Australia New Zealand Minerals and Energy Council

Submission to the House of Representatives Inquiry into increasing value adding to Australian Raw Materials

December 1999

Contents

Introduction

THE ROLE OF THE WORKING GROUP

The Australian and New Zealand Minerals and Energy Council (ANZMEC) Standing Committee of Officials agreed to the creation of the Working Group on Resources Processing (Working Group), at its meeting on 19 March 1999. The objectives of the Working Group include:

- Identification of the issues affecting the ability of Australia to value add to its mineral and energy resources, now and into the future, including identifying opportunities, promoting investment and contributing to the removal of impediments.

- Formulation of a national strategy that supports and strengthens the value adding component of the mineral and energy sectors in Australia.

- In support of the strategy recommend policy initiatives to ANZMEC Ministers where government action is warranted and could be effective.

Agencies represented on the Working Group are:
Commonwealth
- *Department of Industry, Science and Resources (ISR)*
- *CSIRO*

State
- *Department of Resources Development, WA*
- *Department of Mines and Energy, NT*
- *Department of Mineral Resources, NSW*
- *Department of State and Regional Development, NSW*
- *Department of State Development, TAS*
- *Department of State Development, QLD*
- *Department of Mines and Energy , QLD*
- *Department of Primary Industries and Resources, SA*
- *Department of State Development, VIC*

Observers:
Representative of the Minister for Industry, Science and Resources.

BACKGROUND

In May 1999, members of the Working Group considered the issues impacting on Australia's ability to attract further investment into value adding to minerals. Whilst there were a number of issues that reflected the perspective of individual States, general agreement was reached on the broader national policy issues underpinning the business environment for minerals processing and downstream manufacturing.
These policy issues were subsequently discussed with a large number of miners, processors, manufacturers and research groups and the final content of this paper was approved by ANZMEC after consideration of that consultation.

Issues

INTELLECTUAL PROPERTY AND RESEARCH AND DEVELOPMENT

Minerals like other traded commodities are totally exposed to the global economy and the ability of enterprises to maintain a sustainable advantage in mining, refining and manufacturing is heavily influenced by intellectual property gained from research and development. OECD comparisons of science and technology expenditure, as a percent of GDP, find that countries with a positive balance of trade in high growth industries are those which make substantial investments in research and development.

Any strategy for increasing the level of value adding to Australian minerals must recognise the necessity of research and development to compete in the global economy. Policies and programs designed to stimulate research and development leading to new commercial technologies are therefore essential to the establishment and growth of companies across the whole value adding chain from mining to manufacturing.

The roles of industry, government, research organisations and universities needs to be coordinated and an appropriate proportion of their effort focussed on achieving outcomes which stimulate investment in value adding to Australian mineral resources. Opportunities for intellectual property to provide a competitive edge in value adding to individual minerals should also be identified and targeted.

The recent decline in expenditure on research and development is a matter for concern and may not be entirely attributable to poor commodity prices causing companies to curtail their research and development budgets.

Government can assist with incentives where there is market failure. Whilst taxation policies are ultimately a matter for the political judgment of the Commonwealth Government, it is essential that appropriate taxation incentives are included in any policy mix designed to stimulate value adding to Australian natural resources. Whilst some of the taxation incentives provided in the past have led to abuse, this alone does not justify the discontinuance of these incentives. Rather the eligibility criteria should be tightened or conditions applied to produce a fairer system which still encourages companies to invest in genuine research and development.

The policy mix should continue to include schemes which provide direct financial assistance for research and development based on matching contributions from the applicant. These grants may or may not be contestable but they do provide an alternative model which targets assistance to particular outcomes.

Whilst grant schemes like this are sometimes considered to be an alternative to taxation incentives, they are essentially complementary in nature because they do not have the broader reach of taxation incentives which are equitably available to everyone.

