

Prices, Labor Costs, and Profits in the Australian Mining Industry: 2001 through 2006

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The recent expansion and profitability of the Australian mining industry has been used as a key piece of evidence supporting the supposedly beneficial economic impacts of Work Choices. The Australian mining industry has utilized AWAs more than other industries. Have those individual contracts changes the overall economic pattern of labor costs in the sector, and hence contributed to the industry's recent expansion?

	Revenues (\$bil)	Employment (000)	Wages (\$bil)	Profit (\$bil)
2001	\$55.1	78.5	\$5.3	\$15.3
2002	\$60.1	81.2	\$6.1	\$14.1
2003	\$57.4	88.2	\$6.5	\$15.4
2004	\$63.8	96.6	\$7.1	\$12.8
2005	\$84.9	106.4	\$8.3	\$26.5
2006	\$105.8	129.6	\$9.5	\$41.2

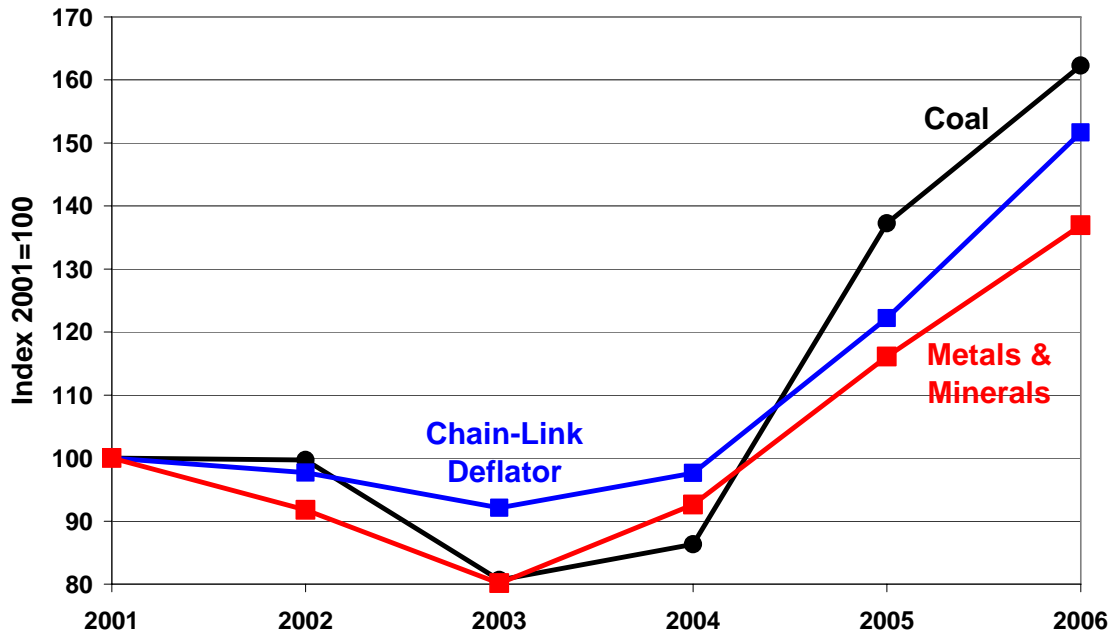
Source: ABS reports 5676.0 and 6291.0.55.003. Calendar years; taxes before tax.

There's no doubt that Australia's mining sector has prospered incredibly in recent years. Revenues almost doubled from 2001 through 2006, driven by the unprecedented increase in global mineral prices. Over 50,000 new jobs were created. Industry profits almost tripled in the same time, reaching \$41 billion in 2006.

Given the capital intensive nature of production processes in mining, direct labor costs have always played a relatively minor role in the industry's total economic picture. Wages account for about 10 percent of industry revenues; non-wage labor costs consume at most another percentage point or two of revenues. Even before the current mineral price boom, the industry paid out over two dollars in profits for every dollar in wages. In 2006, however, the industry paid out over four dollars in profits for every dollar in wages. At some point, it should be more important for analysts to consider the high "profit cost" of mineral production, more than the impact of high "labor costs."

Figure 1

Mining Prices



Source: ABS reports 6405.0 and 5676.0. Chain-link deflator is the ratio of current dollar industry sales to constant-dollar chain-link industry sales.

