Mining's Message to Policymakers: Don't Drop the Ball

Pierre Gratton's Speech to the Economic Club of Canada
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Thank you.

It's a pleasure to speak today in Toronto, where beats the heart of the global mining industry.

Indeed, Toronto is where you can find the majority of the world's publicly-listed mining companies. As a consequence of the TSX's leadership in global mining finance, and the robust financial expertise found here, the city is populated with scores of mining company headquarters and offices.

The TSX is the world's largest stock exchange for mining, with close to 1,500 publicly-listed mining companies calling the TSX and TSX Venture Exchange home. Together, these firms are valued at $265 billion in total market capitalization.

In 2014, 62 percent of the mining equity capital raised globally was raised on the TSX and TSX-V, amounting to $8.9 billion. Also significant, almost $177 billion of equity

from mining stock was traded on the two exchanges in last year alone.

I rattle these numbers off as a preface to three key messages I want to leave you with today.

1) Yes, the industry is in the midst of a significant downturn.

2) Despite the downturn, Canada's mining sector continues to make enormous contributions to our social and economic well-being.

3) It is during a downturn that we need to focus on future opportunities, to take the steps now to position the sector for success when the cycle turns again.

There is a tendency for policy makers – and as CEO of MAC good public policy for mining is my primary concern – to follow trends.

In the dot.com era, mining was abandoned, dismissed as a "sunset" industry whose time was over, as governments across Canada chased high tech companies, looking to establish silicon valleys across the country. The dot.com bubble burst just when the full force of China's expanding economy was starting to be felt in the commodities world. Because we weren't paying attention at the time, policy makers spent a good part of the past decade playing catch-up, looking at ways to capitalize on the resource boom that had arrived.

Some might say that we have spent too much time lately on natural resources, in particular on energy and pipelines.

They're probably right, too.

Because there is just one Canadian economy, and the secret is not to chase trends but to take a consistent, whole of economy approach, recognizing the interconnectedness of it all.

And, of course, this means not making the same mistake we made a decade ago by now abandoning natural resources, whether it's iron ore, coal, copper or oil, because they're slumping.

Because in fact what we want is to be in a position to maximize our return when the cycle changes again; which it will, because unlike the Maple Leafs, mining always bounces back.

We want to be in a position to have new mines open, to have oil travelling safely by pipelines, to have Canada positioned as a choice destination for new exploration and mining investment.

There are lessons to be learned from the past decade. We need to make sure we've learned them.

A Look at Market Conditions

So how bad has it been lately? Like all down cycles, it’s been tough.

First, the ugliest bits. Over the course of 2013, the world's 40 largest mining companies booked record impairments of $57 billion. Aggregate net profits fell 72 percent to their lowest level in a decade, their collective market capitalization declining 23 percent.

2013 was also a grim year for mineral exploration financing, with global exploration budgets dropping by 30 percent. What’s more, PDAC research indicates that in 2013 more than 50 percent of all financings were for $500,000 or less compared to just 13 percent in 2010.

SNL Metals and Mining recently calculated that the mining industry’s total budget for nonferrous metals exploration was $11.4 billion US in 2014. This contrasts with the $15.2 billion in 2013 and the record $21.5 billion in 2012. This decline is as worrisome as it is dramatic.

Global economic growth has been volatile in recent years, with annual growth projections consistently downgraded as market conditions unfolded. Projections by the IMF forecast moderate growth of 3.5 percent in 2015 rising to 3.7 percent in 2016. Whether this forecast will have staying power in the face of a weak European recovery, slowing Chinese demand, and the US hinting at interest rate increases, remains to be seen.

Brazilian GDP growth is forecast to remain anemic this year, while Russia is expected to contract by 3 percent due to sanctions and the country's heavy reliance on oil revenue. China's growth remains strong, but is forecast to drop in 2015 to 7.4 percent and then 6.8 percent in 2016. Meanwhile, India – which many suggest will be the next China from a mineral commodity consumption standpoint – will buck the trend and see growth accelerate to 6.3 percent over the same period.

Let's look at commodity prices. While, for some time, the story was mixed across commodities, it is safe to say that the last six months have been generally dismal. Copper, which withstood predictions of price deterioration much longer than expected, finally began a rapid fall late last year to around $2.50 per pound, although it has rallied since to about $2.80.

Nickel rallied last year on news of Indonesia's ban on exports of unprocessed ore, but has since slumped to around $6 per pound, as it continues to defy numerous predictions of a major upswing. Zinc rose to a 35-month high last year due to declining supply and amid speculation that increasing auto sales in China and the US will boost metal use, but has since fallen back a bit.

Uranium plummeted after Fukushima, but has begun to recover on expectations of an eventual restart of Japan's nuclear reactors.

