



Mining the Age of Entitlement?

**Report Prepared for the Australian
Mining and Resources Sector**

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Acronyms and Abbreviations

AER	Australian Energy Regulator
CPA	Competition Principles Agreement
CPF	Commercial Policy Framework
CSO	Community Service Obligation
GG	General Government
IPART	Independent Pricing and Regulatory Tribunal
NPC	Newcastle Port Corporation
NSW	New South Wales
PHPA	Port Hedland Port Authority
PTE	Public Trading Enterprise
SOC	State Owned Corporation
TCorp	Treasury Corporation of NSW
QCA	Queensland Competition Authority
WA	Western Australia

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Executive Summary

The Australia Institute (‘the Institute’) in its report “Mining the Age of Entitlement” makes the claim that the Australian mining and resources sector in Australia has received subsidies from State & Territory Governments totalling \$17.6 billion over a six-year period, and that those subsidies rival the expenditure by those State & Territory Governments on health care and education.

The Institute further claims that royalties paid to State & Territory Governments by the mining and resources sector are only slightly greater than these subsidies, implying that the sector makes a minimal net contribution to economic activity. Finally, the Institute claims that the value of these subsidies would otherwise have been available for increased vital public services—for example, expenditure on teachers, nurses and police.

The timing of the Institute's report coincides with a heightened national narrative about the need to end the age of entitlement, as framed by the recent Federal Budget. While it is difficult to disagree with the general sentiment that Australia cannot sustainably prop up unproductive sectors of the economy, it is impossible to agree with the conclusions of the Institute’s report that the mining and resources sector has been a significant beneficiary of government largesse. This is because the Institute’s claims are based on an analysis of State and Territory Budgets that reveals a fundamentally flawed understanding of public sector accounting, public infrastructure funding and financing, and the inter-relationship between the public trading enterprise and general government sectors.

Economic infrastructure investments by Government-owned businesses are provided on a commercial basis

The bulk of the expenditure claimed by the Institute as a subsidy is associated with the provision of services through rail, port, water and electricity infrastructure investments by Government-owned business or Public Trading Enterprises (PTEs). Consistent with national competition policy and the state-based legal and policy arrangements that govern these entities, these services are provided on **a commercial, cost recovery basis** through user charges levied equally on all users, including the mining and resources sector. Furthermore, the revenues earned by the PTEs, for rail and port in particular, are guaranteed because of take or pay obligations imposed on users. So, far from providing subsidies, State & Territory Government-owned businesses **earn profits on their investments** in service provision—profits that in the case of State-owned energy network companies, for example, have been criticized as being excessive.

The mining and resources sector enjoys no preferential access to infrastructure that is funded through general taxes

The remaining expenditure claimed by the Institute as a subsidy is on infrastructure provided by General Government (GG) sector agencies where costs are not predominately recovered by user charges. Ultimately, how infrastructure is funded is a policy choice for Government. Most state roads, for example, are funded through combinations of general taxation revenue, Federal Government grants, and license and registration charges. These are levied on **all sectors of the economy**, all of which have equal access to such services. The mining and resources sector is not singled out for preferential treatment.

Investment in economic service provision isn’t at the expense of social infrastructure

Finally, while all State & Territory Governments have finite limits on their ability to borrow, investment in infrastructure recovered by user charges does not impact on a

Government's ability to borrow for social infrastructure. This is because any such borrowings are supported by that user charge income—that is the higher the potential income, the higher the borrowing capacity of the Government.

In this respect, the Institute is just plain wrong in its assertion that mining and resources sector related capital investment comes at the expense of investment in social infrastructure. In fact, the opposite is true; a sizeable portion of the profits of Government businesses that provide such services as rail, ports and electricity flow back to Treasury coffers as dividends, and are used to fund the provision of additional social infrastructure and services.

