

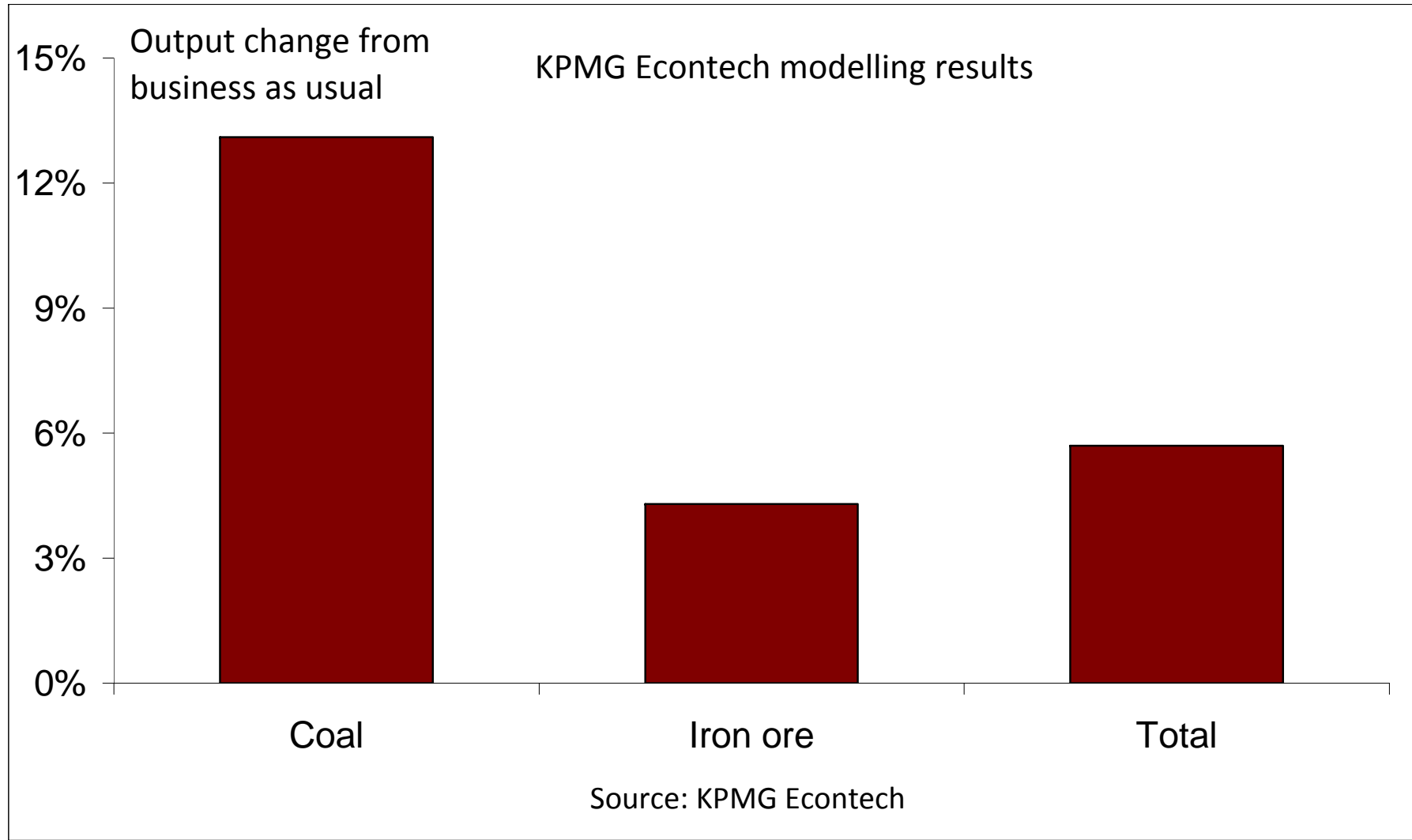
The impact of the RSPT

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First, assume perfection ...

