REALISM AND MINERALS

IT'S A COLD, HARD MARKETPLACE

by A.H. PARBO

Boom times and downturns have taught Australian mineral producers a salutary lesson — that even though the long-term outlook is reasonably secure, there is no room for complacency. Producers will still have to fight for their markets.

The last fifteen years have seen major changes in the world mineral industry. Australia's prominence in this industry and the importance of mineral exports to our economy have placed us squarely in the middle of these.

The changes in the world economy and in international trade are by no means complete; the massive imbalances between the economic giants — United States, Japan and the European Economic Community — and the unmanageable indebtedness of many countries remain to be resolved. No-one knows how this will be achieved, but it is certain that there will be more major international changes. Some of these may well have adverse effects on Australia and on the Australian mineral industry. It is of course also possible that some may be favourable to us.

While the future is not confidently predictable, there are lessons for the future in what has happened in the recent past.

The most extraordinary change in Australia has been in public and political perceptions of the industry.

You may recall that the 1960s were a period of a high rate of growth of the world economy, a high level of demand for mineral products, and great new mineral developments in Australia in response to this demand. These developments gave a tremendous boost to the Australian economy and lifted the Australian mineral industry to a new level of world significance.

In the early 1970s these successes led to what can be kindly described as confused thinking.

A part of this was world-wide: the Club of Rome report *Limits to Growth* was erroneously but widely interpreted as proving that the world would shortly run out of resources, including minerals. In Australia, with its newly enhanced status as a major supplier of minerals to the world, such predictions had the effect of seriously distorting political and public thinking.

The Federal Minister for Minerals and Energy announced that Australians would in the future set the price of Australian mineral exports.

Academics and commentators started to argue that we were exporting too much; that it was desirable to curb the growth of exports.

Strict limitations on foreign investment and "buying back the farm" became a part of the policy of all major political parties.

The environmental movement, then getting into its stride, became largely anti-development and anti-business.

It became fashionable to disparage the "work ethic". Men and women of sensitivity would henceforth concern themselves with the finer things in life.

Literally thousands of new laws and regulations made economic activity more difficult and increased costs.

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Over-full employment and the discontinuance of sanctions against unacceptable union behaviour meant that the unions could demand — and achieve — unreasonable pay rates and conditions. Many of the restrictive work practices we are now trying to eliminate date from that period.

In markets short of commodities and products, enterprises were able to make up for cost increases and inefficiencies by increasing the scale of production. Some key commodities were priced virtually on a cost-plus basis, removing the incentive for producers to be cost-efficient; the Australian coal mining industry was a good example.

When the minerals boom terminated in the mid 1970s, it was replaced as the source of unlimited wealth in the minds of Australians by the then widely perceived sellers' market for energy minerals — remember the "energy crisis"? A very senior Federal Minister assured Australians that they were the "blue-eyed Arabs of the South Pacific".

It is a sobering thought that all these expectations and attitudes are now seen to have been exactly the opposite of what actually happened and what should have been done. The perceptions and the resulting policies could not have been more wrong.

It is an even more sobering thought that those in politics and public life who initiated and sponsored these perceptions and policies have now almost all, one way or another, departed from the scene, without carrying any responsibility for the results.

The world demand for minerals reached a high point in 1979, and then turned down because of the world economic recession. The 1979 level was not reached again until 1984.

During the downturn the previous euphoria about the mineral industry changed into the opposite view: that there was no future for the industry. World-wide production capacity in excess of demand, low prices, and consequent poor financial results by most mineral producers seemed to confirm this view. Commentators started to say that the intensive development of Australian mineral resources had all been a ghastly mistake because it diverted attention from our real mission, which was to establish a world competitive manufacturing industry.

I am sure there is no need for me to tell this audience that neither of the extreme views represents reality. The world will not run out of minerals, nor will minerals go out of fashion. There are no easy pickings in manufacturing, any more than in any other industry. While we must certainly develop world competitive manufacturing and service industries, this does not mean that the existing major industries have no future.

