

Australian Council of Trade Unions Submission to the Senate Economics Committee

Inquiry into the Minerals Resource Rent Tax Bill 2011 & Related Bills

22 December 2011

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Summary

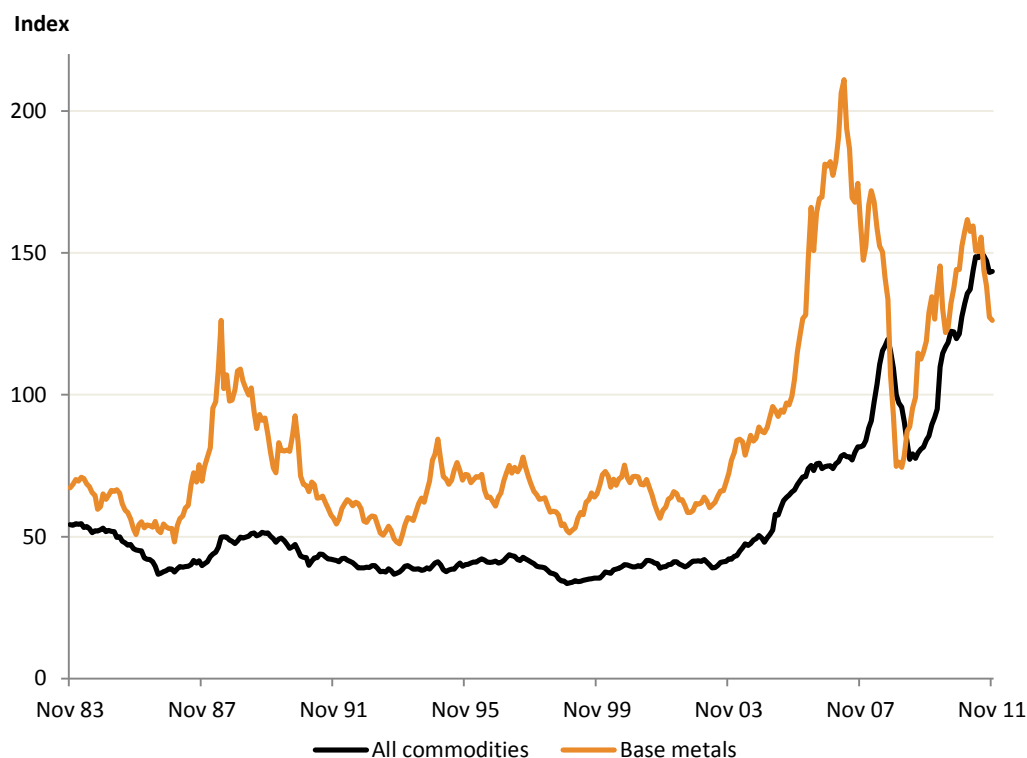
- The ACTU supports the proposed Minerals Resource Rent Tax and expanded Petroleum Resource Rent Tax.
- Improved taxation of mineral resource rents will return a fairer share of windfall gains to the owners of non-renewable resources, the Australian people, and will enable investment in the future via an increase in the Superannuation Guarantee and public infrastructure investment.
- The MRRT regime may also help to reduce some of the negative effects of the mining boom on other sectors of the economy.
- While unions are strong supporters of the proposed increase in the Superannuation Guarantee and the concessional treatment of superannuation contributions, the ACTU recommends improvements to taxation arrangements to make the distribution of tax concessions more equitable.

The reform context

The mid-2000s saw a massive surge in the price of commodities, driven by the rapid industrialisation of China and India. This surge is unprecedented and was unanticipated in size and scope. As a result, firms that export commodities have collected windfall profits.

The scale of the price shock can be seen in the Reserve Bank of Australia's index of commodity prices.

