Inquiry into Horizontal Fiscal Equalisation

Submission

State governments are universally supportive of resource development. They provide considerable financial support to the sector, yet receive relatively little in return. We are unaware of any example of states using the HFE system to argue against resource development.

Rod Campbell
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Level 1, Endeavour House, 1 Franklin St
Canberra, ACT 2601
Tel: (02) 61300530
Email: mail@tai.org.au
Website: www.tai.org.au

INTRODUCTION

The Australia Institute welcomes the opportunity to make a submission to the Productivity Commission's public inquiry into horizontal fiscal equalisation. In particular we would like to comment on point 1.d. of the guidance note:[1]

> *Does the current HFE system influence State policies to facilitate, restrict or tax the development of economic activity, and in particular energy and mineral resources?*
>
> *– What evidence is there for the HFE system affecting State policy choices relating to resource extraction (including regulatory restrictions on development)?*

This point has been thrust into the political spotlight with Treasurer Scott Morrison suggesting that the Northern Territory should receive less GST if its moratorium on unconventional gas development continues.[2]

The Treasurer's comments overlook the fact that all states rely heavily on the Commonwealth as the vast majority of Australia's tax revenue is raised at a federal level. The NT receives around $4.5 billion of its $6.5 billion dollar annual budget from the Commonwealth. It receives less than $200 million from all mining and petroleum royalties, generally between 2 and 3 percent of its budget. It is very unlikely that the development of unconventional gas in the Territory would have a significant impact on its revenues at all and certainly not for some time to come.

The Australia Institute has been extensively involved in economic debate around mining and gas in Australia and has participated in a large number of planning hearings and court cases involving state and territory governments. In our experience, state governments are universally supportive of mining and gas projects, even when the economic merit of such developments is dubious. The Adani proposal is the best known, but examples exist in all states such as the Cobbora Coal project in NSW and Victoria's ongoing support for hopelessly uneconomic proposals for brown coal development.

The idea that states or the NT would hinder mining and gas development due to the HFE system is not supported by any evidence. The Treasurer is either misguided or intentionally pursuing the political interests of the unconventional gas industry.

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[1] Productivity Commission (2017) *Request for initial submissions: A guidance note,* http://www.pc.gov.au/inquiries/current/horizontal-fiscal-equalisation/make-a-submission/horizontal-fiscal-equalisation-guidance.pdf

[2] Uren (2017*) Scott Morrison's GST threat for states*, http://www.theaustralian.com.au/national-affairs/treasury/scott-morrisons-gst-threat-for-states-if-they-limit-gas-exploration/news-story/733a00af3b341c1ee9eea0d06d6539ea

ROYALTIES IN STATE BUDGETS

Royalties are perceived as playing a major role in state budgets not just by Treasurer Morrison, but often by the wider public. Australia Institute polling has shown that on average Queenslanders think 19% of state revenue comes from the coal industry, while in NSW the average perception is 19.5%.[3]

In fact, almost without exception mineral and petroleum royalties play a very minor role in state budgets, as shown in the table below:

Table 1: Mining and gas royalties in state budgets 2015-16

State	Total revenue $m	Royalty revenue $m	Percentage from royalties	source
NSW	72,143	1,431	2.0%	http://www.treasury.nsw.gov.au/__data/assets/pdf_file/0017/128123/2015-16_Budget_Paper_No._1_-_Budget_Statement.pdf
Victoria	55,529	85	0.2%	http://www.dtf.vic.gov.au/files/7e68011b-a770-4d23-bf61-a48200c2de10/BudgetOverview.pdf
QLD	51,186	2,122	4.1%	https://www.treasury.qld.gov.au/publications-resources/state-budget/2015-16/budget-papers/documents/bp2-2015-16.pdf
WA	26,492	3,641	13.7%	http://static.ourstatebudget.wa.gov.au/16-17/2016-17-wa-state-budget-bp3.pdf?
SA	17,097	289	1.7%	http://www.treasury.sa.gov.au/__data/assets/pdf_file/0009/7947/2015-16-BP3-Budget-Statement.pdf
NT	6,508	168	2.6%	http://www.treasury.nt.gov.au/PMS/Publications/BudgetFinance/BudgetPapers/Budget-2015-16_Budget-Paper-2.pdf
Tas	5,308	2	0.0%	https://www.treasury.tas.gov.au/domino/dtf/dtf.nsf/LookupFiles/2015-16-Budget-Paper-No-1.pdf/$file/2015-16-Budget-Paper-No-1.pdf
ACT	4,610	-	0.0%	http://apps.treasury.act.gov.au/__data/assets/pdf_file/0007/733192/2015-16-Budget-Paper-No.3.pdf

