Lessons from the Australian Mining Boom

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The future is in our hands.

And it will be defined by the way we handle the current minerals boom.

Get it wrong, and we falter.

Get it right, and we set the nation up for decades to come.

Australian Prime Minister, the Hon. Julia Gillard

What is a Mining Boom?

- Definition: significant increases in mining investment or mining output, usually both
- Three phases to the Australian boom:
  - **Price increases** that began in 2003 and peaked in 2011
  - **Investment phase** that grew strongly from 2006 and peaked around this year
  - **Output growth** phase expected to continue for some years as resource extraction and export facilities are completed

Not the First Australian Mining Boom

- 1850s gold rush
- Late 19th century mineral boom
- 1960s/early 1970s mineral and energy boom
- Late 1970s/early 1980s energy boom; and
- Current episode, which is again both a mineral and energy boom.

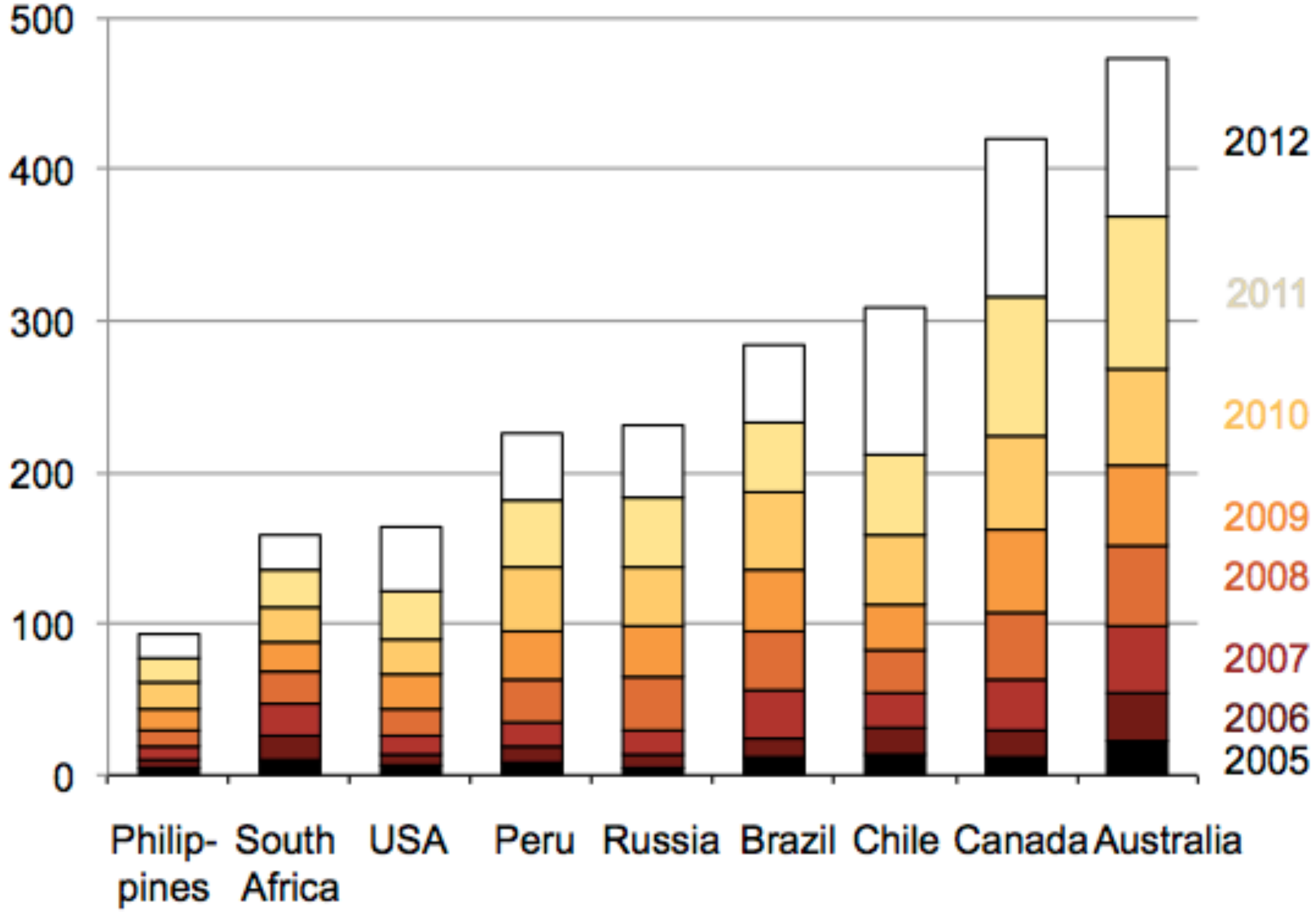
How Big Was the Boom?

