

NEGATIVE SENTIMENT HIGHEST RECORDED

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Negative sentiment as recorded in our QRC CEO Sentiment Index is at its highest level since we began the index in June 2009 (see page three/four). Our CEOs have in fact expressed higher negativity than when details of the Resources Super Profits Tax were made public in May 2010.

This is a particularly disturbing finding and comes precisely at the wrong time. Right now, QRC members are seeking certainty and indeed improvements to their operating environment to capitalise on strong global demand and to shore up in excess of \$100 billion in proposed resource projects.

At a time when other resource rich countries are rolling out the red carpet to get developments going and to capitalise on the associated socio-economic benefits, Australian policymakers are developing an unhealthy preoccupation with putting up new hurdles to investment.

Even more puzzling is the recent media commentary on the supposed economic risks associated with resources expansion and a two (or more) speed economy. This growth should be welcomed as the mechanism by which we are capitalising on our external good fortune, and yielding higher living standards for all Australians.

The real challenge confronting policy makers is to ensure that the adjustments can proceed smoothly. To that end, we need to ensure that, for industries facing increased competitive pressure, regulatory or other policy-related impediments to their ability to respond are removed.

Pricing carbon

Much of this negativity recorded in our sentiment index centres around the federal government's proposal to place a price on carbon ahead of competitors.

With agreed decisions of the multi-party committee on climate change (MPCCC) slowly being revealed, what is becoming abundantly clear is that the resources sector will be treated harshly—especially the coal sector.

The QRC understands that the Australian black coal sector is likely to receive \$1.2 billion which equates to an effective rate of assistance of six percent. This is despite the sector being eligible to have 60 percent of its estimated \$18 billion in carbon liabilities remitted as free permits over the first 10 years of the scheme.

The impact on current and proposed coal investments of this feared call on the coal sector to subsidise the sweeteners in the MPCCC package was the focus of a recent ACIL Tasman analysis for the Australian Coal Association.

The analysis found that of 41 current coal operations in the state, a carbon price starting at \$20 per tonne of CO₂-e and increasing at a price trajectory necessary to achieve a five percent reduction in emissions by 2020 would cause premature mine closures because revenues would no longer cover operating costs. By 2017/18 it is estimated that 2700 Queensland coal workers would be out of a job. Assuming a four-times indirect employment multiplier, this means the loss of more than 13,000 Queensland jobs.

The ACIL Tasman analysis also identified a likely negative impact on the viability of proposed Queensland coal projects, with the loss of 5250 direct and indirect jobs across the Queensland economy.

The futility of this policy is rammed home by the findings of a separate study by the Centre for International Economics, which found that none of Australia's coal export competitors plan to put a price on the carbon emissions released by the mining of coal (the so-called fugitive emissions). The upshot is that Australia will lose some of its coal export business to countries without an equivalent carbon price and not a single molecule of greenhouse gases will have been saved. These reports can be accessed in full at www.australiancoal.com.au.

To add insult to injury, we hear of plans to further increase the industry's fuel tax bill by imposing fuel-related carbon prices via equivalent cutbacks in the fuel tax offset for off-road fuel use by the mining sector.

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- Key indicators: QRC Production and Value of Production Indices
- Feature: The importance of fuel and fuel tax concessions in resource operations
- QRC CEO Sentiment Index



This policy has a number of significant issues and these are outlined in our feature piece on page three.

For a comprehensive overview of the current state of play, the QRC's position, and expert analysis on the potential impacts of a carbon price on the resources industry, I encourage readers to visit our carbon pricing portal on our website at www.qrc.org.au.

KEY INDICATORS

The QRC production index

The QRC production index is a composite weighted index that tracks percentage increases and decreases in the total production of Queensland bauxite, alumina, aluminium, coal (all saleable), copper, gold, lead, silver, zinc, oil, gas, and electricity (NEM) quarter to quarter.

The index at the end of the March 2011 quarter (latest available data) reached 76 index points, 23 percent lower than the previous December 2010 quarter (June 2006=100).

This was due in the main to the large decrease in coal production emanating from the severe wet weather in the latter half of 2010. Saleable black coal production dropped significantly from 43 Mt to 27 Mt in the March quarter.

Minor falls in production were recorded for alumina, aluminium, silver and zinc whilst moderate increases were recorded for copper content and lead production. Gold production remained constant.

With affected mines dealing with the legacy of water inundation built up over the past two wet seasons, the QRC estimates that the Queensland coal sector is operating at approximately 80 percent of capacity as the new financial year begins.

