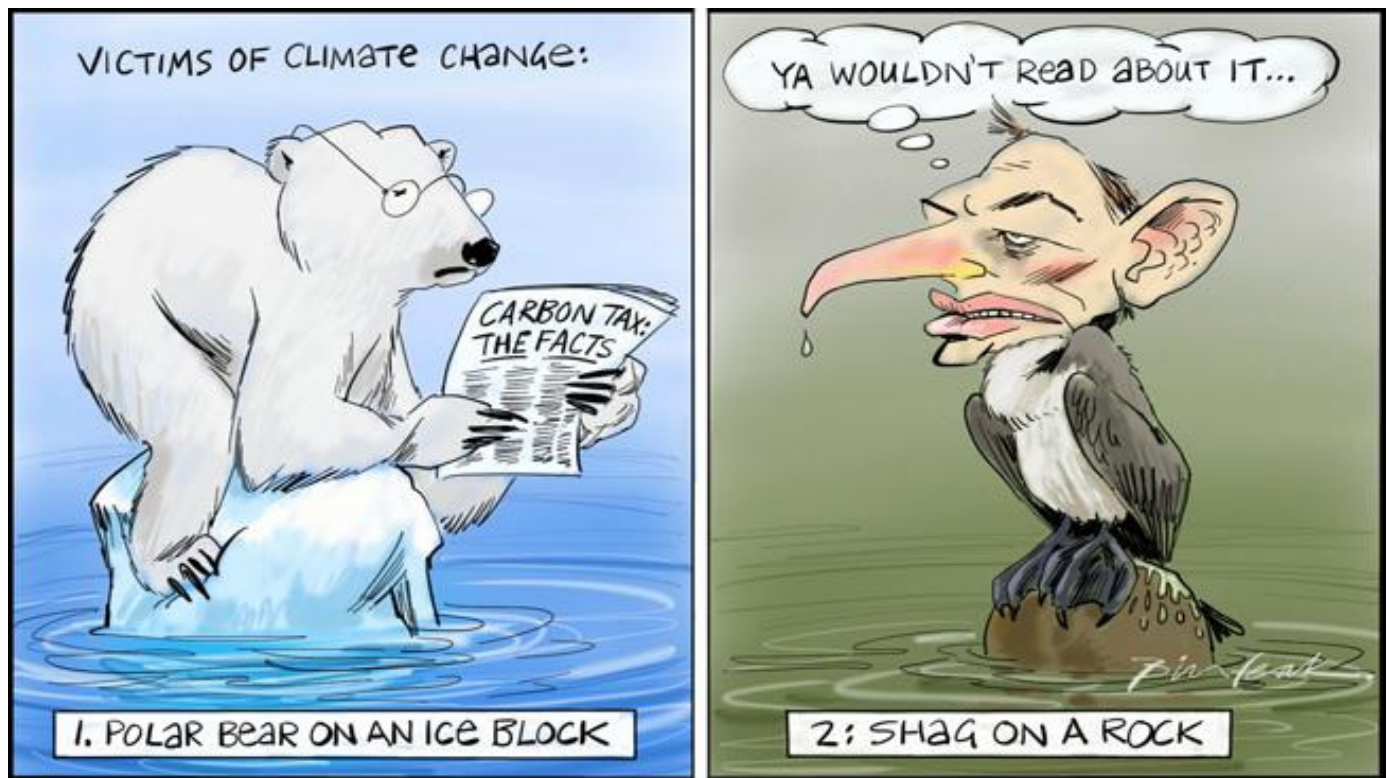


A pity prosperity depends on mining

HENRY ERGAS THE AUSTRALIAN AUGUST 27, 2012 12:00AM



Bill Leak Source: The Australian

REDUCING mining investment is not collateral damage from the carbon tax: it is integral to achieving its objective of shrinking the carbon intensive components of Australia's economy. As Treasury found, because of the tax, "the (Australian) mining sector experiences a significant decline in rates of return. As a result, investment falls significantly."

Pity our prosperity depends on mining. And pity too that the tax was introduced just as minerals prices went into steep decline, making the pain all the greater.

Already, prices for our mineral exports have halved from their peaks. While that partly reflects cyclical factors, world markets are also affected by the sheer scale of the capacity now coming on line. The stratospheric price rises caused by the boom -- with prices for coal and iron ore more than quadrupling from their trough -- have done their job: new mines are being developed around the globe.