In spite of all the technological changes and substitution, the consumption of all the main metals and minerals continues to increase; thus in the 10 years from 1975 to 1985 (which included rapid technological changes and the world recession) the consumption of copper increased by 36 per cent, lead by 19 per cent, nickel by 37 per cent and zinc by 33 per cent. The exception was tin, where an artificial mechanism to maintain the price at a higher than market-determined level resulted in decreased consumption.

There is every indication that the demand will continue to grow, although there is evidence that the high rate of consumption growth in the 25 years after the end of World War II was exceptional and that future growth rates will be lower, partly because of the continued influence of technological changes.

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Australia remains an important supplier of minerals to the world; thus in 1985 we produced 66 per cent of the world's zircon, 55 per cent of the rutile, 40 per cent of the bauxite, 32 per cent of the ilmenite, 15 per cent of the lead, 11 per cent of the zinc, 11 per cent of the nickel, 11 per cent of the iron ore, and so on. Of two other important minerals, black coal and copper, we produced 4.4 per cent and 3.3 per cent of the world total respectively.

Australia's mineral industry also remains very important as an earner of export income, accounting for more than 40 per cent of the total revenue. Among the ten major export commodities in 1986/87 were six mineral products: coal, iron ore, petroleum, alumina, gold and aluminium.

This does not mean that we can sit back, relax, and enjoy our share of the growing world demand. The Australian mineral producers will have to fight for their markets, just like producers in any other export industry. This is the norm in the cold, hard, world marketplace. It is only worth particular mention in relation to minerals because of the extraordinary views about the industry which prevailed in the early 1970s.

Having to fight for markets and work hard for a living does not mean that the mineral industry has been superseded as a substantial pillar of the Australian economy. For quite some years Australian living standards will necessarily remain dependent on the fortunes of the rural and mineral industries which together now provide more than 80 per cent of Australia's exports. With the exception of tourism, the main short-term opportunities for improving our balance of payments are in these industries.

Development of new internationally competitive industries, such as manufacturing, to provide diversification of exports is eminently sensible and desirable; the greatest possible effort should go into this. The reality of the world marketplace for goods and services is, however, that it is extremely well supplied with highly innovative, high quality, and keenly priced products from countries such as Japan, West Germany and others. For us to break into these highly competitive markets means not only matching the price, quality, and dependability of delivery and service of the existing suppliers; we must be better in at least one of these areas. There are no easy pickings. With the exception of the Australian tourism industry, which is in a unique position, it will take years, not months, before any such new industries become significant in the balance of payments context.

A necessary basis for the mineral industry to continue its contribution to the economy and to build on it is that it has to be world competitive. This, of course, applies to any other export industry — including high technology manufacturing and service industries.

There are numerous examples from the world mineral industry where changes in competitiveness have caused strong growth or virtual shutting-down of major industries.

Thus the US zinc-smelting industry, which produced 1,000,000 tonnes of zinc a year in 1968, was down to 300,000 tonnes a year in 1986. The US copper-smelting capacity of 1,750,000 tonnes per year a few years ago was down to 900,000 tonnes per year in 1986, with more smelters due to close. Japan produced 1,000,000 tonnes per year of aluminium in 1980; it now produces less than 250,000 tonnes per year.

All these changes occurred because of non-competitiveness, either because of the increased cost of the inputs into the production process or because of the prohibitive capital cost of modifications due to increasing environmental requirements, or both.

An example on the other side is the Australian alumina and aluminium industry. Australia did not produce any bauxite in the 1950s. We imported supplies from Indonesia for a small government-owned refining and smelting operation. Following the developments in the 1960s and 1970s, Australia is now the largest producer of bauxite and alumina in the world as well as a substantial producer of aluminium metal. It is maintaining this place because of the competitiveness of the newly established operations, but only as long as these remain competitive.

