BRIAN FISHER – MINERALS WEEK SEMINAR, SESSION 2, 26 JUNE 2013

What I want to do this morning is touch on two themes.

First of all, I want to talk a little bit about the policy process; Peter touched on this issue in the introductory session and I'll pick up some of those themes.

And second, I want to look from outside into Australia, and reflect on some of the issues that the minerals industry faces in making investments in Australia.

Just to give you a bit of background, I spend most of my life nowadays in interesting places like Mongolia, Mozambique, Guinea and a range of other places that mining companies now find to be rather attractive places to think about spending their money; rather than (or in addition to) in Australia and I want to come back to that later on.

To the policy process, I'm probably at great risk here of raising some of these issues in my home town and I'll probably have to get on a plane immediately after I say some of these things and go back to Mongolia because it's a dangerous place, Canberra, right at the moment I'm sure!

Peter Johnston in his introductory remarks said that: 'You need a good policy process' and I think you need quite a few ingredients to achieve that.

The first thing you need is good policy clients. You need clients like the Minerals Council, for example, who are prepared to be intelligent and thoughtful and do their research. Generally speaking, I think the Minerals Council actually does that, but of course everybody can lift their game. And I don't want to be critical, of course, but I think for a good policy process you need intelligent players on both sides; both sides have to do their research.

On the part of government and the public service, clearly you also need some intelligent processes. You need, from my point of view, solid experience of the industry that you're dealing with in the relevant Ministers' offices. And I think we've been pretty well served over the last ten or twenty years with good Minerals and Energy ministers.

The current minister said that he gets out and about and that's certainly true, he knows the industry, but he's not the only person that's important in this process. It's important that everybody in Cabinet understands the minerals industry. And I suggest to you that quite a lot of people actually don't.

In recent times, we've seen Ministers' offices become more important than they were, say twenty years ago. And I think we've seen a situation where quite a lot of Ministers' offices are inhabited by persons that are moderately young, certainly younger than I am. I don't want to be ageist in any respect, but I don't believe there is any substitute for experience.

No matter how intelligent or how smart you are, and how many degrees you've got, if you've never seen the industry up close, you can't understand it properly. And therefore, you probably will make some mistakes.

In terms of departments, it's not only the Resources and Energy Department that the minerals industry has to worry about in terms of the policy process.

I suspect that if you look in Treasury you will find a bunch of officers who are extremely intelligent; I've got no doubt about that, dedicated to the task, but many of them will not have had the opportunity to see the industry up close. They really would not know the difference between a lump of iron ore and a lump of copper ore.

You might say, well it doesn't really matter. And I've certainly heard the argument that no it doesn't matter in terms of making good policy, whether you have seen an iron ore mine or not. Well, I don't actually believe that. I think it's important that people who are engaged in the policy process actually understand their industries.

When you work in a public service that has been subject to the grinding process of the efficiency dividend for the past twenty odd years, then there is less opportunity to travel and you can be sure that the young persons, intelligent persons who are thinking about things like mineral resource rent taxes for example will have probably never had the opportunity to travel and see the industry and this leads to bad policy, in my view.

So, you should try to do something about that, I suggest.

The next thing that strikes me is the current structure of portfolios in Canberra is almost unbelievable. Now I say that because if you have a look at how many ministers some departments report to, it's unbelievable.

You here in the minerals Industry would just not think about setting up a process where you establish a headquarters for your company and then have that headquarters reporting to six CEOs. Can you imagine what would happen, if your headquarters were reporting to six CEOs?

Well, you'd probably get a bit of confusion. The current administrative orders that dictate the way in which the public service is structured, frankly it’s quite mad.

Not only do we have really huge and complex departments, we also have very small departments.

The Department of Resources and Energy is so small in fact that I would submit that it's impossible to get economies of scale there and it's impossible to get a critical mass of people.

The Bureau of Resources and Energy Economics (BREE) consists of a very small number of people. Frankly, it cannot do its job properly, no matter how good those people are, if there are only a few of them and they are expected to do forecasting across the entire minerals and energy portfolio, monitor a whole bunch of projects and conduct insightful research into the minerals and energy industries.

That process is not doing you a favour and dare I say this, I think we were much, much better served when we had a Department of Primary Industries and Energy that ranged across the whole range of issues that are a very important to this group, as well as to the primary sector more generally.

