The Australia Institute

Research that matters.

An analysis of the economic impacts of the China First mine

Submission
Dec 2011
ISSN 1836-8948

Richard Denniss

TAI

Submission

About TAI

The Australia Institute is an independent public policy think tank based in Canberra. It is funded by donations from philanthropic trusts and individuals, memberships and commissioned research. Since its launch in 1994, the Institute has carried out highly influential research on a broad range of economic, social and environmental issues.

Our philosophy

As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

The Australia Institute's directors, staff and supporters represent a broad range of views and priorities. What unites us is a belief that through a combination of research and creativity we can promote new solutions and ways of thinking.

Our purpose—'Research that matters'

The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

The Institute is wholly independent and not affiliated with any other organisation. As an Approved Research Institute, donations to its Research Fund are tax deductible for the donor. Anyone wishing to donate can do so via the website at https://www.tai.org.au or by calling the Institute on 02 6206 8700. Our secure and user-friendly website allows donors to make either one-off or regular monthly donations and we encourage everyone who can to donate in this way as it assists our research in the most significant manner.

LPO Box 5096
University of Canberra, Bruce ACT 2617
Tel: (02) 6206 8700 Fax: (02) 6206 8708
Email: mail@tai.org.au
Website: www.tai.org.au

Introduction

The proposal by Waratah Coal to build one of the world's largest coal mines which will transport its coal through the Great Barrier Reef, in the middle of a mining boom, and at a time when the world is attempting to reduce greenhouse gasses has obviously not been without some controversy. However, despite the obvious social and environmental costs associated with such a mine being approved the widespread notion in some circles is that the economic benefits of the mine are so large that the costs are worth incurring.

This paper argues that while the profits flowing to the owners of this mine, which is rather accurately known as the 'China First Project', will be substantial, the net economic benefits to Australia will, at best, be small. Indeed, this paper highlights that even the mine's proponents concede that there will be substantial economic costs for significant parts of the broader economy. Indeed, according to the Economic Impact Statement commissioned by Waratah Coal to help make the case for the China First mine the consequences of the mine's approval for the broader economy include:

- 3,000 jobs will be lost across Queensland and Australia, particularly in manufacturing, agriculture and tourism.
- $1,249.4 million of manufacturing activity will be lost.
- Inflation will rise.
- Small and medium sized businesses will be hit with higher bills for payroll and rent. This will result in some of them shutting down.
- Housing affordability will decline for those who are not employed in the new mine.
- Wealth will become less evenly distributed, with most of the benefits accruing to those employed in the China First mine.

While some may argue that such claims are predictable coming from the opponents of the development of the world's largest coal mine, few could fail to be surprised to learn that these are the claims being made by the mine proponents themselves. That is, as the following sections make clear, the AEC Group, the economic consultants commissioned by the proponents of the China First mine, provide evidence to support all of the claims made above.

While Queensland Premier Anna Bligh has described the proposed mine as a 'shot in the arm' for the Queensland economy the proponents own economic modelling suggests that it might be more like a 'shot in the head' for the broader Queensland economy.

What the China First mine proponents say about the impact of the mine on the manufacturing industry

The recent boom in world demand for Australian mineral resources has resulted in a large increase in the price paid for our resources, the quantity of minerals exported, and the amount of construction activity associated with building new mines. All three of these effects place pressure on other industries, including manufacturing, due to the pressures they place on the Australian exchange rate and the wage rate paid to skilled workers. The authors of the economic impact assessment conducted for the proponents of the China First mine found that[1]:

- Manufacturing output will decline by $1,249.9 million per year between 2013 and 2017 (p. xii)

[1] All page references from Waratah Coal 2010. *Economic Impact Assessment for the China First Project EIS - Final Report*. Online: <http://www.waratahcoal.com/publications.htm> Accessed 14 Dec 2011.

