Executive Summary

Recently completed and planned value-adding projects will greatly increase the level of downstream processing of Western Australia's rich supply of raw materials over the next decade.

The Western Australian government has acted positively to increase the extent of value adding in Western Australia through:

- Energy market reform;
- Use of special State Agreement Acts to facilitate the development of value adding projects;
- Long term planning for industrial land in strategic locations; and
- Sound management of the State's economy which provides a strong basis for investment.

There are a number of issues which must be addressed by governments to encourage private investors to seize the many opportunities for value adding which are presenting themselves. These are:

Greenhouse

Implementation of Kyoto Greenhouse reduction targets could severely impact the viability of several of the planned value adding projects under consideration in WA. There is also some uncertainty about the Commonwealth Government's policy in relation to greenhouse abatement with some agencies promoting economic growth and expansion of industry while others promote policies and strategies which aim to regulate and reduce total greenhouse gas emissions.

This disparity in approach causes confusion and uncertainty amongst investors and hinders planning by government and the private sector.

Native Title

There remains considerable uncertainty at both the State and national levels over the passage and implementation of native title legislation. Until such time as these issues are resolved, doubts over security in relation to land access will act as a disincentive to potential investors in resource processing and other industries.

Taxation Reform

The Western Australian Government has expressed disappointment at the Commonwealth Government's decision to remove accelerated depreciation provisions as a trade off for lower corporate tax rates.

The capital intensive nature, long lead times and long lives of major resource processing projects mean that they are more sensitive to the depreciation rate than to changes in company tax. Prospective new projects would be adversely impacted by the tax changes.

The decision to extend the strategic investment coordination process by providing investment allowances through the tax system, replaces a transparent, predictable system of tax provisions with negotiable, project specific assistance. This adds another element of uncertainty and is likely to be detrimental to the attraction of mobile overseas investment for resource processing opportunities.

Investment Incentives

Commonwealth Government industry incentives to date appear to focus on direct financial assistance through grants or tax relief, although it is understood that the use of grants is under review. The provision of infrastructure services has not been a favoured form of assistance. Western Australia's preference is for any project assistance to be provided in the form of multi-user infrastructure, rather than direct financial assistance or tax relief.

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Downstream Processing in Western Australia

Overview

Western Australia is a leading producer of value-added products from a diverse range of minerals and energy resources. The State's downstream processing industries supply world and local markets with a wide range of value-added products which include alumina, liquified natural gas, synthetic rutile, titanium dioxide pigment, nickel, gold, cement, quicklime, silicon, glass, fused alumina, fused zirconia, copper cathode, liquefied petroleum gas, oil products, tantalum, tin, wood products, and a variety of industrial and agricultural chemicals.

The Western Australian Government's commitment to microeconomic reform in the energy, labour and transport sectors, coupled with rapid advancements in technology, provide increasing potential for more processing industries in Western Australia. Recently completed and planned value-adding projects will greatly increase the level of downstream processing of the State's rich supply of raw materials over the next decade.

These projects include the conversion of iron ore into direct reduced iron, hot briquetted iron, pig iron and steel; the expansion of the titanium minerals processing industry; the development of lateritic nickel deposits (containing cobalt) to produce nickel and cobalt metal; the processing of rare earths; and the production of vanadium pentoxide, aluminium fluoride and further fused materials, to name just a few. Local companies are also evaluating opportunities for adding value to wood resources from State Forest and plantations, as well as to cereal straw.

Just as exciting is the potential establishment of a world-class petrochemical plant in the Pilbara. Such a plant would use ethane from natural gas streams from the North West Shelf, and local salt, to produce petrochemical feedstocks for domestic and overseas industry. Gas from the North West Shelf also offers opportunities for converting methane into methanol and to produce ammonia/urea and ammonium nitrate.

Why is downstream processing so important for Western Australia? The development of technologically sophisticated and competitive resource processing projects in Western Australia will ensure higher levels of investment, provide increased employment opportunities, create a highly skilled workforce and guarantee a strong economic foundation for future generations. The resources and resources processing industries, often located in remote, regional areas, have been a driving force behind regional development in Western Australia over the past three decades.

Mining operations are not typically labour intensive once in production, but during construction provide employment for a great many skilled workers. Downstream processing projects can provide hundreds of jobs to local communities, not only in areas associated directly with construction and operation, but also indirectly through local service industries such as catering, cleaning, maintenance and entertainment. These projects often result in improved local infrastructure including roads, schools, and community leisure and health facilities.