- The largest mining boom in Australia in 150 years
- $400 billion investment in last decade
- Investment in Australia's resources is one of the highest, as a share of GDP, of any developed economy.
- Elevated prices for Australian commodities since 2003
  - Rapid growth in Chinese demand for iron ore, coal
  - Sustained demand from South Korea and Japan
  - Tripled the price Australia received

Comparing to Previous Booms

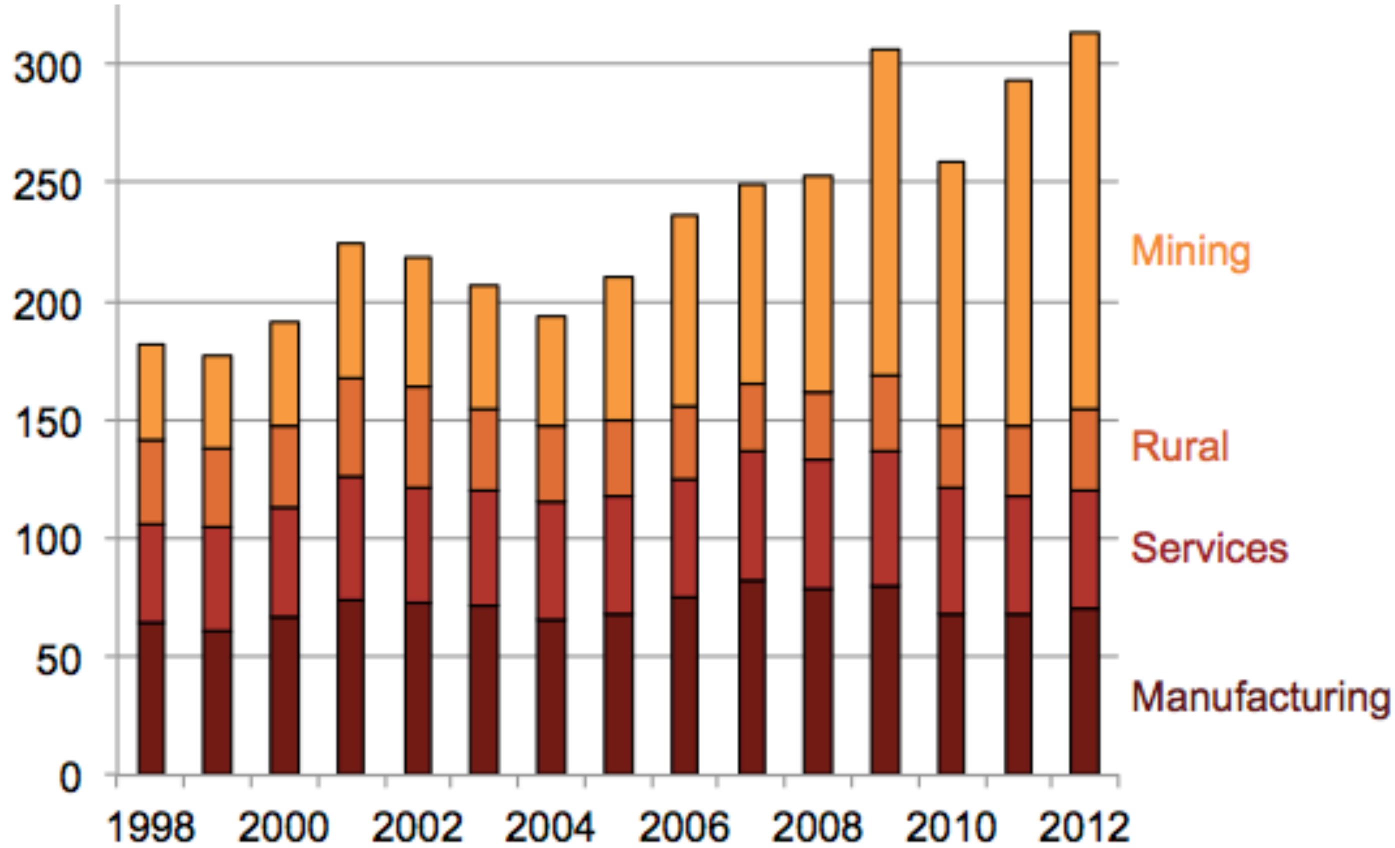
- Mining **investment as a share of GDP has been significantly higher** than recorded in previous booms
- The **terms of trade have risen much more** than they did in earlier mining booms
  - The current level of the terms of trade rivals the sharp peaks that were associated with rises in wool prices following the First World War and during the Korean War
- First boom during which the exchange rate has been floating
  - A significant rise in the nominal exchange rate has been an important part of the economic adjustment