- **No real world tax is perfect. But the RSPT has been modelled and marketed as if it were perfect.**
- Taxes cause most harm when they fall on mobile factors. That is, they change behaviour most when families and businesses can readily react to the tax by switching to less taxed activities.
- In contrast, immobile tax bases are best. So 'resource rents' – the return to the minerals themselves – are a logical tax base, as the minerals can't move in response to higher tax rates.

Does tax more = invest and produce more?



It's just a mechanical proxy

- **Vitally, implicit in the KPMG Econtech modelling and much Henry Review commentary is that there is no difference between 'resource rents' & 'super profits'.**
- Yet you can't observe resource rents. **'Super profits' are just a mechanical proxy formula.** The RSPT merely assumes all profits above a threshold – the bond yield – are no longer 'normal profits' but 'super profits'.
- If you believe the RSPT proxy is perfect at identifying resource rents, you'd also have to believe Australia's **banks and breweries have been doing a lot of mining.**

And proxies aren't perfect

- The formula will show more super profits when miners work harder or smarter. That makes the RSPT **a tax on effort and entrepreneurial expertise as well as a tax on mineral resource rents**. There is no practical way to isolate 'rents' on minerals from the effort to extract them.
- **The upshot is that miners are being taxed on some of their 'normal profit' as well as any 'super profit'.**
- **That's a problem. Any income that's not resource rent but is taxed as though it is will become among the most highly taxed types of income in Australia.**

Investor rate-related issues

- **You need to consider investors as well as miners.**
- The effective tax rate for Australian shareholders paying the top personal tax rate is 67.9%, more than two-thirds of the marginal dollar. (And dividend imputation means that it remains there no matter what happens to the company tax rate.)
- Even superannuation funds – otherwise lightly taxed – will pay marginal rates ranging from 40% to 49%.
- The matching additional marginal tax rate paid by foreign investors will be up to 80% (and could be more).

The tax rate doesn't matter if the base is right and you can ignore the rest of the world

- The KMPG Econtech result will presumably hold regardless of the RSPT rate – at 99% just as much as at 40%.
- That should start you wondering.
- Miners – indeed all businesses – put their money where after-tax returns are highest.
- As the RSPT more than doubles the tax take in royalties, that affects after-tax returns on greenfield mines.

Leaving some investment headed elsewhere

- **Although the minerals aren't mobile, new investment in them is.** And all impacts are at the margin for new projects, so the cost impact of the new tax will send some greenfield developments towards Canada, Indonesia, Brazil and others – **these nations are substitutes** for what is now to be a very highly taxed activity.
- For an individual mine, the RSPT more than doubles what would have been the tax take from royalties. That adds to the cost of mining in Australia, which **pushes Australian development options up the cost curve.**