[3] Campbell (2014) The Mouse that Roars: Coal in the Queensland economy, http://www.tai.org.au/sites/defualt/files/The%20Mouse%20That%20Roars%20-%20Coal%20in%20the%20Queensland%20economy.pdf; Campbell (2014) Seeing through the dust: Coal in the Hunter Valley economy, http://www.tai.org.au/sites/defualt/files/PB%2062%20Seeing%20through%20the%20dust%20-%20Coal%20in%20the%20Hunter%20Valley%20economy.pdf

Table 1 shows that in 2015-16 less than 5% of state and territory budget revenue came from mineral royalties, aside from in Western Australia. In other words, over 95% of state revenue comes from the rest of the economy.

Western Australia is the key exception, where 13.7% came from minerals, almost entirely iron ore. Analysis of earlier budget papers shows that over 20% of WA revenue was raised from royalties in 2013-14. The subsequent impacts on WA GST distribution have been widely noted, particularly by WA governments.

This commentary has further contributed to the public perception that mining is a significant part of state budgets, a myth that is propagated by mining lobby groups. See for example the NSW Minerals Council, which claims:[4]

> *NSW mining is an important part of the NSW economy, but did you know that our miners also help our nurses, teachers and police do their jobs too.*
>
> *That's because mining royalties provided to the State Government – around $1.5 billion in 2011-12 – all help provide essential services as well as the important transport infrastructure that helps us get around the state.*
>
> *This important contribution, which is on top of company taxes and other charges, help to put teachers in classrooms, police officers on in our communities and nurses in our hospital wards; by doing their jobs, NSW miners are helping some of the most important people in our community to do theirs.*

The NSW Minerals Council and similar groups in other states is strategically silent on the wider context of the state budget and what percentage of state services is funded by mining royalties.

All states have well-established mining industries and mineral exploration has been undertaken by public and private sector organisations for decades or centuries. New discoveries and developments are likely to be marginal additions to the existing minerals industry and marginal additions to existing royalty revenue streams. Given this, it is extremely unlikely that state governments would restrict development of resource projects due to HFE changes. Aside from the dubious logic of doing so, state governments would have to overcome powerful lobbying from resource industries to pursue such policies, something few Australian governments have ever been willing to do.

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[4] NSW Minerals Council (2013) *Helping put teachers in classrooms & nurses in hospitals*, http://www.worldclassminers.com.au/news/economy/helping-put-teachers-in-classrooms-nurses-in-hospi/

In our experience, the idea of redistribution of revenues through the Commonwealth Grants Commission system rarely enters the thinking of state governments. We have never seen an example of this reasoning in state government agency submissions or public statements on planning processes despite extensive experience.

Quite the opposite occurred in South Australia during debate on its role in the nuclear fuel cycle. It seems to have never occurred to government member and former minister Tom Kenyon that the HFE system existed when he wrote his article *How Nuclear Billions Could Transform SA*. In addition to trams in Mt Gambier and a new desalination plant for Port Augusta, Kenyon's dreams included:[5]

- *An underground railway like the Paris Metro.*
- *Fast trains to the outer city and inner country areas (Barossa, Clare, Port Pirie).*
- *High speed trains to outer country areas (Port Augusta, Port Lincoln, Mt Gambier).*
- *Build a ring route around the city, tunnelling where necessary.*
- *Fund language classes from reception to year 12, especially Mandarin, Hindi and Indonesian. I would add music training to this as well.*

Beyond optimistic backbenchers, the Royal Commission's own economics consultants, Ernst and Young, Jacobs and MCM failed to include any mention of HFE in their reports that were released for discussion in February 2016. It was only after The Australia Institute pointed this issue out that the May version of the Ernst and Young assessment included a brief section on the possible impact of the HFE process.[6]

The only example of HFE being central in recent economic debate was in relation to the prosed increase in WA's iron ore levy in the lead up to the last WA election. Mining lobby groups complained that their industry was "under attack" and that:[7]

> *In the end it won't raise any extra money for WA because most of the money will end up in other states by virtue of our GST distribution arrangements — it's a net lose-lose for WA.*

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[5] Kenyon (2015) *How Nuclear Billions Could Transform SA*, http://indaily.com.au/opinion/2015/08/25/how-nuclear-billions-could-transform-sa/