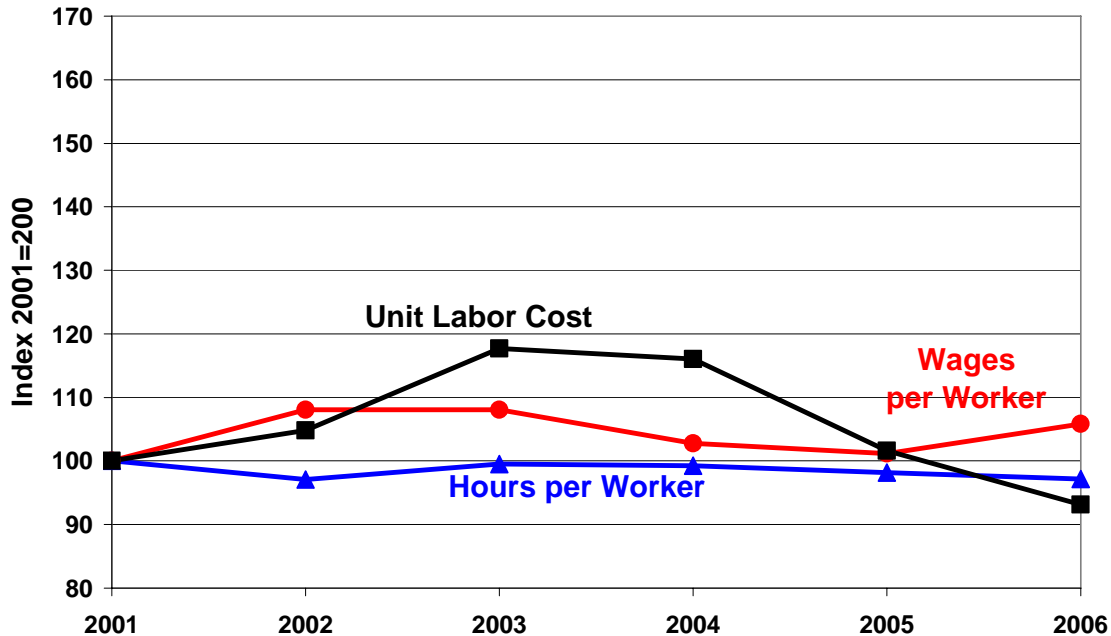
The crucial factor that has changed over the past five years, to explain the industry's recent success, has clearly been mineral prices. Coal export prices are 60 percent higher than in 2001 (and twice as high as the were in 2003). Metal and mineral prices have grown almost as quickly. The industry's overall average output price has grown over 50 percent since 2001, and by two-thirds since 2003.

With the industry's unit revenues growing so spectacularly, thanks to worldwide economic factors, it is no surprise that profits, investment, and production have also increased.

It is far less obvious, however, that there has been any dramatic change in the pattern of work practices or labor costs in the industry. (And remember, labor costs account for only about one-tenth of total revenues – which will make it difficult for changes in labor costs to account for any significant change in the industry's overall performance, one way or the other.) Figure 2 plots three key indices of labor practices, over the same time period and using the same y-axis scale as Figure 1 (so that the degree of volatility demonstrated in the two figures can be compared). By 2006, each of these three measures had settled within a few percentage points of their 2001 values; there has been no dramatic change in work practices or labor costs in the mining industry, despite the industry's relatively widespread use of AWAs.

Figure 2

Labor Indices



Source: Author's calculations from ABS reports 5676.0, 5204.0, and 6291.0.55.003.