It is the view of ANZMEC that:

- **because proprietary technologies are essential to Australia's competitive position in export markets, the Commonwealth Government should continue to implement policies which encourage research and development of technologies in value adding to our mineral resources which will be commercialised in Australia; and**
- **adequate taxation incentives are maintained for research and development of new technologies for value adding to mineral resources.**

TRANSPORTATION

Whilst Australia benchmarks very well against international best practice standards for transportation and shipping of bulk materials for export, almost without exception the same is not true for coastal shipping and shipping of general freight for export.

Regional Australia is the most adversely affected by high freight costs, long distances and low service frequencies. These factors impact directly on the profitability of value adding projects and their ability to attract investment capital.

While the benefits of microeconomic reform of ports, coastal shipping and rail, have begun to deliver improvements in some sectors, Australian exporters are still at a disadvantage compared with international competitors.

Furthermore Australia's competitors are continuing to improve technology and materials handling practices in all transport sectors. Australia's efforts to improve productivity need to continue even to maintain our current competitive position.

An efficient, cost effective logistics system is essential if Australia is to overcome the constraints arising from its small population and domestic market and the large distances between markets. Specialist commercial operators should be encouraged through access to public infrastructure to set up sophisticated logistics chains which lower freight costs, improve efficiencies and increase service levels.

The following transport issues are of concern.

Planning and Integration

There is no National Freight Strategy or plan to optimise our transport infrastructure and it is very questionable whether the small and sparsely spread demand for freight services in Australia will provide sufficient options in a competitive market to optimise our transportation system.

The development of strategies and plans offers the best opportunity to both Commonwealth and State Governments to influence these outcomes and this is a legitimate role of Government.

The Commonwealth Department of Transport and Regional Services is currently developing a Transport Directions Statement incorporating strategies for improving Australia's multi-modal freight and logistics performance. The Department is also exploring the possibility of developing a National Logistics Strategy in consultation with the States and industry. Although this has been conceived primarily in terms of agrifood exports, it is expected there will be scope to extend its relevance to other sectors such as mining. The Commonwealth also established an industry-based National Transport Secretariat, which could undertake research in this area, subject to its other priorities.

Currently, an Integrated Logistics Network exists which brings together the Commonwealth and State governments. This Network has developed a Strategy and supports the industry-based Air and Sea Freight Export Councils which have been established in every state around Australia.

Commercial operators are then able to maximise the efficiencies of existing networks and infrastructure and provide cost and efficiency benefits.

Rail

Rail freight costs are not internationally competitive except for bulk materials like coal and iron ore where dedicated infrastructure and highly efficient shipping arrangements have been established.

It may be that the barriers caused by Australia’s vast distances and low volumes of general freight carried by rail will always prevent commercial freight operations meeting international benchmarks. However this only elevates the importance of achieving greater efficiencies and finding alternative solutions to realise the best outcome possible.

A transparent and equitable third party access regime to the existing track network is essential to the development of sophisticated logistics chains which take advantage of all modal opportunities.

Road

Although some remote projects may be required to upgrade or fund new access roads to an appropriate standard as part of their development costs, the existing road infrastructure is generally considered to be reasonably adequate and road authorities are sufficiently responsive to changing needs. The pricing arrangements for road use, including developer contributions for capital and maintenance work need to be more transparent, given that resource companies in some regions make considerable contributions to the development and maintenance of road infrastructure.

Shipping

Coastal shipping is very expensive and a major deterrent to investment in new projects in Australia. Anecdotal comments received from industry during consultation suggested that coastal shipping under cabotage can almost double shipping costs compared to the use of comparable foreign owned vessels. The impact on a company like Queensland Alumina Limited which ships some 10 million tonnes of bauxite per annum from Weipa to Gladstone would result in a saving of some $30-40 million.

Similar imposts would impact on a potential steel producer wanting to ship iron ore from Western Australia to the east coast or coal from Queensland to the west coast. In contrast Japan, Korea and Taiwan have developed large steel and manufacturing industries by using international shipping to import cheap coal and iron ore from Australia. These companies are also capable of trading competitively throughout the world.

Any decision to reduce coastal shipping costs through the removal of cabotage and the introduction of competition from foreign owned and operated vessels will cause job losses. This has to be balanced against the loss of new jobs which could be created by viable projects which are unable to proceed in Australia because of high shipping costs.