Figure 1 - RBA Index of Commodity Prices (SDR)



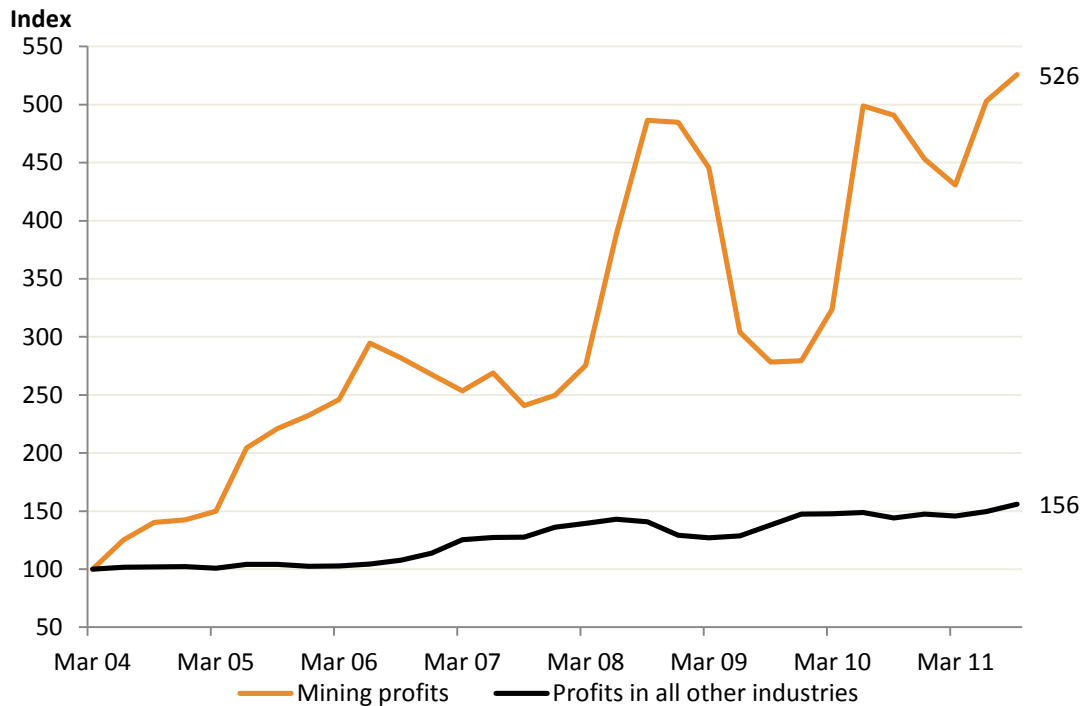
Source: RBA Index of Commodity Prices, denominated in IMF Special Drawing Rights

The trend has been driven by massive increases in the price of certain commodities, notably iron ore and coal. These price increases generated windfall gains for mining companies. These gains largely accrued to firms that had invested in projects at lower world commodity prices when the recent price rises were completely unforeseen. These gains therefore represent pure economic rents, in that they are above the returns that are required to induce and sustain the economic activity in question.

The scale of the mining industry's windfall gains can be seen in an examination of the industry's gross operating profits over the past decade. In the 2001-02 financial year, the industry made \$24.1 billion in profit; in 2010-11, the total was \$93.6 billion.¹ The chart below shows the total nominal profit made in the mining industry each quarter, expressed as an index set to equal 100 in the March 2004 quarter.

¹ ABS 2011, *Business Indicators*, Catalogue number 5676.0, table 15, seasonally adjusted.

Figure 2 - Gross operating profit per quarter in Mining and in all other industries (Index)



Source: ACTU calculations based on ABS 5676.0.

The nominal gross profits made by the mining industry in the September 2011 quarter were 5.26 times the level made by the industry in the March 2004 quarter. Total nominal profits in all other industries increased by 1.56 times over the same period. Gross operating profit in the mining industry represented 47% of total revenue in the industry in September 2011, up from a 34% profits-to-sales ratio in the March 2004 quarter.²

The need for improved resource taxation arrangements

The case for improving the taxation of these profits is based on two principles:

- Mining companies' profits are made by selling non-renewable resources that belong to the Australian people. Australians deserve to receive a fair return for the sale of the assets. The return that Australians receive should rise in line with the returns that accrue to mining companies.

² ABS 2011, *Business Indicators*, Catalogue number 5676.0, table 22, original.

