

**IRON ORE AGREEMENTS LEGISLATION AMENDMENT BILL (NO. 2) 2010**

*Second Reading*

**DR M.D. NAHAN (Riverton)** [8.39 pm]: I will make a few comments on the Iron Ore Agreements Legislation Amendment Bill (No. 2) 2010 both in relation to the agreement itself and also the importance of agreement acts in general. I will also respond to some of the statements made by the Leader of the Opposition.

This is an unambiguously good outcome for Western Australia. It has been an aim of governments for a long time to alter the dispensation or the lower royalty rate given on fines to the early miners. These royalty rates reductions were given with the aim of facilitating downstream processing and to try to address the problem, when the mines were first started, of fines being of a lower use. As time went by, the market value of fines increased. And, of course, downstream processing did not take place. The issue was how to go about increasing the royalty rates.

One of the cornerstones of Western Australian development is, in fact, the agreement acts. The process is unique to Western Australia, though I think Queensland had some in the past.

As I understand it, Queensland moved away from agreement acts. In fact, there is a trend or quite widely held view that agreement acts no longer have a major role to play and that we should at least reduce them if not do away with them altogether. I disagree.

Western Australia has a quite unique mineral base, particularly in iron ore. It requires long-term investment involving multi-billions of dollars. The miners have to put in huge infrastructure—rail; ports; in the past, town sites; water; and electricity—at a cost of billions of dollars and which will go on for decades. The world is an uncertain place. Our agreement acts are basically a contract between the Parliament of Western Australia and the developers that outline each others responsibilities and where there are areas for negotiation and flexibility.

They provide the proponents with a level of certainty second to none. Of course, as all contracts do, they restrict the flexibility or unilaterality of one party to change, but that is the nature of the agreements and that is actually one of their strengths. Once there is an agreement in place, the government cannot unilaterally decide to change certain terms of the contract.

Early on, the agreements actually specified royalty rates. As time went by, some of the royalty rates were left out of the agreements. Nonetheless, the early agreements specified the royalty rates and that gave the developers a great deal of certainty. In response to that certainty, they invested hugely in infrastructure.

I will talk about one of the interesting things, which the people in Canberra miss out. The comparative advantage Western Australia has in iron ore does not lie with its iron ore resource. Western Australia's comparative advantage and the reason it was able to respond very rapidly to the growth in demand from China both before and after the global financial crisis is that it had huge and world-class infrastructure in terms of the processing facilities, the people and teams working with it, the rail and the ports. It had the infrastructure that was able to move the mountain to the port and to China.

**Mr E.S. Ripper:** And the infrastructure was capable of relatively rapid expansion.

**Dr M.D. NAHAN:** Yes, and that is the key comparative advantage of the Western Australian system. South Africa has equivalent resources, but it simply does not have the logistical infrastructure to bring it to port. That is one of the weaknesses of the super tax or the mining tax—the federal government thinks that the value of the operation lies in the resource rather than in the infrastructure. It is going to try to tax the resource, assuming that the resource cannot move around, but it will actually tax the infrastructure, and the infrastructure simply will not be reinvested as it has been in the past.

The agreement acts pursued by Western Australia are a unique but excellent mechanism for addressing issues between developers and the state, particularly for very large projects. The positive outcome of this bill is not only the lump sum payment and the increase in the royalty rates on fines, but also that the agreement was reached in a very amenable manner and that there was not huge argy-bargy. Both Rio Tinto and BHP have plans for massive increases in infrastructure and expansions. This took place in a rather positive manner.

As I understand it, the lump sum payment will not affect our grants. It depends on how the Commonwealth Grants Commission rules. Sometimes it has rulings in which lump sums are included in the grants commission process. That is yet to be determined. The royalty rates will be wound back in the grants commission process, but I think the lump sum payment will not be to date.

A couple of comments have been made repeatedly in Parliament about the grants commission process and the goods and services tax. I think members opposite get those two purposefully confused.

There are two things about how we get money from Canberra in terms of general purpose grants. First, the money that comes from the GST, which is raised on most expenditure, is put into a machine called the grants commission fiscal equalisation process and redistributed back to the states. The question about our share is not determined by the source of the money—the GST—but rather the grants commission process.

