ANDEV Australians for Northern Development and Economic Vision

Friday, 6 August 2010

Email: fuelenergy.sen@aph.gov.au

Senator Cormann
Senate Select Committee on Fuel and Energy
P O Box 6100
Parliament House
Canberra ACT 2600

Dear Senator Cormann

Thank you for the opportunity for ANDEV (Australians for Northern Development & Economic Vision) to submit our views to your Committee. Given recent events, it is timely that we are able to put briefly our comments to you.

Background

ANDEV promotes:

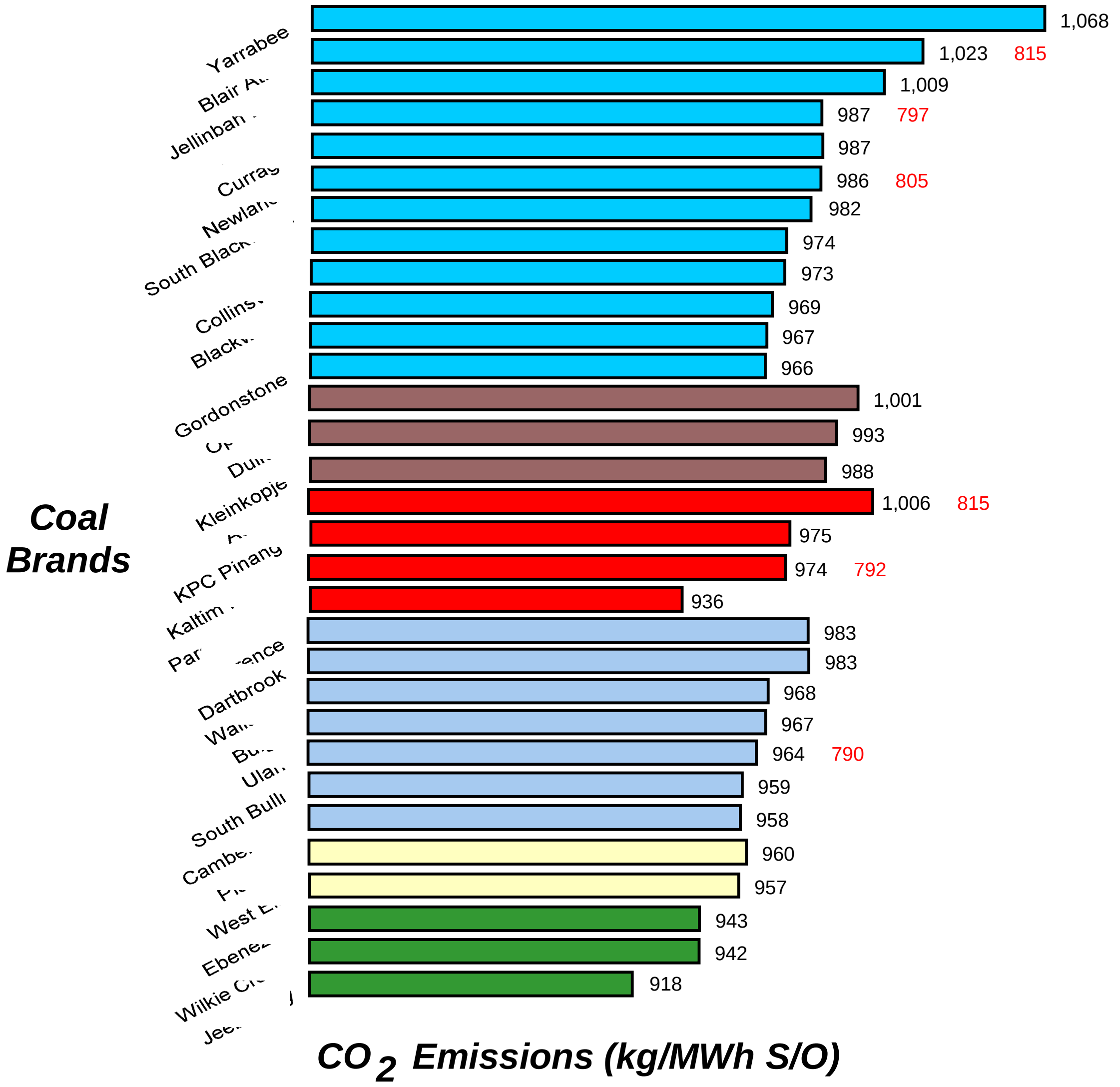
1. The creation of a 'Northern Economic Zone' that will offer tax advantages to attract and retain individuals and companies.
   - No Mineral Resources Rent Tax (MRRT), "Super Tax" (or similar)
   - Lower personal income tax or tax rebates for those who live and work in the Northern Zone
   - Lowered / eliminated payroll tax
   - No FBT
2. Policies that welcome and attract investment
3. Policies that enable growth
4. The creation of attractive towns or cities in these remote zones away from capital cities, that attract people and support businesses for the long haul.