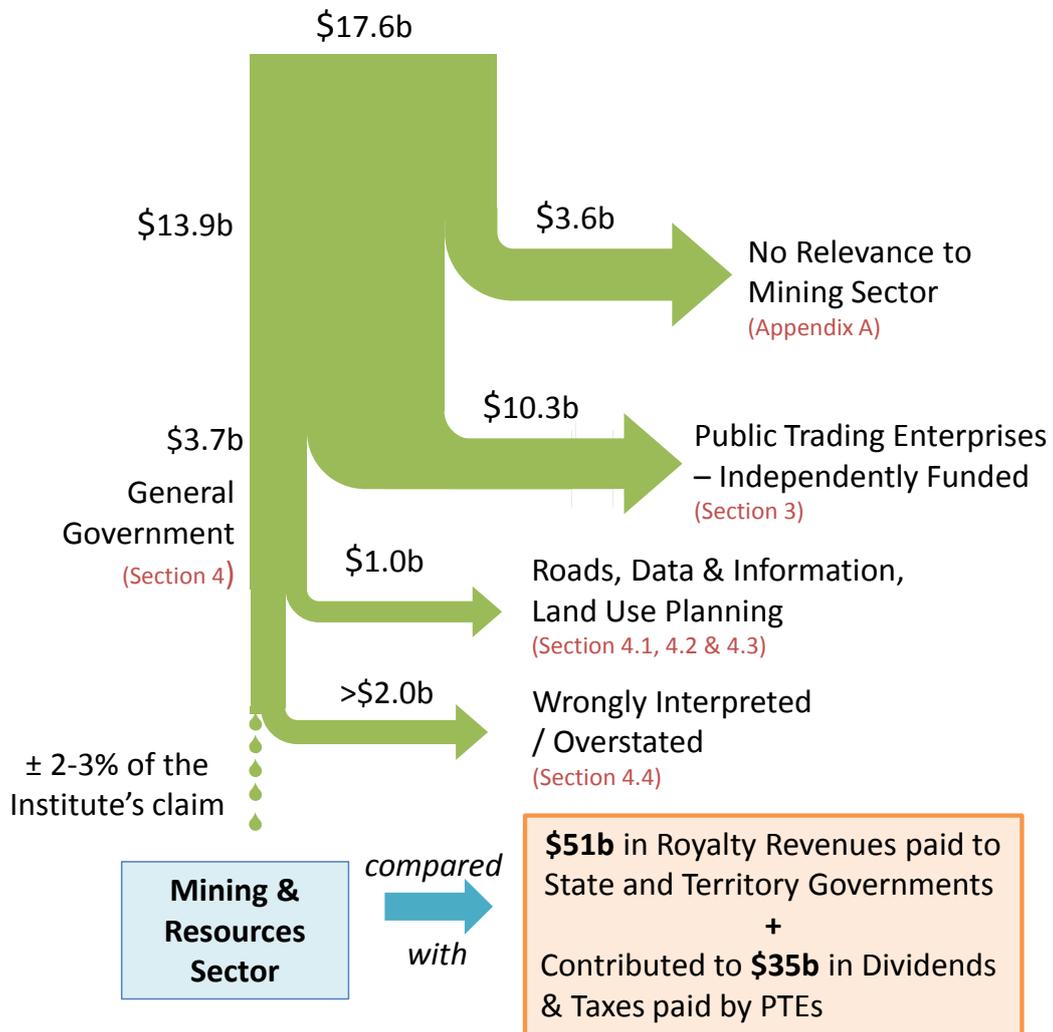
Conclusion

Our analysis shows that the Institute has applied a flawed analysis – based on a distorted understanding of public sector accounting - that grossly exaggerates the level of subsidy to the mining and resources sector. This is summarised in Figure 0.1. We find that the \$17.6 billion claimed as subsidy almost entirely fits into one of the following categories:

- Not relevant to the mining and resources sector (for example, the provision of subsidised passenger rail travel in Queensland at \$1,051 million)
- PTE expenditure fully recoverable through cost reflective tariffs that are commonly underwritten by take or pay obligations on users (for example, the provision of the Goonyella-Abbot Point Rail Expansion at \$831 million); or
- GG sector expenditure either (i) equally socialised across all sectors of the economy, (ii) subject to fees and charges, (iii) the extent of the level of subsidisation exaggerated, or (iv) not verifiable.

We therefore conclude that the actual amounts of subsidy across all the States & Territories are, at best, likely to be negligible, amounting to no more than a few percentage points of the \$17.6 billion claimed by the Institute. Any benefit that the mining and resources sector may have received needs to be seen in context. Over the same period, the sector directly contributed \$51 billion in royalty payments to State & Territory Governments, while also making a significant contribution to the \$35 billion in PTE dividends and taxes also paid to State & Territory Governments that are in turn made available for investment in social infrastructure.

Figure 0.1: Decomposition of State & Territory Government Expenditures Highlighted by the Institute as Subsidies to the Mining and Resources Sector (2008/09 to 2013/14)



1 Introduction

In this report we expose as fundamentally flawed the Institute's analysis that the mining and resources sector in Australia has received subsidies from State & Territory Governments totalling \$17.6 billion over a six-year period.

The structure of our report is:

- **Section 2:** We explain the basis of public sector accounting for State & Territory Government investment in economic service provision infrastructure, and the inter-relationship between the Public Trading Enterprise (PTE) and General Government (GG) sectors.
- **Section 3:** We detail the governance arrangements and funding sources for the PTE sector and outline the significant reforms that were implemented to ensure that government businesses operate commercially and on an equal footing with private entities. This means that where they provide services, to the mining and resources sector and other sectors of the economy, there is no subsidy.
- **Section 4:** We detail the governance arrangements and funding sources for the GG sector, where typically State Governments have made a policy decision to socialise the costs of certain types of infrastructure—that is, rely primarily on funding through general taxation revenue. As such, taxation is applied equally to all sectors of the economy; there isn't any explicit or inherent subsidy to the mining and resources sector.
- **Section 5:** We show that as the PTE and GG sectors have different funding sources; the level of expenditure in each sector is independent of the other. This means that any expenditure on the provision of services to the mining and resources sector is not at the expense of expenditure on public services and social infrastructure. On the contrary, returns on investments in the PTE sector facilitate larger investment expenditures in the GG sector.

2 Public Sector Accounting: Analysis of State Budgets—Capital Expenditure, Funding and Subsidies

State & Territory Governments deliver services to the public and industry through two broad mechanisms:

- Predominately **social services** such as health, education and justice are delivered by government departments and agencies that are under direct control of the Government. In budget papers, this is referred to as the **General Government** Sector; and
- Predominately **commercial services** such as the provision of water, ports, electricity and rail transport are delivered by government businesses. Budget papers refer to this as the **Public Trading Enterprise** (PTE) Sector.

2.1 The PTE and GG Sectors are Funded Differently

In the PTE sector, the businesses are established as separate legal entities under legislation such as the State Owned Corporations Act 1989 (SOC Act) in New South Wales (NSW) and similar legislation in other states. PTEs operate under the control of independent commercial boards, are accountable to shareholding ministers, and have their own financial accounts and capital structure—that is, debt and equity. The PTE sector is largely self-funding from commercially-based user charges, as would be expected given that the legislative and governance regimes of PTEs require that they act commercially.

By contrast, government departments and agencies in the GG sector typically aren't separate legal entities, don't have independent boards—they are under direct ministerial control, and their financial accounts and capital structure are integrated with the overall Government. Capital expenditure in the GG sector is funded largely from the cash surplus of the GG operating budget. That cash surplus arises as the GG sector operating expenditure is less than the GG revenue. For State & Territory Governments, sources of such revenue are mainly:

- General taxation revenue—for example transfer duty, payroll tax
- Commonwealth grants—a transfer of Commonwealth taxation such as the GST, as well as other special purpose payments
- Sales of goods and services
- Dividends and tax equivalents from the PTE sector
- Royalties—from the mining and resources sector; and
- Fines, regulatory charges and other revenue.

There are two consequences of the different funding sources:

- Firstly, that PTE capital expenditure is funded through cost reflective user charges, and thus PTE services provision isn't subsidised; and
- Secondly, as the capital expenditure of each sector is supported by separate funding sources, capital expenditure in one sector is not at the expense of capital expenditure in the other sector.

2.2 Categorisation of Subsidies Claimed by the Australian Institute

We have undertaken a high-level analysis of the capital investments identified as “subsidies” by the Institute and categorised them into either PTE or GG investments. Our analysis shows that the majority relate to the PTE sector.

Of the total \$17.6 billion expenditure:

- About 59 percent or \$10.3 billion is in the PTE sector; and
- About 21 percent or \$3.7 billion is in the GG sector.

The remaining investments—comprising about 20 percent or \$3.6 billion—aren’t associated with the mining and resources sector at all and appear to have been incorrectly categorised. We detail all of this expenditure and our reasons for not attributing it to the mining and resources sector in Appendix A.

3 Governance of Commercial PTEs

Commercial PTEs typically operate businesses that are natural monopolies such as ports, rail networks, electricity distribution networks, and water networks.