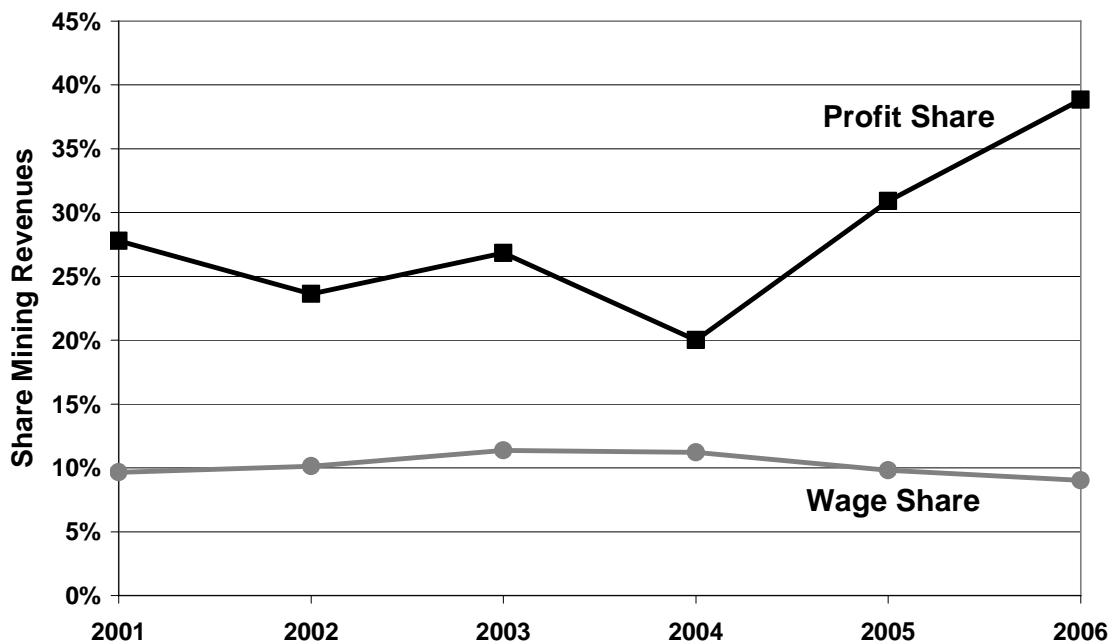
Wages paid per employed worker have grown by just 6 percent over the 5-year period covered in Figure 2, and currently average about \$72,000 per worker. (This includes both hourly and salaried staff in the industry, and excludes non-wage labour costs such as super contributions.) The amount of new hiring in the industry has helped to keep down average wage levels (since most new hires start at lower wage levels). This data refutes the oft-made claim that mining workers under AWAs have substituted more “flexible” work arrangements and loss of certain rights and standards for higher pay; in fact, there has been virtually no increase in average pay at all. Similarly, there has been no dramatic change in average hours worked per worker in the sector. This also contradicts the common assumption that AWAs have allowed the industry the “flexibility” to entice workers to work longer in return for more pay; average hours, in fact, have actually declined very slightly under the AWA system. Finally, another composite measure of labor costs illustrated in Figure 2 is average unit labor cost, measured here as the amount of wages paid per dollar of industry output. This measure thus takes account of both compensation and productivity. (ABS data indicates that average labour productivity in Australian mining has in fact declined since the introduction of AWAs.) It grew early in this decade, but has declined more recently.

None of this evidence could justify a conclusion that there has been any dramatic change in work practices or labor costs under the AWA regime, that has contributed meaningfully to the industry's recent success.

Labor's share of total revenues in the industry has remained, therefore, relatively constant through this time. In contrast, the profit share of output has grown dramatically – thanks mostly to the run-up in average prices. By 2006, company before-tax profits were equivalent to an incredible 40 percent of the industry's total revenues. This unprecedented profit margin reflects the sudden increase in value of Australia's non-renewable resources on world markets, not any noticeable improvement in the real economic conditions of their extraction.

