

Notes for Crommelin seminar talk, 1974

Cromwell is desperate. I called conf. bcs. I wanted answers - now I've called on to give them.

~~Not a pinch hitter.~~

Objectives of Govt. Policy.

Intro - Adam Smith

Objective: Act like max's landowner; avoid diversions, temptation to use power to manipulate & control, unless meet burden of proof.

1 important proviso: subject to ~~overriding~~ Federal power - Tupper budget e.g. Fed. not overriding. Province always engaged in implicit bargaining & bluffing. But that is another topic, will not treat here, stick to more fundamental & general problems.

But ^{Provinces shd.} take as given Fed. determinations to give large tax subsidies to indy. - so we can offset. (But only a little, bcs. what we can do, others can. & Ottawa responds.)

Max's landowner wants to max. rent?

Not quite. 1. PV of rent, so timing is of essence.

2. Rent base, so some expln. needed

3. Avoid destroying rent, as by his regulations.

(But as to this, note asymmetry, the way we tax labor, no concern about input effort, and we shouldn't apply double standard.)

4. Avoid dissipating rent, as by open access, Free Mining.

But in general, want the fat & not the lean. The less lean you cut by dissipation, the more ~~lean~~ of fat you can take.

The positive art of squeezing out rent is subject of other papers. I'll begin by negative - common errors to avoid.

5. Avoid dissip. rent by requiring it be plowed back

6. Avoid dissipating rent by indulging itch to meddle, manipulate - as F.S. does

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Things to avoid. A hornet's nest of things one can easily do wrong, in effort to get rent. ^{produce some too late; & some too early; & carry excessive inventory.}

1. Overdecentralization. A transcendent error, way to dissipate rent. Has several causes & aspects.

(A) "Regional Development." Pushing back frontiers. Opening new land.

a compulsive, atavistic, Pavlovian twitch, little basis.

Mines are isolated, narcissistic, not serried. Need single purpose rails & ports, do not share easily. Output moves a long way to market. Mines create no great cities. (Butte, Evad Kniesel)

Minuscule capt. -- 1.2% in B.C.

"Devmt." & "growth" not much in selves. Tundra sits there very peacefully until we need it.

They consume ancillary capt., but do not share it. Rails, roads, ^{burgeon} hydro energy (Kittimat), ports & superports, unit trains, Mackinac pipeline. Leverage of port. over public invt.

Better to build roads, ~~than~~ put pressure on land where roads already are. And we need energy more for lots of things than reducing alarm, 133 kWh per \$ v.a.

(B) Chrono. mgmt. (For collecting rent, like surfing w. tide can)

Higher royalties (or lower price) on older gas, oil causes high grading there — & slow-grading, too. There is much less urge to produce

Thus spreads out to new areas prematurely.
demand

Indonesian variation: after expln. costs are recovered, go to very high royalty (Bentzen both in U.S.)

(C.) Excessive reserves to amortize capl., for one firm, (or well.)
Firms like to tie up huge Crown reserves on the cheap.

Amortize in 20 yrs. for $10\% + \Delta$, & $\Delta = 1.75\%$
 $\Delta <$ usual claimed risk premium.

Better to recover cap. fast, recycle. Thus run mines w. much less cap. tied up -- & stop draining rest of ec., where the cap. combines w. labor & creates many more jobs.

Firms love to tie up public reserves, let public cover carrying costs. It's all gain to them, is abetted by: MER; well spacing; large acre units for permits, & leases; low delay rentals; low work requirements.

(D.) Fed. tax loopholes, expensing expln.; deferral of tax to realize. Provinces can't stop it, but needn't add to it.

~~Depth allowance, speeding along usage. (Royalties ch. offset.)~~

If at same time allow oversized leases, or holding permits, on better land, this forces decentralization.

(E.) Prop. tax

(E.) Claimstaking - drill boundaries first.

E.g. U.S. holds Gulf on reserve, & held Canada for long time, using further res.

E.g. No. Sea, well on boundaries

E.g. Canada in High Arctic

Loose terms at fringes. Nearest land may be held firm. Outer land more claimstakable, attracts explorers like flies around a pot of honey.

(F.) Sliding scale royalties

Higher rates on bigger wells

(1) They may not be lower cost - another blunt scalpel, "tin can surgery", capricious results

(2) If they are lower cost, get hi-grading & slow-grading of better deposits.

The Price Control Variation: Price held below what, coupled w. subsidies to expln., mgns., etc. Same as higher tax on richer deposits.

(G.) Pvt. appropn. of tax-free accrual

There is more accrual, a higher % rate, on input deposits beginning from 0 value.

You have to pay more for better deposits.

This is another inc. tax subsidy related to expensing

(H.) Remitting royalty on low-cost deposits as credit for expensing.

E.g., new Canadian deple. allowance which you must "earn" by investg in new expln. (or deple.?)

[This is ^{both} a subsidy to new, ^{and} more than a benefit to ~~depletable~~ depletable deposit.] - ~~it can't be both, but it can be double counting.~~

Any aggregation or consolidation of accts. runs this risk. A double risk:

- (1) Losses carried by winners
- (2) Capl. outlays written off current inc.

Firms say they must drain rent from rentable deposits to make up for losses on exploring. (They call it risk premium)

Is element of truth, but more untruth.

(1) If they used entire rent this way, it wd. dissipate rent, exhaust net social gain.

(2) Qn. of timing.

They cd. get discovery value of successful future mines, & it wd. dissipate rent.