Of the total \$10.3 billion PTE sector capital investment attributed to mining and resources as a subsidy:

- About 22 percent or \$2.3 billion is energy related
- About 6 percent or \$0.6 billion is water
- About 38 percent or \$4.0 billion is ports; and
- About 33 percent or \$3.3 billion is rail.

All of the PTEs that have undertaken these capital investments are monopolies or near monopolies and thus their prices are regulated either by independent regulators such as the AER, QCA or IPART, or set by State Governments directly.

A feature of all PTE legislative and governance structures is that they must operate commercially and charge efficient prices. This dates back to the Competition Principles Agreement between the States and the Commonwealth in 1995.

3.1 The Competition Principles Agreement

In 1995, the State Governments and the Commonwealth agreed to a series of principles for efficient resource allocation which targeted how PTEs operated—known as the Hilmer reforms. These reforms were a deliberate attempt to ensure that PTEs with significant business activities operated as commercial businesses on an equal footing to private sector entities.

The Hilmer reforms were set out in the Competition Principles Agreement (CPA). This agreement ensures PTEs set tariffs that reflect the costs actually incurred in delivering the service as well as any additional costs that would apply if under private ownership. These costs include:

- The cost of capital to fund its own assets through borrowings or investment from the owners, and
- Tax equivalence fees and government guarantee fees that are levied on PTEs to mitigate the tax and financing benefits that arise from public ownership.

To improve transparency, the Hilmer reforms also required PTEs to report explicit subsidies or Community Service Obligations (CSOs) regularly—which now forms an integral part of their annual reports.

Under these principles, PTEs are obligated to maximise the net worth of the State Government's investment. Financial expectations of PTEs are outlined in Statements of Corporate Intent (SCI) or similar agreements between the Shareholders (the Government) and the board of the PTE. The SCI sets out, among other matters, the expected return on equity, dividend payments, and capital programs, in keeping with shareholder expectations.

To simulate private sector entities, PTEs function at arm's length from the Government—allowing boards and management to operate within incentive structures that mirror those faced by the private sector.

All the States have captured the CPA in a set of State-based legal, policy and regulatory frameworks that govern the functioning of their respective PTE sectors. As an example,

the Commercial Policy Framework (CPF) established in NSW demonstrates the intention to establish comprehensive guidelines that replicate the commercial practices of the private sector within government businesses (Box 3.1).

Similar policies exist in other States across Australia such as the:

- Good Governance Guidelines for public sector agencies in both Western Australia and Victoria; and
- Corporate Governance Guidelines for Government Owned Corporations in Queensland.

These frameworks ensure that PTEs operate commercially and charge efficient prices—that is the provision of services to any sector is not subsidised.

This is especially true for PTEs such as energy and some water businesses that are regulated by independent regulators such as the AER, QCA and IPART. Under the regulatory framework the PTEs must demonstrate to the regulator not only that their costs are efficient but also their prices—in other words they cannot cross subsidise different classes of users.

As evidence of the requirement and tendency to act commercially, the NSW Government-owned electricity businesses have, on more than one occasion, appealed regulatory decisions of the AER to the Australian Competition Tribunal on the basis that the returns allowed were inadequate. They were successful in increasing their allowed revenue in the order of \$1.5 billion in 2009.¹ This certainly isn't the action of a business seeking to provide subsidised services.

Box 3.1: The NSW Commercial Policy Framework

NSW has established a Commercial Policy Framework (CPW) for PTEs which sets out specific measures to maximise value for the public. The CPW aims to replicate within government businesses the disciplines and incentives that lead private sector businesses towards efficient commercial practices. In NSW, PTEs are established under the State-Owned Corporations Act (the SOC Act).

Capital Structure Policy

The Capital Structure Policy for Government Businesses is one of the key policy mechanisms of the CPW to ensure that government businesses operate on a commercial basis and make appropriate investment decisions. Given that the cost of debt and mixture of debt to equity may be influenced by benefits of public ownership, a surrogate approach is used to determine efficient capital structures for government businesses. This uses the mixture of debt and equity disciplines followed in the private sector—such as:

- Financial leverage ratios—debt to capital, debt to assets, long-term debt to capital
- Profitability ratios—return on assets, return on equity, return on capital
- Cash flow ratios—debt service cover, loan life cover, payback period, internal financing; and
- Dividend expectations.

Guidelines for Boards of Government Businesses

The NSW Treasury has established specific recommendations that boards of government

¹ See “Australian Competition Tribunal makes decision on AER electricity determinations for NSW”, <http://www.aer.gov.au/node/2259>

business should adhere to. The guidelines largely mirror standards that are recommended for private sector businesses to minimise risks concerning corporate governance and optimise performance and accountability of boards—requiring directors to act in the interests of the company as a whole.

Tax Equivalency

The Tax Equivalent Regime was established to ensure competitive neutrality between government businesses and competitors in the private sector. Tax equivalent payments ensure that government businesses do not have a net competitive advantage over their private sector counterparts due to their public ownership origins.

Government Guarantee Fees

Government businesses borrow funds through the NSW Treasury Corporation (TCorp). These funds are issued at interest rates based on the credit rating of the State of New South Wales, which currently receives an AAA rating. To nullify this advantage a *Government Guarantee Fee* is issued on government businesses equal to the interest rate difference received by TCorp compared to the business as a stand-alone entity. This ensures that government businesses' cost of debt is market-related.

These fees are calculated using private sector debt practices by:

- Establishing stand-alone credit ratings from private sector credit rating agencies
- Matching guarantee fee charges to the business' credit rating
- Referencing the prevailing credit spread for each rating from an independent and credible data source; and
- Maintaining credit charges for every line of debt.

Source: Commercial Policy Framework NSW

3.2 Criticised for Excessive Profits

Far from providing subsidies, PTEs have actually come under scrutiny for the level of profits they extract. For example, in the face of record high dividends, the State-owned distribution networks have come under criticism. In Queensland a recent report on behalf of the Electrical Trades Union² (ETU) identified that the State received about \$600 of revenue per household from the dividends provided by the energy sector PTEs.

3.3 Mining and Resources Sector PTEs

The general rule that PTEs behave commercially holds even for those PTEs for whom the mining and resources sector is the dominant customer. We review the capital programmes of two such PTEs, focused on investments providing services almost entirely to the mining and resources sector, and examine their relative financial performance over the past six years:

- Newcastle Port Corporation – \$66 million in capital expenditures; and
- Port Hedland Port Authority – \$390 million in capital expenditures.

We summarise the financial results of each PTE in Appendix B.