The technology developed to create these complex processing projects — from initial exploration through design, construction and management of the plant — is increasingly becoming an export commodity in its own right. Overseas operators are eager to utilise the knowledge and expertise developed by Western Australian companies, particularly in engineering, exploration, geographical information services, occupational health and safety, and even catering.

Downstream processing offers returns to the investor and provides the State with benefits such as job creation, higher value exports, increased taxation receipts and, in general, an expansion of economic activity through the stimulation of other associated industries, such as process chemicals manufacturers and service suppliers.

Western Australia has a number of comparative advantages for the mineral processing industry, including:

- extensive, low cost mineral and petroleum resources
- abundant, competitively priced energy;
- skilled workforce;
- world class mining services
- a technologically advanced business sector;
- political stability; and
- good industrial relations.

These comparative advantages create an ideal opportunity for the State to build on its resource-based industries and add value to the commodities produced. The opportunity for further downstream processing of minerals in Western Australia is considerable.

Energy Reform as a Driver for Downstream Processing

The greatest boost to further downstream processing in Western Australia has come from the State Government's energy sector reforms. In the past, energy prices have been identified as the single largest impediment to additional mineral processing in Western Australia. Since January 1995, the State Government has been implementing major energy reforms aimed at reducing energy costs, and promoting the development of a vibrant and competitive energy sector.

The reforms have included the disaggregation of the North West Shelf domestic gas contracts and total deregulation of gas sales in the Pilbara, the splitting of the State energy utility into separate gas and electricity corporations — AlintaGas (currently being privatised) and Western Power — and the development of open access regimes for the gas and electricity transmission and distribution markets.

The energy reform initiatives have delivered enormous benefits to the State. There is now head to head competition between the gas and electricity industries, there has been a fall in gas prices in the Pilbara of 50% which has encouraged industry to consider downstream processing opportunities, and substantial private sector investment in new electricity generation, particularly in the Pilbara and Goldfields.

A further step in the progressive reform of the Western Australian energy market came with the privatisation of the 1530km Dampier to Bunbury natural gas pipeline (DBNGP), which transports gas from the North West Shelf to Perth and the South West of the State. The DBNGP is one of the State's most strategically important energy assets and one of Australia's largest gas transmission systems.

The DBNGP system was sold by AlintaGas to Epic Energy Australia for $2.407 billion, making it the largest and most successful privatisation in the State's history. The State Government has retained ownership of the DBNGP easement as a gas pipeline corridor and will expand it from the present 30 metres to 100 metres. The expanded easement will allow the new DBNGP owner the option to expand the pipeline's capacity and it will also be available for the construction of new pipelines.

In addition, new regulations will enforce a set of reference tariffs for the first two years of operation under private ownership. This will see transport costs to the metropolitan area fall from around $1.19/GJ (nominal) in 1998 to around $1/GJ (nominal) by 2000. Tariffs to other locations on the pipeline route will fall by a similar percentage. From 2000, the National Access Code will apply.

Taking advantage of the energy reforms, the 1380km Goldfields Gas Transmission (GGT) pipeline was completed in October 1996 at a cost of $450 million. It is now providing an alternative to diesel as an energy source for mining operations along its path: iron ore mines in the central Pilbara and gold and nickel operations in the Goldfields. The high running costs of diesel generators will one day be a thing of the past in many mining areas.

Attached for the information of the Committee is a copy of the publication "*Downstream Processing - An Overview of Resource Processing in Western Australia – May 1998*" published by the Department of Resources Development. This publication provides an overview of the current mineral and petroleum-based downstream processing industries in Western Australia and those presently under construction. It is divided into two sections: the first identifies and describes existing processing activities in Western Australia, including a description of the technical processes involved; and the second section provides company details and project descriptions. The document can also be viewed and downloaded from the Department's web site at http://www.drd.wa.gov.au/resource/downstm.pdf .

Facilitation of Downstream Processing through State Agreement Acts

State Agreements are facilitating documents, ratified by the Western Australian Parliament, used to foster major resources development projects. Western Australia's first State Agreement was ratified by an Act of Parliament in 1952. Mining projects operating under such agreements now account for around 70% of the total value of the State's mineral production and 60% of all direct employment in mining.