But they want more, the rent of going mines
—? Too much, too soon. (I.e., by charging new expln. vs. current rent.)

Each expln. ~~must~~ should justify itself, in terms of probability of success.

The ~~2nd~~ indy. variations.

~~18~~ H. EYE Squeezing customers, & ~~being~~ disposing of rent.

Muny. govt. ^{agency,} ~~trust~~, selling to outsiders, holds back to maintain price. As Alta. always has, w. its private.

Earns large rents. It likes to internalize them — keep from general treasury. Agency in charge of leasing puts back in minerals. Familiar bureaucratic behavior. Also, how to invest earnings w/o. by output.

The govt. in charge wants to avoid a social dividend (Alta.), only attract outsiders. So, squirrel away for future, by underwriting input, exploration.

(Alta. broke pattern, bought an oil line)

[Pipeline rate structures; subsidy to McKenzie line; a f effect, re utilization]

J Use of i below mkt, — or any subsidy to capt, which has same effect.

Slows liqu. of low-cost; & underwrites expln. for new. Makes indy. carry too much cost.

Avoid guilt feelings about future generations.

(Cdn. use corp. plant/buses as ex.)

overdelegation
[2.] Avoid temptation to hand problems over to one big firm to internalize the externalities.
It will internalize us.

Only way to find rent is in competitive mkt.
We - govt. - are the big firm to whom this has been turned over.

As to taking risks, greatest risk-avoiders are bureaucrats in large corps.

If do meddle in mkt, do it to encourage small, & compn.

[3.] Avoid allowing large alleged risk premia
1st easiest way to pad costs. Sounds so innocent,
& is legal.

Converts our rent into their income.

Are premia needed? Great costs. have thought not. Marshall, " "

There is gambling pref. in many people. Some go into crime, some to Las Vegas, & some into prospecting. (They also have high tax aversion.)

As for frigs dry holes, who needs dry holes? They are not an end in themselves. Each expln. needs to justify itself on probabilities of success.

"Success" needs to give enough to cover some failures. Qn. is, how much? "Risk" approach opens door to limitless draining of crown rents.

[4.] Avoid dissipating rent by free & open access. Like Canada's & free-ranging permits to explore for oil & gas, described by Croumwell in NRJ. Like fishing on open seas.

Underpricing, [5.] Avoid subsidizing rent via low price. Consumer wants: ~~producer stop~~. Avoid subsidizing Idry indy. by cheap feedstock, or remission of royalties.

Purpose of Idry indy. is to create jobs. Subsidize them then for hiring men, not wasting res.

Producers stop.

[6.] Avoid confusing rent & income.

It will be done a dozen times today.

Income = Cash flow - deprec.

Rent = " " - cap. recovery

- [deprec. plus int. on unrecovered cap.]

Debt also makes a diff.

Another diff.

Rent is in rem, attaches to the site

Inc. is in personam (or in corpore), attaches to firm, allows more scope for padding costs by including offsite "overhead", losses, etc. interest on debt

Legal diff.

Rent belongs to Crown Provincial, more clearly — if anything is clear since Turner budget.

✓ Charges by Province on rent are deductible — prop. tax, maybe royalty. After reading La Forest, I am convinced Provinces problems w. Ottawa spring from failing to define and take just rent.

Avoid confusing rent & "windfall". Windfall adds to rent, but isn't the whole of it. Dave Schwartz.

There is rent b/c. world not uniform. Low-cost deposits.

E.g. one of our cos. has net = $\frac{1}{2}$ gross. (Related to size. Kierami figs. on top 34)

Overlooking taxn. of non-mis; 7. Avoid partial eq. anal., which depletes effects of taxing mining as the other invts. were not taxed (8 of prop. inc. as the labor not taxed over-moved, auto)
 8. Avoid letting large hide behind small, Widows & orphan game, old as time. Kierans
 fig. on conc. of ownership, "old prospecting miner..."
 Now my negatives are becoming positive, so new list.
 Above all should truth in provts, "Is easier to meet a common enemy calmly than to share a surplus."

1. Use rent as base of royalty.
 Deduct as many costs as possible
 Then raise rate — whether royalty or delay rental.
 Hit the low cost deposits, yielding big surplus.
 This is scalped instead of tin can.

2. Minze. cap. requir.
 Royalty bidding not the only way.
 Bonus bidding, & pay on instalments. (Delayed bonus.)

Brainstorming session, explore new ideas, ^{fix} ~~the~~ nests & holes later.
 Such as —

3. How to avoid royalties?
 Mr. A. Let lessee bid for a given A, down to a given grade, over a \$ max. pd., say 12 years.
 Then mine rents, & can call of any fixed capt. he can't salvage.

Keep tenure short. No tie up resources. Auction & re-auction.

B. Tax Reserves — best of all, if can ext. them. Sand & gravel, e.g.

4. Crown shd. open land for permit when value rises at i.
 at decision of Crown, not pt. As in U.S., not Canada.
 Then max. PV to Crown — or try to.

5. Best way to incant explor. is selective leasing
 take away half each year.
 and give explorer A he can use, over previous value est. by Harris.
 Won't develop now. Appraise, sell to Crown for resale & control.
 But Alta. already uses checkboard system. 6. Sell as much (Crown)

D. Campbell

~~Security of supply - not at current prices~~
as possible. Govt. never as effic., bec. is no one above to
exert pressure on govt. Govt. can alienate & then tax.