² Orion Consulting Network (2014) Analysis of Queensland Government Electricity Sector Cash Flows
<http://images.brisbanetimes.com.au/file/2014/02/12/5156117/Qld%2520Energy%2520GOC%2520Analysis.pdf?rand=1392200918394>

Expenditures by the Newcastle Port Corporation

Over the past six years, the Newcastle Port Corporation (NPC) returned \$49 million in dividends to the NSW Government on profits of \$78 million. This amounts to an average after-tax profit of \$13.3 million over the past six years, and a \$22.8 million profit in 2013. The entire capital expenditure of \$66 million over the six-year period was funded from retained earnings, with no equity injections required from the NSW State Government.

Expenditures by the Port Hedland Port Authority

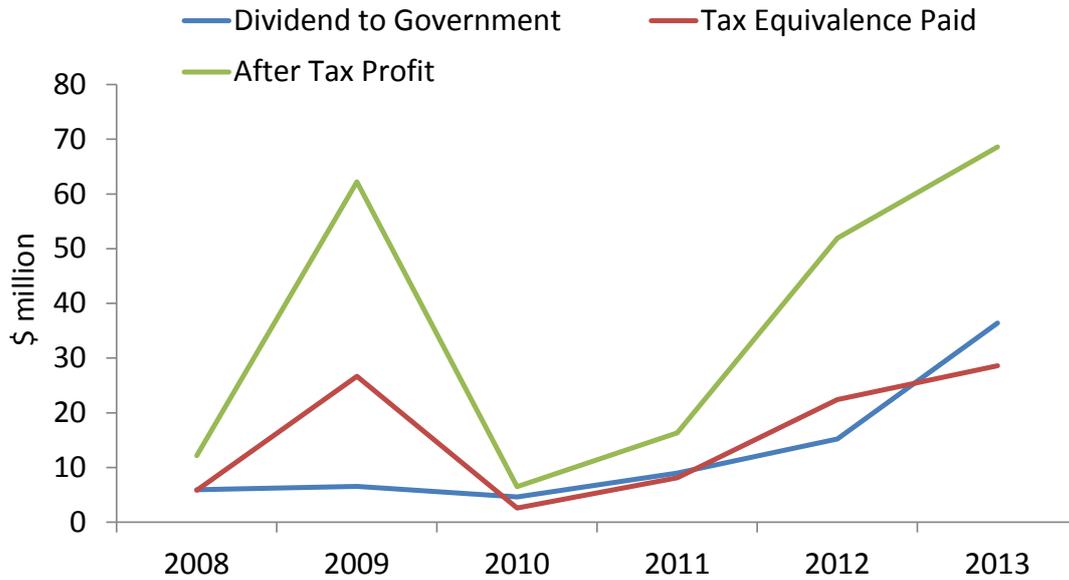
During the same six-year period the Port Hedland Port Authority (PHPA) earned after-tax profits of \$140 million that were used to fund dividends of about \$29 million to the Western Australia (WA) State Government. The State also benefited from tax equivalence payments that totalled about \$59 million over this period. The Authority did not receive any equity injections from the WA State Government over this period. Their financial performances show they aren't subsidised.

In businesses that provide services at a subsidised cost we would expect to see regular equity injections, negative cash flows and no dividends. Instead what we actually see in these PTEs that directly service the mining and resources sector is quite the opposite.

Far from receiving equity injections, both NPC and PHPA have had substantial equity withdrawals in the form of dividends. In addition, these PTEs have funded their entire capital programmes from retained earnings—that is, the remaining profits after dividends are paid. In effect these businesses have operated on a stand-alone basis without Government assistance while returning an increasing dividend stream.

If recent capital expenditure were somehow subsidised, we would expect to see a noticeable decline in profits and a substantial decline in dividend payments. As we illustrate in Figure 3.1, the trend is quite the opposite. Over the past six years profits, tax payments, and dividends have increased, and returns to shareholders have comfortably outperformed government bond yields, with NPC and PHPA delivering average returns of 6.7 percent and 13.2 percent respectively—in fact, over the past two years the PHPA has delivered an average equity returns of 30 percent.

Figure 3.1: Combined Profits, Dividends and Tax payments of Newcastle Port Corporation and Port Hedland Port Authority from 2008-2013



Source: Various Annual Reports of Newcastle Port Corporation and Port Hedland Port Authority

Privatisation of the Port of Newcastle – the opposite of industry subsidisation

In the last decade—prior to its privatisation in 2014—the Port of Newcastle achieved substantial growth. This was directly as a result of the expansion of coal mining in the Hunter Valley. In Table 3.1 we highlight the growth in both financial and physical terms.

The quantity of coal exported has almost doubled, and key financial parameters such as profits, total assets and revenue have almost tripled.

This has all been achieved without any direct investment by the owner—the NSW State Government. There have been no equity injections or other forms of financial support. In fact, quite the reverse—NPC has paid to the State Government dividends and tax equivalents of about \$100 million in the period 2003-04 to 2012-13.

Table 3.1: Port Of Newcastle 2003-04 to 2012-13

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	Growth/ Ave
Revenue from Port Operations (\$m)	37.1	38.5	39.8	39.3	41.5	44.8	60.6	74.4	84.3	97.2	162%
Operating Surplus (\$m after tax)	9.5	8.0	11.6	11.5	9.6	6.1	8.0	13.2	19.6	22.8	140%
Total Assets (\$m)	156.5	161.4	159.5	170.2	177.3	197.6	404.2	477.4	494.4	502.2	221%
Return on Assets	10.8%	8.2%	12.4%	9.8%	7.1%	4.8%	6.1%	6.1%	7.5%	8.0%	8.2%
Earnings Before Interest and Tax (\$m)	13.5	10.1	17.1	16.7	13.2	11.0	18.5	26.7	36.2	39.8	194%

Dividends Paid	3.1	2.4	3.1	6.0	3.8	4.8	2.0	3.1	9.0	13.2	325%
Tax Equivalents	4.0	3.2	3.2	5.5	5.1	4.5	3.7	2.6	3.7	8.5	144%
Coal Export Trade (million mass tonnes)	77.7	77.8	80.3	80.8	88.9	90.5	97.1	108.3	121.9	142.6	84%

Source: Newcastle Port Corporation Annual Reports

In 2014, the Port of Newcastle was privatised and the Government received \$1.75 billion from a 99-year lease to private interests. There are three key aspects to this privatisation that show the benefits of the mining and resources sector to the State Government:

- A sale a decade or so earlier would have only yielded the State Government proceeds that at best would be around a half to a third of the 2014 sale price. In this way the State has directly benefited from the expansion in the mining and resources sector as the value of its asset has substantially increased over that period. That increase in value occurred with no equity injections by the Government, and with equity withdrawals in the form of dividends and tax equivalents
- The sale price—much higher than the book value in 2014—was largely due to the private sector having a high degree of confidence that their investment would be recovered by strong future cash flows from an expanding mining and resources sector; and
- The State has monetised that future growth by receiving a certain upfront payment rather than uncertain future cash flows as the mining and resources sector moves through the peaks and troughs of the business cycle. Since the demand for spending on public services and social infrastructure is constant for a State Government and does not fluctuate over the business cycle, certain upfront revenue is preferable to an uncertain and fluctuating future revenue stream.

