FROM THE CAPITAL

Shining a light on bad policy

Australia's missed opportunity to better understand well-oiled revenue generator

John Robertson*

After flip-flopping over whether to support a parliamentary enquiry into the iron ore industry, the Australian government has decided to let sleeping dogs lie. Meanwhile, the best reason for an enquiry has been ignored.

Fortescue Metals Group chairman Andrew Forrest has been vociferously challenging the Australian government to initiate an enquiry into the behaviour of BHP Billiton and Rio Tinto. The two giants of the iron ore trade had deliberately forced iron ore prices down to shut smaller competitors, according to Forrest's allegations.

Senator Nick Xenophon joined the fray by giving notice of a motion for a senate enquiry. Although no shrinking violet when it comes to self-promotion, Xenophon is a credible independent voice among a sometimes incoherent throng of balance of power politicians in Australia's upper house.

Coincidentally, both BHP Billiton (BHPB) and Rio Tinto had been in the crosshairs of another politician trying to make a name for himself. As chairman of the senate economics committee, up and coming senator Sam Dastyari of the opposition Australian Labor Party had been leading the charge against several high-profile international corporates. Among them, BHPB, Rio Tinto, Apple and Google were accused by Dastyari of profit shifting to reduce their tax liabilities.

Trading hubs in Singapore had caught Dastyari's eye. BHP Billiton came under more severe criticism than Rio Tinto when its executives refused to answer questions under public examination about its business conduct in Singapore. Both were outflanked by Swiss-based Glencore, which voluntarily (at least after being drawn into the public debate) opted to close its Singapore hub, claiming it was a hangover from the activities of Xstrata and no longer needed.

Threats of government expenditure cutbacks and higher taxes linked specifically to falling iron ore prices have added prominence to the industry's political profile. Ministers in both the Western Australian and Federal governments had been talking about this impact incessantly for weeks in the approach to budgets due in May.

Australia's two most senior government ministers – prime minister Tony Abbott and his treasurer Joe Hockey – seemed happy enough to jump on the bandwagon. Both have been campaigning hard to recover from historically poor personal and party polling positions.

Australia's independent senator Nick Xenophon… credible opposition to iron ore status quo

Neither would have anticipated the blistering backlash from BHPB and Rio Tinto executives and the ripostes from industry lobbyists. Ministers got an earful and the cabinet ministers for industry and trade both put their case against an enquiry, needlessly antagonising Australia's trading partners.

Within two days of seemingly waving one through, Abbott and his treasurer concluded that a parliamentary enquiry was unnecessary "after discussing the issue with regulatory bodies and stakeholders". On the left of politics, the change of heart was characterised as capitulation. The billboard for the leftish weekly The Saturday Paper was emblazoned, "The mining giants who control Tony Abbott".

Amid the posturing on all sides there had been one sound argument for an enquiry, namely, improved clarity. An understanding of iron ore price setting may be as important for Australian policymakers as a grip on exchange rates or interest rates. Other than vague references to free markets, most politicians had little idea about how iron ore prices were set. The prospect for misunderstanding remains high as long as one man's competitive advantage can so easily be construed as market manipulation by another.

An enquiry might have happened if there had been more faith in the self control of Xenophon and Dastyari. The prospect of their Chinese customers enjoying the two Australian producers being dragged through the political mire helped win the day for the enquiry's opponents.

Ironically, the strongest argument in favour of an enquiry was not mentioned in the recent political flurry. Throughout 2010-2014, analysts outside BHPB and Rio Tinto were claiming that the two of them were exercising market power to artificially inflate prices. Such claims were made frequently at conferences and in private meetings by traders and other companies involved directly in the market.

The most conspicuous charges of manipulation were levelled at the two companies by the Chinese government. In March 2013, the Chinese National Development and Reform Commission accused the major miners on its website of manipulating shipments "to send a fake market signal that there was a supply shortage". Clearly enough the Chinese had a vested interest in making the point just as, today, Forrest's representations are being seen as an attempt to fix his own financial plight.

The relevance today of China's attitude in 2013 is that Australian politicians missed their chance. When there was widespread agreement that something dodgy was happening, Australian politicians were too busy working out how to spend the windfall. When the Chinese government might have welcomed an enquiry, none of Australia's political leaders was agitating to find out how prices were being set.

Australia's heavy and unthinking reliance on iron ore prices to fund unsustainable government spending should never have happened. There are models among other commodity-dependent countries of more sensible fiscal regimes.

Speaking at the International Monetary Fund on, 'Falling commodity prices: what it means for emerging markets' last month, Mauricio Cardenas, Colombia's minister of finance and public credit, described how his government operates under a constitutional amendment requiring savings from oil royalties. The amendment recognised that prices fluctuated and were likely to fall.

At the same time, in Colombia, an independent body mandates a long-term oil price to be used for conservative budgeting to prevent short-term overspending by politicians and to reduce the country's structural deficit. Oil-rich Nigeria has a similar regime.

Other countries have been more attuned to market realities than Australia. The more sensible policies of others managing the impact of volatile commodity markets make Australia's fiscal ill-discipline so much more disappointing. An enquiry could still be worthwhile if this was the primary topic. ▼

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