Figure 3

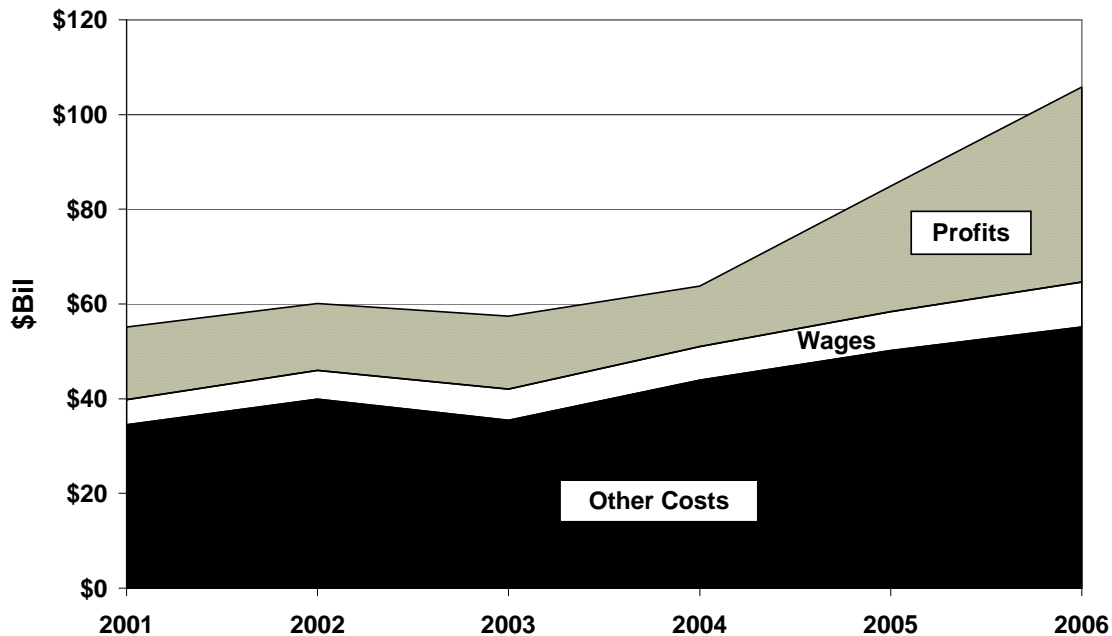
Wage and Profit Shares



Source: ABS report 5676.0.

Another view on the allocation of the mining industry's very healthy revenues among the various factors of production is provided in Figure 4. This graph illustrates the distribution of rising revenues among capital (before-tax profit), labor, and other inputs. Labor costs account for a small, stable wedge of the industry's total revenues. There has been no noticeable decline in that wedge, to "explain" the rise in mining industry profits. Indeed, the simple scale difference between the two factor shares makes it arithmetically impossible to argue that lower unit labor costs (either through "flexibility"-based productivity growth, or lower wage and other costs in an individual contract environment) could have caused an improvement in profits anything like what the industry has seen since 2001. Australian mining workers could have agreed to work for free, and yet this dramatic act would increase industry profits by well under half of the profit growth that has actually been registered. Clearly the benefits enjoyed by this industry have come from the revenue side of the account, not the cost side. Indeed, there has been no visible evolution on the cost side at all. **Figure 4**

Allocation of Mining Revenues



Source: Author's calculations from ABS report 5676.0

By the same token, suppose that the mining industry's labor costs were indeed to deteriorate as a result of the elimination of the AWA system. (We've already seen that this is not likely, given the apparent absence of any real impact of AWAs on the industry's broad cost structure.) The relatively small importance of direct labor costs in the industry's overall revenue and cost structure implies that even a significant change in labor costs would not substantially alter the industry's profitability and competitiveness.

The following table illustrates two utterly hypothetical scenarios. Suppose that as a result of eliminating the AWA system, the mining industry's unit labor costs increased – either as a result of higher wages (resulting perhaps from a restoration of collective bargaining in the sector) or perhaps reduced productivity (from an erosion of so-called “flexibility” in the industry). I stress that there is no empirical evidence to support the fear that eliminating AWAs would have such an effect. Even if it did, however, the Australian mining industry would remain tremendously profitable, measured on both historical and international grounds.

Suppose that eliminating AWAs were somehow to increase average unit labor costs by 25 percent. This would be an unprecedented increase. In this case, bottom-line profits would decline by \$2.4 billion (or just over 5 percent), but would still equal almost \$39 billion – more than 2.5 times the industry's average profits during the 2001-04 period. Suppose, even more catastrophically, that unit labor costs increased by half. Profits

