

11 April 2012

Senator Eggleston
Chairman
Senate Standing Committees on Foreign Affairs, Defence and Trade
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Senator Eggleston

Inquiry into the Indian Ocean region and Australia's foreign, trade and defence policy

The Australian Coal Association (ACA) welcomes the opportunity to provide a submission to this inquiry. The ACA represents Australia's black coal industry. Our members account for over 95 per cent of Australia's coal exports and also supply coal for domestic power generation plus iron, steel, alumina, manganese, mineral sands and cement manufacture.

The black coal industry is Australia's second largest commodity export and the main export of Queensland and New South Wales. Exported coal is transported by bulk carriers from dedicated coal terminals. The coal industry, therefore, has a keen interest in issues relating to the safe and environmentally sound production, transportation, storage, loading, unloading and shipment of Australia's dry bulk commodities.

Australia is the largest exporter of seaborne coal in the world although, given its abundance on the earth's surface, this trade represents about 4 per cent of world production of coal.¹ In 2011-12 this trade is forecast to generate over \$49 billion in export revenue.² The oceans – particularly the Western Pacific and Indian Ocean – provide the essential highway which sustains this trade and contributes to Australia's economic well-being. Any major disruption to these Sea Lines of Communication would have a significant impact on every Australian's standard of living.

It is vital that Australia's policy settings maximise the opportunities for coal production and exportation and do not compromise the international competitiveness of the industry. Critical here are policies that promote free trade and investment and do not add to the existing tax and regulatory burdens on coal miners.

Recommendations:

1. The Australian Government should promote the international competitiveness of the Australian coal mining industry by minimising regulatory burden and duplication and ensuring that the total tax take is internationally benchmarked so that Australian coal mines do not move any higher on the comparative cost curve. In particular, there should be no increased taxation of mining inputs or adverse changes to long-standing minerals tax arrangements that take account of the distinctive characteristics of the mining sector.

¹ In 2010, the world produced over 7.2 billion tonnes of black and brown coal. Australia produced around 420 million tonnes and exported 290 million tonnes. Exports represented 4 per cent of total black and brown coal produced. See the International Energy Agency, *Coal Information 2011*, Tables II.2, II.3, and Australia table 3.

² Bureau of Resources and Energy Economics, *Resources and Energy Quarterly*, March 2012, p 178.

2. The Australian Government should maximise the capacity of Australian coal miners to take advantage of opportunities in the Indian Ocean region by pursuing free trade and investment agreements, both multilateral and bilateral.
3. The Australian Government should work with major Indian Ocean nations to forge a strategic approach to the Indian Ocean region by:
 - Deepening and extending strong bilateral relations and, where appropriate, increased cooperation in defence-related activities (such as intelligence exchange, technical assistance and education) designed to improve regional security and build trust and understanding between nations
 - Ensuring regional energy issues are high on the agenda of the Indian Ocean Rim Association for Regional Cooperation
 - Utilising other relevant bodies such as the Commonwealth of Nations, the Australia-India Framework Dialogue and the Australia-India Energy and Minerals Forum to pursue open trade and regional security
 - Continuing to safeguard merchant shipping, preserve the marine environment, enhance the safety of seafarers and promote open Sea Lines of Communication within the Indian Ocean region, on both bilateral and multilateral bases, particularly through the International Maritime Organisation
 - Forming a subcommittee of the Council of Australian Governments to encourage intergovernmental cooperation and consistency on Indian Ocean policies.
 - Re-establishing an academic centre of excellence for Indian Ocean studies, with a focus on the implications of Indian Ocean issues for the whole nation (not only Western Australia).

Importance of the Indian Ocean Region to Australia

The Senate Inquiry into the Indian Ocean region is timely. As the Australian Strategic Policy Institute observes, the Indian Ocean contains major shipping route Sea Lines of Communication connecting Europe, East Africa, East Asia and Australia. Further, the economic expansion of Asia means that the Indian Ocean region is becoming ever more important to global trade, especially trade in energy.³

Australia has the largest area of maritime jurisdiction in the Indian Ocean region: 5.9 million square kilometres, consisting of 3.88 million square kilometres surrounding its mainland and offshore territories, and 2.02 million square kilometres of extended continental shelf.⁴

Moreover, and of direct importance to Australia, approximately one-third of Australia's exports originate from Western Australia,⁵ and five of Australia's major two-way trading partners – India, Singapore, Thailand, Malaysia and Indonesia – are located in the Indian Ocean region.⁶

By extension, and of equal importance, is the dependence of Australia's major trading partners - particularly Japan, the Republic of Korea, India and China - on Indian Ocean Sea Lines of Communication. These sea lines facilitate imports to our major trading partners, such as oil coming from the Middle East and raw materials from Western Australia, Brazil and North and South America.

³ Australian Strategic Policy Institute, 'Our Western Front: Australia and the Indian Ocean', March 2010, p. 12. <http://www.aspi.org.au/publications/publication_details.aspx?ContentID=248>

⁴ *ibid.*, p. 12.