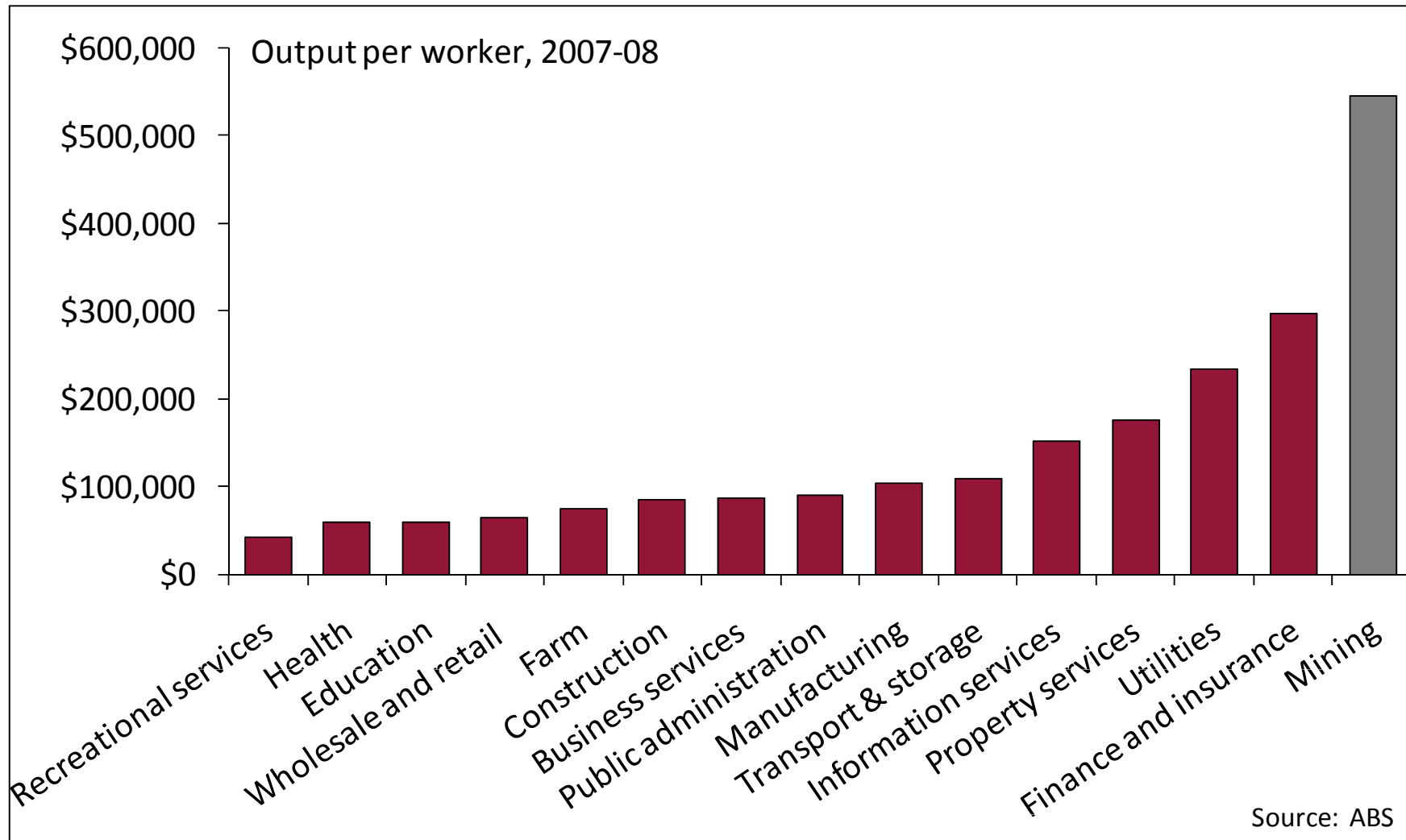
So three phases of RSPT effects

- **First**, it squeezes extra production from existing mines – where the decision to locate here was made years ago. That happens because a profit-based tax bites less deeply than a production- or revenue-based royalty.
- **Second**, it slows greenfield investment here by cutting the return to Australian development options.
- **Finally**, it raises output once more in the long run – but only once Australian mines have returned to their initial relative position on the global cost curve in 50-100 years.

Up or down – or both?

- Proponents of the new tax claim that it will increase the size of Australia's mining sector.
- Yet they also claim that it will preserve more of the benefits from mining for later generations, and act to reduce the 'curse' of Australia's strength in minerals, thereby taking pressure off sectors such as manufacturing and tourism.
- As this analysis makes clear, **both these things are possible – they just refer to very different periods of time (and won't both be true at the same time).**