**Mr E.S. Ripper:** Yes, but when the GST agreement was signed, it was directed that the grants commission process would apply to its distribution.

**Dr M.D. NAHAN:** As it did before. To my knowledge, none of the grants commission processes was changed. They evolved after that, but the GST deal did not change the grants commission process.

**Mr E.S. Ripper:** But that was the big opportunity, was it not, to change the processes? It was missed.

**Dr M.D. NAHAN:** Yes, it was a big opportunity. But as the Leader of the Opposition well knows—he was involved in a couple of these debates and, when in government, in attempts to change it—we have a real problem at a state base. It is a zero-sum gain, if members wish. Some states lose and some states win from any changes to the grants commission process. Commonwealth governments will always say, "You go out and decide and then tell us," knowing full well that there will be no outcome.

**Mr E.S. Ripper:** That was Peter Costello's approach.

**Dr M.D. NAHAN:** Every federal government in memory has done that, except Bob Hawke's government way back in the 1980s. He lost the prime ministership on that basis, if the Leader of the Opposition remembers. The issue in terms of share is not a problem with the GST but a problem with the grants commission. Treasury officials have indicated to the Premier that, under the conditions forecast, if our share of GST drops below 50 per cent, it will be a real issue.

**Mr E.S. Ripper:** I once had cause to ask Treasury whether it could take us below zero.

**Dr M.D. NAHAN:** Yes.

**Mr I.C. Blayney:** What did they say?

**Mr E.S. Ripper:** They weren't entirely sure that they couldn't get at us even if it dropped to zero.

**Dr M.D. NAHAN:** It depends how well New South Wales and Victoria go. How we go about changing the grants commission process is this state's biggest long-term challenge. If a significant change were made, Tasmania and the Northern Territory would steer towards bankruptcy. The level of transfers they get through the grants commission, largely via us, is huge. An issue facing members on both sides of the house; that is, to argue the case that the grants commission process, which was set up in the 1930s after a fiscal crisis, no longer fits and needs to be changed significantly.

We have to come up with a model. The Premier has suggested that we put a floor of 75 per cent on that. That is one way to do it. Canada has two parts. Part of the transfer to the commonwealth is for redistribution, so that all the provinces can provide similar levels of services—that is equalisation—and another one is just a per capita payment. We could evolve towards something like that.

It would require a transitional period for Tasmania, South Australia and the Northern Territory, and that could be negotiated.

**Mr C.J. Barnett** interjected.

**Dr M.D. NAHAN:** Yes.

**Mr E.S. Ripper:** It would spark up their politics in Tasmania!

**Dr M.D. NAHAN:** It would, significantly, since they are now dismantling one of their sole export earners—namely, the native timber industry. How we go about effecting change, particularly with a fragile Parliament in Canberra, is the big question, but that is what must be done. I believe the Gallop government, in conjunction with the New South Wales and Victorian governments, started a process and hired a number of groups to argue the case.

**Mr E.S. Ripper:** I commend to you the report by Vince FitzGerald and Ross Garnaut.

**Dr M.D. NAHAN:** Allen Consulting Group.

**Mr E.S. Ripper:** Unfortunately it went nowhere, but it would be interesting to see whether Victoria and New South Wales would still support it.

**Dr M.D. NAHAN:** It went nowhere, but as I remember, the problem at the time lay with Western Australia making changes to the Commonwealth Grants Commission that benefited Western Australia, and there was less of an incentive to remain in the coalition at that time. I think they treated capital a bit differently, if I remember correctly, and Western Australia went from a contributor to a claimant state again, along with Queensland, which had always been a claimant state. Partners have to be found—namely, New South Wales, Victoria, and maybe Queensland—and some sort of alternative has to be developed, which is our biggest challenge.

I turn now to the subject of the grid in the Pilbara, which has often been discussed. A central issue to the agreement we are debating now is, should we negotiate the necessary changes to a range of agreement acts that have been established over 40 years? What should we open up and should we use those as leverage? The Leader of the Opposition suggested that since they were going to be opened, we should use the opening up to achieve not money in hand, because the commonwealth would take it away from us at least in part.