- Manufacturing jobs will decline by 2,215 in Queensland alone between 2013 and 2017 (p. xvi)
- ‘The draw of labour to the mining and transport and storage sectors...is estimated to result in some other sectors recording a decline in employment compared to what would be achieved without the China First Project' (p.xvi)
- 'Manufacturing employment in the (mine region) is also estimated to be adversely impacted by the China First Project's influence in terms of strengthening Australia's exchange rate and subsequent impacts on trade exposed industries' (p.xvi)
- 'Support for the strength of the Australian dollar which may adversely impact the profitability and long term prospects of some sectors that are exposed to international competition, in particular manufacturing, some agricultural commodities and tourism related sectors' (p. xxv)
- 'of note, the manufacturing sector is estimated to record a considerable decline in overall industry output during operation. It is expected that the mining- related manufacturing sub-sector will benefit from the China First project through demand for, and provision of, goods and services to support the project once operational. However, offsetting this it is anticipated the manufacturing sector will be one of the hardest hit sectors in terms of the reallocation and draw of labour to the China First Project given the relatively similar skills sets employed...further, the export of $4.6 billion of coal will likely place some upward pressure on Australia's exchange rate, which may impact on the global competitiveness of manufacturing goods produced in Australia.' (p.24)
- 'overall manufacturing output is estimated to decline in Queensland relative to what would be achieved if the project does not proceed' (p.24)
- 'the increase in Australia's (coal) exports will assist in maintaining the value of the Australian dollar, which may have some negative ramifications for the 'trade exposed' industries that operate on relatively tight margins and compete in a global market against low cost overseas producers (e.g. Manufacturing and agriculture) potentially leading to industry rationalisation' (p.52)
- Average annual impact on manufacturing employment in Queensland 2013-2017 -2,215
- Average annual impact on manufacturing employment in Queensland 2018-2036 - 1,666

The Australian economy has been losing manufacturing jobs to China for many years due largely to the disparity in wage costs. It would seem, however, that the Chinese have found a new way to shift Australian manufacturing jobs offshore: invest heavily in the expansion of the Australian mining industry.

What the China First mine proponents say about the impact of the mine on other industries

Of course it is not just the manufacturing industry that will be hurt by the construction of the China First mine. Again, according to the authors of the economic impact assessment conducted for the proponents of the China First mine:

- 'The increase in competition for labour from the China First Project...will place pressure on local businesses to increase salaries and wages in order to retain and attract staff. The increase in labour costs will eat into business profitability, and will likely require businesses to either increase the price of their goods and services or cut back on their expenses in order to recover costs. This may make some businesses operating on or near the margin unviable in the medium to long term...' (p.31)

- 'On a broader scale, however, the development of a local value chain is likely to predominantly represent a transfer of activity from projects elsewhere in Queensland...rather than a genuine increase in activity' (p. 60)
- Under the heading 'crowding out of business due to competition for resources' the proponents identify: 'reduced profit margins for business due to higher costs of production (e.g. Wages and rents) eroding the viability of some businesses, particularly smaller businesses already operating at or near the margin' (p. 62)
- 'Agriculture is estimated to record a decline in employment compared to the baseline scenario'. (p.36)
- ‘The draw of labour to the mining and transport and storage sectors...is estimated to result in some other sectors recording a decline in employment compared to what would be achieved without the China First Project' (p.xvi)
- 'the increase in Australia's (coal) exports will assist in maintaining the value of the Australian dollar, which may have some negative ramifications for the 'trade exposed' industries that operate on relatively tight margins and compete in a global market against low cost overseas producers (e.g. Manufacturing and agriculture) potentially leading to industry rationalisation' (p.52)

What the proponents of the China First mine say about the risk of riding a mining boom

If a regional area becomes too dependent on an industry that has historically had large fluctuations in demand then this can be particularly devastating during any future down turn in demand. This can be made worse if during the boom the industry has crowded out other industries will more stable demand. The report’s authors state:

‘Because of the dependence on coal and coal seam gas in the region, fluctuations in global resource markets can potentially have grave impacts on the region with little support from other industries to soften a downturn in the resources sector. (p. viii)

What the China First mine proponents say about the impact of the mine on the distribution of wealth in Australia

Julia Gillard has said that 2012 will be the year of distributing the gains of the mining boom but the proponents of the China First mine make clear that the main beneficiaries of their proposal will be those who own, or work for, the mine itself.

- 'Wealth generated by the China First Project will be primarily distributed to those directly engaged in the project' (p. xxii)
- 'Opportunities for wealth distribution to investors (i.e. shareholders) (p.xxii)
- 'Experiences during the most recent mining boom (2003 to 2008) suggests the disparity in salaries could contribute to a wealth divide between mining families and other residents ... housing affordability could become an issue, in particular for those that are not employed by the China First Project or in other high earning occupations' (p. Xxii)
- 'the disparity in wealth distribution may contribute negative implications for households that are in the lower income thresholds' (p.51)
- 'the higher salaries paid to mining employees enables them to afford the rapidly rising prices of properties' (p. 51)

What the proponents of the China First mine say about the impact of the mine on wages and inflation

Adding more demand to an already booming sector can add fuel to wage and price increases which has negative effects for the local area as well as for the state and the nation. The report says:

- 'the China First Project will place additional pressure on the already tight labour market in an industry (and region) that in recent years has been exposed to significant skills shortages...placing upward pressure on prices...' (p. 57)
- By 2015 wages will be around 1.5 per cent higher than would otherwise be the case. This is equivalent to an extra $300,000 per year for a medium sized firm with a payroll of $20 million per year. In the words of the mine proponents:
- 'The increase in labour costs will eat into business profitability, and will likely require businesses to either increase the price of their goods and services or cut back on their expenses in order to recover costs. This may make some businesses operating on or near the margin unviable in the medium to long term...' (p.31)

What the proponents say about buying Australian

While project construction must contain at least 50% Chinese content (in line with debt financing agreement with Export-Import Bank of China), MCC will give preference during both the construction and operational phases of the project to local contractors and local suppliers wherever possible...