Meanwhile, gold has hovered around $1,200 an ounce over the last six months, stable after major declines last year.

The worst stories are in the iron ore and coal business, where prices have fallen steeply, driven by a glut of low cost supply. Of all the commodities, these two are expected to take the longest to recover.

Sounds pretty grim, but even so, some perspective is needed.

A Bedrock of the Canadian Economy

Even in a slump, mining's contribution to Canada is enormous.

Despite some job losses at some operations, mining and mineral processing are directly employing over 380,000 Canadians, including well over 10,000 Aboriginal Canadians, paying the highest average industrial wage in the country.

We invest over $20 billion every year in new capital construction and in machinery and equipment.

We account for almost 20% of Canadian exports, valued at nearly $90 billion, with a positive balance of trade of $17.1 billion.

We're responsible for over half of railway shipping and around half of marine shipping, making sure other commodities, like our subsidized grain sector, can ship their products economically.

We're paying an average of $3.8 billion annually in corporate taxes and royalties.

We're supporting the second largest mining-supply sector in the world, with over 3,400 companies providing technical, legal, financial, accounting, engineering and environmental services to the industry.

We're sitting as a top five global producer of 11 minerals and metals.

We're managing assets worth $234 billion in Canada and another $153 billion on 4,000 properties in over 100 countries.

To coin Winston Churchill, that's some sector. That's some slump.

Furthermore, at the same time as commodity prices have fallen, so too has the Canadian dollar relative to the US. So when Canadian copper mines sell their concentrate with copper at $2.80 US, that's $3.42 Canadian. That's higher than last September when copper sold for $3.04 per pound and the dollar was worth 91 cents.

Of course, some purchases are also made in US dollars, but on balance, a lower currency rate does provide Canadian mines with a bit of a buffer against falling commodity prices.

And so the point I'm making is that while it's tough out there, it's less tough in some places. The industry remains strong; a bedrock of the Canadian economy. Our miners, long experienced in the ups and downs of this sector, are focused on controlling costs and preparing for the next upturn.

The prevailing view remains that the Canadian mining industry's economic prospects will be strong over the medium and long term. We continue to identify proposed, planned and in place mining project investment in Canada of upwards of $160 billion over the next five to ten years. Overall, the potential for mining growth in Canada is not a lot different than a few years ago.

The fundamentals that drove the super cycle are still largely in place. China's growth, while slower, is still significant and over a much larger base. Consumption of minerals and metals continues to increase and is expected to accelerate as other emerging economies, such as India, take their place behind China. We must make sure Canada remains one of the best places in the world for investment in mineral exploration and development, to find and develop the mines whose products the rest of the world needs.

Learning Lessons

To prepare for the next upswing, we should make sure we learn the lessons of the past decade and not let history repeat itself.

Let's look at how we did.

Since the commodity boom began a decade ago, the number of major operating mines in Canada, not including industrial minerals, grew by 25 percent from 96 in 2003 to 122 in 2013.

The value of mineral production soared, reflecting the rise in commodity prices. The value of copper produced in 2003 was $1.3 billion. In 2013, it was over $4.6 billion. Coal was worth almost $1.5 billion in 2003, and exceeded $4.6 billion in 2013. Similar stories for gold, whose production value more than doubled in 10 years, while iron ore's quadrupled.

All of this sounds pretty good. However, despite the increased number of mines and soaring production values, our actual production of mineral resources did not increase substantially.

Actual copper production only increased by a little over 13 percent, while coal production rose by 10 percent. Lead fell almost four-fold, while gold fell by over 40 percent by

2008, recovering 25 percent four years later but still below 2003 levels.

Of all the major commodities, only nickel and iron ore told the kind of story we should be telling, with 40 and 30 percent production growth, respectively.

The fact is, while a vast country rich in resources, Canada has lost ground. We were a top five producer of 14 major minerals and metals in 2007, but today of only 11, with mineral reserves for most commodities plummeting since the 1980s.

And that's not all. Last year, after an eight-year reign as the number one jurisdiction for global exploration spending, we fell to the number two spot behind Australia.

It’s a competitive world out there. Much of Africa, once unattractive to mineral investment and poorly explored, has a rapidly growing mining industry. Latin America, with a longer mining tradition, is also growing rapidly. Australia, closer to the Asian markets, is outmaneuvering Canada in its trade relationships.

Hence, on some fronts we’re slipping. I don't like to be a pessimist, but what these numbers suggest is that although mining will continue to be an important part of our economy, we may be at risk of losing our status as a global mining leader. Given that mining is one of the activities Canada excels at – indeed is a global leader in – this should concern all of us.

So What's Wrong?

As I said at the outset, we spent too much of the last decade playing catch-up.

Let’s look again at the fundamentals.