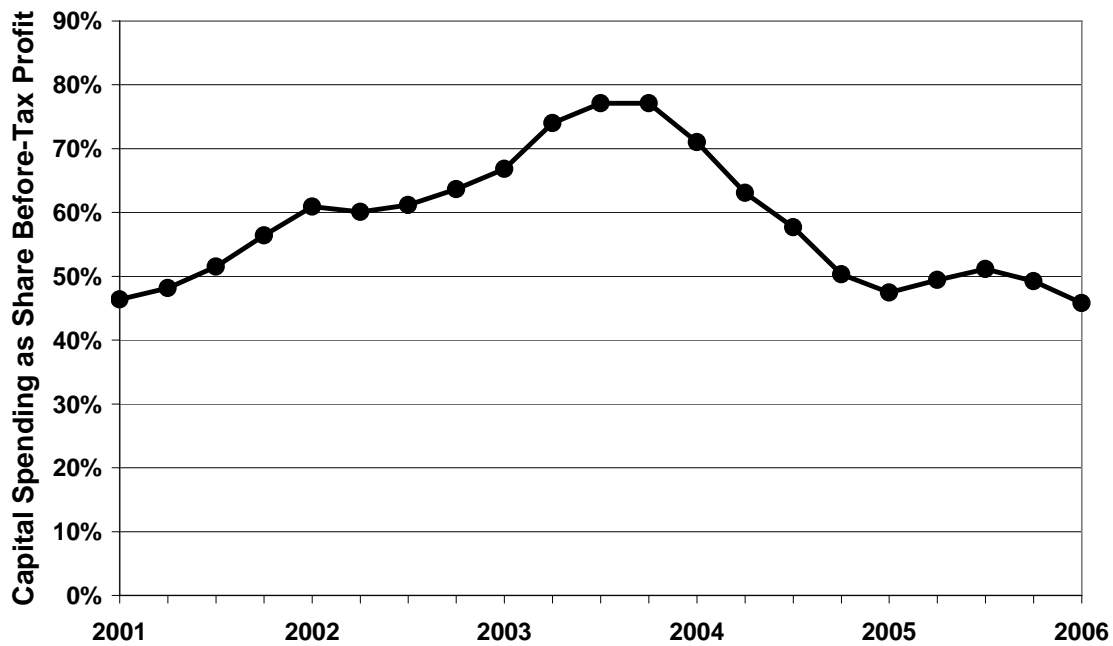
would decline by just 11 percent from their 2006 all-time highs, to \$36.4 billion – more than 2.5 times their average levels during the 2001-04 period.

Table 2			
“What-If” Unit Labor Cost Scenarios			
	Revenues (\$bil)	Wages (\$bil)	Profit (\$bil)
2001-04 Avg. Actual	\$59.1	\$6.3	\$14.4
2006 Actual	\$105.8	\$9.5	\$41.2
Higher ULC Simulations:			
Up 25%		\$11.9	\$38.8
Up 50%		\$14.3	\$36.4
Source: Author’s calculations from data in ABS report 5676.0.			

In short, the notion that eliminating AWAs would have any significant impact on the Australian mining industry’s spectacular profitability performance, and hence would undermine the potential for future prosperity in this sector (and the communities which depend on it) is simply not credible.

Figure 5

Reinvestment Rate



Source: Author’s calculations from ABS report 8417.0.

The credibility of the mining industry’s claim that eliminating AWAs would undermine future new investments is further undermined by the industry’s own deteriorating record in reinvesting its (record) profits back into new Australian capital projects. Figure 5 illustrates the proportion of before-tax profits which have been reinvested by the industry in new capital projects. Just 45 percent of before-tax profits are being reinvested in new capital projects – a notable decline from the reinvestment rate of 2003-04, before AWAs were introduced. AWAs have not changed the fundamental economics of Australian mining, and they have not elicited extra investment or job-creation.

Moreover, the profitability record of Australian mining firms has been so positive in the current boom, the notion that incremental changes in the industrial relations environment (and hence, possibly, in labor costs) would send investors fleeing from the country is not believable. Australian mining firms are currently reporting rates of return on shareholder equity ranging between 35 and 70 percent *per year* (see Table 3). Compared to typical business profit rates of 10-15 percent on equity, let alone to the 5 percent returns that are paid on typical personal financial investments, and it is clear that Australian miners are enjoying a uniquely favourable business environment. It would take immense and unfavourable changes for miners to walk away from the possibility of earning 35-70 percent profit rates.

Table 3
Profitability of Selected Australian Mining Companies
 2006, \$ billions

Company	Net After-Tax Income	Average Equity	Return on Equity (%)
BHP Billiton	\$10.45	\$21.19	49.3%
Rio Tinto	\$7.44	\$17.56	42.4%
Oxiana	\$0.55	\$0.77	72.1%
Wesfarmers	\$1.05	\$2.95	35.5%

Source: Company financial reports. Consolidated; excludes minority interests; average equity is average of year-end 2005 and year-end 2006 total equity.
 1. Mining interests account for only a minority of assets.

In summary, there is no empirical evidence that AWAs have altered fundamental labor practices (compensation, hours of work, productivity, and unit labor costs). Mining profits have increased to record levels, generating extremely high profit rates, solely because of an unprecedented increase in global mineral prices, which have risen by two-thirds since 2003. A diminishing share of those profits are being reinvested in new projects, even under the AWA regime – partly because of resource constraints and other factors. There is no credible case that future mining investments would be undermined by the elimination of AWAs.