- Resource rents represent an immobile tax base. The taxation of such rents is generally seen to be the most efficient tax base, as noted in the report of the *Australia's Future Tax System Review*.

The mining industry's windfall profits have not been shared sufficiently with the ultimate owners of the resources being extracted: the Australian people. Resource taxation should be seen as the charge imposed by the owners of a factor of production; it thus differs in principle from other forms of business. It represents the price that firms pay in order to extract non-renewable resources that are owned by the people in common.

The outmoded and inefficient system of resource taxation that presently exists, State royalties, sees the rate paid by companies rise and fall with the quantity of production, but not (for the most part) with the price per unit of production. This is a major systemic design flaw in the present system of resource taxation.

A profits-based tax, such as the MRRT, corrects this flaw. Such a tax ensures that the dividend received by the owners of non-renewable resources (the Australian people) rises and falls with the profits of mining companies, which are determined by both the price and quantity of extracted resources. This system is more equitable and also more efficient; it shares the windfall gains arising from exogenous price shocks with the owners of the primary factor of production, and has a less distortionary effect on the market.

There are other sound public policy reasons for moving from quantity-based resource royalties to a profits-based resource rent tax. The terms of trade shock experienced by Australia as a result of soaring commodity prices has caused the value of the Australian dollar to appreciate sharply relative to other currencies.

The value of the Australian dollar in US dollar terms rose above its post-1983 average in October 2004, and has been above that level for almost all of the period since that time. The Australian dollar has also appreciated sharply against the Trade Weighted Index of currencies

The strong Australian dollar has the effect of reducing the competitiveness of non-resource export sectors, such as manufacturing, tourism and higher education.

Increased real exchange rates also harm import-competing sectors, as Australian households and firms find it cheaper to acquire goods and services offshore.

This process, by which a booming export sector (mining) crowds out activity in other sectors through an appreciation of the real exchange rate, is known as the Gregory Thesis or Dutch Disease. It is sometimes referred to as a problem of a “multi speed economy”. Resource rent taxation can help to alleviate the pressures on non-resource export industries and import-competing industries. This is particularly the case where some of the proceeds of such a tax are used to assist other industries and where revenue is also used to divert funds from consumption to investment, such as through an increase in compulsory superannuation.

The “commodities super-cycle” driven by increased demand from China and India is expected to endure for decades. The 2010-11 Commonwealth Budget observed that “there are reasonable grounds – in particular, an expectation that global demand will continue to grow strongly for an extended period – to believe that the terms of trade and mineral resource prices will be sustained at high levels for some time”.³ While commodity prices have declined slightly from the record highs experienced in recent years, prices are expected to remain elevated well above historical levels. It is therefore prudent for the Commonwealth Government to plan for the nation’s future with this central forecast in mind. Failure to implement an improved system of resource taxation now would leave Australia worse off in the coming years and decades.

The ACTU considers the new system of resource taxation is needed: on equity grounds, to deliver an appropriate return to the owners of Australia’s non-renewable resources); on efficiency grounds, as rent taxes are less distortionary than royalties; on macroeconomic grounds, as the tax and its revenue can be used to ameliorate the negative effects of a mining boom on other industries and deliver a more balanced economy overall.

The MRRT

If a resource rent tax is well designed, the usual tax policy trade offs do not apply. Ross Garnaut and Anthony Clunies-Ross said this in 1983:

³ Commonwealth of Australia 2010, *Budget 2010-11*, Budget paper no. 1, p.4-10.