Comparative Investment



Source: Engineering and Mining Journal Project Survey (2013); ABS (2012d)

Exports by Sector | Impact of Price Rises



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Community Concerns

- Many worry that Australia **could be thrown into recession** as economic growth slows in our major mining customer, China
- Most Australians believe the **boom has not benefited them personally** – and has even driven up the cost of living.
- The boom has **turned Australia into a 'quarry economy'**
- The **persistently high dollar has permanently damaged industries** that will be needed once the boom ends.

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Benefiting from the Boom

- On average, **wages and household incomes have grown strongly** through the boom.
  - The spread of full time earnings broadened, but the boom has increased wages in less skilled occupations
  - Unemployment remains low and the rate at which firms lay off workers has changed little
  - Households and workers in both mining states and other states have benefited from the boom
  - By pushing up the dollar, the boom has accelerated the reshaping of the manufacturing sector

Turning Australia into a Quarry

- Manufacturing, tourism, education of overseas students, and agriculture, have **survived the boom in reasonable shape**.
  - Producing goods and services at or above their levels prior to the boom.
  - Agriculture and education exports have grown strongly.
  - Tourism and manufacturing output have hardly grown over the period

- The mining **boom is not the prime cause of manufacturing's declining** share of GDP
  - Manufacturing has declined as a proportion of the economy in Australia and most other high- income economies for decades.

Saving the Inheritance

- Governments have made spending and tax decisions that have produced almost no net savings
- Successive Commonwealth governments appear to have treated the terms of trade windfall largely as if it were recurrent income.
- Saving commodity price windfalls:
  - Chile, a major copper exporter, has explicit budgetary rules for revenues related to copper prices.
  - Norway reserves its oil revenues largely into a sovereign wealth fund, which now stands at over 160 per cent of GDP.

“But I am not a miner”

- In terms of numbers, the mining sector is not a large direct employer, providing jobs for less than 100,000 people (2% of Australia’s workforce).
- In comparison, small to medium enterprises (SMEs) have two million owners and employ five million people.
- Need to consider secondary impacts of mining boom on talent attraction and retention
- Access to skilled professional services

Lessons: Drive Growth Conventionally

- Ultimately, to drive growth, there is no avoiding the conventional prescriptions:
  - maintain macroeconomic stability
  - avoid the temptation to subsidise industries in decline
  - pursue reforms to enhance participation, responsiveness and productivity

Lessons: Labour and Trade Flexibility

- Labour market flexible enough to allow wages to reflect conditions in each sector
- The value of the dollar has adjusted to resource prices, helping to shift demand to imports and maintain domestic demand at a level consistent with price stability.
- Australia's relatively low trade barriers allowed producers and consumers of a broad set of tradable goods and services to adjust to the appreciating real exchange rate.