You might think that I'm dredging up the past there a bit, but at least in those days we had the economies of scale and the critical mass of people dealing with the issues that are critical to the maintenance of the minerals and energy industries' competitiveness.

Alright, now let me move on to what are the advantages and disadvantages of building a minerals or energy project in Australia.

We should have significant advantages. We are a modern democracy with a strong rule of law. Generally, we are free of corruption, although there's the occasional state that gets itself apparently into a little bit of trouble in this respect. But generally we are not dealing with a situation like some of the countries that I work in.

We have a well-educated workforce. We have good public health systems. I don't have to worry if I'm working in Australia about being bitten by a rabid dog, getting malaria or potentially dying from The Black Death.

So from that respect it's easier to work here in Australia than it is in some other jurisdictions. But minerals companies choose to work in these other jurisdictions and more and more they have been forced offshore to do that. There must be some reason for that.

Let me address the reasons I think that's happening and I want to start by thinking about some of the economy-wide issues.

I should say that Peter, Mark and I did not collude in preparing our speeches, but there are a fair few themes here that are pretty common so maybe that tells you a story for a start.

First of all industry protection - it seems to me we have gone soft on protection. I understand having worked in government for twenty odd years that Cabinet ministers and Cabinets more generally will want to splash cash around when somebody like Ford decides that they're leaving in five years' time.

But frankly that is not the right thing to be doing. I understand why it happens, but it is not helping us, basically. Now, why do I say that?

Well basically if we are protecting a domestic industry, then effectively what we're doing is imposing a tax on the traditional export sectors. So every dollar that goes to Ford or Holden represents a tax on the minerals industry.

Why is that the case? It's the case because the exchange rate is higher than it otherwise would've been and real wages are higher than they otherwise would've been. There's a consequence of that protection.

In the 1980s, the agricultural sector and the minerals sector came together to attack this problem in a coherent way and we saw the effective rates of protection across the economy fall substantially. And as consequence of that we are better off today, but we seem to have lost our way in that respect.

When I look at the effective rate of protection on the mining industry as measured by the Productivity Commission, it's 0.3%. That is certainly different from the sort of numbers that you hear from the Australian Institute.

Maybe it's time that we had a more aggressive approach taken by the minerals industry and the agricultural industry in terms of defending itself as to exactly what its effective rate of protection is – it's basically zero.

In the case of sheep, beef and grain according to the Productivity Commission the effective rate of protection is 2.7%.

For manufacturing, it's 4.1% and the components inside there:

- Motor vehicles; 9.4%,
- Textiles, clothing and footwear; 7.3%.

Those numbers are much much less than they were in the early 1980s but they still represent a tax on you all and I think it's time that we made that point plainly in the policy debate.

The second thing I wanted to touch on is infrastructure. In introducing me, John mentioned that in 2005 I chaired the then Prime Minister's Export and Infrastructure Taskforce. And in preparing to talk to you today I went back and had a look at some of the things we did in that taskforce and frankly, it seems to me there has been a lot of activity in the infrastructure space but we haven't actually made much progress in terms of the things that matter to this industry.

I'll give you an example, I'm going to draw some graphs in the air. Greg had some excellent graphs up there. I don't like PowerPoint actually, so I'm going to draw some graphs in the air for you.

If you go back and get the data on the volume of exports of iron ore from Australia and you graph these numbers from 1980 out to 2012, then you'll find that you've got a line on a reasonable slope to about 2003 and then, beyond 2003 we get exponential growth out to 2012.

So nothing much happening up to 2003 then we get exponential growth on export volumes of iron ore.

In 2003-04 prices lifted and basically what that says to me is that the iron ore industry was able to respond to the price incentive received from overseas markets, by lifting the supply that is supplied into world markets and it did so with exponential growth. It was able to do that because the industry and the firms in that industry control the infrastructure; they control the mines; they control the railroads they use; they control the car dumpers; and they control the ports. They own everything, it's an integrated process.

We've been through the courts for many many years on this issue with people attempting to undo that excellent process. So far, they have failed but I'm sure there's the occasional public servant in Canberra who still would wish to have somebody else's train on the BHP Billiton railroad for example. Or the Rio Tinto railroad for that matter. I'm sure they're here.

This is not a good thing basically.