“Many people believe that the only important characteristic of a tax is how much it takes. This is far from true. The form of the tax may have extremely weighty effects in encouraging some activities or discouraging others. It is easy to assume, as governments often seem to have done in meeting the question of taxing mining companies, that there is a simple dilemma between heavy taxation, which discourages mining, and light taxation, which yields little in the way of revenue. On the contrary, provided that the form of the tax regime is chosen prudently, it is possible to improve the trade-off considerably...” [Taxation of Mineral Rents, 1983]

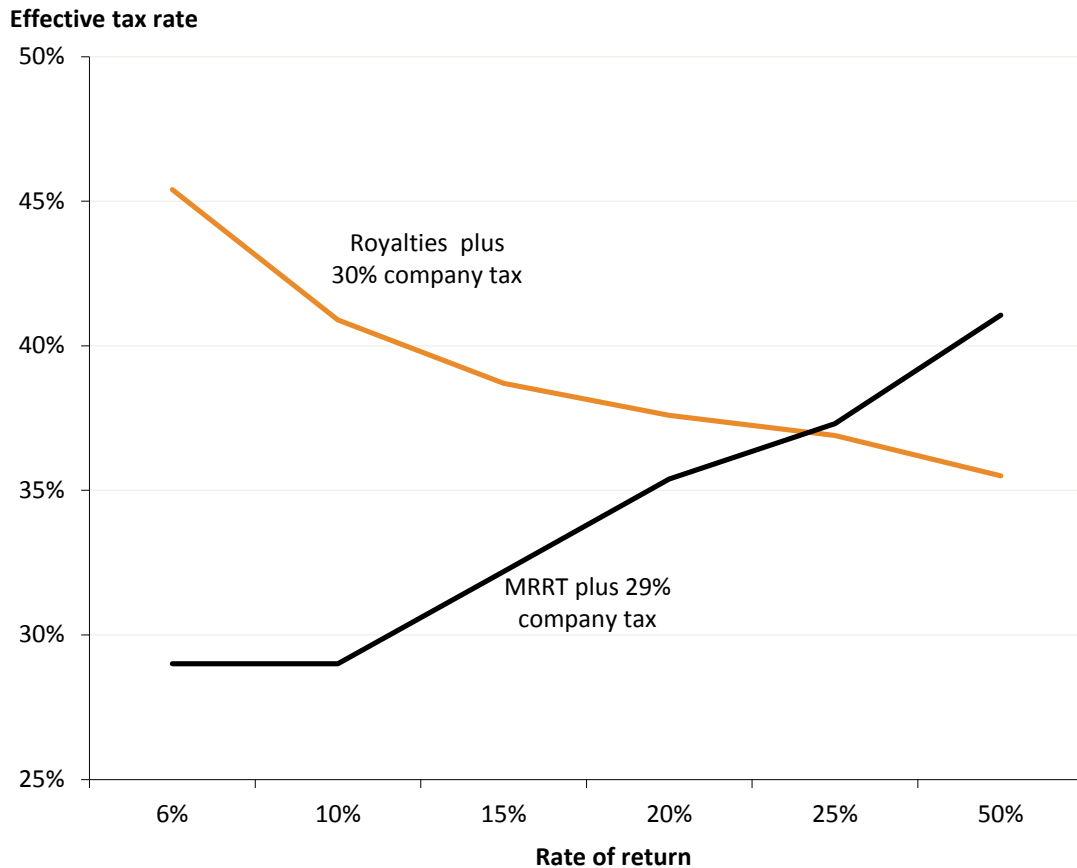
KPMG Econtech modelling suggests that, of all existing taxes, the petroleum resource rent tax imposes the smallest marginal welfare loss on the economy, while royalties and crude oil excise impose the largest marginal welfare loss.⁴ Taxes with a greater marginal welfare loss have a greater distortionary impact on economic activity. While such modelling is dependent on the assumptions made and should be used with caution, the finding regarding the relative efficiency of resource rent taxes is widely accepted.

The Minerals Resource Rent Tax package is well-designed and will have little distorting impact on the structure and composition of the mining sector.

Resource companies that are not accruing economic rents will see their effective tax rates reduced by moving from the present system to the MRRT system. The chart below shows the effective rates paid by firms at different rates of return. This analysis suggests that a mining firm will only face a higher effective tax rate under the post-MRRT regime than under the present system at rates of return in excess of 25% (this assumes a 5% benchmark Commonwealth 10-year bond rate).

⁴ KPMG Econtech modeling cited in Australia's Future Tax System 2010, *Report to the Treasurer*.