The Red Bull days are therefore drawing to a close. Yes, Asia's long-term demand for coal, iron ore and other metals will remain strong. And yes with a slew of projects under way, there is considerable momentum left in our mining sector. But as that pipeline clears, merely being abundantly endowed with natural resources will no longer be enough to make Australia wealthy.

Rather, if our mines are high cost, consumers will readily turn to alternatives. Nor is it only price we will be competing on. It is every dimension of performance: how long it takes to move output from mine to port, and even before that, to go from initial design through construction to first shipment.

In that competition, we are not even making the final round. According to Port Jackson Partners, capacity expansion costs in iron ore, which were line ball with competitors' in 2007, are now 25 per cent above world's best practice. As for coal, five years ago building a tonne of export capacity cost 15 per cent less in Australia than in our closest rivals; now it costs 75 per cent more.

Cost increases are to some extent inevitable as mining bids the inputs it needs away from other sectors of the economy. But they are aggravated by self-inflicted wounds. The carbon tax is a case in point. With Australia the only major exporter imposing such a tax on its miners, the tax simply diverts production to

other countries, for no environmental gain.

But the carbon tax is merely the latest environmental policy burden. A proliferation of regulations has ensured the volume and detail of environmental impact statement requirements verge on the absurd.

Olympic Dam project, for example, is not in a class A nature reserve like Barrow Island, where the Gorgon project must tip-toe around 1.3 per cent of the land area. But even so, its initial EIS for the now shelved expansion required 29 chapters, 51 appendices and, thankfully, an executive summary. Not to be outdone, the subsequent supplementary EIS numbered 35 chapters, 51 appendices and 13 information sheets but, curiously, no executive summary.

No surprise then environmental approvals for major resources projects now take four years or more, from notification to state governments to commonwealth approval. An agreement between the states and the commonwealth promised to make approvals a single seamless process. But federal environment minister Tony Burke has effectively torn it up. With the backlog of projects awaiting EIS approval in Queensland alone blowing out to 41 (about as many as were cleared in the previous eight years), lengthening delays and falling prices risk tipping yet more projects on to the wrong side of the commercial viability line.

There is no evidence whatsoever that the environmental benefits associated with these requirements come close to justifying their costs. But to use the mot du jour, they do yield slush funds for greenies -- such as the obligation Burke just imposed on the Alpha coal project in Queensland to pour millions of dollars into a trust "to conduct research on the black-throated finch and the squatter pigeon".

Nor does it end there. So as to ensure the unions also get their snout in the trough, the Fair Work Act makes it virtually impossible to start work on major resource projects without union approval. And while even the panel reviewing the FWA had to concede the act's "greenfield" provisions were unworkable, its proposed changes will do nothing to quell the stand-over tactics that are increasingly widespread.

Moreover, such is the unions' grip on the Gillard government that even a sensible reform, as was the introduction of Enterprise Migration Agreements, gets strangled in a "spreading the benefits of the boom," federal Labor caucus committee, the moment the unions say boo.

That question will loom even larger in future. After all, out-Whitlaming Whitlam by a factor of five, this government has been increasing public spending each year it is in office by nearly \$1000 per man, woman and child. With the International Monetary Fund forecasting our structural budget balance will be in deficit until at least 2017, that additional spending must come from somewhere. So must the unfunded commitments to the National Disability Insurance Scheme and the Gonski report, as well as election approaches.

Already, Ken Henry and Treasury Secretary Martin Parkinson have said tax rises are inevitable. What better target than mining ventures that, once the capital is sunk, can hardly pack up and leave? With the minerals resource rent tax in place, it would be simple to raise its rate and extend its scope, as this government did to offshore gas. Further cutting the diesel fuel rebate would also be straightforward, with the recent reduction in the rebate increasing gross project costs for the now postponed Olympic Dam expansion alone by at least \$1 billion.

Those measures would have the enthusiastic support of the Greens, for whom any excuse to slug mining is a good one. And with Julia Gillard having imposed more retroactive tax hikes on business than any previous government in Australia's history, another bout of tax grabs at mining's expense by a re-elected Labor-Green coalition can hardly be ruled out. Such actions would require a lethal dose of ignorance. But bad habits cast long shadows. These are the people who brought you the resource super-profits tax, the MRRT and the carbon tax. Little wonder mining investors are skittish. They should be. And so should you.