The boom time and the bottom line

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Australia is in the midst of the greatest mining boom since the Gold Rush. This time it is black gold – coal – and rust-coloured iron ore. The largest contract in Australian history was recently signed to export gas to China from Gladstone in Queensland.

Companies are flocking to the diggings just as they did to Ballarat and Bendigo in the 1850s and later to Kalgoorlie.

There is a buyer with an insatiable appetite, and our resources of coal, gas and iron ore will last a lot longer than the narrow seams and alluvial gold deposits ever did. The China boom has increased our terms of trade by 30 per cent since 2004.

When the Coalition was in government, it was common to hear Labor critics complain it had "wasted" the China boom. Compared with today's prices it was never a boom at all. The rise in prices looked significant in 2004 but it was dwarfed by the past three years.

Once you've seen a tidal wave, an ocean break will never look as big again.

From 2004, Australia finished paying off government net debt, established a savings fund – the Future Fund – and set about reducing taxes.

So how are we using this cycle of super-charged prices and mining company profits? The Labor government is back in deep debt, the endowment funds for education and health infrastructure have been run down and the Treasurer is proposing a new tax on the resource sector.

What we have to show for the China boom is insulation batts and local school halls.

When the Henry tax review is released at the weekend, it is going to use the extraordinary profits of the mining sector to argue it should pay higher taxes. But remember the existing taxation arrangements – royalties on production and company tax on profits – increase the tax take as production increases and profits increase. The government does not need to change the taxation arrangements to collect more from the mining industry. The current arrangements do that already.

Changing the arrangements is a plan for a double bite. The government takes an increased amount. It wants to increase the rate at which it gobbles those increases.

There would be no need to go looking for new money if the old money had not been spent in the way it was.

There will be a lot of talk between now and the budget about savings to improve the bottom line. Savings can offset spending, but the easiest way to improve the bottom line is to stop new spending.

If a member of your family had a credit card debt and asked for help, you could give them advice on how to save in all sorts of ways and let them go out and use the plastic some more. Or you could confiscate the card. If you stop new spending you do not have to find so many savings to pay for it.

The best saving for the government would be to stop spending on all those school halls. At last it's stopped spending on insulation batts. An even better idea would have been not to start that spending in the first place.

The budget will show, just as it is looking for savings, the government will go on rolling out "stimulus" spending for next year and the year after. Just as it puts the left foot on the brake, it has the right foot pumping the accelerator.

When the Henry tax review is released, the government will also tell us which proposals it supports and which it rules out. Any tax changes it has decided to adopt should be factored into the budget numbers to be brought down next month.

If the government has decided on a new resource tax, it should be in the bottom line. Otherwise the budget does not reflect the government's real estimates of what its policy will deliver over the next four years. There will be a lot of huffing and puffing on budget night about the bottom line. But if it does not reflect those parts of the Henry review the government intends to introduce, it bears no relation to reality, or what the government proposes to make reality.

That would mean the budget's accuracy would be as bad as last year's. All those graphs supporting what would happen without the stimulus and how things would improve as a result of the stimulus? Wrong, wrong, wrong. The baseline forecast of the effect of the downturn was so wrong the forecast effect of the stimulus is thoroughly unreliable.

The 2008 budget underestimated the financial crisis. Last year's massively overestimated it. And one of the reasons is that all this time the China boom has been gathering pace. It would be nice for taxpayers to have something to show for it.

Peter Costello is a former Liberal federal treasurer.

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