



# The economic rents in Oil and Gas

by David Collyer

For thirty years, the Petroleum Resource Rent Tax had been a successful revenue-sharing device, delivering well over \$33 billion to consolidated revenue, derived from the economic rents of resource extraction and thus causing no harm.

In that time, it never deterred exploration or production.

Once lifted out of the ground, our valuable mineral wealth is gone – which is why resource rent taxes are so fundamentally important.

A properly functioning PRRT will take many billions of dollars in economic rents from producers' profits and market capitalisation. Much of this current value is due to the failure of our tax arrangements to honour the express intent of Australia's Constitution, which rules natural resources are owned by the government on behalf of us all. Bad legislation means these lofty constitutional principles are not put into practice.

Professor Craig Emerson, principal architect of the PRRT, says:

“As the resource owners, the community is entitled to a share of any resource rents from gas extraction; that is, the profits in excess of the returns needed to attract exploration for and development of gas reserves.

He proposes three changes to the PRRT.

“First, the 15 percentage-point compensation uplift factor for exploration expenditure was agreed as a compromise with industry in 1984 on the assumption that it was mainly searching for oil in frontier offshore territory, not gas.

“Second, one of the three legislated methods of setting a price for gas – called the Residual Price Method – might be open to exploitation by companies seeking to minimise PRRT liabilities.

“Third, if Tax Office projections indicate offshore gas producers are unlikely to pay PRRT in the foreseeable future, a royalty could be contemplated, but one that recognises legitimate gas extraction costs.

“A 10 per cent royalty based on the gross value of gas production – as advocated by the Tax Justice Network – would result in higher-cost gas being left in the ground, generating no government revenue. A royalty that allowed cash operating costs as a deduction would avoid this problem.

Prosper's submission to Treasury's Callaghan review written by Dr Cameron Murray backs this assessment, tartly observing that a simple 10 per cent royalty would be better than the sorely compromised PRRT that has

diverged strongly from producer profits and delivers a smaller and smaller revenue stream to government.

Murray says: "The reaction of the industry – investing tens of millions of dollars in lobbying and campaigning – is the normal and logical outcome of effective tax reform that reclaims economic rents for the public.

"Indeed, if the reforms are not challenged in court by the affected oil and gas companies, they can probably be judged as ineffective. Taxing economic rents is a battle over who gets billions of dollars, and the loser will go down fighting.

Norway successfully resisted the resource rent-seekers. Its petroleum tax regime allowed it to start a sovereign wealth fund in 1990, now worth over a trillion dollars. This gives Norwegians lower taxes and better services – a prize available to Australia as well.

There is a lot of money involved here and we can expect a bare-knuckle response from oil and gas producers offering blood and bruises to anyone wanting to take some of 'their' profits as an extraction charge.

Prosper regretfully doubts Australia's politicians and bureaucrats have the institutional courage and stamina

to stand up to resource rent-seekers and hold them to a quality resource rent regime.

If this is so, we must go back to a royalty – which means marginal production stays in the ground and the economy underperforms.

Australia's PRRT is more than just another grubby tax. It rises and falls with prices and profits, an automatic stabilizer, reducing oil and gas producers' risk. It does not deter marginal production.

And taking less in damaging taxes from wages and business is an outcome worth fighting for.

The Turnbull government must expect casualties from this battle. After all, they were elected to represent the interests of ALL Australians.

<https://www.prosper.org.au/2017/02/27/this-government-wouldnt-fight-for-a-trillion-dollars/>

<http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2016/Review%20of%20Petroleum%20Resource%20Rent%20Tax/Submissions/PDF/Propser%20Australia.ashx>