In regard to the Committee's Terms of Reference, we will address some of these specifically as they impact not only on the mineral resources current and more importantly future operations but also on other similar businesses, particularly those that are predominantly Australian owned (and consequently may choose not to move offshore or have chosen to be primarily owned and operated in Australia).

Terms of Reference Item (d) the impact of an emissions trading scheme on the fuel and energy industry

At this point, an ETS is another proposed cost impost.

The attached histogram shows work originally commissioned by the Queensland Government in 1998. It indicates the estimated CO_2 emissions of a suite of Australian and international thermal coals. Work recently commissioned on a number of coals included in this histogram (identified with red coloured coded numeric data) demonstrates that power station emissions have decreased by approximately 19%, due in part to improvements in generating technology.



Further improvements are underway with each generation of power station design and construction.

In addition to this, there are large deposits of coal known to be low in ash, sulphur and gas and with comparatively superior burning efficiency thereby minimizing CO2 emissions for example. There is an ongoing, increasing demand at this point for at least another generation of coal fired power stations currently being built to use thermal coal and it is therefore sensible to utilize the deposits particularly when many Australian coals are more clean (with lower, ash, sulphur and gas) than coals in China for instance. Australia should be seeking to benefit from export of this lower sulphur and lower ash by world standards and low gas coal whilst demand is in place and as new power stations are being built now. Australia needs the revenue from such coal exports to be able to maintain the foundations of our standard of living. It is not an earnings stream that should be "put off" for an uncertain future.

There are now mines planned in the Galilee Basin set to be the largest thermal coal mines in Australia (and the world), we are concerned that uncertainty and potential future cost imposts of an ETS will make investment in such mining developments too difficult, and uncompetitive when compared with our Asian competitors.

It is critical to remember that Australia is not the only country that has coal projects endeavouring to reach markets and hence Australia must remain competitive. For instance AAP released the following on 5 August 2010:

> # Mongolia may kill Aussie coal: Friedland
> 5-August-10 by AAP
>
> Mongolia's lower-tax coal sector could rob global market share from Australia, Canadian billionaire mining executive Robert Friedland says.
>
> Mr Friedland, who chairs the Toronto stock exchange-listed miner Ivanhoe Mines Ltd and its 90 per cent owned Ivanhoe Australia, said "Mongolia could kill Australian coal" because its mining tax was lower than in Australia.
>
> Ivanhoe Mines' 79 per cent-owned coal company South Gobi Energy Resources is the largest coal producer in Mongolia in terms of export sales.
>
> The tax on mining profits in Mongolia was 25 per cent compared to Australia's proposed 30 per cent mining tax, Mr Friedland said.
>
> Mongolia had a clear advantage in that it neighboured its Chinese customers.
>
> "They're closer to China than your lucky island," Mr Friedland told the Diggers and Dealers mining conference in Kalgoorlie.

Terms of Reference Item (e) the existing set of federal and state government regulatory powers as they relate to fuel and energy products;

There are delays in progressing State, then Commonwealth environmental approvals. The processes are time consuming and expensive and hopefully concurrent consideration of documentation to cut down both time and expense can be built into processes.

Further, as an overall comment, changes in royalty and taxation quantities and regimes, in environmental and other policies has impacted on Australia's (and Queensland's) place as an investment opportunity. In our discussions over the past few months with a suite of potential overseas investors, there has been a noticeable increase in caution with respect to Australian and Queensland investments.