'Waratah Coal has entered agreements with Chinese partners for the financing, construction and marketing of the project. The Metallurgical Corporation of China (MCC) has been engaged to undertake the engineering, procurement, construction and management of the project, although Waratah Coal will have a management team and will maintain a supervisory role during construction, operations and decommissioning. MCC will utilise the expertise and resources of a number of other major Chinese companies, including the China Railway Group, the China Communications Construction Company and the Sino Coal International Engineering Group. (Appendix 23 - Social Impact p.xviii)

'Debt financing is being organised through the Export-Import Bank of China. As part of the agreements, the Export-Import Bank will provide US$5/6 billion in debt finance; project construction will contain at least 50% Chinese content; and all production will be sold to China Power International Development. At the same time, agreement has been reached with MCC that preference during both the construction and operational phases will be given to employees from the local area, Queensland and Australia, in that order, before foreign workers….' (p.2)

What the proponents of the China First mine don't talk about

The proponents of the China First mine focus heavily on two issues, the large increase in coal exports and the large increase in local mining employment associated with the mine being approved. While it is inconceivable that one of the world's biggest coal mine could be built without increasing mining employment and exports, it is irresponsible and misleading to conflate those specific benefits to an industry and region with significant national economic benefits. Indeed, as discussed above, the mine's proponents themselves concede that there will be substantial economic and social costs associated with the mine.

That said, while the proponents concede that the China First mine will cause significant employment and output costs in other industries there are a range of other significant costs that will flow from the mine's approval including:

1) **The impact on the China First mine on the Consumer Price Index (CPI).**
   While the proponents concede that the mine's approval will boost wages and prices they do not provide any estimate of the impact on the rate of inflation
2) **The impact of the China First mine on interest rates.**
   The Reserve Bank of Australia (RBA) has repeatedly linked the expansion of the mining industry to its decision to increase official interest rates. Given the large size of the China First mine and the proposal to build it in the middle of a mining boom it is likely that official interest rates, and in turn the interests paid on mortgages and small business overdrafts, will increase.
3) **The impact of the Current Account Deficit**
   While the proponents make repeated reference to the likely increase in coal exports this provides a very narrow perspective in relation to Australia's international trade flow. That is, while the new mine will inevitably lead to an increase in mining exports will also inevitably result in a reduction in non-mining exports due to the increase in the exchange rate and the reduction in the size of the manufacturing, tourism and agriculture industries as labour is drawn towards new mining activity. The report does not analyse the impact on net-exports. Furthermore, to the extent that the mine is foreign owned the profits will be sent offshore and such flows have a negative impact on the Current Account Deficit, a point that, again, is neglected in the report.
4) **The estimates of tax revenue included in the paper are based on an $A exchange rate of $US0.80.**
   Given that the current exchange rate is currently well above that, and the authors conceded that the proposed mine (and a large number of similar developments) will all place upward pressure on the exchange rate, this seems surprising. The significance of this decision is that the amount of state government royalties is influenced by the exchange rate and as the $A rises the royalty payments fall. In turn, by assuming that the exchange rate is lower than it really is the report predicts that royalty payments will be higher than they likely will be.

Conclusion

According to the proponents of the China First mine the impacts of its construction will be devastating for the broader Queensland and Australian economy, with thousands of jobs forecast to go in the non-mining industries and the manufacturing industry set to decline by more than $1 billion per year.

It is important to realise, however, that these results reflect the best case scenario. That is, these results come directly from the economic consultants commissioned by the China First mine's proponents. Modelling based on more realistic assumptions, including more realistic exchange rate effects, would likely result in even larger job losses in other industries.

Finally, the economic modelling is, by design, confined to the impact of the China First mine in isolation when in fact it is one of a suite of new fossil fuel developments in Australia. When all of the mines, all of the LNG, and all of the Coal Seam Gas developments are viewed collectively the exchange rate effects will be significant and, in turn, the impact on other industries will be much greater than those presented in the modelling for the China First mine.

While this is not meant as a specific criticism of the specific modelling commissioned for the China First mine it is meant as a fundamental criticism of the way in which decisions about the expansion of the mining industry are being made. Proponents of each mine are arguing that their mine will have only a small impact on the exchange rate, but the economic impact on other industries will be determined by the collective impact of the mines going ahead.