Whilst the QRC is hopeful that the soon-to-be-completed review of the Fitzroy model conditions, which govern mines' ability to discharge water, will see mines better placed to handle the next wet season, the mine water legacy will

continue and will need to be managed on site through very costly investment in water storage solutions. The joint QRC-DERM sponsored study of the potential applicability of a Hunter River style salinity trading scheme in the Fitzroy Basin may deliver some relief over the medium-longer term.

The QRC value of production index

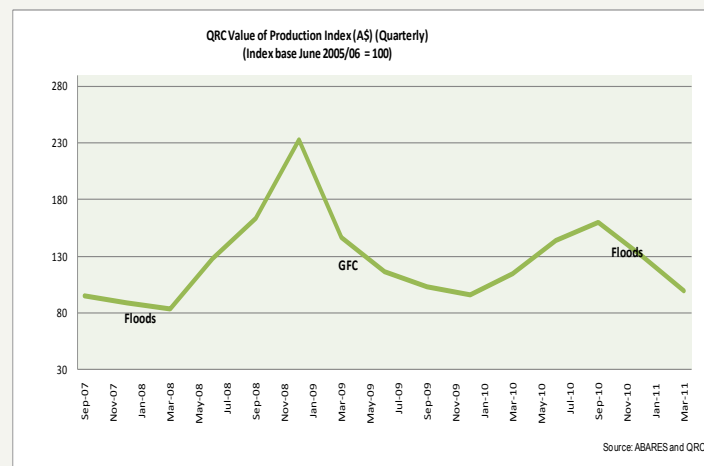
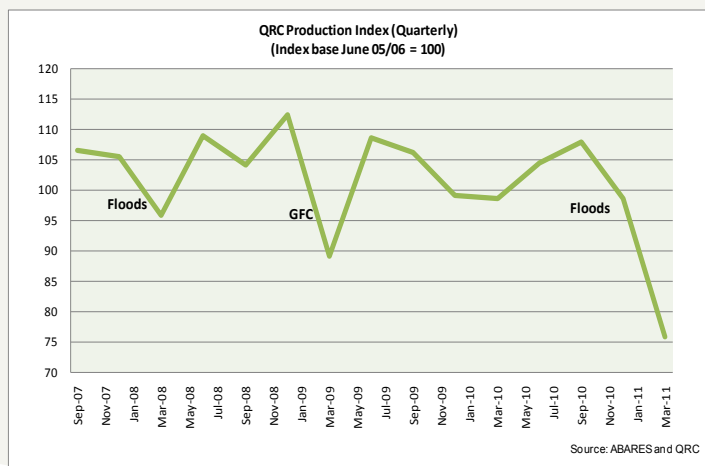
Comprising the same basket of goods as the QRC production index, the QRC value of production index combines domestic production and average global benchmark prices to track percentage increases and decreases in the total value of production.

The index at the end of the March 2011 quarter (latest available data) reached 99 index points, 31 percent lower than the previous December 2010 quarter (June 2006=100).

In real terms this is a decrease of \$2.4 billion (from A\$9.4 billion to A\$7.0 billion). Whilst average thermal and metallurgical coal prices strengthened during the quarter, coal production was very low with value of production A\$2.2 billion lower than the December 2010 quarter.

Other significant developments in the March quarter include:

- The Australian dollar continued to appreciate and averaged 1.03 against the US dollar (compared to US0.82c in June 2010). ABARES predicts that the dollar may remain relatively strong (especially against the US dollar) over the next few years, but will eventually ease beyond the short term as financial market sentiment towards the US dollar strengthens and as global supply of resources increases (thus weakening Australia's terms of trade and demand for Australian dollars). This spells good news for the resources sector and other other export orientated sectors of the Australian economy.
- The rise and rise of most commodity prices reflecting strong global demand and global supply shortages. Prices for alumina (A\$335/t), aluminium (US\$2500/t), copper (US\$9651/t), gold (US\$1385/oz), lead (US\$2540/t), silver (US\$3186/troy oz), and zinc (US\$2393/t) are all either at or close to record highs.



STATE OF THE SECTOR

THE IMPORTANCE OF FUEL AND FUEL TAX CONCESSIONS

The Australian resources sector has come under unwarranted criticism because it, like most other Australian industries, accesses the federal government's fuel tax credits scheme (for resources this is generally 38.143c per litre credit for most off-road activities).

Perhaps in response to these criticisms, and certainly as a government budget cost saving measure, the scheme may be trimmed as part of the government's carbon pricing policy package.