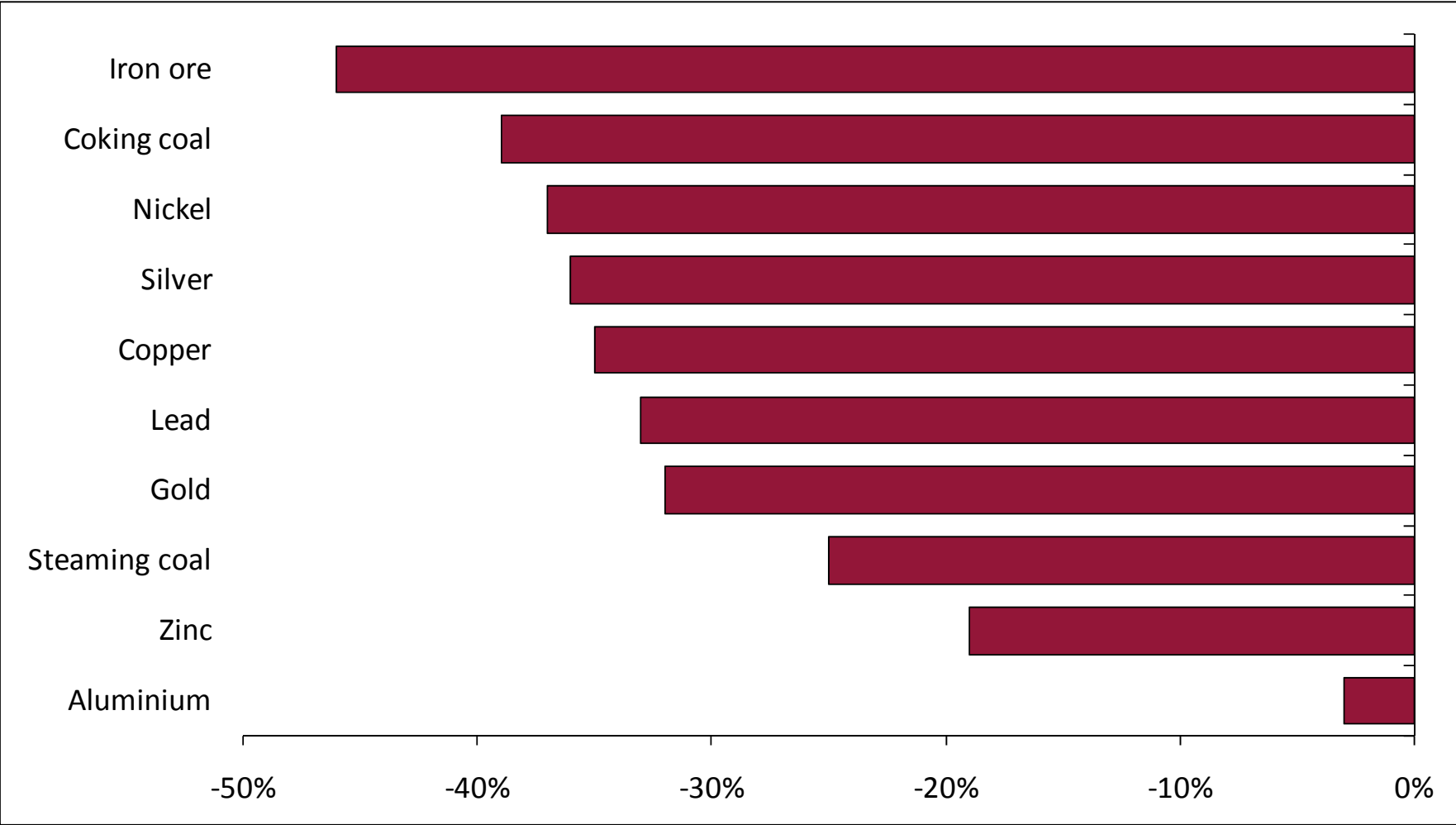
Ricardo and the pursuit of comparative advantage ...