Terms of Reference Item (f) taxation arrangements on fuel and energy products

Additional taxes (such as the MRRT, increases in state royalties, and any potential ETS) on commodities affect the price of these commodities on-used in Australia

For instance, if the price of thermal coal was higher due to the addition of the MRRT (and/or ETS or similar), the effect of this higher cost would be passed on to electricity wholesale and retail consumers through domestic power generation. This in turn means increasing costs for all items or services which require electricity. Electricity consumers include for example, mum and dad and family consumers, the suburban rail system in south east Queensland and Melbourne, the electrified narrow gauge coal network currently managed by Queensland Rail, Perth's new northern electrified line and light rail systems which are growing in popularity in Australia, and the electricity consumption of various public buildings, and many companies. Any federal or state government power exercised such as price capping or subsidy to protect the retail consumer will be at a cost to the government that will need to be recouped in some form. The government would likely recoup such deficit through some other form of taxation.

We strongly believe that should exceptions, waivers/exclusions or other special arrangements be applied to magnetite for the MRRT, then such exceptions, waivers etc should at least also apply to thermal coal which is a far more important impact on Australia and Australian costs than magnetite, which is primarily for export. In terms of relativity, the current price at which thermal coal is sold is $94 per tonne as quoted on the globalCOAL platform for the week ending July 30th 2010 whilst a typical Queensland hard coking coal is sold for up to $225 per tonne yet similar costs are involved for mining and transporting the coal.

To again use the Galilee Basin it faces the same if not greater mining and transport infrastructure costs, including construction of a 495 km standard gauge railway from the Galilee Basin to the port of Abbot Point, which will be funded and owned by private enterprise. This is well over $6 billion of investment that will enable a new Basin to be developed that will otherwise remain dormant, producing no revenue, no tax or jobs.

This demonstrates that thermal coal although absent from recent media (in part as both the NSW and QLD Labour State Premiers do not seem to be compelled to speak out to their Federal counter parts unlike the Liberal State Premier of WA) provides arguably greater justification in being excluded from the proposed MRRT, than WA's magnetite.

The Australian coal and iron ore industries, will be made less profitable should any new additional tax be applied, and will have increased costs due to any new additional tax, leaving less funding available for investment. Political decision makers cannot continue to rely on Australia being able to compete on world markets against lower cost commodities from other low cost countries in the near term, if taxes and hence cost go up, and hence should factor in less, not growing, ongoing revenue. Particularly, when 400,000dwt ore ships are being built and Asian ports are being modified to cater for those larger ships, this reducing the freight benefit and protection Australia has enjoyed for decades, protecting Australia against its high costs.

Also, Australia will increasingly compete against countries with much lower labour costs such as Indonesia, African countries, Mongolia and Brazil. The cost differential particularly impacts lower margin thermal coal, far more than metallurgical coal. In summary, regarding the MRRT, various iron ore companies are asking for exceptions on particular ores which are lower in iron content and are hence lower priced. If an exception were to be made for magnetite, only in the instance of on sale to steel mills based in Australia, then such an exception should also be applied to thermal coal, particularly as higher electricity prices would affect more Australians and Australian businesses.

