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TITLE: **Why we need a Resource Super Profits Tax**

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The Minerals Council of Australia's advertising campaign against the Resource Super Profits Tax (RSPT) highlights its $80 billion tax payments over the last decade. Eighty billion dollars in the abstract does not really mean much. It has to be related to the mining industry's profits and compared with other industries. The Australia Institute has made those estimates based on the broad measure of profits used in the national accounts; the industry *gross operating surplus*.

Using the national accounts basis for Australian industry as a whole, the average tax rate paid by Australian business in the nine years since the Howard government introduced the New Tax System was 24 per cent. (To ensure the estimate is based on the same figures as the mining industry, tax contributions here include company tax as well as other taxes less subsidies on products but exclude the GST.)

In comparison, the $80 billion tax contribution of the mining industry averages out at just 19 per cent. So, on the mining industry's own figures the taxes raised on the mining industry represent a smaller share of profits than for Australian industry as a whole.

It gets worse though. Mining is different to other industries since miners are given privileged access to resources that belong to the community as a whole. Royalties are collected to reflect the community's ownership of the minerals. So one would expect to find mining is more heavily taxed than other industries. To find the opposite is surprising and reinforces the need for a resource super profits tax. It's pretty clear that, to date, mining simply has not been paying its fair share.

The *Henry Tax Review* recommended a "resource rent tax" to cover most minerals in Australia which the Rudd Government has adopted as policy. The day after the release of the government's response to the Henry review, the Reserve Bank published its commodity price index which showed the commodity price index had increased 18 per cent in the month of April alone. This seemed to reinforce the need for the RSPT to allow the community to share in those high commodity prices.

The essential idea of the RSPT is simple: if a mining project is only earning ordinary returns then it would only attract the ordinary company tax. However, where a mine is sitting on a superior resource and generating super profits then the company should pay more tax. As the Henry Report put it:

> Through the Australian and State governments, the community owns rights to non-renewable resources in Australia and should seek an appropriate return from these resources.

The RSPT will also address the decline in the share of mining profits being collected by governments in Australia. The combined share of royalties and collections under the Petroleum Resource Rent Tax has fallen substantially: the annual figures quoted by the Federal Government show mining taxes, including company tax, went from around 40 per cent of profits on the eve of the mining boom to about 13 per cent at the moment.

The real question then is how much of the mining industry's super profits should be taxed? Using Norway as an example, it imposes a 78 per cent tax on super profits in the petroleum sector.

The government has accepted the *Henry Tax Review's* recommendation that super profits be taxed by way of a separate resources super profits tax of 40 per cent. However, ordinary company tax would still apply and the RSPT would be deducted from taxable income in calculating company tax. In the first year of operation, 2012-13, the total tax on super profits would be 58 per cent. However, as the company tax is reduced to 28 per cent by 2014-15 the RSPT would be reduced to 56.8 per cent.

While the rates on super profits could have been higher, in other ways the RSPT is rather tough. To tax super profits, or profits above a normal profit rate, the government has to define the normal rate of profit. For the Petroleum Resource Rent Tax the rate is the government bond rate plus 5 per cent for most expenditure and the bond rate plus 15 per cent for some exploration expenditures. However, for the proposed RSPT the rate is just the long bond rate, currently around 5.8 per cent. The government has flagged negotiations with the mining industry to determine the final shape of the tax and there may be some concession in the rate of return used to distinguish normal and super profits.

The reason the government uses the government bond rate for the RSPT is that it is seen as the risk-free rate of return in Australia. But a risk free mining investment would still not look like a government bond. Government bonds are not only risk free but are otherwise desirable; they are liquid in that there is a strong second hand market. They can be sold easily if a better alternative comes along. Presumably these and other arguments will be raised by the mining industry when they get beyond their immediate tantrums.

Prior to the Henry Review there was speculation that the Commonwealth government would have to negotiate with the States to abolish their royalty regimes. However, the scheme announced by the government allows the State royalties to be deducted against RSPT obligations. That effectively gives the States first claim on super profits. This may well be taken as an implicit recognition that the States have a more direct claim of ownership of the resources concerned.

The last mining boom gave very little by way of benefit to most ordinary Australians. Indeed, prior to the global financial crisis most people would have been affected only by the higher interest rates on their mortgages caused by the Reserve Bank's attempt to offset the macroeconomic impact of the mining boom. As the global financial crisis passes the mining boom has returned and once again the benefits are unlikely to touch most Australians, but the Reserve Bank response will.

In this context the RSPT is a vital mechanism for capturing some of the national benefits of high commodity prices and distributing them more widely. Without the RSPT mining companies and their largely foreign shareholders would get virtually all the benefits of Australia's superior resources while the bulk of Australians are either barely affected or made worse off.

Of course the question of distributing the gains raises a host of issues, and most of us would have different opinions as to the best use for any surge in revenue. Not surprisingly there has been some debate about how the additional super profits tax should be used, with some emphasis on building up reserves for a post mining future. The government's response goes some way towards that with its emphasis on infrastructure spending.

As for sharing the benefits of the super profits tax among individual Australians; most will go to superannuation benefits or lower company taxes that will benefit shareholders, including indirect shareholdings through superannuation. Nothing is expected to change for those on income support. Indeed, the Henry Report has flagged a reduction in pension payments through the use of lower rates of benefit indexation.

Likewise there is little so far from the government that goes towards assisting the sectors that have been adversely affected by the indirect impacts of the mining boom. All other trade-exposed sectors of the Australian economy have had to put up with a loss of competitiveness as the Australian dollar appreciated. Tourism and manufacturing appear to have been particularly hard hit.

A more imaginative approach could have addressed some of the other problems associated with the mining boom, in particular the tendency of the mining boom to squeeze out other sectors such as agriculture, manufacturing, tourism and other trade exposed sectors. A fund that is used to invest offshore can offset the cash inflow associated with mining revenue and so remove the pressure on the exchange rate. This is the approach taken by

Norway's Petroleum Fund. In addition, by keeping some of the RSPT revenue offshore the government will not be tempted to spend the revenue in a way that might exaggerate the boom.

The important point here is not the details of how a mining boom fund might be set up but the recognition of the principle that if a mining boom is associated with a massive increase in cash coming into Australia, it should be offset with the government managing a simultaneous outflow of cash. The build up of a portfolio of overseas assets also makes a lot of sense as a means of hedging against a possible future when the mining boom might end, either through a crash in commodity prices or a depletion of our resources.

Indeed, it is not even necessary that the government undertake all the offshore investment. Super funds and other financial institutions could be encouraged to invest in offshore assets. The mining companies themselves might be encouraged to keep their profits surge offshore. The important thing is that we understand how the Norwegian Fund works and debate the need in Australia to set up a mechanism that would do a similar job.

David Richardson is a Senior Research Fellow at The Australia Institute, a Canberra-based think tank, and is the author of *The benefits of the mining boom: Where did they go?,* published in June 2009. The paper is available at www.tai.org.au