Figures point to holes in Treasury chief's assumptions on tax

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THE day after leading angry protesters in chants of 'axe the tax' while Prime Minister Kevin Rudd addressed Perth media, billionaire Fortescue Metals Group founder Andrew Forrest could not hide his antipathy for Treasury boss Ken Henry, the architect of the government's planned resources super profits tax.

"I don't have an axe to grind with the prime minister, but I'll certainly never hold a candle for Ken Henry," Mr Forrest said, following an 80-minute face-to-face meeting with Mr Rudd last week.

According to the Fortescue camp, Mr Rudd had been genuinely unaware of the scale of Fortescue's planned investments in the Pilbara and the threat posed to them by the tax.

Once so enlightened, Mr Forrest reckoned the prime minister accepted Fortescue's statement that the tax had put $17 billion of planned expansions and 30,000 future jobs at risk was "no bluff, no fear campaign".

But Mr Rudd's continuing refusal to countenance fundamental changes to the proposed 40 per cent tax on mining profits is a failing that industry leaders such as Mr Forrest put down to what they believe is misplaced faith in Dr Henry.

Battlelines drawn

Modelling commissioned by the government, which expects to bank an extra $9 billion from the tax, suggests that the RSPT would ultimately boost mining investment by 4.5 per cent, mining production by 5.5 per cent and jobs by 7 per cent "in the long run".

But industry critics argue that Dr Henry's expectation the tax will not hinder investment is fundamentally flawed, because Dr Henry's model assumes there are no constraints on the availability of investment capital and ignores the lure of more attractive tax regimes overseas.

Instead, miners see only unprecedented risks to the long-term viability of an industry that is central to Australia's economic wellbeing.

And given the succession of national opinion polls, which have put Mr Rudd's popularity at election-losing lows since the tax was announced, it would seem many Australians share their fears.

Industry's fundamental concerns can be summarised fairly simply. Foremost is an expected slide in mining investment here if Australian miners are slugged with a 40 per cent tax on profits once they exceed the "risk free" rate of return on long-term bonds, currently around 6 per cent.

That ignores the reality that, given the higher actual cost of capital, the return threshold needed for most mining projects to secure funding is at least 12-15 per cent.

Miners also argue the change will lift their effective tax rate, including royalties, as high as 58 per cent, making them the highest taxed miners in the world and making rival resource-rich nations such as Canada far more attractive investment destinations.

The government has persistently claimed that miners currently pay only around 17 per cent in tax, based on company tax alone and ignoring the billions also paid in state royalties and other government levies such as payroll tax.

That has been countered aggressively by industry. BHP Billiton, which paid $6.3 billion in Australian taxes last year, last week revealed its tax receipts showed that it paid an effective tax rate of 43 per cent, including royalties, in Australia last year.

Meanwhile, Rio Tinto released externally audited numbers proving its effective tax rate in Australia had averaged almost 35 per cent during the past five years, and Perth-based conglomerate Wesfarmers revealed the effective tax rate paid by its big coal mining division was 41 per cent last year, including royalties.

While such statements have dented some of the government's pitch to voters, more concerning for industry is Dr Henry's seemingly poor grasp of how the industry operates and how investment decisions are made.

As Mr Forrest revealed early this month, Dr Henry had personally conceded to him in a private meeting that the tax could not work if financiers saw no value in the proposed guarantee to cover 40 per cent of the losses for any failed investment.

According to Grange Resources chief Russell Clark, who is planning a $2 billion magnetite iron ore mine at Southdown near Albany, Dr Henry's concession exposes his and the government's lack of understanding of how such investment decisions made.

"We don't build projects to fail," he said.

In other words, projects considered marginal or unlikely to succeed simply don't secure funding in the first place, making the guarantee worthless.

Reality meets rhetoric

But perhaps a more revealing sign of Dr Henry's level of understanding was revealed when he told a Senate estimates committee late last month that the mining industry had not played any significant role in helping guide Australia through the worst of the global financial crisis.

Under fierce attack over the RSPT, Dr Henry leapt on estimates the resources sector had laid off over 15 per cent of its workforce at the depths of the downturn last year.