Lessons: Strong Education System

- Many of the jobs created in the mining investment boom have required relatively low formal qualifications
- This may have offset longer-run forces that favour highly educated workers. Such support cannot be relied on in the next phase of the boom: as investment ramps down, wages and opportunities for less educated workers may grow more slowly
- This is why work to strengthen the Australian education system remains vital

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Lessons: Public Saving v Spending

- Saving during the boom
  - Means that levels of government expenditure on welfare and services are smoother over time, instead of payments rising during the boom and falling afterward
  - reduces the risk that governments will run up large liabilities should the terms of trade fall
  - May also relieve pressure on trade-exposed industries by reducing the real exchange rate

Minerals Resource Rent Tax

- Tax on profits generated from the exploitation of Australian non-renewable resources - levied on 30% of the "super profits" from the mining of iron ore and coal introduced on 1 July 2012

- Originally called the Resource Super Profit Tax
  - was to be levied at 40% and applied to all extractive industry including gold, nickel and uranium mining as well as sand and quarrying activities. The tax was replaced by the MRRT following the appointment of Julia Gillard

- For MRRT – a company was to pay the tax when its annual profits reach $75 million, a measure designed so as not to burden small business

Minerals Resource Rent Tax

- Mining interests had spent $22 m in campaigning and advertisements against the RSPT in the six weeks prior to the end of the Rudd prime ministership

Table 1: Changes in Minerals Resource Rent tax revenue projections ($ billion)

	2012-13	2013-14	2014-15	2015-16	2016-17
May 2010 announcement of Resource Super Profits Tax	3.0	9.0	Not available	Not available	Not available
November 2011 introduction of MRRT Bills	3.7	4.0	3.4	Not available	Not available
November 2011 MYEFO	3.7	3.8	3.1	Not available	Not available
2012-13 Budget	3.0	3.5	3.2	3.7	Not available
October 2012 MYEFO	2.0	2.4	2.1	2.6	Not available
2013-14 Budget	0.2	0.7	1.0	1.4	2.2

The Music Stops …

- Growth in underlying profits but impact of impairment

	2012 A$'m	2011 A$'m	Change %
Revenue from ordinary activities			
- Operating revenue	21,484	17,704	21%
- Non-operating revenue	309	185	67%
Total revenue	**21,793**	**17,889**	**22%**
Less expenses from ordinary activities	(15,515)	(12,710)	22%
Gross profit	**6,278**	**5,179**	**21%**
Exploration expenses	(593)	(493)	20%
Other income/(expenses)	(364)	(79)	362%
EBITDAI*	**5,321**	**4,607**	**15%**
Gain/(loss) on sale of investments	67	683	-90%
Impairment	(1,176)	100	-1274%
EBITDA	**4,212**	**5,391**	**-22%**
Depreciation and amortisation	(2,073)	(1,560)	33%
EBIT	**2,139**	**3,831**	**-44%**
Net interest income/(expense)	(156)	(192)	-19%
Profit from ordinary activities before tax	**1,983**	**3,639**	**-46%**
Income tax expense	(401)	(803)	-50%
Net profit/(loss)	**1,582**	**2,834**	**-44%**

Source: Company Financial Statements, PwC analysis

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Journalist

Do you think that Australia is transitioning out of the resources boom?

Andrew McKenzie | Chief Executive Officer, BHP Billiton

Not at all.

I think maybe some of the best days are ahead of it ...

We're looking at the possibility of an increase in demand of about 75 per cent in the next 15 years

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