An economic assessment of the Minerals Resource Rent Tax Bill

Submission to Senate Economics Committee inquiry into the Minerals Resource Rent Tax Bill

John Quiggin

Australian Research Council Federation Fellow

School of Economics and School of Political Science and International Studies

University of Queensland*

http://www.uq.edu.au/economics/johnquiggin

* This submission is made in my capacity as an independent researcher and does not represent the views of the University of Queensland.

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The case for a Minerals Resource Rent Tax in Australia has three main elements

(i) Mineral resources belong to the people of Australia, and we are entitled to an adequate return on this non-renewable asset. Current state royalty regimes have failed to deliver such a return

(ii) Taxes on rents (that is, returns to the exploitation of fixed assets) are more efficient and less distorting of economic activity than other taxes

(iii) A tax on the mineral sector, with revenue used to finance a reduction in the general rate of company tax, will be economically beneficial in Australia's current circumstances

An adequate return?

As a result of strong growth in global demand for commodities, particularly coal and iron ore, the volume and value of Australia's mineral output has grown very rapidly since the mid-2000s, as has the associated flow of profits to mining companies, both Australian-owned and foreign-owned. Pre-tax profits for the mining sector exceeded $50 billion in 2009-10 and are on a rising trend.

The process of political bargaining between the government, other parties and mining companies has produced a tax estimated to raise an additional $3-4 billion per year. The question of what constitutes an adequate return on our mineral assets is ultimately a political judgment. My personal view is that a larger return would be justified.

The case for rent taxes

The theoretical case for the optimality of rent-based taxes is well-established. In the Australian context, it has been put forward in numerous reports and research articles including my own work with Professor John Freebairn, which is attached. The central point is that access to mineral resources yields profits greater than the normal return to capital. Even if some proportion of this excess return is taxed, mining projects will remain profitable. By contrast, a fixed-rate royalty will discourage marginal projects.

In practice, no tax works perfectly as designed, and the proposed tax will doubtless have some disincentive effect on marginal mining projects. However, even an imperfect rent tax is superior to alternatives such as company income tax. Hence, if the revenue from the MRRT is used to reduce the general rate of company tax, an improvement in the allocation of resources can be expected.

In this context, I note a statement by a large number of Australian economists supporting the governments original proposal for a Resource Super Profits Tax (attached). The proposed tax would have been closer to the theoretical ideal, would have raised more revenue and would have permitted a greater reduction in the rate of company tax. However, while the net benefits of the revised proposal are smaller than those of the original, they are still positive

Effects of a tax on mining activity

Because the MRRT is designed to fall on rents, effects on the mining sector are likely to be modest. Moreover, the mining sector has historically been lightly taxed. It is therefore unlikely that the introduction of the MRRT will result in a tax system that discourages investment in mining relative to other sectors of the Australian economy. But even if there were such an effect, it is unlikely that it would make Australians in general significantly worse off.

A number of characteristics of the mining sector support this conclusions

* Direct employment in the mining sector is small (about 2 per cent of all employment) both in absolute terms and compared to its share of output and profits. Even taking account of the fact that mining is a high-wage sector and that the construction phase of mining projects generates additional jobs does not change this conclusion

* The mining sector is expanding rapidly, so any adverse effect would only result in somewhat slower expansion. Thus, it is unlikely that significant structural adjustment problems will arise

* By contrast, the expansion of the mining industry imposes significant costs on other parts of the traded sector through the resulting appreciation in the value of the Australian dollar. The tourism sector, a large employer of relatively vulnerable workers has suffered particular adverse effects. To the extent that tax changes slowed the expansion of the mining sector, these adverse effects would be reduced.

Summary

The main elements of the case for the MRRT are supported by economic analysis. The main conclusion of economic analysis is that the original RSPT proposal would have yielded larger benefits, but that the compromised MRRT still yields net economic benefits.