Competitiveness and stability of supply are vital assets through both good times and bad. The market mechanism does work; high cost producers will go out of business, although rather more slowly than theory would indicate.

Thus, throughout the recent depression, the outlook for the non-ferrous metals industry seemed poor as far as one could see. As recently as in March 1987, a global mining outlook brochure by an eminent world-wide commentator forecast that in 1987 the copper price would average US$60 cents/pound, the lead price around US$17 cents/pound and the nickel price US$1.85/pound. No sooner was the brochure issued than these prices — and some others, such as aluminium — increased by between 25 per cent and 50 per cent. The higher prices appear likely to be maintained at least for the remainder of the year. The gradual shutting down of non-competitive operations and running down of stocks created a situation where a modest improvement in demand resulted in tightness of supply and higher prices.

As an aside, the experience just cited also confirms that forecasting in the mineral industry is a highly hazardous business. The results need to be taken with a large dose of salt, and forecasters should take care not to agree to payment by results.

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Whether Australia is competitive or not depends on many factors, many of which come under the control of management. The recent hard times in the industry have brought about major improvements in efficiency, some of which would have been thought impossible only a few years ago. We have not reached the limit in this: further gains can be and are being made. The opportunities for improvement are not only in the mining and processing operations themselves, but also in the cost of supplies and services, many of which are provided by government-owned or controlled bodies, and in imposts by government. Improving efficiency and containing costs in these areas is just as important as in the operations themselves.

Another important determinant is the exchange rate of the Australian dollar. When money flows force the rate to unrealistically high levels the competitiveness of all Australian export industries suffers. This is of course self-correcting over time, as a high exchange rate cannot be supported by poor external economic performance.

I should not conclude without saying something about gold. Gold has been the best recent example of the fallacy of saying that the mineral industry has lost its importance to Australia, and also the best example that there is no lack of investment if there are adequate rewards.

Gold is now Australia's fourth-largest export, moving up from seventh place just over one year ago and from literally nowhere seven years ago. With the expected further increase in production, gold is likely to become Australia's third-largest export earner next year, exceeded only by coal and wool.

The most important reason why the Australian gold industry is at present expanding rapidly is that there are good financial rewards to successful miners. The growth of gold mining has brought with it substantial capital investment both in exploration and in the development of new operations. This investment is proving to be a life-saver for much of Australia's secondary and tertiary industries in both regional areas and cities throughout Australia, through additional demand for goods and services.

One of the reasons why gold is an attractive investment at present is the taxation treatment of gold mining. This has been subject to much comment, much of it uninformed.

Some commentators and, I suspect, most of the public, are under the impression that the industry pays no tax at all. This is not so; the industry is subject to all the usual taxes imposed by Federal, State and local governments other than corporate tax. These include income tax by employees, payroll tax on salaries and wages, sales tax on purchase of goods, excise tax on fuel and other products, fringe benefits tax, customs duties and tariffs on imported goods, land rates, licence and tenement fees, and a variety of other government fees and charges.

The exemption from corporate tax has to be viewed against the new tax rules applying to corporations and shareholders from July 1, 1987.

Gold mining profits will not be subject to corporate tax, but dividends paid to shareholders will be fully taxed in shareholders' hands at their personal tax rate. Only profits retained by companies, which are invariably used for development, expansion, and new investment, are free from such tax. When used in this way, there are of course no tax deductions for the expenditure.

In other industries companies will pay corporation tax, but will then be able to pass a tax credit to shareholders; dividends paid are not taxable in shareholders' hands. Retained profits are taxed, but on the other hand such profits when applied to development and new investment are tax deductible.

The advantage to gold mining is only one of timing and is therefore nowhere near as great as is commonly assumed. The different tax treatment does not result in lining the pockets of shareholders; the main advantage is in companies being able to retain a larger proportion of the cash flow for re-investment in the first instance. This is significant in encouraging investment in the industry, which is exactly what the country needs. ☐