

Don't kill the iron goose

Michael Stutchbury, Economics editor

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KEN Henry's silly claim that the mining industry didn't "contribute strongly" to keeping Australia out of recession last year serves only to underline the febrile debate over his resource super-profits tax.

The Treasury secretary further told a Senate estimates committee last week that mining had weighed down the economy last year with its own "deep recession". Mining investment and production had both "collapsed". Australia's jobless rate would have soared to 19 per cent had other industries retrenched as severely as mining, Henry said in answer to an apparent Dorothy Dixier from left-wing Labor senator Doug Cameron. "Suggestions that the Australian mining industry saved the Australian economy from recession are curious, to say the least," he said.

The implication is that Australia was handicapped by our reliance on mining. But even high school economics suggests Australia benefited in this instance from being underweight in manufacturing, the sector after banking that globally was hit hardest by the financial crisis. And we benefited from being a resource supplier to China, the one big economy that defied the global downturn. This meant the economy had a powerful momentum behind it when the financial crisis hit. Along with a healthier banking sector, this distinguished Australia from other developed economies. This needs to be kept in mind when springing a complex new tax regime on the source of Australia's modern prosperity.

Henry's argument is based on the 15.2 per cent slump in mining jobs between November 2008 and May 2009. That sounds big but it equates to only 15,900 jobs because mining accounts for less than 2 per cent of total employment. The mining boom generates most of its employment impact in other industries by lifting national income and spending. It's a mighty stretch to extrapolate job fluctuations in capital-intensive mining to the rest of the economy.

Henry's even bigger stretch is to isolate this six-month change in mining activity to assess

the industry's contribution to averting two consecutive quarters of "negative growth" in gross domestic product. True, mining did take a hit after Lehman Brothers collapsed in September 2008. But this came at the high altitude peak of a mountain of mining development over the previous half decade. Even at its weakest point in May last year, mining employed 16 per cent more workers than two years earlier and nearly double the number six years before.

The same is true of mining development, the biggest component of business investment. Mining capital expenditure dropped 12 per cent in real terms over 2009. But even at its post-crisis trough, quarterly mining investment was 21 per cent higher than two years before and three times higher than six years earlier.

Rather than a "deep recession", mining took a bit of a breather amid what is shaping as the biggest resources boom in Australian history. Importantly, such booms take time to filter through the wider economy. Even though the terms of trade fell 17 per cent from the peak of their pre-crisis spike, this trough was still 30 per cent higher than six years earlier.

This big step-up in commodity export prices stimulated the boom that helped propel the economy through the crisis. The post-crisis breather did little to clip the momentum of the fastest expansion in the economy's stock of physical capital since the early 1970s and the most rapid immigration-fuelled population growth since the 60s.

Moreover, the mining boom's income bonanza had pumped the economy close to "full employment" when the crisis hit. The fresh memory of labour shortages encouraged businesses to "hoard" underused workers rather than retrench them, so limiting the rise in the jobless rate.

By helping produce a healthy budget surplus, the pre-crisis mining boom meant the government had the leeway to deliver a big fiscal stimulus. The mining boom helped make the budget stimulus more effective.

As it happened, the inflationary pressures from the pre-crisis boom also gave the Reserve Bank scope to slash interest rates without getting close to zero and printing money. The pre-crisis boom helped its crisis monetary stimulus grip. And the pre-crisis boom facilitated an extra stimulus from the dollar, which temporarily sank from US90c to US60c, without turning into a currency crisis.

As the Reserve Bank emphasised well before the end of 2009, Australia was one of the few developed economies to increase export volumes amid the global crisis. That's because our economy is heavily weighted to iron ore, coal, gas and other mining and energy sales to China, which quickly shrugged off the crisis. In contrast, most other developed economies suffered sharp export slumps as consumers suddenly stopped buying manufactured consumer durables such as cars.

Australia's factory exports also slumped. But manufactured goods are a much smaller share of our exports than in the US, Britain, Europe or Japan.

The mining boom has now regained momentum so quickly that Henry simply is not worried that the proposed 40 per cent resource super-profits tax will hit investment. Henry told the Senate committee that "there is more than enough investment in train in the mining sector". He reckons the constraint is not what mining executives think about the new tax; it's whether they can actually attract enough workers and capital to get their plans off the drawing board all at once.

There is something to this, notwithstanding the Clive Palmer extremes of the miners' RSPT rebellion. But it is still dangerous to underplay the longer-term sovereign risk threat. After the trade union militancy of Australia's previous mining boom 30 years ago, Japanese steel mills actively encouraged Brazil to become a big alternative supplier of iron ore.

The case for a profit-based resource rent tax to replace inefficient state mining royalties is sound. But it is far from clear that the RSPT's radical design features are sound or whether it would be more prudent to extend the established offshore petroleum resource rent tax instead, as Ross Garnaut suggests. The Rudd government could help evidence-based policy debate on this by releasing the secret report of its Resource Tax Consultation Panel.