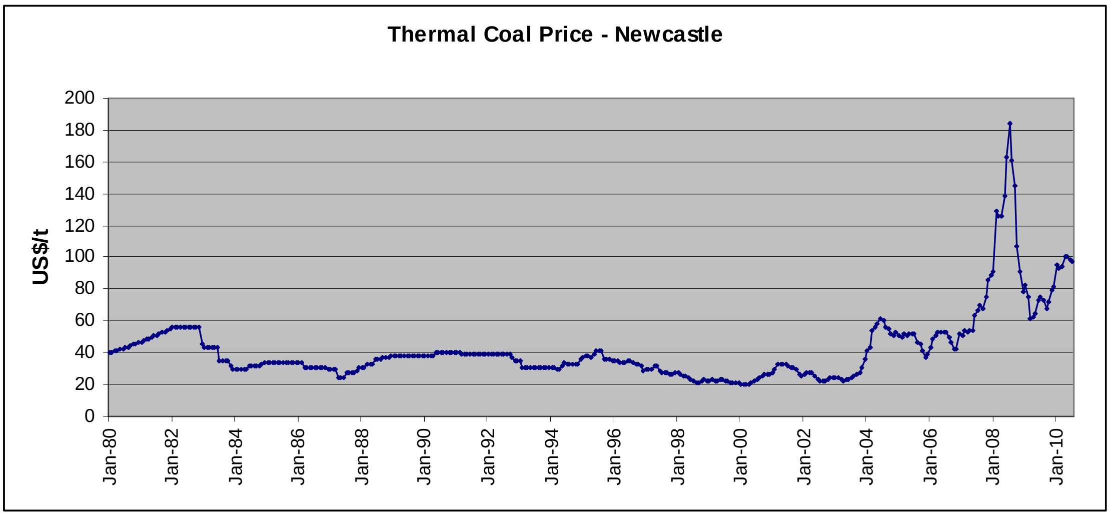
To date the debate on taxation or "super profits" taxation or "resource rent" taxation, has focused very much on market activity in the recent past, and on the myth that these growing markets will still be available to Australia on a growing basis. They won't be if Australia's costs continue to go up and Australia becomes uncompetitive. It is acknowledged that since 2004 there has been a step change in the market for most commodities corresponding to the emergence of China as a voracious consumer of raw materials. In Australia's case the neglect of infrastructure, the slowness of government approvals and the resultant slowed development of new sources of supply contributed to a short term period of boost in commodity prices. "Short term" as the market is not content with paying higher prices and is very actively pursuing the development of cheaper alternatives, especially in Africa. Many unthinking pundits subscribe to the "super cycle" concept and foresee a long period of sustained growth, but they completely ignore the reality, a reality readily available to them through history, that to continue to be able to supply in any cycle, you must remain competitive. They should be able to remember what has happened to economies throughout the developed world, such as USA, Europe and Australia, who used to manufacture goods, however given that they are now no longer competitive in comparison to cheaper Asian and Indian countries especially, their own manufacturing industries have closed.

The mining boom has not been "booming" for that long and in the case of thermal coal the statistics quoted below indicate that care needs to be taken when trying to forecast future returns.

Coal is the most abundant fossil fuel in the world, leaving ample opportunity for competition for less costly countries. Global recoverable reserves were estimated at 844 billion tonnes in 2005 and located in 68 countries according to International Energy Statistics (IES) which are produced by the U.S. Energy Information Administration. Coal is produced in huge volumes in many countries for both domestic consumption and for export. According to IES, coal (in all of its forms) was produced in 67 countries in 2008 and exported by 60 countries of which 25 exported more than 1 million tonnes with total exports standing at 986 million tonnes. In the same year 104 countries imported coal of which 48 imported more than 1 million tonnes with total imports standing at 964 million tonnes.

So it is true to say that we are going to see increased volumes but we will see more increased volumes from countries that are cost competitive.

Prices are dictated by the market as are costs (cost of labour, cost of consumables, cost of capital). Prior to 2004 the thermal coal seaborne market was driven by cost minimization. The industry was fragmented and the market was regularly oversupplied resulting in the price being locked between US$20/t and US$40/t for most of the past 24 years (as indicated on the below graph) despite the existence of a substantial market. What profits were made were generated only by suppliers at the competitive end of the cost curve.



Source : globalCOAL and IMF

The poor state of the industry was exacerbated by the rapid introduction and expansion of Indonesian export tonnage, which continues to this day, and remains an ongoing major lower cost, competitor to Australia.

This was the age of "profitless prosperity" and many countries such as communist style countries, produced for State requirements, not for profits.

The above mentioned "super cycle", if it persists, will provide a step change in prices for commodities but will do so in an environment where there are abundant reserves in countries outside Australia ready to substitute for high cost Australian supply, and markets which are currently "ours", turning to other less high cost sources, such as depicted in the AAP report re Mongolia.

The highly regarded and independent International Fraser Institute in Toronto has noted that :

> "While nations globally are striving to simplify their tax codes, Australia seems intent on adding complexity to its resource taxes: the RSPT is out; the MRRT is in, and the petroleum resources rent tax (PRRT) is expanded."

And

> "The problem with assessing Australia's return to competitiveness is that the dust is suspended in mid-air, instead of settling. The mineral resources rent tax (MRRT) numbers don't add up, details are uncertain, complexity has increased, and the whole episode creates new risks for Australian miners."

And concludes that in regard to the MRRT:

> "Complexity and uncertainty have produced a deadweight competitiveness loss."

Regards

Greg Anderson and Chris Codrington
on behalf of ANDEV Executive and ANDEV Members