The changes may see large businesses paying the embedded carbon price in fuel via equivalent cutbacks in fuel tax concessions (ie fuel tax credits). Advice from petroleum companies is that these embedded costs will equate to approximately 2.7c per litre at a \$10 t/CO₂-e price. Resource companies at a \$20 t/CO₂-e price would see their fuel tax credit reduced from 38.143 c to 32.743c.

Whilst it is not yet clear how the mechanism would work in practice, the more fundamental issue that needs to be examined is the policy merit of this 'reform'.

Principles of an efficient and fair tax system

A long-held and deeply entrenched principle of taxation policy in Australia is that taxes should not fall on business inputs such as fuel. As stated in the Henry tax review (pp.7 of the Overview) 'the tax system (should) support investment, allocate resources to their most valued uses and not inadvertently add to the cost of production through taxes on business inputs or excessive complexity and compliance costs'.

This is similar to the 2002 Trebeck Fuel Tax Inquiry that concluded that whilst business input taxes do raise government revenue, this unfortunately comes at a considerable cost to efficiency, output and national savings.

The importance of fuel in resources discovery, development and transport

Fuel, predominantly diesel, is an essential resources sector input, constituting anywhere between five to 30 percent of operating costs depending on the activity.

It is used in:

- long-range heavy transport (rail, road and sea)
- generation of electricity/production of process steam in regional and remote locations where there is no alternative power source and linkage to a national grid is not commercially viable
- in-pit and other vehicles for development and operation of mine sites
- exploration, construction and rehabilitation activities.

The Australian resources sector operates in competitive global markets. These markets are characterised by increasing competition and substantial fluctuations in demand, prices and exchange rates. Whilst prices today for

coal, base and precious metals and other commodities such as alumina and aluminium are buoyant because of strong demand and global supply shortages, leading forecasters expect these prices to remain cyclic and continue to fall in real terms as additional global supply comes on line.

The Queensland resources sector's ongoing competitive advantage in global markets will continue to be tested by real price decreases, a significant reliance on liquid fuels (with the attendant fluctuations in global oil prices), declining resource grades, deeper mining levels, and additional imposts such as high labour costs and carbon and resource rent charges.

Fuel is not consumed wastefully

It has been suggested that because the industry is able to claim back most of its fuel excise payments, that this may encourage 'wasteful' consumption. The sector's reliance on diesel is not because of artificially low prices (on account of fuel tax offsets), but of necessity and practicality. Indeed, in most applications there is no substitute. The sector therefore has a very strong market incentive to keep fuel costs as low as possible to lower operating costs to remain globally competitive.

This is evidenced by the efforts of QRC members as part of their Energy Efficiency Opportunities obligations. The QRC in conjunction with EarthHour launches an annual compendium of QRC member initiatives to abate greenhouse gases (GHGs). These can be found at www.qrc.org.au.

In our 2010 edition, the efforts of New Hope Corporation, Jellinbah Resources, Thiess, and Downer EDI Mining to implement efficiency programs to mitigate particulate pollution, greenhouse gases and operating costs are outlined.

The QRC encourages government to tread very carefully when introducing policies that reduce the fuel tax credit and impose greater business input costs. Such policies risk imposing costs to the economy that outweigh any benefit that may be realised, such as to government finances.

QRC CEO SENTIMENT INDEX

The QRC CEO Sentiment Index is a survey of the QRC's full member company Chief Executives.

These companies cover the majority of mining, minerals processing, contracting, exploration, electricity generation and oil and gas extraction activity in Queensland.

The attraction and retention of skilled employees and uncertain and/or poor regulation rank as the highest order issues with a 'very strongly' rating (score above 80).

Issues that are likely to 'more than normal' (score between 60-80) adversely impact upon operations over the coming 12 months include climate change policies, high input costs, social licence to operate pressures, industrial relations, insufficient government resources, the global

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macroeconomy, and soft and hard infrastructure availability. Lower order concerns are raising capital (significant for exploration companies though) and accessing global markets.