**Mr E.S. Ripper:** No, I am happy for us to get the royalty increase, even though I am sceptical about the long-term real benefit.

**Dr M.D. NAHAN:** Yes, but we have to deal with the grants commission process irrespective of whether we get more royalties or remain with what we have now. If the forecast trajectory from Treasury is accurate, we simply will not be able to meet many of our obligations, be they infrastructure or recurrent expenditure. An important thing that Canberra does not seem to understand is that liquefied natural gas projects, from which all the revenue goes to Canberra, but more importantly for mining projects—particularly those of the junior miners—require large amounts of up-front capital, both social and economic, that the state is required to pay, and the money is quickly going to Canberra and being spent in New South Wales or Tasmania, that will undermine our ability to provide the necessary capital.

**Mr E.S. Ripper:** Let alone the demands of our population as they pay increased prices for everything because we have a resources boom on.

**Dr M.D. NAHAN:** That is right. My own view is that Premier did the right thing. The issues of the agreement were opened up and the debate on the table at the time was the fines royalty but he also allowed for changes to downstream processing requirements, and he did a deal. If, for instance, we followed a couple of areas that the Leader of the Opposition suggested, I think we would never have got a deal at all.

The Pilbara grid, which we have debated and which was a pet project of the former member for Armadale, has merit in the long term—it does. Horizon Power, I think, has forecasted 2 000 megawatts of baseload demand into the future, over the next decade or so; that is huge growth, and there could be substantially more. A number of power stations are also being built in isolation, and if they could be put on some sort of grid system it could improve efficiency, build flexibility, and add capacity to the system for junior miners and other smaller developments that cannot afford to pay for the infrastructure.

The problem is that this takes a great deal of planning, and a key issue that must be addressed in the operation of a grid, before it happens, is whose priority does it operate by. Right now, all the miners, largely, operate their own power stations 24/7 to their own demands and their own requirements, and security of supply is paramount. They cannot afford outages or breakdowns.

Basically, since all these things are gas-fired baseload power, they just operate 24/7. If we were going to have a grid system to connect urban areas—limited as they are—or tack on small miners, then we would have a multiplicity of objectives to decide on and fulfil. Then the big miners would say that they are worried that if they are part of a grid, by contributing their power stations to the grid, and allowing them to be operated under the rules of somebody else, what would the rules be and would they be worse off.

**Mr T.G. Stephens:** Can I say to that, though, that in the case of the Tom Price and Paraburdoo communities, those communities are hanging off a power supply that's first priority, from the company's point of view, is to look after their mine sites.

**Dr M.D. NAHAN:** Yes.

**Mr T.G. Stephens:** So they look after their mine sites and don't mind shutting off a town, in the absence of a grid, that looks after a significant community.

**Dr M.D. NAHAN:** Do they shut off the power to Paraburdoo?

**Mr T.G. Stephens:** They do, and they have.

**Dr M.D. NAHAN:** Have they?

**Mr T.G. Stephens:** And the town goes down.

**Dr M.D. NAHAN:** Paraburdoo is mining town created by the firm, right? It is the only operation in Paraburdoo.

**Mr T.G. Stephens:** Yes, but Tom Price and Paraburdoo are towns with residents who have an entitlement to power like any other citizen of Western Australia—maybe more than most because they produce more than most!  
[Member's time extended.]

**Dr M.D. NAHAN:** As I said, there is a case for that, and we have Horizon Power operating up in the north to provide power to urban areas. Right now we have the mine sites operating for their own purposes, and there is a case for that. But it will be a long-term project to negotiate how the grid will work and under whose priority, and who pays. There will be questions around what the source of energy will be.

If we started loading the grid up with windmills and solar cells, the costs would increase significantly. As I think the Leader of the Opposition suggested, we should use this grid as a hallmark investment for minimising greenhouse gases. That is a laudable aim, but how it would be achieved is questionable, and also why should it be there? I think there is great capacity for integrating it and increasing the scale of the units that are operating. CITIC Pacific just built a very large gas-fired power station, and it seems to me that there could be huge gains from putting that on a grid. But that will take time.

