Re: mineral resource rent taxation

At this stage NIEIR has not been retained by any party to comment on Commonwealth taxation. We accordingly present this submission in our own right. The submission is based on our macroeconomic expertise and also on past experience advising on negotiations involving the mining industry, particularly work for the NT Contractors' Association, the NT Government and three of the four NT Aboriginal Land Councils.

For decades now this Institute has emphasised the limitations placed on Australian economic activity by the balance of payments deficit. This deficit has persisted despite microeconomic reform. Faith in the exchange rate as an equilibriating mechanism has proved misplaced, for two reasons:

- Short-term influences over the rate have proved more important than long. The rate has tended to move in the direction contrary to that required for balance of payments equilibriation.
- The unpredictable fluctuations of the rate have themselves discouraged the long-term investments required if the balance of payments deficit is to be removed without major reductions in national income.

Given this starting point, NIEIR has consistently called for measures to encourage investment in the production of tradable goods and services. It might be expected that NIEIR would therefore favour incentives for mining, which produces highly tradable products. However, two points should be remembered.

- Net export revenue from mining investments is considerably less than gross revenue. This is because imported inputs (particularly diesel and increasingly equipment) absorb much mining revenue and in addition the greater part of gross operating profit is payable overseas due to the ownership structure of the industry. The importance of the industry for net exports is best assessed after deduction of these items, just as its importance for the overall Australian economy is better assessed by its contribution to National Income than by its contribution to GDP.
- For the most part, the mining industry adds minimal value to non-renewable resources. In this respect, the words 'resource rent', though technically accurate, are misleading: the rent concerned is not payment for use over a period of time, as in the rent of a building, but the price for the final sale of state-owned resources. This raises two further questions: first, the relationship of resource rents to royalties, and second, the relationship of mining to value added in downstream processing.

First, royalties. With three exceptions (minerals beyond the three-mile limit, uranium in the NT and some of the minerals on old-title land in NSW) minerals in the ground in Australia are the property of the Crown in the right of the states and territories. A royalty is the established term for revenue from the sale of these assets. For practical purposes the term can also be extended to payments negotiated by Aboriginal Traditional Owners for access to surface land required if underlying mineral resources are

to be extracted, in so far as they are additional to the compensation for disruption payable to surface landholders in general. The opportunity for Commonwealth taxation of 'resource rents' arises because, despite their need for revenue to counter the vertical fiscal imbalance, the states and territories have failed to exploit the revenue potential of royalties. This is serious, if only because a royalty has a different basis in law. It is not a tax and should be excluded from estimates of the tax burden. An alternative to the proposed tax would be for the Commonwealth to encourage the states and territories to modernise their royalty systems by calculating a target for royalty revenues for each state and territory. The target could be brought home by subtracting a proportion of each state and territory's shortfall in meeting this target from grants for capital purposes (thus underlining the capital nature of royalty revenue), or, failing this, by subtracting from the general revenue grants payable to that state or territory. The target could be set on the lines of the proposed tax, and might include an allowance for payments to Traditional Owners where appropriate.

Second, downstream processing. Just as the value of mining to Australia is commonly over-estimated, the value of downstream mineral processing is easily under-valued. In so far as such production meets domestic needs, it does not appear in the export statistics, but rather as a reduction in imports, with less obvious but equally important benefits to the balance of payments. Again, as explained by Peter Brain in Chapter 3 of his book 'Beyond Meltdown' (Scribe, 1999) downstream processing of minerals – i.e. manufacturing – is of critical importance to the productivity of modern economies. Australia's failure to maintain a vibrant manufacturing sector will, in the course of business as usual, lead to a steady fall in national income. The day of reckoning has so far been held off by running a balance of payments deficit, but this is unsustainable. Australian manufacturing has withered for many reasons, few of which are due to any inherent lack of competitiveness and most of which reflect the lack of supportive infrastructure, marketing and skill development policies coupled with poor risk management (rapidly fluctuating exchange rates and high real interest rates both discourage manufacturing, which depends on long-term investment). NIEIR accordingly supports measures to encourage downstream processing of minerals. An appropriate form of support would be to define mining for the supply of materials for domestic processing as part of the processing industry, and therefore exempting it from resources rent taxation. (We are aware that this would be appropriate only in the event that resources rent taxation is not replaced by royalties, as advocated in the preceding paragraph. However, the states and territories are major providers of infrastructure for manufacturing, and it would be a simple matter to indicate to them that target royalties should be so invested.)