Now, let's have a look at what's happened to coal. If you do exactly the same graph and Greg had a graph up of exports of coal out of Australia. Go back and run that graph out from 1980 to 2012, and what you see is an upward trend like that, lifts a little bit in 1995 and is on exactly the same trend as from 1995.

There is not a change in the trend despite the fact that coal prices lifted very substantially in international markets from 2004 onwards. Basically what it means is that the industry was not able to shift from the trend that it already had been on in the long term in terms of shipping coal out of here and as a consequence of that, as Greg said, we've lost market share.

Yes there has been, after a lot of hard work, progress, for example, in the coal chain in the Hunter but that process still is nowhere as efficient, in my view, as the dedicated infrastructure processes that we have in the iron ore industry. We have failed our coal industry in terms of providing decent infrastructure that would allow us to respond to the serious marketing incentives that we faced from 2004; and probably we have now lost the opportunity.

I know Greg is very, very hopeful. Well that's good, it's good that he's hopeful but, hope will not come to reality unless there is a lot of hard work done in that area.

Taxation - I won't say very much about taxation other than to say that the MRRT is a bad tax. It's a bad tax, just as the same as a payroll tax is a bad tax.

One of the things people do not truly understand is that if you have a look at the profits made in the iron ore industry, say, from 1968 when the Pilbara was just started out to about 2004 the industry struggled and there are quite a few major operators who thought very carefully about whether they would persist there or whether they would sell out and go away.

Luckily for Australia they persisted, because from 2004 we had the so-called 'seven good years'. So for 35 years we struggled, and then we get seven good years.

Now, if you're in agriculture, would any of you bemoan a farmer getting seven good years after struggling with 35 bad years? Well you would say, 'that's fantastic'. Farmers, you deserve it.

Well, why is it that the government can't take the same attitude to the minerals industry?

You spend 35 years making no rent, to get a few good years and it's not really the minerals industry we're talking about here. It's the shareholders of that industry who in the end get the dividends from that process.

So, my contention is that there are actually no super profits in the long-term in any of these industries and, therefore, a process that attacks and attempts to extract a short-term rent, because of a short-term boom, will end up in reducing the incentive to invest in Australia.

The other thing that I might say here is that profits based taxes – which I understand is a Minerals Council policy – are theoretically a good thing. Theoretically, they are the right thing to be advocating.

If you dredge back through my publications, you would probably also find a case where I have said that a profits-based tax is a good thing. I am on record having said that so I should confess right away before I get myself into trouble here or be accused of being inconsistent.

Now, the point I wanted to make is that - in policy, the perfect should not be the enemy of the good. What I mean there is, in Australia, we have a constitution, and we have a bunch of states.

The Commonwealth doesn't necessarily like the states; they're a pain in the neck and the states don't necessarily like the Commonwealth. But there is an uneasy balance between the players Australia and the existence of the states and the Commonwealth together has in my view saved us from a lot of bad policy in the long run.

We have a COAG process that basically doesn't work.

It will never work. It's a process where everybody gets together and argues with each other and it doesn't matter what side of politics is in charge in Canberra. There will always be some other person in the states that wishes to do something else.

That is the reality of what Australia is, and yes we've gone to a lot of trouble to try and reform the COAG process, but fundamentally, we're not going to be able do much about that.

Second, states, rightly or wrongly own the mineral rights on shore. They will wish to tax those resources and royalties provide them with a relatively stable tax base. So getting that off the states is going to be extremely difficult. So any notion that suggests the Commonwealth at some point is going to take over all minerals taxation and impose a profit-based tax on you all, I think is just rubbish - it's not going to happen.

So, when we are designing taxation policy, I suggest that what we should be doing is recognising there is a Constitution, there are states, there is a Commonwealth and we need to come up with some sort of a compromise that is not theoretically perfect, but is reasonable.

Now, a little bit on our cost base. We know that our cost base here is almost, well, it's basically out of control.

When you look at the construction costs here compared to, say, China, we simply cannot compete.

Nobody will ever build another aluminium smelter here. Not only because our energy prices make it impossible, not because aluminium smelting is a dog of a business to be in, but because it costs us probably 3 or 4 times as much to construct exactly the same smelter in Australia as it does in China.

I'm not saying for a moment that Australian workers should accept Chinese wages, I'm not saying that. So I don't want to be verballed. But what I am saying is we need to recognise that we have a high cost base, but also to do something about the flexibility in the labour market so that we can at least start to lift labour productivity.