Figure 3 - Effective tax rates under royalties and the MRRT



Source: MRRT/CIT ETRs are ACTU calculations; Royalties/CIT ETRs are derived from Swan, W., *Economic Note No. 18*, 9 May 2010.⁵

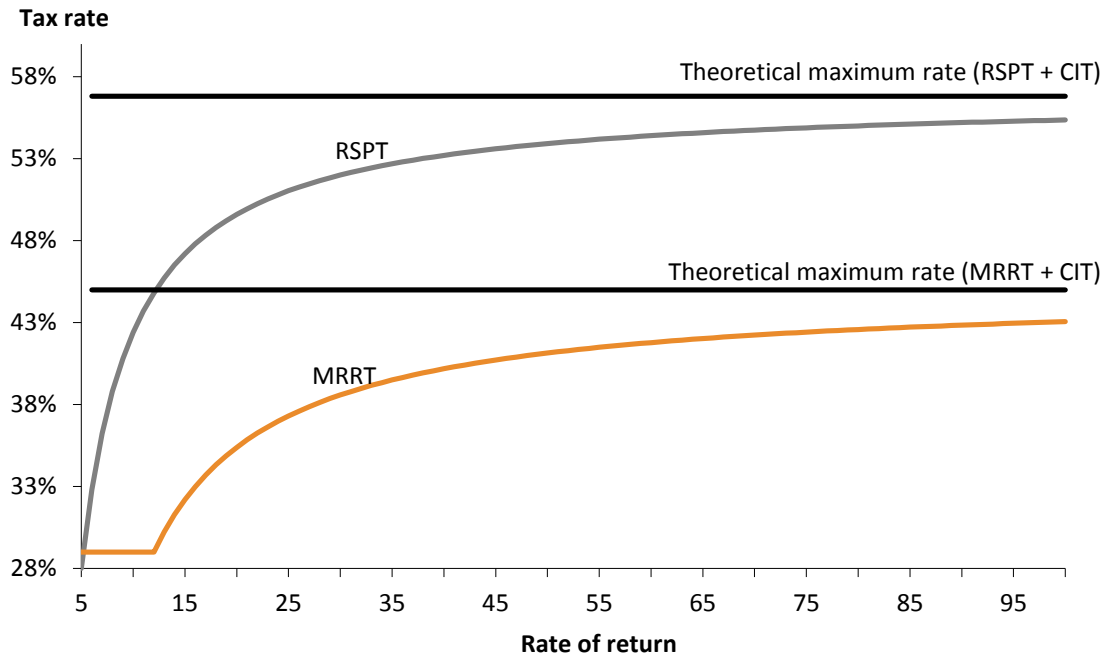
The MRRT will also exclude companies with MRRT-assessable profits of less than \$75 million per annum. New investment will attract an instant write off, which means that projects will not be liable for any MRRT until they have made enough profit to pay off their up-front investment. Unutilised losses will be carried forward at the long-term government bond rate plus 7 per cent. Furthermore, the headline rate of the MRRT (30 per cent) is reduced to a 22.5 per cent effective rate by the 25 per cent extraction allowance. These are significant concessions relative to the previous rent tax proposal.

Moving from the proposed Resource Super Profits Tax (RSPT) system to the proposed MRRT system has resulted in a significant reduction in the effective tax

⁵ Effective tax rates for royalties plus 30% company income tax derived from Swan, W., *Economic Note No. 18*, 9 May 2010. Effective tax rates for MRRT plus 29% company income tax are ACTU estimates. The MRRT regime provides full credits for State royalties and carries unused royalties forward at the long-term Government bond rate plus 7 per cent; royalty payments are thus excluded from calculation of companies' effective tax rate under the MRRT regime. This analysis assumes a long-term Commonwealth bond rate of 5%.

rate to be faced by mining companies. The scale of this reduction can be seen in the chart below.

Figure 4 - Effective tax rates under the RSPT and MRRT systems



Source: ACTU calculations⁶

The MRRT also has a substantially narrower base than the RSPT, applying only to iron ore and coal rather than the broader range of commodities to which the RSPT was intended to apply. This substantial concession to the industry has resulted in a diminution in the number of companies to be liable to the tax, from 2500 to around 320. The ACTU believes that the *Australia's Future Tax System* review was right to recommend a broadly-based resource rent tax with a 40% headline rate, but we accept that the Government has negotiated in good faith with the industry to address its concerns and has developed the MRRT in response to those concerns.

