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From mining tax to subsidy in 15 years

Australia

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- Oh, how the policy environment has changed. Fifteen years ago, the national policy discussion was about introducing a 'resources super profits tax'. Resource companies were making very high profits from Australia's resources exports driven by a China-led commodity prices "super-cycle" of the early 2000s. Fast forward to now, and Australian fiscal policymakers have proposed a subsidy scheme of tax credits to support the critical minerals and hydrogen export industries. This comes at a time when Australia's terms of trade have been even higher than they were 15 years ago. Quite a shift. Why? Read on.

First, a brief history. In the first decade of this century, China's demand for resources seemed insatiable and commodity prices rose to multi-decade highs driving Australia's terms of trade to, at the time, record highs. Australia had its largest mining investment boom ever – markedly bigger than anything before it – mining profits were very high and nominal growth in the whole economy was very strong.

In 2009, the Henry tax review – a landmark tax system review – was published and, in 2010, amongst its 138 recommendations, the government of the day endorsed only three, including a 'Resources Super Profits tax'. The Henry review suggested that 'a rent-based tax would ensure the right levels of exploration and extraction and provide sufficient encouragement for private sector participation'. Treasury noted at the time that this was consistent with trends in developed countries, with Norway being the most relevant example.

After all, these resources were, in principle, national wealth.

However, Australia did not introduce the resources super-profits tax. Instead, a smaller version, the mineral resources rent tax arrived in 2012, to then, with a change of government two years later, in 2014, be repealed.

As a point of comparison, Norway has a sovereign wealth fund that is now worth around 350% of its GDP, and net government *assets* of over 100% of GDP. Australia's national net *debt* (including the states) is around 32% of GDP – which is low by global standards, but far from a net asset position.

Fast forward 15 years and the policy proposal is quite different even though Australia's terms of trade is around levels that are even higher than they were fifteen years ago.

The policy environment has shifted such that last week's budget included a proposed *tax credit scheme* for producers and processors of critical minerals and hydrogen as part of the 'Future Made in Australia' industry policy initiative.

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This initiative, albeit yet to be legislated, includes a range of elements, including subsidies to support onshore production of solar panels and quantum computing, but the largest part is a tax credit scheme for critical minerals processors and hydrogen producers, with these tax credits costed at $A13.7bn over ten years.

This is designed to help to re-focus the economy on new growth engines that help the country to take advantage of the global energy transition by shifting the export base.

We have written extensively about Australia's 'super-power' opportunity.

Australia's geography – with lots of sun, wind and empty space – gives the country a comparative advantage in the production of renewable energy.

The question is not whether these are growth opportunities – they clearly are – but rather, how policy should be best set to take advantage of these opportunities.

One approach is to make the economy as flexible as possible to thereby encourage the private sector to invest. This should include ensuring regulatory hurdles are appropriate but not overly burdensome, that skill-workers are available and that the jobs market is flexible, that the tax system is efficient and transparent, and that the price signals in the economy are appropriate.

Another approach is to directly fund projects using public funds, for example, through subsidies and tax credit schemes.

These paths are not mutually exclusive. Elements of both approaches would help to achieve the objective.

As described above, last week's budget contained subsidy measures and tax credits.

However, there was very little focus in the budget on productivity enhancing policies – the word 'productivity' was not used once in the Treasurer, Jim Chalmers, budget speech. As we wrote before the budget, a focus on productivity enhancing policy is much needed in Australia.

A key rationale for the subsidies approach is that other countries have stepped up with significant industry subsidies too, including the US with its Inflation-Reduction Act, and that without public subsidies, Australia may not be able to compete to attract investment. That is, the comparative advantage and profitable opportunities may not be enough incentive on their own – a public subsidy is also needed, or investment could go elsewhere.

On that front, a design feature of tax credits is that they would only benefit projects that get off the ground. It's not 'picking winners', as much as 'supporting winners'.

The way the tax credits would work is to be factored into the likely returns that a critical minerals processor or hydrogen producer should expect to get once the operation is running and profitable. That is, it would lower the estimated 'hurdle rate' for investment, with the idea that this encourages the investment to happen.

But here is the interesting turn.

Once the project is profitable, the operator then pays less tax (gets a tax credit) – even if there are super profits.

The opposite of a super profits tax.

Quite a shift in the national policy approach in just 15 years.

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