⁵ *ibid.*, p. 39.

⁶ Department of Foreign Affairs and Trade, 'Trade at a Glance 2011', p. 5. <<http://www.dfat.gov.au/publications/trade/trade-at-a-glance-2011.pdf>>

These imports are essential to sustain the manufacturing bases of our major trading partners. Australia is an increasingly important supplier of minerals and energy and thus the Indian Ocean is of significant strategic importance to us.

Opportunities and Challenges for the Australian Coal Industry

Of all the prospects in the Indian Ocean region, the industrial development of India itself is the most obvious and substantial opportunity for Australian coal miners. According to the International Energy Agency, coal accounted for nearly half of the increase in global energy use over the past decade, and India is set to displace the USA as the world's second largest coal consumer (after China) by 2025.⁷

India's escalating use of coal is in turn a function of its growing production of steel. India is now the fourth-largest steel producer and will continue to expand capacity substantially to meet demand.⁸ However, while India has approximately 73 billion tonnes of hard coal reserves, it is generally of poor quality, with high levels of ash that cause technical problems and drive up operating costs. In addition, the productivity of India's coal industry is low. State-owned mining companies control over 90 per cent of coal output and more efficient open-cut mines are difficult to develop, given administrative barriers and a lack of coal-washing capacity.⁹

Further, India's domestic coal supplies are not always competitive with imported coal, even for inland markets, because domestic coal supplies often have to be hauled over long distances. Consequently, India is an increasingly large purchaser in the global coking coal market.¹⁰ Australia has approximately 1.6 trillion tonnes in hard coal reserves and much of it is high quality.¹¹ This means it is well-placed to meet the continuing strong growth in demand in the Indian steel sector. Coal now accounts for approximately one-third of the value of Australia's exports to India, with almost all coal exports made up of coking coal. Continued growth in Indian steel production is likely to see coal exports from Australia expand further.¹²

The exchange of goods and services is one of the main pillars of prosperity as international trade confers enormous benefits on the nation. When Australia moved in the 1980s to make its trade sector more competitive, its trade performance also improved.

Australia is a successful black coal exporter due to various factors, including its:

- Substantial supplies of high quality thermal and metallurgical coal
- Established mining industry
- Readily accessible coal deposits – although coal mining increasingly involves getting access to more deeply buried resources that are further from shipping ports
- Close relations with and a reputation as a reliable supplier to major Asian coal markets.

However, notwithstanding these strengths, Australia cannot take its comparative advantage in coal resources for granted. The trade sector is highly exposed to relentless competition and Australia cannot afford to be complacent as it faces strong and increasing competition inside the Indian Ocean region from Indonesia, South Africa and Mozambique, and outside the region from Mongolia, Colombia, the USA and Canada (among others).

⁷ International Energy Agency, 'World Energy Outlook 2011', p. 353.

⁸ Markus Hyvonen and Sean Langcake, 'India's Steel Industry', Reserve Bank Bulletin, March Quarter 2012, p. 29. <<http://www.rba.gov.au/publications/bulletin/2012/mar/pdf/bu-0312-4.pdf>>

⁹ International Energy Agency, 'World Energy Outlook 2011', p. 431ff.

¹⁰ *ibid.*, p. 432; Markus Hyvonen and Sean Langcake, 'India's Steel Industry', p. 34.

¹¹ Markus Hyvonen and Sean Langcake, 'India's Steel Industry', p. 34.

¹² *ibid.*, p. 34.

Furthermore, technological change in steel production has reduced the amount of coking coal needed to produce a given quantity of steel and increased the scope for substitutability between different types of coal sourced from competitor countries as inputs to the steel making process. In addition, both established and new suppliers to the world coal market have aggressively pursued market share and increasing competition in the electricity and steel markets have impacted the basis on which coal is traded.

The highly competitive nature of the coal industry is illustrated by the growth of Indonesia's coal exports over the past few years. In 2006, Indonesia surpassed Australia to become the world's largest exporter of thermal coal, exporting 223 million tonnes of coal equivalent in 2010 – approximately 85 per cent of its total coal production. Indonesia was able to expand its production and win market share from Australia, which was constrained by lack of export infrastructure capacity.

Mozambique is another new competitor to Australia in the Indian Ocean region. The International Energy Agency describes Mozambique as 'a promising new player in the international hard coal trade', which 'enjoys favourable geology' and 'is expected to produce relatively low cost coal, of higher quality (particularly coking coal).'¹³ New coal supplies from the Benga and Moatize open-cut mines are scheduled for this financial year, and are planned to reach a capacity of more than 30 million tonnes per annum. Despite projecting a deceleration in Mozambique's coking coal exports after 2020, the International Energy Agency expects Mozambique's growth rates for production and exportation to 'remain among the highest in the world'.¹⁴

Australian policymakers should be alive to the fact that Mozambique is ideally located to export to Indian coal markets at low freight cost. In these circumstances it is hardly surprising that the Indian company, Jindal Steel and Power, has invested US\$250 million in its mine in the Changara district and expects to start exporting to India later this calendar year. The company expects to export 10 million tonnes per annum when the mine is fully developed.¹⁵

While Mongolia lies outside the Indian Ocean region, it too is an important new supplier of coal (especially coking coal) to the international market. Mongolia enjoys large resources and close proximity to China, which is a key 'extra-regional stakeholder' in the Indian Ocean region. Mongolia's production of brown and coking coal has increased sevenfold since 2000, reaching approximately 20 million tonnes of coal equivalent in 2010. The Mongolian Government has indicated that exports could rise to 50 million tonnes by 2015.