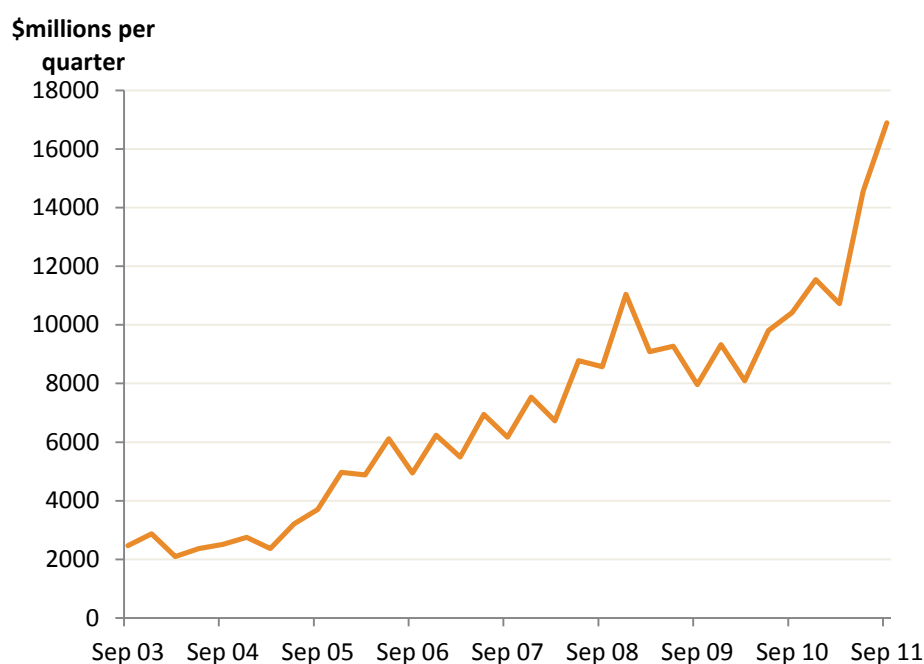
Despite the generous concessions afforded to the mining industry, the MRRT package achieves many of the same fundamental goals as the RSPT package. The ACTU therefore strongly supports the MRRT package.

⁶ Based on ACTU calculations which assumes a 10 year Commonwealth bond rate of 5%. The RSPT rates include a 28% company income tax rate, and the MRRT rates include a 29% company income tax rate.

There is no evidence to suggest that the announcement of a resource rent tax has materially affected investment and activity in the Australian mining industry.

The mining industry spent \$16.9 billion on capital investment in the September 2011 quarter, more than double the \$8.1 billion it spent in the final quarter before the announcement of the original RSPT, the March 2010 quarter. Mining investment in September accounted for 48.5% of all capital expenditure in the economy.⁷

Figure 5 - Mining industry capital expenditure per quarter



Source: ABS 5625.0⁸

This is not the investment behaviour that would be expected if the mining industry's warnings about the effect of the MRRT were sincerely believed by the industry. There is a sharp disjuncture between the mining industry's public reaction to the announcement of the Resource Super Profits Tax on May 2, 2010 and its investment behaviour since that time.

The evidence, as opposed to the industry's rhetoric, demonstrates that the announcement of a resource rent tax has not discouraged investment in the mining

⁷ ABS 2010, *Private New Capital Expenditure and Expected Expenditure*, Cat. No. 5625.0, Table 1A, Original.

⁸ Derived from ABS 2010, *Private new Capital Expenditure and Expected Expenditure, Australia*, Cat no 5625.0, June 2010, Table 1b, original.

