

The Australian

Held to ransom over resources

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SPEAK of going from bad to worse. The resource super-profits tax was poorly designed and even more poorly implemented.

But at least it attempted not to distort economic decisions. Its successor makes no such attempt, and despite a lower tax take, is likely to be extremely inefficient.

That the outcome is so flawed is little surprise. The process was inept from the start. But the weaknesses that it created were then magnified by the way the dispute was resolved: a backroom deal between the government and the three major miners. This too was no surprise: such deals were also pivotal to the emissions trading scheme and to the agreement with Telstra over the national broadband network. These deals may win the government peace. But it is a peace too often bought at a high cost to the public.

The new mining tax is a case in point. The government's estimate that it will immediately raise a great deal of revenue shows that it remains a retrospective tax like the RSPT, with all that implies in terms of increased sovereign risk. But the new tax then adds to that harm by distorting the structure of investment going forward.

This is because it taxes coal and iron ore projects that earn rates of return above a threshold rate, reducing the expected profitability of investing in those resources. The effect will be threefold.

First, it will make investing in Australian coal and iron ore projects less attractive compared to investing in these resources overseas. Second, within Australia, it will shift investment from coal and iron ore towards resources that are not subject to the tax, regardless of the underlying merits. And third, within Australian iron ore and coal projects, it will penalise projects (and ways of undertaking projects) that have high risks (and therefore require high expected rates of return if they are to be undertaken), relative to projects with lower risks.

These distortions are then compounded by others. In particular, a tax whose effective rate depends on the rate of profit is a tax on innovation and on efforts to reduce costs. Those projects that are undertaken will therefore be undertaken less efficiently. Accentuating that inefficiency is the fact that such a tax also distorts the timing of extraction and of costs and revenues more generally.

For example, depending on the tax's details, it can become profitable to smooth costs and revenues over time, avoiding or postponing periods when returns are especially high. That smoothing diminishes the tax take even if its overall impact is to raise costs and lower revenues, reducing the gain to Australia from our mineral wealth.

All of these effects are well-known and were discussed in this column some weeks ago. They mean this tax could be even less efficient, per dollar of revenue raised, than are royalties. But whether that is indeed so we do not know, not least because the government has released none - yes, none - of the Treasury modelling on which it has relied.

Rather, the entire negotiating process has been cloaked in secrecy. Of course, such backroom deals with private interests are not a recent development. Now, however, they have become an integral part of the process of government, as the trifecta of the ETS, the NBN and the new mining tax clearly shows.

These three deals have one thing in common. In exchange for acquiescence to the policy being proposed, they allocate to private parties a property right that is strange but no less valuable for being so: the right to be treated less badly than one might otherwise have been, and perhaps less badly than are others.

Inevitably, such deals raise concerns about probity. A society in which favours and penalties are negotiated with the state risks degenerating into patronage and corruption. But it is also a society that is especially likely to adopt policies that make the community poorer.

To see why, consider bargains freely entered into by private citizens. These bargains usually increase welfare, because if a bargain does not make those who enter into it better off, it will not be accepted. As a result, the courts will generally enforce private bargains. But bargains entered into under duress, or that harm the rights of third parties, are unenforceable, and for good reason.

Such bargains can lead to outcomes where the gain to the winner is more than outweighed by the loss to the losers. Indeed, these

bargains are unenforceable even when they make both parties better off, as when a kidnap victim's family chooses to pay the ransom, preferring the outcome with that payment to the possible outcome without. We prohibit those payments because allowing them would encourage the growth of Kidnap Inc, diverting scarce resources from productive uses into the search for victims to be plundered.

Yet bargains with the state are not constrained by those restrictions on agreements that impoverish society: rather, they are pervaded by the very factors that would allow Kidnap Inc to flourish. Thus, the state is uniquely placed to get its way by threats, deteriorating the options to its negotiating counterpart so as to win consent even when the loss to that counterpart exceeds the gain to the community. And it is also uniquely placed to win agreement with its counterparts by shifting the costs of bargains on to third parties, especially when those costs, though in aggregate greater than the gains, can be so thinly spread as to be difficult to notice and resist. Little wonder then that in each of these recent instances, stoushes of remarkable ferocity resulted in peace settlements of remarkable folly.

That outcomes like these can occur is hardly news. Nor is the risk of these outcomes one that lends itself to pat solutions. For better or worse, such negotiations are hardly likely to go away. But one thing is clear: the less transparency there is, the greater the risk of ultimate harm.

That the new Prime Minister is committed to greater consultation is without doubt a good thing. But that only makes it more important that there be a renewed emphasis on transparency, for consultation without full public scrutiny is a recipe for shabby policies.

As Jeremy Bentham said two centuries ago: "The greater the temptation to which the exercise of public power is exposed, the more necessary it is to give to those who possess it, the most powerful reasons to resist it. But there is no reason more constant and more universal than the superintendence of the public." Until that superintendence becomes more effective, the peace these deals buy may well not be worth having.

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