as a potentially efficient tax but plagued by numerous exemptions, with a tax on business cash flows.

With the possibility that such a replacement cash flow tax may be subject to constitutional challenge, such a tax would need to be imposed by the Commonwealth with revenues subsequently disbursed to states and territories.

Any illusions that a tax on cash flows would represent a state tax would have been shattered by the Rudd government’s recent policy earmarking 30 per cent of GST revenue, a much hyped ‘state tax‘ in the Commonwealth's care, to public hospitals.

As noted above, the Henry Review also suggested that the states abandon stamp duties and existing motor vehicle taxes. The Review urged states to abolish their mining royalties, however the federal government is instead proposing a convoluted scheme whereby mining companies receive refunds for royalty payments made to states.

Ultimately the Henry review needed to contain a blueprint for a financial settlement between the Commonwealth and the states, centred on a timetable for the return of full personal income taxing powers to the states.

This would have secured sufficient revenues for states to fund their core public services, while giving jurisdictions the freedom to adjust taxes accounting for voter preferences.

The national interest would also have been served by the consequent elimination of the blame game bedevilling Australian intergovernmental relations.

Conclusion

The Henry Review and the 2010/11 federal budget provide the textbook and action plan respectively for an Australian future characterised by new and higher taxes, including on a mining industry which is playing a fundamental role in underpinning our success through a turbulent economic period on an international scale.

The Rudd government's arguments that heavily taxed mining companies are not paying their 'fair share' of government revenue could potentially have serious economic consequences.

Indeed, the price of such folly is being keenly felt today by holders of mining company shares, and superannuants whose nest egg savings were being invested in the sharemarket. The mining sector is actively reconsidering its capital investments in Australia in light of the punitive RSPT, with the cost of the tax to be felt by all Australians as companies either close existing operations, relocate to other countries, or abstain from future opportunities to develop resources in Australia altogether.

The key to economic prosperity was highlighted by Adam Smith two centuries ago, when he referred to the role of 'easy taxes' as a key to opulence. The federal government should pay heed to Smith's advice, through a commitment to lower (and decentralised) taxes funded by expenditure reductions.