Western Australia has used State Agreements to foster its resources sector more than any other Australian State or Territory. As a legal instrument that binds both Government and developer to specific responsibilities, State Agreements have been a key to the extraordinary development of the State's vast mineral and energy resources, especially in remote regions.

The value of the Agreement mechanism is probably best exemplified by the fact that it is not compulsory. It is sought by developers who require an additional level of security over the life of a major project. Certainty of project operation and management is assured because Agreement provisions can only be changed by mutual consent of State and developer.

One of the State's core objectives in the use of State Agreements has been to increase the value-added component of minerals through further processing within Western Australia. Successive State governments have aimed to achieve the maximum amount of secondary iron ore processing in the Pilbara (ultimately steel production). State Agreements commit developers to establishing secondary processing facilities, but these obligations depend on the commercial viability of such projects.

A number of projects involving low-level secondary processing of iron ore, such as the production of pellets, have operated from time to time under State Agreement provisions. More recently, the BHP direct reduced iron project was assisted by way of the Iron Ore Direct Reduced Iron (BHP) Agreement Act 1995. This $2.3 billion project by BHP, at Port Hedland, is the largest single investment undertaken in Australia in recent years.

Further information on State Agreements can be obtained from the Department's publication "*In Agreement – A Guide to State Agreements*", a copy of which is attached. The document may also be downloaded from the Department's web site at http://www.drd.wa.gov.au/resource/agreemen.pdf .

Western Australian Government Initiatives to Promote Value Adding

The Government's primary role in attracting new industry to Western Australia is one of responsible economic management, creating a stable and attractive environment for new investment. It is also a facilitator, removing impediments wherever possible and helping potential investors meet the requirements for Government approvals.

In 1995 the State Government commissioned a report "*A Background Paper for a State Heavy Industry Policy*", produced by Dover Consultants in consultation with major industry organisations and State Government economic development agencies. A copy of the report is attached. The report identified a number of key areas requiring government attention in order to promote the development of value added industries in Western Australia. These included: availability of suitable industrial land and supporting infrastructure, efficient approvals processes; financial and other incentives; and an appropriately educated and trained work force.

In order to take advantage of the emerging opportunities for the further processing of its natural resources the State is planning now for the provision of land on which these activities may take place. It is only through a process of long-term planning that the Government, through its agencies, can establish strategic industry areas that meet all of the requirements for social, environmental and economic viability. Problems with heavy industry areas in other parts of the world have resulted from the failure to develop them in a long-term planning context, and without adequate buffer areas and appropriate infrastructure.

The Western Australian Government is acting to secure adequate land, including buffer areas, for strategic industry areas in key locations throughout the State. Strategic industry areas will be developed around sea ports as gateways, and will be integrated into land based transport as hubs connected to mining or other industrial activities. Where possible the strategic industry areas will be selected on the basis of their ability to incorporate a number of complementary industrial activities so as to provide synergies for the area as a whole and benefits to individual projects that would not otherwise be realised.

Initial planning and investigation has already commenced for new strategic industrial areas at Oakajee (north of Geraldton), Boodarie (Port Hedland), Maitland (Dampier), Breton Bay (north of Perth) and into the expansion of the Kemerton industrial estate north of Bunbury.

The State Government's priority is responsible economic management to ensure that Western Australia continues to be a highly competitive, stable investment environment. The benefits of deregulation and privatisation of transport, telecommunications and energy infrastructure at both the State and national levels are apparent in lower costs for consumers, including industry.

The State has the highest possible credit rating, AAA, with international credit rating agencies Moody and Standard & Poor. Western Australia also enjoys one of the fastest growing State economies in Australia, with unemployment consistently below the national average. This is bolstered by labour market reforms which have introduced flexible work practices and by increased investment in education to provide a labour force with the skills and flexibility required to meet the requirements of expanding resources, processing and advanced manufacturing industries.

Through these and other initiatives, the Government will ensure the responsible development of the State's minerals and energy resources for the benefit of all Western Australians, now and in the future.

Issues in Value Adding

There are a number of issues at a national level that impact on the attractiveness of Australia as an investment location for value adding industry. These include:

Greenhouse

Most of the resource processing activities under consideration in Western Australia are energy intensive and will involve significant levels of greenhouse gas emissions. Implementation of the Kyoto Protocol could impose an additional cost impost on these activities, reducing their competitiveness against producers in countries not a party to the Protocol. This could result in downstream processing projects locating to non-Protocol countries, a move which is unlikely to improve global greenhouse emissions and could result in increased emissions if the overseas producers are less efficient users of energy than Australian based projects.