Now, have a look at statistics for labour and capital productivity in the minerals industry and again you do the graph. Basically what you see is in the 1980s we saw both capital and labour productivity rising, on a reasonable trend. Then from the early 1990s to about 2003, we see labour productivity on a flat trend, nothing happening.

Over that period from the late 1980s right out to 2003, capital productivity in the industry was growing quite substantially. So capital productivity had been on a long term upward trend, up to 2003. Labour productivity was pretty flat from the early 1990s and then productivity growth rates fall right out of bed from 2003 on, both labour and capital.

That's understandable because what's been going on here is we have been in a massive expansion phase over that period. So you would expect, at least you could potentially expect (we don't actually know what's going on here), but you could expect that both capital and labour productivity would fall, when you're in an expansion phase.

Clearly, if you're preparing a pit and you've got a bunch of workers doing that and you're not digging out iron ore, then you're digging out less iron ore per worker than you otherwise would've been if you had them all in the pit digging out iron ore. They're just moving waste so you can get to the iron ore. Then they're not being registered as productive as they would previously have been even though you have to shift the overburden before you get to the iron ore. So this fall in productivity during the expansion phase is understandable.

What is not understandable is why we've seen labour productivity not rising at the same rate as capital productivity over that period from the early 1990s out till 2003-04. I suspect we have a fundamental problem there, in terms of the drivers of labour productivity as we come out of the expansion phase. I suspect we will not see as big a kick in labour productivity as we otherwise would've done.

That seems to me to be a place where the Minerals Council could rightly focus.

I think other speakers before me have made that point.

The carbon tax and the renewable energy target (RET), as Greg has said, drive up the cost of electricity, therefore, drive up input costs in Australia and make us less competitive and those points have been made. I think the remaining point that I would like to make in terms of issues is a policy like the RET, in its various guises, is that when you design a policy that ends up protecting an industry so effectively, giving a subsidy to a particular industry, you are picking a winner, basically.
Governments have decided to pick a winner.

When you do that, you distort the relative prices that everybody sees and we've talked about that already, so I won't mention that again. But you also then create an industry designed to protect the 'protected species' that lives inside the artificially created industry. So, you create a group of lobbyists and other people who spend their time doing nothing but pretending that this distortionary policy is a good thing.

All of those people are in fact a complete dead weight loss to society. They are imposing a cost on you. Those lawyers and other individuals, I wish them no malice of course, but those people are a dead weight loss and they would be much better employed in helping you do useful things in terms of enhancing the exports of Australian minerals instead of wasting their time protecting an industry that's imposing more costs on you.

Finally, John, I wanted to say a little bit about demography and dependency ratios.

The way you calculate a dependency ratio is you take the people who aren't able to work because they're too young or they're too old and you divide that number by the people who do work.

So effectively what the United Nations does in calculating these numbers is it takes the number of people from 0 to 14 and the number of people over 65, because apparently they can't work anymore!

It adds those up and divides by the number of people between 15 and 64.

When dependency ratios are high, you struggle as an economy.

Australia's dependency ratio in 2010 was 48%. In 2030, it will be 61%.

That means that those people who are working will be supporting 61% of the population.

The reason for that of course is because there are a bunch of you in this audience who are getting a bit older and will flop into my category of beyond 65 and therefore, will be counted as dependents.

I council you that you must all work a lot longer.

The sweet spot for an economy is where you have most of your people in the working age group.

In 2010, the dependency ratio in China was 36 %, remember Australia was 48%.

Apparently, China has got an aging problem, which it does, but its dependency ratio will be 47% in 2030, which is about the same as Australia today.

So, China has got a long way to run in terms of being able to be a productive workforce.
In Guinea today, the dependency ratio is 85%. It's 85%, because there are enormous amounts of people under 15 years of age.

So they don't have many old people. They have enormous numbers of young people and in about 2030 their dependency ratio will be 69%.

Economies like that are moving towards the sweet spot.

If you can position yourself so you can invest in those economies, if you can overcome the other impediments that everybody knows about then in the long term those economies will be good places to be.

What's John going to do about the demography problem in Australia?

Well, I suspect what he should be doing is making sure that people who are 65 are not retiring.

I know some of you won't appreciate that particular recommendation but that is the only way out of this problem for Australia. So, John, you're not retiring at 65.

Thanks very much.

Ends.