

It's not just the tax that's wrong, but the process

June 9, 2010

Kevin Rudd needs to get out from under his 40 per cent tax on the mining industry. He can't just repeat slogans about how fair it is - he's lost that argument. The polls show most Australians don't agree with him. The Nielsen poll on Monday showed opposition to the tax at 49 per cent.

What's worse for Rudd is he has stirred up a huge constituency and motivated it to defeat him at the election. Before this, business would have been a lethargic supporter of the Coalition. But the mining industry is hardly lethargic now. It has a real interest in defeating this tax, as do investors, superannuants, contractors and just about anyone else who understands how important mining is to Australia's trade and economic performance.

In Rudd's corner are the Greens, who vote Labor through preferences, and rusted-on types who will always vote Labor. Rudd has resuscitated the class-based rhetoric that drew them to Labor but has not moved the middle ground.

The government will begin the backdown by increasing the rate of interest on carried-forward expenses - probably to the rate applicable to the petroleum resource rent tax. It will not be enough.

At the least, the industry wants the new tax to apply only to new projects. It should avoid any hasty compromise. It has withstood a misleading campaign and turned it around. It will never be in a stronger position than now.

Usually the government would be able to harness the prestige of Treasury to hammer out a compromise. But Treasury is not seen as independent and trustworthy on this tax. The thoroughly misleading graph purporting to show taxes fell as mining profits rose in the past decade originated in the tax review led by Ken Henry.

And here lies the problem. The serving secretary of the Treasury should never have been asked to decide on tax policy options. The government should have understood that once it decided policy the Treasury would have to settle the detail - maybe in some cases re-engineer it - and would need to be respected and disinterested about implementation.

Its head is irrevocably committed to the original design. His department feels bound by loyalty to him.

If the government wanted a successful example of how to prepare options on business tax it should have followed the model of the 1999 business tax review chaired by John Ralph. This provided the basis for cutting company and capital gains tax, and for tax consolidation. Other recommendations were rejected. The Treasury was kept out of the process to advise once the report was complete. It was not asked to advise on its own conclusions.

Which brings us to the members of the Henry review. All, including Henry, have a public sector background except Heather Ridout, the chief executive of the Australian Industry Group. She was obviously appointed to give a business perspective.

After the report's publication she talked warmly of the new mining tax. It was, she said, "a move in the right direction". She must be the only business representative to think so.

The mining industry is aghast. The government's business adviser, Rod Eddington, says it should restart the whole process. The chairman of the Future Fund, David Murray, said the tax "should be abandoned" in its present form. The Business Council of Australia has come out against it. The ANZ Bank has warned about sovereign risk. Which leaves Ridout isolated.

On this occasion, she has let Labor down. She should have made it clear inside the review and publicly that this was a bad idea and alerted the government to the damage of adopting it. Some have suggested that as a representative of manufacturing she would be unfazed that a draconian new tax falls harshly on mining. But as the sole business person on the review she owed it to the government to give a broader perspective. Her members would include many contractors to mining and many manufacturers who supply those contractors, who will be affected.

This sorry shemozzle was doomed by bad process but more importantly poor understanding of tax policy. It is plain Rudd and Wayne Swan had no idea what they were signing on to. The sooner they understand it the better.

Ridout will have to account to her members. Henry will not be on the ballot paper at the election. Rudd and Swan will be. The government has to fix this problem.

Peter Costello is a former Liberal federal treasurer.