Had the rest of industry acted likewise, Dr Henry told the committee that the national unemployment rate would have topped 19 per cent.

That being the case, he said it was simply wrong to claim that the mining sector had been Australia's saviour during the global downturn.

But when compared against the government's own data, released last month, Dr Henry's comments look decidedly shaky.

According to the Australian Bureau of Statistics, the total gross added value of mining activity, as a share of Australia's gross domestic product, topped $73 billion in 2008-09, the financial period incorporating the period from Lehmann Brothers collapse in September 2008 to the first shoots of recovery in mid 2009.

That compares to $70.6 billion in the previous financial year when the global resources boom was at its absolute peak, and $69.7 billion in the year before that.

In comparison, the gross added value of the manufacturing sector plummeted from $109.9 billion in 2007-08, to $103.4 billion last financial year, while gross value added by the finance sector plunged by $2.2 billion to $117.7 billion.

Furthermore, the government's own budget papers show that Dr Henry ignored the overall net growth in mining employment over the entire year, whereby total mining employment actually rose to around 1.1 million in 2008-09 despite the lay-offs sparked by the global downturn.

In the process, mining for the first time overtook manufacturing in terms of total employment, with manufacturing employment dipping to a fraction over 1 million.

The budget papers also reveal that mining investment, as a percentage of gross domestic product, continued to grow strongly last financial year and especially in contrast to the manufacturing sector.

The papers show mining investment grew from around 4.3 per cent to 4.75 per cent in 2008-09. In comparison, manufacturing investment had remained virtually at a standstill since 2005-06 at around 2 per cent of GDP.

Commenting on Dr Henry's remarks, Commsec chief economist Craig James suggested the numbers showed "the mining sector may have saved the Australian economy after all during the global financial crisis".

Figures from Western Australia's Department of Mines and Petroleum also underline the sector's key role during the downturn, with the gross value of WA's resources output surging almost 19 per cent to a record $71.3 billion in 2008-09.

Over the same period, royalties collected by the WA government soared 41 per cent to $3.24 billion, up from $2.3 billion the prior year, largely on the back of the iron ore and liquefied natural gas sectors.

The latest monthly unemployment statistics, released last week, further undermine Dr Henry's position.

While economists had been expecting a rise of 15,000 jobs in May, total employment actually rose by 26,900, cutting the national unemployment rate to 5.2 per cent from 5.4 per cent in April.

The result was built on solid rises in most states, but WA – the state most reliant on mining – led the way with unemployment falling from 4.6 per cent to just 4.1 per cent. That represents a 10.9 per cent fall in unemployment for the period.

In contrast, the manufacturing-heavy state of Victoria was the nation's worst performer with its unemployment rate actually rising from 5.3 per cent to 5.4 per cent.

According to Chamber of Minerals and Energy of WA chief executive Reg Howard-Smith, the weight of evidence leaves Dr Henry's claims on uncertain ground.

"The data clearly shows that despite a general fall in commodity prices, production actually increased in most areas of the WA resource sector," Mr Howard-Smith told WA Business News.

"Had the industry collapsed, as Dr Henry suggests, this would have left a massive hole in state and national finances."

Bankwest economist Alan Langford said he believed Dr Henry's comments were really just "throwaway" remarks that showed his frustration over the debate about the RSPT.

"I think he was probably getting frustrated that his pet is being hijacked by the political process," he said.

But high-profile Perth resources lawyer Neil Fearis said a lack of direct commercial experience was evident both in Dr Henry's views and those of key ministers in the Rudd government who support the tax.

"Ken Henry is an extremely able fellow, but … he's an academic economist, I don't think he's been in the mining industry," Mr Fearis said.

"Look at the federal cabinet. How many of those (ministers) have been in private business, let alone the mining industry? None of them has ever run a business.

"So it would be interesting to speculate if you had someone with hands-on experience in the resources industry sitting in cabinet, whether we'd be confronting this proposal."

To date, the government has drawn great comfort from the support of a statement backing the tax by 22 economists, mostly representing government agencies and universities.

The problem now apparent to many in the Rudd government facing the potential loss of their seats is that those 22 votes alone will not carry the election.

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