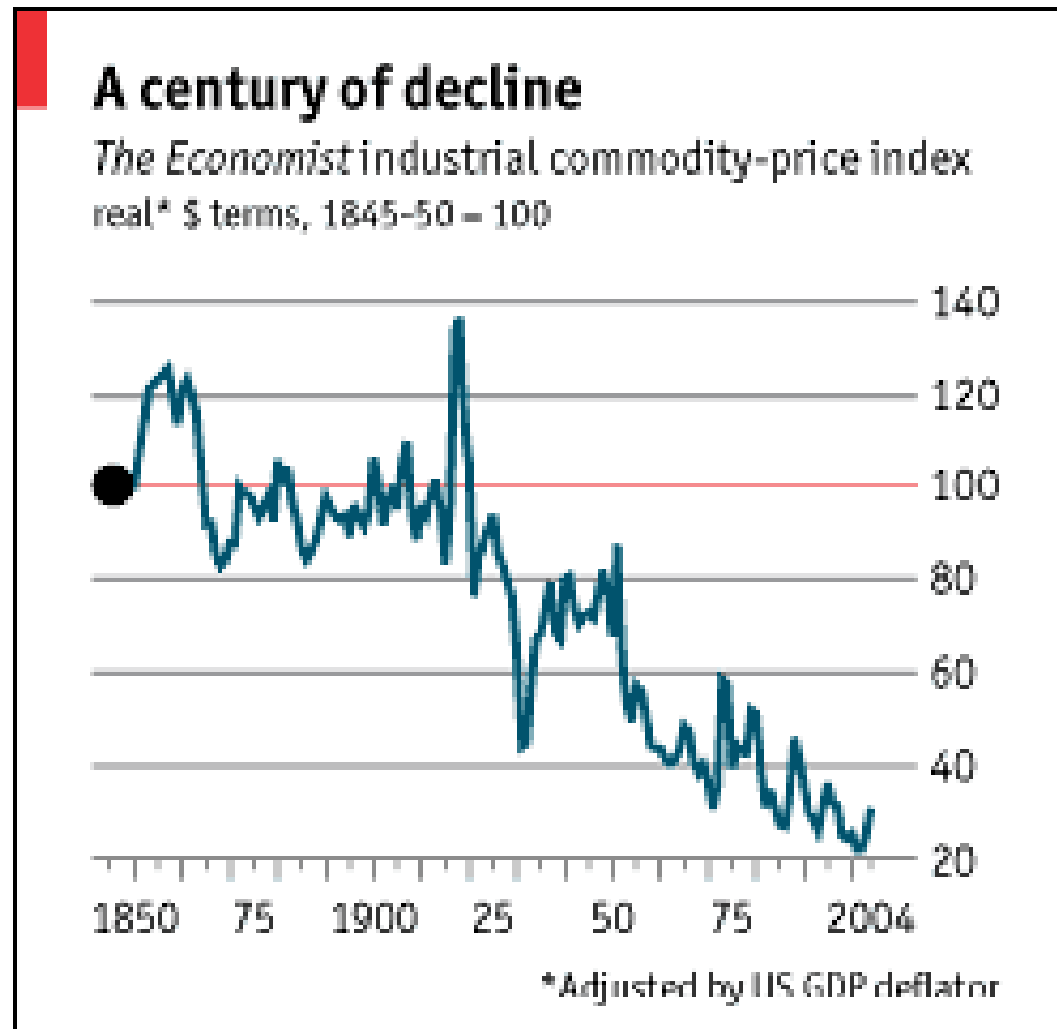
The rewards of patience?

- **The argument is that this policy will make sense as mining margins will rise over time.**
- Many people expect they will. We expect they won't.
- And the world's miners seem to agree. If they expected future margins to keep rising strongly enough, then they would simply leave minerals in the ground – the same way that developers put together 'land banks' on the outskirts of large cities in the hope of future capital gains.
- The consensus among forecasters is also for big falls – almost a halving in iron ore prices in real terms in the long run, and not far behind that for coking coal.

The consensus sees long run price falls



“Decades to come” versus “Two out of three ain’t bad”



If future mining margins aren't flash, much of the RSPT rationale falls away

- If so, then the RSPT may slow mining activity when mineral margins are highest (thereby reducing the community's return from their extraction), leaving the sector recovering only once the benefit to margins from the industrialisation of China and India passes.
- **This policy shift may therefore run the risk of a perverse outcome, with the result of delaying Australian mining development being moderate returns to the public despite notably increased taxes on the profits of miners.**

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