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Blowing a black hole in budget

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Illustration: Eric Lobbecke Source: The Australian

NOW we know. Locked away in Parliament House were the world's largest miners. In strode the new Prime Minister and her Deputy Prime Minister and Treasurer, with a spring in their step and fresh blood on their hands. As the execution of Kevin Rudd had shown, it wasn't that they lacked scruples; they simply wouldn't let them get in their way. And so our capi dei capi made the miners an offer they couldn't refuse.

But these mafiosi were postmodernists: the offer they made was one they couldn't understand. Luckily, the miners were smarter. They wouldn't have found the minerals resource rent tax mysterious. Trapped in the bunker, some must have smiled, others smirked, a few sniggered. They knew it would end in a whimper.

But Wayne Swan had promised a bang. Big enough to fund more promises than Jim Cairns could have imagined in a month of Nimbins. And Cairns's fantasies benefited from chemical assistance. All Wayne had to go on were memories of Bruce Springsteen and class hatred.

Little wonder the fiscal strategy born of such beginnings now looks like a series of nosebleeds. The MRRT was to yield $3.7 billion in 2012-13; instead, it has raised $126 million, with only one more payment due this fiscal year. And even that is an overestimate, as 30 per cent of the MRRT's revenues are forgone company tax payments. So it has yielded a paltry $95m. But it costs $50m to administer, while the mining industry spends $20m on compliance. It therefore consumes 75c of resources for each $1 of revenue. And as Jonathan Pincus, Mark Harrison and I showed immediately after it was announced, those revenues are so volatile that each $1 may only be worth 60c or less as a "sure bet". The tax's direct costs alone consequently exceed its value to taxpayers.

But the MRRT's failure to raise revenue is not the real problem. After all, there is nothing wrong with taking into consideration the value of the industry's accumulated capital investment when assessing profits, as the MRRT does: not doing so would be expropriation. Sure, resource super profits tax-like expropriation would have yielded more dollars in the short term, but at a staggering cost to Australia's reputation.

Rather, the real problem is the premise on which the MRRT and the RSPT were based: that there are vast mineral rents waiting to be taxed. Belief in that el dorado was central to the Henry report. But it never

examined mining's long-run profitability. Instead, it relied on questionable modelling to claim the resource states were leaving a fortune on the table.

Yet the government's own data tells a different story. According to the Australian Bureau of Statistics, a dollar invested in manufacturing in 1985 would have been worth $10.70 in mid-2010 (the latest date available); invested in mining, it would only have been worth 35c more. And that reflects six recent years of unsustainably high mineral prices: for most of the period, manufacturing's return was comfortably above that in mining.

Moreover, returns in mining, while barely higher than those in manufacturing, have been nearly three times more variable. That is unsurprising. Australian mining is immensely capital intensive, using $4 of capital for each $1 of labour. Yet it faces large and historically rising swings in world prices. True, there are periods of plenty; but there are lengthy lean spells too, when returns fall far below the level investors require to finance mining in the long run.

The class warriors' quest to tax super-profits was therefore the hunt for a chimera. But it has been far from costless. With mining nowfacing an effective tax rate of more than 50 per cent, our attractiveness as a destination for investment has been compromised. And because the MRRT cuts in when profitability exceeds a fixed threshold (regardless of the riskiness of the investment), the effective tax rate on high-risk mining ventures is greater, discouraging resource development.

That makes the medium-term fiscal prospect all the grimmer. The MRRT was to raise nearly $40bn by 2020. It may not raise 10 per cent of that. Yet the torrents of income have been built into spending promises and community expectations.

But the costly failures don't end there. For there is the carbon tax as well. The government locked in expenditure assuming carbon prices would rise to $29 in 2015-16 and then increase by 4 per cent a year. Greg Combet has repeatedly said the carbon price would indeed reach those levels. But with European permits trading for as little as $4, it has long been apparent Combet's assurances lacked any basis in reality.

Now he has finally admitted that fact. But he hasn't admitted the fiscal consequences. Assuming the carbon price falls to just under $11 in 2015-16, which is significantly higher than it may be, and then rises by 4 per cent a year, the effect is a cumulative budget hole of $24bn to 2019-20.

So that is the Gillard government's fiscal legacy. To lose one tax may be regarded as a misfortune; to lose both looks like recklessness. And that recklessness leaves taxpayers an aggregate budget shortfall over the balance of this decade in the order of $50bn.

But there are broader costs as well: the distortions these taxes have caused; the deterioration of transparency and integrity in government, as Combet and Swan have gone to extraordinary lengths to hide their errors and deceptions; the enduring harm to the reputation of Treasury, which has played an integral role in these fiascos; and last but not least, the cargo cult mentality Labor has done everything it could to foster.

With so much damage, a real mafioso would have something to show for it; ours have merely shot themselves and their party. And left their country to pay the bill.