The Industry and Waste Management Technical Panel of the Western Australian Greenhouse Council reports that significant cost burdens from 'beyond-no-regrets' greenhouse gas abatement actions are likely to severely damage industry viability in Australia if such measures are adopted.

There are some 27 major resource development projects currently under consideration in Western Australia. If none of these projects proceed there would be a loss to the State of an expected $34 billion in investment, along with the associated lost annual output of $11 billion and at least 60,000 direct and indirect jobs. Because Western Australia consistently accounts for half of the total Australian resource sector's annual new capital investment, this conclusion has equally dramatic implications for Australia as a whole.

The Technical Panel also noted that there is an apparent disconnection between Commonwealth economic and greenhouse policy and strategies. In particular, there are some Commonwealth agencies that promote economic growth and expansion of industry while others promote policies and strategies which aim to regulate and reduce total greenhouse gas emissions. These approaches are incompatible and the disparity is causing confusion in decision-making and planning for future investment, within both government and industry.

Native Title

There remains considerable uncertainty at both the State and national levels over the passage and implementation of native title legislation. Until such time as these issues are resolved, doubts over security in relation to land access will act as a disincentive to potential investors in resource processing and other industries.

Taxation Reform

The Western Australian Government has expressed disappointment with the Commonwealth Government's decision to adopt the recommendation of the Review of Business Taxation to remove accelerated depreciation as a trade off towards moving to a lower corporate tax rate.

Resources and resource processing projects are typically capital intensive. The Australian and New Zealand Minerals and Energy Council (ANZMEC) submission to the Review stated that projects involving large capital expenditures, and long operating lives (around 15 years or more), and with marginal to moderate profitability, are more sensitive to the depreciation rate than to changes in company tax rates. This is explained primarily by the timing impact on the cash flows. The complete removal of accelerated depreciation and the introduction of a 30% company tax rate would make such resource projects worse off than under previous arrangements.

New projects involving energy production and distribution that act as fundamental drivers for other strategic developments, such as smelters, refineries and petrochemical plants, could be prevented from proceeding.

The Commonwealth Government has indicated that, in order to offset the loss of accelerated depreciation provisions, it is prepared to consider expanding the strategic investment coordination process, including consideration of targeted investment allowances.

This would replace the certainty of a transparent, predictable system of tax provisions with the uncertainty of negotiable, project specific assistance. This would be detrimental to the attraction of mobile overseas investment for resource processing opportunities. In the absence of accelerated depreciation these investments could shift to offshore locations, to Australia's loss.

Investment Incentives

The Commonwealth Government's *Investing for Growth* policy document mentions that incentives for industry "*could include grants, tax relief or the provision of infrastructure services*". Assistance to date appears to have focused on direct financial assistance through grants or tax relief, although it is understood that the use of grants is under review. To date, the provision of infrastructure services has not been a favoured form of assistance.

Western Australia’s preference is for any project assistance to be provided in the form of multi-user infrastructure, rather than direct financial assistance or tax relief.

One reason for this preference is that it reduces the level of risk borne by taxpayers, while still providing significant direct assistance to individual projects. For example, a government contribution to improving infrastructure in a region will have the effect of improving the overall attractiveness of that region for investment as well as lowering costs for existing businesses. Considerable economic benefits are likely to be generated even if the original project which was the catalyst for the investment fails. This is not the case with direct, project specific financial assistance which is effectively an all or nothing bet on a single project.

It is this State’s position that the Commonwealth would maximise the benefits from its investment incentives program if it were to concentrate its efforts on providing assistance in the form of infrastructure. There are a number of projects under consideration in regional Western Australia for which the project proponents are likely to seek assistance from the State and Commonwealth governments. The State’s preference would be for any assistance to be directed into infrastructure services rather than direct financial assistance or tax relief for the projects.

Conclusion

Western Australia’s continuing development, from a resources dominated economy to a mature market with a balanced mix of primary industry, value adding and service industries, depends upon the willingness of private sector investors to seize the many opportunities for value adding which are presenting themselves.

These opportunities are supported by Government initiatives to reform energy, transport and labour markets and in the future will depend upon our commitment to address the issues which may hinder further processing, such as greenhouse, taxation, native title and the provision of investment incentives, particularly for multi user infrastructure.