A global study by McKinsey a year or so ago ranked Canada very near the top across a wide range of indicators measuring investor attractiveness. We know what many of these are: political stability, skilled workforce, respect for the rule of law, low corruption, etc.

But the same study also showed that Canada is one of the most expensive places to build. There are a few reasons for this.

Cheap power used to be a Canadian advantage, but it is becoming less so. The price of diesel has doubled in a decade, while electricity rates in many provinces, notably here in Ontario, have been increasing significantly.

The availability of skilled labour - or the lack thereof - is driving up labour costs. Innovation and investments in skills training to enhance productivity to counteract rising labour costs are crucial.

It is increasingly expensive to build and operate a mine in Canada, especially in remote and northern regions of the country where infrastructure is lacking. According to MAC research, it costs about 2 to 2.5 times as much to build

and operate a gold and base metal mine in northern Canada off grid than in the south. The elimination of mining tax measures in recent federal budgets, such as the Accelerated Capital Cost Allowance, has made capital intensive projects even more expensive. This is particularly true in the north with large infrastructure components.

Moving product to market is getting more expensive. Canada is a vast country, competing with other countries with much shorter logistical supply chains. And with what is effectively a monopoly rail system, shippers are often at the mercy of service challenges and unilateral rail pricing.

Time is money and our approval processes are complex and lengthy. Recent federal reforms have had mixed effects. Changes to the *Canadian Environmental Assessment Act* have led to better managed, though no fewer federal mining EAs, but federal/provincial harmonization remains a work in progress. Amendments to the *Fisheries Act* have created new uncertainties and delays for mining projects, though these are being worked out. Governments failing to fulfill their obligations to First Nations, or delays in meeting these obligations, also contribute to delayed decision making on major projects.

All of these major regulatory reforms, well intended but inadequate and, in some instances poorly implemented, were introduced in 2012, right at the end of the commodity boom.

Too little…but not too late.

As with all major reforms, devils are in the details. We need to use the time now to fine tune the new regime to make sure it is truly efficient and effective so that good projects that are certain to meet regulatory requirements can proceed in a timely basis. We have to continue to improve the efficiency of decision making on new projects and avoid duplication.

We also have to make sure the symbiotic relationship between mining and railways works to the advantage of both. A first step would be to mandate that the railways publish performance and capacity data, because without data disclosure we cannot know the actual causes of service failures. Data disclosure would also level the playing field in negotiations between shippers and railways, hopefully reducing the need for lengthy, expensive court proceedings.

We have to double down on our trade negotiations. Canada has made tremendous progress over the past decade, concluding a record number of free trade and foreign investment protection agreements. Canada's relationship with Latin America, home to the largest share of Canadian direct investment abroad, is stronger than ever. The new deal with India on uranium sales is a major accomplishment, and one I have been told Prime Minister Harper played a critical role in making happen. But we can't be complacent. We need to turn our attention to Asia and Africa, get over our inconsistent attitude towards

China, and secure new open markets for Canadian products and investment.

We need to roll up our sleeves, pool our resources and collaborate as an industry on innovation, addressing key challenges such as energy efficiency, productivity and water management.

We should be looking at ways to level the playing field in the north where infrastructure is lacking. This can be done by increasing government investment in new infrastructure, or by using the tax system to offset some of the costs incurred by companies for infrastructure components that also provide a broader public good. Think of the road to Baker Lake built by Agnico Eagle for its Meadowbank project, or the powerline extension built by De Beers for its Victor mine that now serves northern communities.

Many, including Prime Minister Harper, have highlighted the potential of Canada's North to our future prosperity. But it's not enough to tour the north and talk about it. This year's federal budget made a start, by allowing for the deductibility of Aboriginal community consultations as a Canadian Exploration Expense and by increasing the borrowing limits of the NWT and Nunavut governments to facilitate infrastructure investments.

The re-start of Quebec's Plan Nord is encouraging. The extension of BC's Northwest transmission line is a smart example of a strategic federal/provincial investment, about

to pay dividends with the commissioning of the Red Chris mine.

Here in Ontario, we all know how helpful a road to the Ring of Fire would be, while the Ring of Ice in the NWT would open up further with an all-season road, as would a road to the world-class base metal deposits in Nunavut, such as Izok Lake. New infrastructure will be a catalyst to our economic future. We need to find a way to get this infrastructure built to pave the way for growth.

Just as mines helped spur the building of much of Canada's southern infrastructure, so too can mining help build our north. In doing so, Canada's cities like Vancouver, Toronto, Saskatoon, Edmonton and Montreal, will remain major hubs for mine finance, mine supply and as locations for corporate headquarters.

The opportunity is there. We can seize it, but to do so we have to act now and not make the mistakes we made last time, playing catch-up and losing opportunities to our competition.

Thank you.