Apart from the major ports of Melbourne, Sydney and Brisbane, shipping services are limited and expensive for low volume and general freight in comparison with our international competitors. This adversely impacts on the competitive ability of regional enterprises serving export markets. Under present arrangements, it is not cost effective or timely to ship containers from regional ports because of low shipping frequencies, lack of container handling facilities and high costs. These constraints are driven by the low demand for containers to be shipped from regional ports.

ANZMEC is of the view that:

- **freight costs comparable to our international competitors are essential if Australia is to develop value adding industries which rely heavily on exports into the global economy;**
- **the Commonwealth consider the possibility of working with State Governments to develop a National Freight Strategy which will raise our logistics performance to meet our competitors and maximise the utility of existing infrastructure;**
- **commercial enterprises should be encouraged to develop sophisticated logistics chains by providing equitable access to public infrastructure and continuing deregulation and microeconomic reform;**
- **lowering the cost of coastal shipping to reduce this constraint on Australian mineral resources being processed in Australia is very important to projects wanting to ship material from remote ore bodies for processing in locations serviced with the appropriate infrastructure; and**
- **the exclusive arrangements afforded to conference shipping should be kept under scrutiny to ensure that freight costs for exporters are not excessive.**

INFRASTRUCTURE

There are a number of particular difficulties in providing services infrastructure for large value adding projects in remote areas and regional areas with little urbanisation. Some of the particular issues are:

- absence of any existing infrastructure or very small scale infrastructure which is unsuitable for major expansion;
- the need to oversize any new infrastructure to provide for future expansion of the project or additional projects. Oversizing attracts holding costs which cannot be carried by the project or the community; and
- existing infrastructure providers do not have the financial capability to fund or borrow for unplanned large expansions.

State governments and service authorities, as traditional providers of infrastructure, are always called upon to fund and carry the holding costs for new projects and generally seek to recover these costs from the developer. In many instances projects do not proceed because they are not able to absorb the cost of surplus or additional capacity required for the community and future growth.

As even a cursory examination shows that the Commonwealth is the overwhelming beneficiary of taxation revenues from these projects, it is arguable in that some instances the Commonwealth should contribute to infrastructure costs in anticipation of the financial benefits it will receive from the projects. The benefits from infrastructure development flow to both Commonwealth and State Governments and therefore there is a need to ensure governments continue to contribute to the cost of infrastructure.

Importantly, these projects diversify regional economies and provide sustainable, long-term employment which is capable of revitalising local economies. There will be many instances where investment in infrastructure linked to a major value adding project will repair or ameliorate the losses caused by the withdrawal of services which have been occurring in regional areas. In essence, new communities and services based on new industries will regenerate older communities in decline because of their reliance on traditional economic activities undergoing rationalisation.

State Governments should also seize on the opportunity to identify particular regions suitable for the aggregation of value adding projects. This will reduce the capital and operational costs of infrastructure services to be provided for large projects co-locating in the same region. Examples include the Gladstone State Development Area being set up by the Queensland Government, Kemerton in Western Australia, the Bell Bay Major Industry Zone in north-east Tasmania and the Lithgow Minerals Processing Park in New South Wales.

ANZMEC therefore proposes that:

- **State Governments identify regions suitable for large value adding projects to co-locate to reduce infrastructure costs and improve their viability;**

- **the Commonwealth continue to participate in the Regional Minerals Program, a co-operative approach between Commonwealth and State Governments and industry to assist development of the mineral industry in regional areas through identification of infrastructure requirements/impediments; and**

- **the Commonwealth, through the Strategic Investment Co-ordinator continue to consider requests for financial assistance for major projects.**

MARKET ACCESS

Tariff issues are still a concern for Australian export industries. Tariffs on exports of minerals and mineral products into the Asian market typically escalate with the degree of processing creating a bias towards the export of raw materials at the expense of value added products. These tariff barriers effectively restrict the export of elaborately transformed products from Australia and inhibit export based manufacturing opportunities.