**Mr E.S. Ripper:** There would be big gains in the long run.

**Dr M.D. NAHAN:** And it will require some agreement as to how the grid will be operated, who the operator of the grid is, what the priorities are, what the conditions are, and what types of power will be built there.

Rail access has been one of the biggest and most contentious common-user issues in Australia for 10 years. There have been numerous cases on it and the Australian Competition and Consumer Commission has ruled on it repeatedly. If member read the legal judgements, one of the key issues up in the north, particularly with BHP and Rio Tinto, is that they argue—it is debatable—that these are not just ordinary resources and that rail lines are an integral part of their operations.

More importantly, they argue that they are expanding operations so there will be 100 per cent capacity utilisation of the rail facilities. There may be times when there may be surplus capacity, but there must be negotiation around when that surplus capacity will be available and whether the rolling stock—its origin and destination—would fit with the operations of Rio Tinto and BHP.

That will take time. There are formal processes to it. The member for Kalgoorlie, who is not in the house, made a very important statement today; that is, whatever we do, we must keep our mines world class, particularly our big ones but also our small mines, in terms of operating. What the member for Kalgoorlie said is absolutely right—we are going through a period of change in which China has come in and has, quite rapidly, become “the” world steel producer.

I think it now produces more steel than Europe and Japan combined. It went from a minor producer to the world producer in less than 10 years. Most of that steel is being used in its own development, but eventually China’s development levels will level off. All other countries that in the past went through this major development grew very rapidly in terms of infrastructure, but eventually it levels off.

As the member for Kalgoorlie quite rightly said, when other ore bodies, particularly in Africa, are brought online—whether it is Rio Tinto’s investment or China’s investment—we will see additional sources of supply and volumes in competition with Western Australian output; and prices will drop. I believe the key objectives of Rio Tinto and BHP Billiton, and everybody else, is to get into the market quickly, get the contracts and system lined up so they are there first.

We have to assist them in getting their expansion up first by making sure that we do not load it with unnecessary cost, so that when the prices come down, they remain as they were before the China boom; that is, the most cost-competitive producers of iron ore in the world, particularly towards China. That is their objective. Rail access is a very important issue with small miners but we do not want to undermine the alterations of these agreements to achieve that. There are other ways to do that.

One of the important debates that the opposition leader pointed out related to royalties. I remember years ago we had a review of royalties. The issue was how to get returns from mining resources. Do we put a royalty on them, which is transparent, the process is open and applies to everybody, or do we go out and say to large miners in particular that we want payment in kind, like rail access or grid, water, or something of that nature?

**Mr E.S. Ripper:** The grants commission cannot get it, though.

**Dr M.D. NAHAN:** The grants commission cannot get at that—that was the debatable point. The problem is it increases sovereign risk significantly. One negotiates by saying, “I want you to build a port. I want you to build excess capacity for the junior miners. I want you to build excess capacity in your rail line so that you can use it for somebody else.”

Firstly, that causes an excessive cost to miners that, as the member for Kalgoorlie says, we do not want to load them with. Secondly, it causes sovereign risk. The miners come into the deal but they do not know what they will be asked for, particularly if there are minor changes in agreement acts. I believe that the appropriate thing to do is solve, as best we can, the distortions of the transfer from Western Australia that underlies the grants commission rather than start allowing excessive costs on our miners.

I might add that if we look around the world, large numbers of nations have resources but those resources are not being developed. Resources can be a curse. One of the causes of the curse is that people start to try to grab it, it is not negotiated, which in turn leads to a lack of transparent deals rather than transparency through royalty rates.

This deal is excellent for Western Australia. It shows the continued importance of the agreement act. It also shows how we can vary agreement acts and modernise them over time. The fact that the bill comprises 1 000 pages shows it should have been done some time ago. There are a large number of infrastructure needs out there.

The Pilbara grid should be looked at. Water is a major issue. I would argue that gas pipelines and rail access are other issues, but this agreement achieved a very good outcome. There are other ways to achieve those needed pieces of infrastructure.

The real challenge all of us here face is to convince our colleagues in other states, and in Canberra, to start looking at state–federal relations in particular, but more importantly, how the nation’s and Western Australia’s fiscal largesse is allocated primarily to the needs where it is being generated out of Western Australia.