The rapid emergence of new competitors reinforces the importance of keeping Australia a competitive coal-exporting nation. Government has a critical role to play in encouraging free trade and investment in coal and not disadvantaging the industry with additional tax and regulatory burdens.

In particular, the Australian Coal Association is deeply concerned by reports that the Government is considering the abolition or reduction of long-established mining tax arrangements, including the fuel tax credit. The abolition of the fuel tax credit would effectively be a tax on production and lessen the international competitiveness of Australian coal companies. Far from relying on subsidies, the mining sector in fact receives negative net tariff assistance and a negligible effective rate of combined assistance.¹⁶ The Australian coal industry is already facing substantial new tax imposts (notably the carbon tax and Minerals Resource Rent Tax) and, based on Australian Taxation Office statistics, it is

¹³ International Energy Agency, 'World Energy Outlook 2011', p. 443.

¹⁴ *Ibid.*, p. 435.

¹⁵ 'Mozambique: Indian Company to Start Coal Exports This Year', *allAfrica*, 28 February 2012. <<http://allafrica.com/stories/printable/201202281283.html>>

¹⁶ Productivity Commission, 'Trade & Assistance Review 2009-10', 16 June 2011, pp. 7 and 19. <http://www.pc.gov.au/_data/assets/pdf_file/0010/110044/tar0910.pdf>

estimated that removing the fuel tax credit alone would add almost \$650 million in costs per year to the coal mining industry.¹⁷

Recommendations

Australian Government policy positions should:

1. *Promote the international competitiveness of the Australian coal mining industry by minimising their tax and regulatory burdens. In particular, there should be no increased taxation of mining inputs or adverse changes to long-standing minerals tax arrangements that take account of the distinctive characteristics of the mining sector.*
2. *Maximise the capacity of Australian coal miners to take advantage of opportunities in the Indian Ocean region by pursuing free trade and investment agreements, both multilateral and bilateral.*

Broader Strategic Issues

The Australian Strategic Policy Institute argues that Australia lacks a holistic Indian Ocean policy, and advances a number of recommendations to boost Australia's engagement on security, energy and environmental grounds.¹⁸

The Australian Coal Association broadly agrees with these recommendations, and in particular proposes that:

3. *The Australian Government work with major Indian Ocean nations to forge a strategic approach to the Indian Ocean region, by:*
 - *Deepening and extending strong bilateral relations and, where appropriate, increased cooperation in defence-related activities (such as intelligence exchange, technical assistance and education) designed to improve regional security and build trust and understanding between nations.*
 - *Ensuring regional energy issues are high on the agenda of the Indian Ocean Rim Association for Regional Cooperation*
 - *Utilising other relevant bodies such as the Commonwealth of Nations, the Australia-India Framework Dialogue and the Australia-India Energy and Minerals Forum to pursue open trade and regional security.*
 - *Continuing to safeguard merchant shipping, preserve the marine environment, enhance the safety of seafarers and promote open Sea Lines of Communication within the Indian Ocean region, on both bilateral and multilateral bases, particularly through the International Maritime Organisation*
 - *Forming a subcommittee of the Council of Australian Governments to encourage intergovernmental cooperation and consistency on Indian Ocean policies*
 - *Re-establishing an academic centre for excellence for Indian Ocean studies, with a focus on the implications of Indian Ocean issues for the whole nation (not only Western Australia).*

¹⁷ Australian Taxation Office, *Taxation Statistics 2008-09, Detailed Tables: Fuel tax credits scheme - quantity and value of claims paid, by industry, 2006-07 to 2009-10 financial years.*

¹⁸ Australian Strategic Policy Institute, 'Our Western Front: Australia and the Indian Ocean', pp. 2, 5ff.

Yours sincerely

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CHIEF EXECUTIVE OFFICER

Cc: Senator the Hon Bob Carr, Minister for Foreign Affairs
The Hon Dr Craig Emerson MP, Minister for Trade and Competitiveness
The Hon Martin Ferguson AM MP, Minister for Resources, Energy and Tourism
The Hon Richard Marles MP, Parliamentary Secretary for Foreign Affairs
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The Hon Julie Bishop MP, Shadow Minister for Foreign Affairs and Trade
The Hon Ian Macfarlane MP, Shadow Minister for Energy and Resources