An Australian Bureau of Agricultural and Resource Economics (ABARE) research report has found that "*tariffs on highly processed minerals in the region are around six percent higher than on ores and concentrates while elaborately transformed metals attracted tariffs around 15 percent higher*". In contrast, average tariffs in industrialised countries, e.g. USA and the EC were found to be lower at every stage of processing. Under the Uruguay Round of Multilateral Trade Negotiations, countries have until the year 2020 to reduce tariffs to minimal levels. Australia has complied with this requirement since 1996. However, countries in the Asian region are not expected to reduce tariffs significantly in the short term.

The use of non-tariff border measures follow a similar pattern, increasing in frequency with the degree of processing. These non-tariff border measures such as import licence restrictions, foreign exchange controls and import quotas reinforce the protection provided by the tariff structure, particularly against imports of processed commodities. Maximising local value-adding opportunities will most likely depend on continued negotiations on access to markets in spite of tariff and non-tariff barriers.

It is the view of ANZMEC that:

- **whilst the Commonwealth has allocated considerable effort to improving the trading regime for agricultural commodities, more needs to be done to open markets and improve the opportunities for export of Australia's value added products.**

FOREIGN GOVERNMENT INTERVENTION

Australia has a high exposure to the fortunes of the world steel industry with $13 billion of exports of steel, steelmaking raw materials and alloying elements. Australia is the world's largest exporter of iron ore and the second largest producer (after China's production is adjusted for its low iron content). Converting all of our iron ore production to steel would increase Australian exports by some $20 billion to $80 billion depending on the degree of value adding.

The major obstacle to further value adding to Australia's extensive iron ore resources is that Government policies in many countries have led to the creation and maintenance of excess capacity and hence low prices and profitability. This makes it harder to finance new projects in Australia. At the same time, projects in other countries are receiving direct or indirect government assistance.

Whilst Australia does not by itself have sufficient international standing to force foreign governments to cease their intervention, Australia could cooperate with the major world powers, the US, the EU and Japan, in discouraging intervention. In August 1999, the US announced its Steel Action Program whereby it would seek to take action against foreign government intervention in steel. Unfortunately, the US is assisting its own industry with loan guarantees and with widely condemned anti-dumping practices. Whilst this will make the task harder, the potential benefit to Australia from reducing foreign government intervention is great and thus the goal should be pursued.

ANZMEC is of the view that:

- **Australia needs to work in appropriate international fora to discourage foreign governments from creating or maintaining excess capacity in iron and steel.**

VERTICAL INTEGRATION AND INVESTMENT ATTRACTION

The overwhelming investment strategy of the existing mining and minerals processing companies in Australia is focussed on their core business and their interest in further value adding is declining. Priorities include development of existing mines, improved mining methods through research and development and productivity improvements through revised work place practices.

There is also a strong understanding that the managerial culture of the mining and minerals processing industries does not translate well to manufacturing.

There are some opportunities to encourage Australian companies to undertake further refining of their products but because they see themselves as being expert in commodities, it will be necessary to attract new investors into value adding activities producing components and consumer products. Whilst some of this investment will come from indigenous companies a large portion of it will need to be sought from foreign multinationals.

The view of ANZMEC is that:

- **Invest Australia should continue to work co-operatively with State Governments to identify and match suitable international investors with value adding opportunities in Australia, and where justified by the overall benefits, develop suitable attraction incentives to help offset other local impediments;**

- **Australia will need to ensure that local manufacture is not penalised by high local prices for inputs from local refiners. Some large Australian companies which sell on a London Metal Exchange (LME) basis in the Northern Hemisphere will only supply local manufacturers at import parity prices i.e. LME plus return transport and handling. This pricing arrangement requires Australian exporters to pay more than their overseas competitors for their raw materials and still be liable for freight to export markets.**

- **Invest Australia should also continue to aggressively market Australia as a destination for investment in value adding projects.**

Recommendations

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Implementation

One option available to the Committee for the implementation of these and any other recommendations adopted by this Inquiry is to request ANZMEC to task its Resources Processing Working Group with the preparation of a National Strategy for Value Adding to Mineral Resources.

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