4 The General Government Sector

The GG sector provides services to the public and all sectors of the economy. However these are vital public services such as schools, hospitals, and other social services as well as some infrastructure such as roads.

For these types of services, State Governments have typically made the policy decision to socialise the costs on the basis that it's a public good or that user charges are impractical or inefficient. Thus these services and infrastructure are largely funded from general taxation revenues, although there may be a level of user charges and co-payments.

In the GG sector, State Governments make further policy decisions on the allocation of funds to various social services and infrastructure on the basis of their social value.

Of the \$3.7 billion GG sector capital expenditures attributed as subsidies:

- About 5 percent or \$0.2 billion is for provision of road infrastructure
- About 11 percent or \$0.5 billion is for the provision of information and data;
- About 8 percent or \$0.3 billion is for land use planning and environmental protection; and
- About 76 percent or \$2.7 billion is for “other”.

In this section we discuss the validity of characterising the GG sector capital expenditure in these four categories as a subsidy.

4.1 Capital Expenditure on Roads

In the eyes of the Institute, capital expenditure on road projects associated with the mining and resources sector constitutes a subsidy.

This isn't correct. As a general principle, where State Governments socialise the cost of infrastructure or services—that is they fund provision largely through general taxation—then access to that service or infrastructure is available to all. All citizens are entitled to be served by the publically funded health system. In regard to roads, all vehicles whether private or business have access to all of the public road system on payment of the appropriate licenses and registration charges.³ Those charges are non-discriminatory—it costs a mining and resources company just as much to register a vehicle as a farmer—and both have open access to the road network.

Roads are subject to economic appraisal

The provision of roads is informed by economics—that is the benefits to the taxpayer of constructing a road are higher than the cost. State & Territory road projects with a cost greater than \$100 million must undergo a formal business case evaluation—see Box 4.1.

Box 4.1: Economic Appraisal of Road Infrastructure

Projects over \$100 million require a formal business case evaluation in accordance with the framework by Infrastructure Australia. Economic appraisals are formulated to assess and rank the relative value of major road projects—to ensure the benefits outweigh the costs. The key benefits considered in the economic appraisal include:

- Reduction in vehicle operating costs
- Time savings that accrue to people, goods and vehicles
- Reduction in road maintenance costs

³ With the possible exception of toll roads

- Improvement in road safety
- Improvement in economic activity

Economic appraisals ensure that the benefits of road projects exceed their costs and that the net benefit is higher than other proposed projects in the region. This improves the likelihood that projects deliver maximum value for money.

Dedicated public road projects that predominately support one industry receive contributions

There are occasions where a public road is constructed by the Government and it largely benefits one user. An example might be an upgrade of an existing road in a rural area where a new mine is being developed. In this case the mine would be expected to make a significant contribution to both the capital and operating cost of the road.

There are several examples of dedicated road projects within the mining and resources sector where road upgrades or developments were co-funded. In Table 4.1, we outline examples of the contribution made for dedicated road projects to the NSW mining and resources sector.

Table 4.1: Examples of Road Contributions Made by the Mining and Resources Sector in NSW

Name of Road	Construction	Maintenance	Description
Obley Road	\$23 million or 100% of project cost	\$614k per annum - 100% of all maintenance costs	Mine Access from a 27km road from Dubbo to Toongi - including 1km major bridge upgrade
Bogan Road	n/a	\$600k per annum	Access for the Northparkes Mines Step Change Project
Bluevale Road	n/a	\$360-\$500k per annum or 95% of maintenance costs	Tarrawonga and Rocglen Mines

However the gross expenditure on these roads would appear in the State Budget and in the accounts of the relevant government agency responsible for construction. The contribution from the mining and resources sector would also be reported in the accounts but typically would not be easily matched to the project.

Summary on Roads

For all of these reasons, it is unlikely that any of the road projects nominated by the Institute are truly subsidies to the mining and resources sector.

4.2 Capital Expenditure on the Provision of Information and Data

A number of the GG sector “subsidy” investments nominated by the Institute, roughly \$0.5 billion by our estimate, appear to be associated with the provision of information and data to the mining and resources sector.

Again, this is unlikely to be a subsidy as typically there are substantial fees and charges levied by government agencies for the provision of maps, geological survey data, technical data, drill cores and the like.

In other words, these services are generally recovered through fees and levies, and it is misleading to recognise the expenditure side of the equation and ignore the revenue side. The revenue associated with the recovery of information and data service costs typically appears in the agency accounts, but it isn't usually possible to attribute the specific expenditure item to the revenue, which tends not to be disaggregated to the same degree.

We estimate that around \$0.3 billion of this expenditure is likely associated with regulation and oversight of the industry and thus is very unlikely to be a subsidy for two reasons:

- First aspects of the regulation of an industry has a public good aspect—for example planning and land use regulation; and
- There are usually significant user charges for the granting of mining leases, tenancies, permits and licenses that may recover significant portions of the costs of industry oversight and regulations. Once again, the failure to identify a direct link between a specific expenditure and revenue item does not constitute a subsidy – it simply reflects how State Government budget paper information is typically prepared.