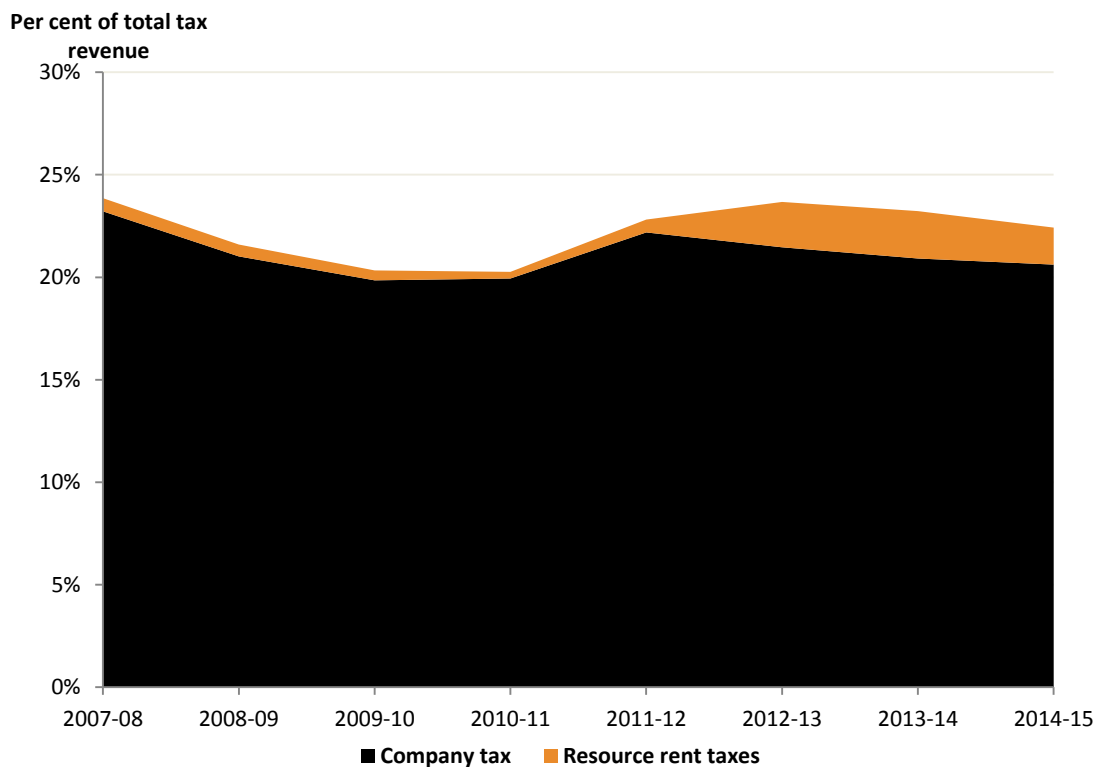
industry. On the contrary, investment and planned investment have soared in the past 18 months.

The Stronger, Fairer, Simpler Tax Package

The amended tax package, with the MRRT replacing the RSPT, still achieves the overall goals of the initial package. It finances a reduction in the company income tax rate to assist non-resource export industries and import-competing industries to deal with the more difficult environment they face as a result of the soaring Australian dollar.

The aggregate impact of the package on business taxation arrangements can be seen in the following chart of the share of total tax revenue paid by business (including the company income tax, the PRRT and MRRT).

Figure 6 - Business tax revenue as a proportion of all tax revenue



Source: Budget papers, MYEFO⁹

⁹ Graph compiled using data derived from: Commonwealth Budget Paper No 1 2011-12, p.5-35; MYEFO 2011-12, pp.47-48.

The Stronger, Fairer, Simpler tax package is forecast to result in a slight reduction in the total share of tax revenue paid by business. The share of revenue derived from company income tax is forecast to fall and be replaced by resource rent taxation (including the MRRT and the PRRT). The package can therefore be seen as a form of industry assistance to all industries other than the sections of the mining industry that will be liable to pay resource rent taxes. This will assist manufacturing and services sectors including tourism.

While there are always factors other than the exchange rate at play in the fortunes of particular industries, it is no mere coincidence that all Australia's non-commodity based export industries are enduring difficulty at the same time. Economic modelling suggests that 10 per cent appreciation of the AUD leads to a decrease in investment in the manufacturing industry of around 4.2%.¹⁰ Other industries are also likely to see a decrease in investment and a decrease in demand for their products as the currency appreciates.