[6] Compare Ernst and Young (Feb 2016) *Computational General Equilibrium Modelling Assessment DRAFT REPORT FOR PUBLIC CONSULTATION,* http://nuclearrc.sa.gov.au/app/uploads/2016/02/Ernst-and-Young.pdf; with Ernst and Young (May 2016) *Computational General Equilibrium Modelling Assessment Nuclear Fuel Cycle Royal Commission Attorney-General's Department Government of South Australia*; http://nuclearrc.sa.gov.au/app/uploads/2016/05/Ernst-and-Young-Report-CGE.pdf

[7] Gartry (2016) Proposed WA iron ore tax would cost 7,200 jobs nationally, Deloitte report says, http://www.abc.net.au/news/2016-11-14/wa-iron-ore-tax-would-cost-7,200-job-nationally-deloitte-says/8021966

Despite these claims, the policy was a sound one economically, representing an opportunity for the Western Australian and wider Australian public to derive more revenue from the sale of our resources to multinational mining companies. The known high profit margins of these mines meant part of these profits could be redistributed via the levy without affecting incentives for the mines to operate.[8]

Far from being used to argue against the development of the resource sector, HFE has been more successfully used to argue against the taxation of mining companies.

STATE GOVERNMENT SUPPORT FOR MINING AND FOSSIL FUELS

In fact, state governments provide considerable subsidies to minerals projects, particularly via provision of infrastructure. Between 2008-09 and 2013-14, state and territory governments provided $18 billion in such assistance measures.[9]

State treasuries use this expenditure to appeal for a greater share of GST revenues:

> *Some costs may also be recovered by the government over time if they are directly industry related. However, there is a real opportunity cost for governments in undertaking the initial capital expenditure. Governments face budget constraints and spending on mining related infrastructure means less infrastructure spending in other areas, including social infrastructure such as hospitals and schools. For many projects directly related to assisting mining industry development, such as land acquisitions for state development areas, the expected timeframes for cost recovery are extremely long (sometimes decades). The opportunity cost of this use of limited funds is a real cost to government and the community.*[10]
>
> *In 2010 net present value terms, the cost of Western Australia's assistance to the North West Shelf project (e.g. payment of subsidies to the State's power*

[8] For full discussion of this debate, see Richardson (2016) *The $5 levy on iron ore in WA,* http://www.tai.org.au/sites/defualt/files/P310%20The%20%245%20levy%20on%20iron%20ore%20in%20WA%20FINAL.pdf

[9] Peel, Denniss and Campbell (2014) Mining the age of entitlement, http://www.tai.org.au/content/mining-age-entitlement

[10] Queensland Treasury (2013) *Queensland Treasury Response to Commonwealth Grants Commission*, https://cgc.gov.au/index.php?option=com_attachments&task=download&id=1727

utility to help cover the losses it initially incurred under crucial 'take or pay' gas contracts) is estimated to be around $8 billion.[11]

It is clear that far from delaying development, state governments provide huge financial assistance to the resource sector. This expense is then used as an excuse for greater GST share.

CONCLUSION

State and territory governments should make decisions on resource developments based on their costs and benefits. While royalty revenue is undoubtedly a benefit, resource development comes with social and environmental costs that are often borne by communities, taxpayers and the environment.

The Northern Territory needs to consider these costs and benefits. In our opinion the Territory is unlikely to derive significant financial benefit from unconventional gas development, while the potential for taxpayer expenditure and environmental damage is significant. We have published several papers on this topic.[12]

The Australia Institute has often disagreed with state and territory government decisions over the costs and benefits of mining and gas development. We know of no example of a state or territory government attempting to hinder resource development due to the HFE system. As argued in this submission the logic of trying to do so is dubious and the politics of doing so almost impossible.

[11] WA Treasury (2011) GST Distribution Review WA Submission, http://www.gstdistributionreview.gov.au/content/submissions/downloads/issues_paper/wa_gov.pdf

[12] See Campbell (2017) *Economics of NT unconventional gas development*, http://tai.org.au/content/economics-unconventional-gas-development Ogge (2015) *Be careful what you wish for*, http://www.tai.org.au/sites/defualt/files/Be%20careful%20what%20you%20wish%20for%20FINAL_0.pdf ; Campbell (2015*) Passing gas: Economic myths around the Northern Territory's North East gas interconnector*, http://www.tai.org.au/content/passing-gas-economic-myths-around-northern-territorys-north-east-gas-interconnector-pipeline; Campbell, Browne and Aulby (2017) *Submission to Scientific inquiry into Hydraulic Fracturing in the Northern Territory,* *http://www.tai.org.au/sites/defualt/files/P393%20NT%20fracking%20inq%20submission%20FINAL.PDF*