4.3 “Other” General Government Sector Expenditure

The other category is significant, amounting to expenditure of around \$2.7 billion. We have not attempted a detailed analysis of the expenditure claimed by the Institute. However, a review of the largest expenditure items suggests that many of them have been wrongly attributed or the extent of the subsidy grossly exaggerated. Examples include the following:

- **Gladstone Power Station.** This relates to a contract between CS Energy and the Gladstone Power Station.⁴ Under the contract CS Energy trades the output from the power station that is in excess of the requirements of Boyne Smelter Ltd. As the contract isn't for the supply of electricity to the smelter, there is no benefit to the smelter. Further the present value of the contract as estimated in CS Energy's Annual Report depends on the way CS Energy utilises that output and on the assumptions it makes about current and future electricity prices
- **Investments by Development Commission.** Expenditure by the Pilbara, Kimberley and Peel Commissions relates primarily to community development initiatives - such as housing, health and education—with funds provided largely from a combination of mining and resources sector royalties and GG sector taxes
- **Browse LNG Precincts Regional Benefits Agreement.** The Agreement focuses predominately on providing social and economic benefits to the Dampier Peninsula and broader Kimberley region by funding initiatives such as housing, education and cultural preservation. This Agreement is between the Western Australian (WA) Government, Woodside Energy Ltd and the Kimberley Land Council
- **Onslow Infrastructure Package.** The WA Government and the Wheatstone Joint Venture (WJV) are investing in a broad range of new and existing community infrastructure in Onslow. New and upgraded infrastructure will

⁴ CS Energy's 2013 Annual Report shows this as an onerous contract with present value of \$154 million. This is substantially less than the \$467 million claimed by the Institute.

include education, health and housing facilities, water and wastewater management facilities, a power plant, transport infrastructure and so on. This infrastructure will support future growth of the town. The WJV is investing more than \$250 million, whereas the Government is investing \$55 million on infrastructure for the town; and

- **Industry Administration.** A sizeable component of this expenditure appears to include administering the royalties, taxes and charges the mining sector has to pay. It is difficult to see how this can be considered a subsidy to the industry.

Much of the balance of the “other” expenditure considered to be a subsidy is difficult to assess, given the often vague descriptions and lack of detail in the Institute’s Report. For example \$411 million is attributed to “*Industry Development and Investment Facilitation*” across Treasury & Finance, Industry and Resources and State Development departments. \$245 million is attributed to “*Mineral Resources*” across Manufacturing, Innovation, Trade, Resources and Energy departments. Furthermore, whilst expenditure on clean coal research for example may appear to be a subsidy, in reality this is another example of pre-competitive research and development that is prone to market failure, and because it is also government policy, requires government intervention. Furthermore, the Australian coal industry through the Australian Coal Association Low Emissions Technologies Fund looks to match government’s commitment by making a voluntary industry contribution.

Given the misattribution on several of the largest expenditure items, and in the absence of detail and specificity on the rest, it is difficult to conclude that anything more than a relatively trivial amount of this “other” expenditure may, at a stretch, be considered a subsidy, although the Institute has hardly made a strong case for this.

5 Government Expenditure on the Mining and Resources Sector Does Not Displace Social Expenditure

The Institute also claims that capital expenditure on the provision of infrastructure providing commercial services is at the expense of expenditure on social infrastructure.

In this section we show that while the borrowing limits of State Governments are finite, borrowing for different types of infrastructure have different sources of funds—user charges or general taxation. As each source of revenue is separate, then so is the level of investment.

Different sources of funds means different borrowing limits

The different sources of funds for the different sector means different borrowing limits apply. While the limits for State & Territory Government's aren't absolute, credit rating agencies in their analysis of the debt levels of State & Territory Governments consider:

- For PTE debt—the overall level of debt when compared to the strength and value of the PTE revenue supporting that debt; and
- For GG debt—the overall level of debt when compared to the strength and value of the Government's taxation base.

While the analysis also takes place at a consolidated level, there is little opportunity for borrowings in one sector to “cross subsidise” expenditure in another sector.

For the GG sector, increasing borrowings to fund GG capital expenditure may ultimately lead to a ratings downgrade unless that expenditure increases the Government's taxation base. Since a downgrade will increase borrowing costs for the State Governments, the threat of a downgrade limits borrowings to a level that enables maintenance of an appropriate credit rating.

In the PTE sector, user charges are cost reflective, either because the PTE is subject to economic regulation by an independent regulator, or—more rarely—because the PTE operates in a competitive market with private sector businesses. In this instance, cost reflective prices also include the cost of capital and the Government (as owner) makes a normal return on their investment. While that return is used by State Governments to fund GG sector expenditure and infrastructure, reducing the PTE sector capital expenditure doesn't release any further funds to the GG sector.

This is because a reduction in PTE capital expenditure will lead to lower prices—because prices cannot be above efficient costs—or lower levels of service and thus lower revenue.

The consequences of the PTE and GG sectors having different sources of funds for capital expenditure is that broadly speaking expenditure in one sector cannot be substituted for expenditure in the other sector.

Thus the assertion from the Institute that the mining and resources sector “subsidy” crowds out expenditure on public services and social infrastructure is incorrect on two counts:

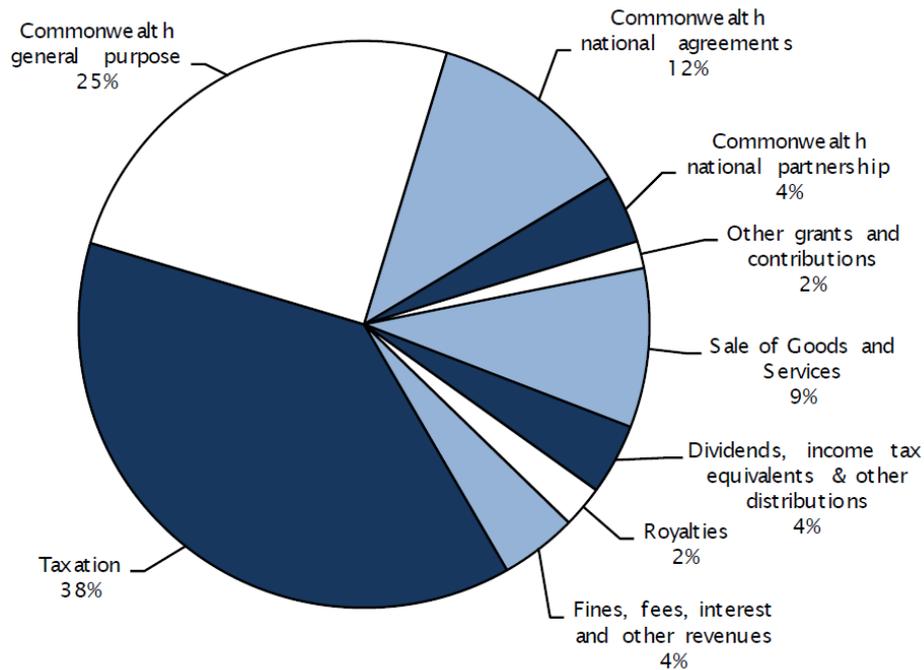
- Firstly very little of what they claim as a subsidy is actually a subsidy; and
- Second, reducing PTE sector capital expenditure does not allow an equivalent increase in GG sector expenditure.