The MRRT package is a vital and necessary part of the policy response to the effects of the mining boom on other Australian industries. The package is designed to ameliorate the effects of 'Dutch disease' in several ways:

- By saving the benefits of improved resource revenues for the future in the form of superannuation;
- By investing in infrastructure to enhance supply capacity; and
- By reducing the rate of company income tax.

Increasing the Superannuation Guarantee rate to deliver financial security for workers in retirement is estimated to cost the Australian Government \$3 billion in foregone revenue due to the preferential tax treatment of superannuation relative to wages. The Government's improvements to superannuation, including the increase in the SG rate, are projected to result in over \$500 billion in additional funds in Australians' superannuation accounts by 2035. This is a sound public investment for the future and it is made possible while adhering to the Government's strict fiscal rules by the revenue derived from the MRRT.

¹⁰ Swift, R. 'Measuring the effects of exchange rate changes on investment in Australian manufacturing industry' [Paper from the Australian Conference of Economists (34th: Melbourne: 26-28 Sept 2005). Freebairn, John and Griffiths, Bill (eds).], *Economic Record*, v.82, Special issue, Sept 2006.

The MRRT revenue also enables the Government to expand investment in vital infrastructure, particularly in resource-rich states. Mining regions have struggled with the additional pressures that rapid economic expansion can bring. The ACTU strongly supports the use of revenue from the MRRT to improve social and economic infrastructure in mining regions. Allocation of funds for infrastructure investment should be done in consultation with local stakeholders including community groups, unions, local governments and others.

The Superannuation Guarantee rate and retirement income adequacy

Unions are strong supporters of the SG increase from 9 to 12 per cent. We have long argued that the current 9 per cent rate will not deliver a standard of living consistent with a reasonable level of comfort and dignity in retirement.

An adequate retirement income is widely agreed to comprise between 60 and 65 per cent of gross pre-retirement earnings (taking into account any age pension entitlements). Modelling by AIST indicates that a single male on average income who spends 40 years in employment would not achieve an adequate retirement income with 9 per cent, but would with 12 per cent.¹¹

The problem of retirement income adequacy is particularly acute for those workers on below average wages and those with broken patterns of employment. By international standards Australia has above-average participation rates at an aggregate level but relatively low rates for older males and for women between the ages of 25 and 44. Unemployment among older workers and extended periods of absence from paid employment because of pregnancy and childcare make the 9 per cent rate even less appropriate.

An increase to 12 per cent will not by itself resolve the adequacy problems many of these workers will face after they retire. However, it will help to deliver higher account balances and therefore increase their capacity to cope with the costs of life after work.

¹¹ Australian Institute of Superannuation Trustees (2010) *The Benefits of an SG rate of 12 per cent*. AIST: Melbourne.

Equity and the taxation of contributions

Our superannuation system is supported, in part, by the concessional taxation of contributions. At present around 2.5 million individuals receive little or no personal income tax benefit from their contributions. However, around 200,000 taxpayers (those who earn more than \$180,000) receive a concession on their contributions of 31.5 per cent.

Unions have argued there is considerable scope to make the distribution of tax concessions more equal.

Unions have welcomed the government's announcement that from 1 July 2012 all employees earning \$37,000 or less will receive an automatic co-contribution from government of up to \$500 a year. This will effectively offset the tax they pay on their contributions in 2012/13.

This will help to correct some of the imbalance in the present system. However, a large number of high-income taxpayers will continue to benefit disproportionately from how contributions are taxed. In our submission to the *AFTS* review, the ACTU suggested that one way of making the taxation of contributions more equitable would be to link the tax paid to the individual's marginal rate. For example, contributions could be taxed at the individual's marginal rate, minus a fixed percentage point offset. The *AFTS* review ultimately recommended something similar to this arrangement. Other organisations such as ACOSS have called for changes along these lines.

Unions will continue to press for further action to make the taxation of contributions more equitable.