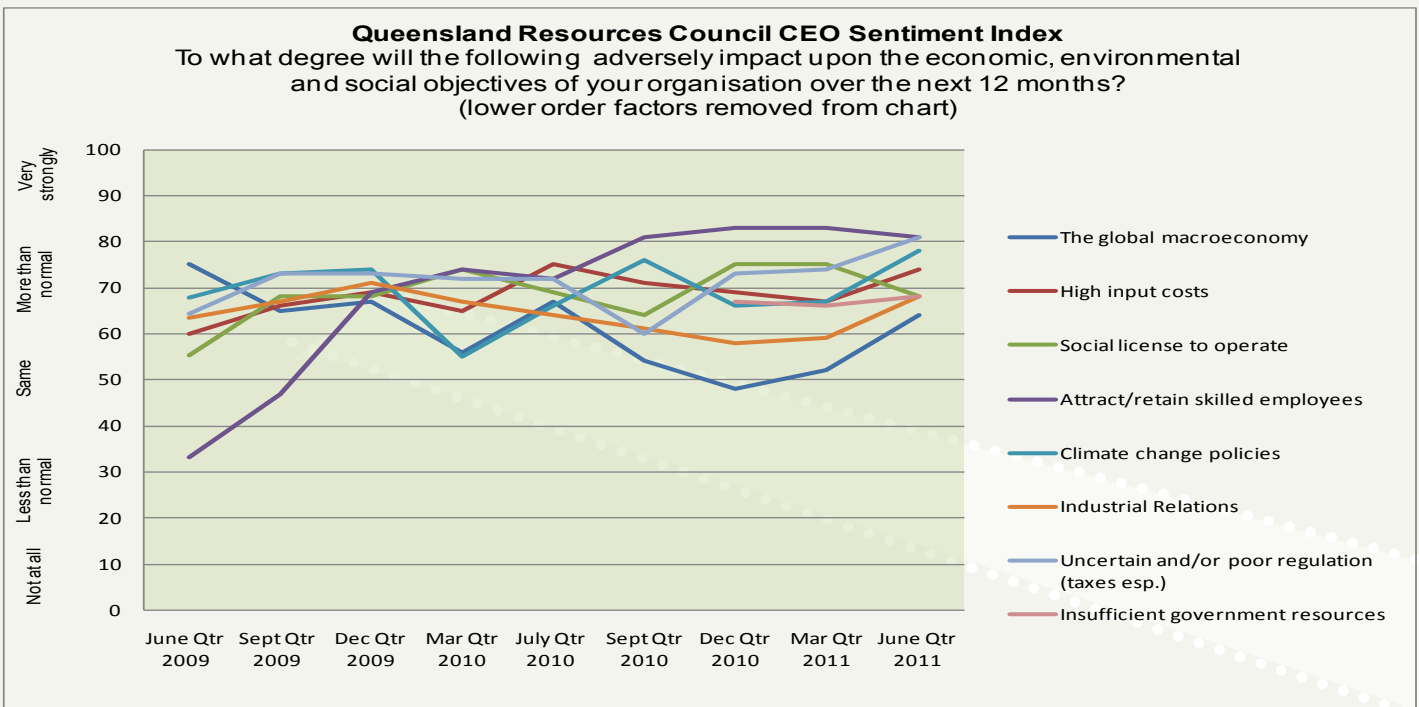
Noticeable increases in negative sentiment were recorded for the global macroeconomy (up 12 points), climate change policies (up 11 points), industrial relations (up nine points), and high input costs and uncertain and/or poor regulation (both up seven points), viz:

- Global macroeconomy = on account of the Greek debt crisis and potential for broader European contagion in important financial markets and lower resources demand. Also, China's 12th five-year plan, which will see GDP growth target lowered from 10 to seven percent per annum.
- Climate change = reflects the resource industry's ongoing concerns that Australia will be far ahead of our competitors, and without adequate transitional assistance, the risk of driving investment offshore.

- Industrial relations = return to more difficult and adverse enterprise bargaining arrangements with higher expectations will be problematic.

- High input costs = in response to the significant increases in labour, accommodation, services, parts and tyres, electricity and fuel currently being experienced and the attendant global competitiveness concerns.

- Concerns about uncertain and/or poor regulation = reflects the disproportionate influence of the minority parties at the state and federal government levels. Specific concerns include the state government's decision to end sand mining on North Stradbroke Island without public and industry consultation or completion of a regulatory assessment statement; ongoing issues in finalising the details of the proposed strategic cropping land policy; and a lack of flexibility by the state regulator to address mine dewatering.



QRC PROFILE

The Queensland Resources Council is the peak representative body for more than 200 companies with interests in the state's minerals and energy sector. The QRC's 89 full-member companies comprise explorers, miners, contractors, mineral processors, oil and gas producers and electricity generators. QRC's 134 service company members cover the gamut of professional services provided to the resources sector in the four corners of Queensland.

Written and prepared by the QRC. The data for this publication is sourced from a number of public sources—notably the Australian Bureau of Agricultural and Resource Economics and the Australian Bureau of Statistics. For more information, contact the QRC on (07) 3295 9560 or qrc.org.au