5.1 The PTE Sector is a Source of Funds to the GG sector

In contrast to the Institute's claims, the dividends and tax from the PTE sector—the profits and returns to the Government as owner—are actually a significant source of funds for the GG sector and allow the Government to provide more public services and social infrastructure, not less.

In Figure 5.1 we show this with respect to NSW, which would be fairly representative of the other States.

Figure 5.1: Composition of NSW Government Revenue 2014-15



Source: Chart 6-2, NSW Budget Paper Two, 2014-15

In 2014-15, dividends and income tax equivalents amount to some 4 percent of total revenue for the NSW State Government. Since some 43 percent of the NSW Budget revenue comes from Commonwealth grants and payments, dividends and tax equivalents are some 7 percent of the total State taxation base. In other words without the PTE sector contribution, general NSW State taxes and charges would need to increase by 7 percent to maintain the same level of spending on public services and social infrastructure.

Across Australia, PTE dividends and tax equivalents are material, amounting to some \$35 billion over the six-year period from 2008-09 to 2013-14 as shown in Table 5.1.

Table 5.1: Total PTE Dividends and Tax Equivalents 2008-09 to 2013-14 (\$million)

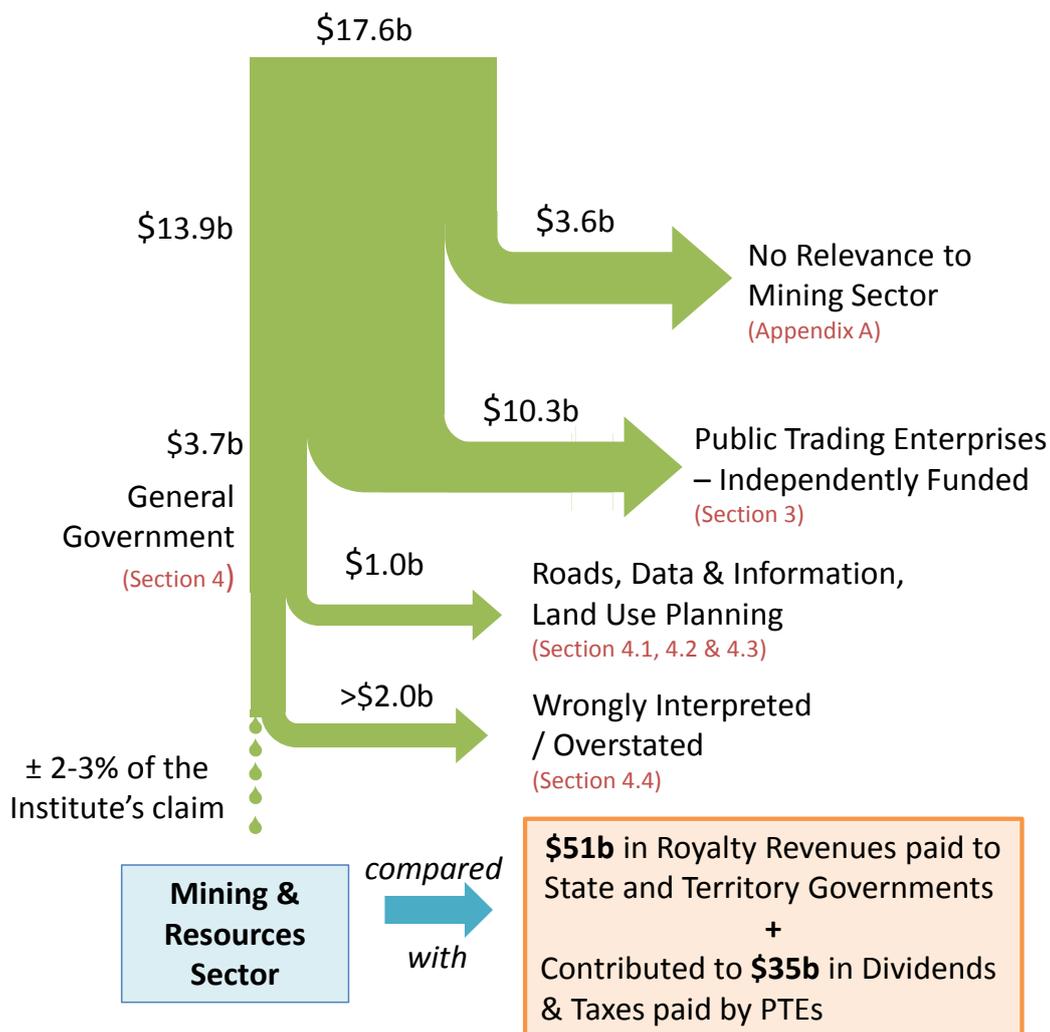
State	2013	2012	2011	2010	2009	2008	Total
NSW	3,243	2,474	2,411	2,321	1,555	2,062	14,066
QLD	1,391	1,111	1,232	950	1,180	1,255	7,119
WA	1,219	1,085	1,066	920	821	880	5,991
VIC	1,233	1,009	404	485	491	474	4,096
NT	51	39	24	18	17	22	171
TAS	229	214	165	100	154	149	1,011
SA	349	371	408	388	348	429	2,293
Total	7,715	6,303	5,710	5,182	4,566	5,271	34,747

Source: Various State & Territory Budget Papers

6 Conclusion

Our analysis suggests that the Institute has applied a flawed analysis—based on a misunderstanding of public sector accounting and therefore grossly exaggerated the extent of the subsidisation of the mining and resources sector. Our analysis suggests that it is nothing like the order of magnitude argued by the Institute. In Figure 6.1, we summarise how the \$17.6 billion in supposed “subsidies” can be decomposed to reveal negligible State support to the mining and resources sector.

Figure 6.1: Decomposition of State & Territory Government Expenditures Highlighted by the Institute as Subsidies to the Mining and Resources Sector (2008/09 to 2013/14)



We have shown that PTE expenditure is fully recoverable, consistent with the commercial frameworks that govern their activities. We have shown that GG sector expenditure is either equally socialised across all sectors of the economy or subject to fees and charges. The vast majority of the balance has either been misattributed; the extent of the level of subsidisation exaggerated, or cannot be verified, given the lack of detail and specificity.

Thus, far from being a major receiver of State funds, the mining and resources sector is actually a substantial source of State & Territory Government revenues—in the past six years the sector provided:

- \$51 billion in royalties; and
- Contributed significantly to the \$35 billion in tax equivalent and dividend income generated by the PTE sector that was used to fund social infrastructure.

Our findings across all States & Territories are broadly consistent with other State-based data. In Queensland, for example, the State Government publishes a transparent and explicit Concessions Statement annually as part of its Budget Papers. Consistent with previous years, the Government concludes that in 2014-15, the vast majority of the \$5 billion in concessions will be allocated to the Department of Transport and Main Roads as well as to the Department of Housing and Public Works, with the Queensland mining and resources sector receiving negligible assistance.

This relationship is also replicated at the Federal level. A recent report by the Productivity Commission found that Federal net budgetary assistance to the mining and resources industry was \$330 million in 2013/14.⁵ This compares to net assistance of \$7.1 billion for manufacturing and \$1.3 billion for primary producers such as forestry, horticulture and farming. However, the mining and resources sector's net assistance per unit of value added (GVA), a measure of the **effective rate of assistance**, is negligible at less than 1 percent. To put this into perspective, the mining and resources sector accounted for 18 percent of Australia's total GVA in 2011/12—double its share of the economy in 2003/04.⁶

⁵ Productivity Commission (2014) Trade and Assistance Review 2012-13, Annual Report Series http://www.pc.gov.au/__data/assets/pdf_file/0007/137788/trade-assistance-review-2012-13.pdf

⁶ Bishop J., Kent C., Plumb M. and Rayner V. (2013) The Resources Boon and the Australian Economy: A Sectoral Analysis. Reserve Bank of Australia, <http://www.rba.gov.au/publications/bulletin/2013/mar/pdf/bu-0313-5.pdf>

Appendix A: Expenditure not related to the Mining and Resources Sector

In our analysis we have identified a number of significant items of expenditure that have little or no relationship to the mining and resources sector. They total \$3.8 billion or 22 percent of the total identified by the Institute.

Major items that we have identified include:

- The provision of subsidised passenger rail travel in Queensland (\$1,051 million)
- Capital expenditure on the Queensland coal rail network undertaken by Aurizon after privatisation (\$376 million); and
- Expenditure on the Ord River irrigation project that will increase the land available for primary production (\$268 million).

Those projects could not reasonably be attributed to providing any benefits to the mining and resources sector and appear to be errors.

We make no claim that we have identified all of the misallocations.

In particular we note that in our categorisation of PTE capital expenditure there are many projects that would appear to have only a tenuous link to mining and resources—for example electricity transmission expenditure in the Newcastle area which increases supply to the North Coast and Sydney does not appear to provide any direct benefits to coal mining activities in the Hunter Valley.

The projects that appear to be clear misallocations by the Institute are listed in Table A.1.

Table A.1: Non Mining and Resources Related Expenditure

Project	Cost (\$ millions)	Explanation
QLD Aurizon Adjustments		
Goonyella to Abbott Point Expansion	310	Expenditure earmarked to incur post 2010/11 which is after the privatization of Queensland Rail
Duarina Electricity Feeder Station	25	
Bluff Electricity Feeder Station	22	
Wycarbah Electricity Feeder Station	6	
Vermont Spur and Balloon Loop	5	
4000 Class Loco E Inspection Program	2	
12 & 16 Cylinder Loco Overhauls	6	
QLD Concessions Statement (2012-13 & 2013-14)		
Queensland Rail infrastructure concessions	1,051	Concession for passenger rail services and some non-coal freight
WA Treasury and Finance / Industry and Mining and resources / State Development		
Ord River Expansion Project	268	Increase irrigation land area for greater agricultural production

WA Water Corporation		
Woodman Point Odour Control (Stage 1 and 2)	29	Major sewerage treatment plant and ocean outfall for Perth metropolitan area
WA Transport and Main Roads		
Infrastructure for State Development	1,593	The objective of this program is to expand the road network in accordance with Government transport and land use strategies that will facilitate the economic and regional development of the State. These works are mostly aimed at increasing the capacity of the road network through the addition of new links, which include town bypasses
NSW Department of Agriculture, Forests and Fisheries		
Cobbora Coal Mine (feasibility study)	76	The purpose of the NSW Government's investment in the Cobbora was to underpin the privatisation of the generation sector with long term contracts for non-export quality coal from Cobbora. It may represent a subsidy to the generation sector but not the mining sector. In fact it is to their detriment as without Cobbora the existing industry would sell additional coal to the generators
State Investment Attraction Scheme and Regional Industries Investment Fund	69	To build capacity and provide vital infrastructure to boost the State's overall economic performance and drive economic growth in regional areas.
NT Mines and Energy		
Resource Industry Development	125	Department of primary industry and fisheries--food based industries
Total	3,587	

Source: From Appendix C of the Institute's report and various State Budget papers and agency websites

Appendix B: Financial Results of PTEs in the Case Studies

Table B.1: Financial Summary of Newcastle Port Corporation's Performance From 2008 to 2013

Financial Performance	2008	2009	2010	2011	2012	2013	Sum
Return on Equity		7.0%	7.5%	4.9%	6.6%	7.5%	
Return on Assets	6.7%	4.8%	6.1%	6.1%	7.5%	8.0%	
Interest Coverage	7.9	24.3	8.6	4.4	5.1	6.7	
Gearing		20%	29%	25%	24%	23%	
Dividend to NSW State Government (\$m)	4.7	4.7	2	9	13.2	15.4	49.0
Tax Paid -including neutrality fee (\$m)	4.0	3.1	3.7	6.3	8.5	10.2	35.8
Net Profit After Tax (\$m)	8.5	6.1	8.0	13.2	19.6	22.8	78.2

Source: Newcastle Port Corporation Annual Reports 2013-2008

Table B.2: Financial Summary of Port Hedland's Performance From 2008 to 2013

Financial Performance	2008	2009	2010	2011	2012	2013	Sum
Return on Equity	11.1%	6.6%	-2.1%	3.7%	27.1%	32.9%	
Return on Assets	9.2%	6.8%	0.5%	3.9%	12.0%	14.2%	
Interest Coverage	4.9	4.0	0.4	1.4	4.6	7.2	
Gearing	55.3%	56.2%	29.4%	29.0%	32.8%	36.9%	
Dividend to WA State Government (\$m)	1.3	1.9	2.7	0	2.0	21.0	28.8
Tax Paid -including neutrality fee (\$m)	1.9	23.6	(1.1)	1.8	13.9	18.4	58.5
Net Profit After Tax (\$m)	3.7	56.1	(1.5)	3.1	32.3	45.8	139.5

Source: Port Hedland Port Authority Annual Reports 2013-2008



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