

Queensland Privatisation: Fraser's Folly

SECOND REPORT

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by:

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EXECUTIVE SUMMARY

Our Briefing Paper, *Queensland Asset Sell Offs, Budget Black Holes, Borrowings and Credit Ratings*, released in November 2009, analysed the Bligh Government's rationale for its privatisation proposals and concluded that:

- **Queensland's finances were better than presented:** At the time that dire predictions by the Premier and the Treasurer were made about the alleged crisis in state finances, followed by the announcement of the asset sell off, Queensland's finances were substantially better than presented.
- **Queensland's debt was not excessive and there was nothing wrong with borrowing to fund infrastructure:** Queensland debt ratios compared well, not only in the international context but also in relation to the Triple A credit rated NSW. In any case, it was noted that there is nothing wrong in borrowing to finance infrastructure that will be of benefit to current and future generations. That is especially the case if the projects under contemplation – be they toll roads, ports, rail links, or new investment in public utilities – are also revenue producing
- **Impact of changes in credit ratings was overstated:** The interest cost of a one-notch downgrade in the State's credit rating was exaggerated by Mr Fraser by a factor of at least 80 and possibly as much as 240.
- **10 misleading claims:** The November 2009 Briefing Paper reviewed claims made about the impact of the GFC on Queensland's finances, the 'savings' that could eventuate from a sell off of government businesses that are earning a positive rate of return, and the way the forecast sale proceeds had been presented as a 'magic pudding'. It examined and debunked 10 misleading claims none of which could be taken seriously. Some featured inconsistency and exaggeration. Others ignored the financial returns that would be enjoyed if government-owned businesses were retained in public ownership – particularly those assets that have the features of natural monopolies and stand to reap the benefits of a revitalised resources boom.
- **Conclusion: sell-off a bad, unnecessary decision:** The November 2009 Briefing Paper concluded that privatising the listed public assets which have been funded and accumulated by past generations in order to solve a short term revenue shortfall potentially could cost current and future taxpayers billions of dollars in lost value and earnings potential.

It was noted that Queensland has been blessed with significant natural resources and that it stands to reap enormous benefits from the demand for those resources in future years. All the more reason to retain major items of infrastructure – rail, ports, coal loaders and tollways – in public ownership. A sell off of natural monopolies would be in financial – and political – terms a fundamentally foolish decision.

This Report reviews developments since the November 2009 Briefing Paper including the information revealed in the following statements and publications:

- Queensland Government, *2009-10 Mid Year Fiscal and Economic Review*, December 2009;
- Commonwealth Grants Commission, *Report on Revenue Sharing Relativities 2010*, 26 February 2010;
- Access Economics Report, *Queensland Economic and Fiscal Analysis*, 26 March 2010;
- *2010-11 Federal Budget*, 11 May 2010;
- various reports and statements by the Reserve Bank;
- successive issues of Queensland Treasury's *Queensland Economic Review*;
- statements by the Queensland Treasurer.

Of these, the most astonishing was easy to overlook. In April 2010 the Treasury's *Queensland's Economic Review* acknowledged that a turnaround after the global financial crisis had started more than 12 months earlier, in March 2009. Note the date. The economic turnaround had started three months before Premier Bligh and Treasurer Fraser told Parliament and the media and citizens of the State that Queensland was facing a financial crisis.

Conclusions reached in our November 2009 Briefing Paper – questioning the validity of Treasurer Fraser's projections and pointing to facts revealed in audited financial statements signed off within weeks of Mr Fraser's exaggerated claims – have only been confirmed by subsequent events, and in the analyses undertaken by a range of respected economists and public officials. The Queensland economy has strengthened as has the Queensland Government's financial position. Even the Government's own *Mid Year Fiscal and Economic Review* (MYFER) conceded a better fiscal position than previously claimed by Mr Fraser. All indications are that further improvements are on the horizon.

This expectation is further confirmed by the following developments.

- **Reserve Bank statements and 2010-11 Federal Budget:** Support for a generally optimistic economic outlook – particularly for Queensland as a major exporter of commodities - is provided by various statements by the Reserve Bank and the recent Commonwealth Government's 2010-11 Budget Papers.

The latter reported that the world economy is expected to grow by 4¼ per cent in 2010 and in 2011, led by growth in Asia; Australia is expected to benefit from our close trade links to the rapidly growing Asian region, and in particular China. The recovery in exports is expected to be broad-based, but with particular strength in non-rural commodity exports especially iron ore and coal. The terms of trade are forecast to rise by 14¼ per cent in 2010-11 to their highest level in 60 years, largely due to strong price rises

for Australia's iron ore and coal exports, driven by a recovery in global demand. Commodity prices are expected to moderate somewhat in 2011-12, but still remain at high levels.

- **Commonwealth Grants Commission:** Following recent determinations by the Commonwealth Grants Commission, Queensland can expect an increase in GST distributions. Rather than a decrease in Queensland's share of GST revenue of \$3.6 billion over 2010-11 to 2012-13 (as predicted by Treasurer Fraser in 2009), there will be an increase of \$1.155 billion to 2012-13, and \$1.837 billion if 2013-14 is included. So that on this measure alone, in contrast to Mr Fraser's presentation in his 2009-10 Budget, Queensland's finances are expected to be better off over the three years to 2012-13 by nearly \$5 billion (\$4.755 billion).
- **Access Economics:** In a report dated 26 March 2010 Access Economics found that the economic outlook was stronger than presented by the Queensland Government in its latest projections in the MYFER.

Access Economics concluded that by 2012-13 total taxation revenue in Queensland will be some 13% higher – with taxation revenues expected to be \$763 million higher than the MYFER forecast in 2009-10, building to an additional \$1.5 billion by 2012-13; total non-taxation revenue in Queensland will be some 10% higher – with non-tax revenues expected to be some \$2.4 billion higher than projected in the MYFER; and total revenue in Queensland will be some 10% higher – with an additional \$3.7 billion total revenue than currently allowed for in 2011-12, moving up to \$4.3 billion by 2012-13.

- **Improvement in Queensland's Fiscal Position since the 2009-10 Budget:** This Report has combined the increases in revenues since the 2009-10 Budget as presented in MYFER in December 2009, with the increases projected by Access Economics since MYFER. This shows that ***rather than a loss of \$15 billion in revenues*** as claimed by Treasurer Fraser, the Government will have ***an increase of nearly \$14 billion over the four years to 2012-13 – a turn-around of \$29 billion.***

Queensland also stands to benefit from the Federal Government's announcement that it proposes to reinvest some of the proceeds from the Resources Super Profits Tax into an Infrastructure Fund for the States. The Fund is expected to deliver \$700 million to the States in 2012-13 and grow over time (Commonwealth *Budget Paper No. 3*, p. 1).

No financial case for the privatisations: Mr Fraser's dire predictions about the impact of the global financial crisis on Queensland, and his use of them to support his asset sell off, were wrong when he made them in June 2009 and they even more wrong now. Developments since then support the contention in our November 2009 Briefing Paper that there is no financial case for the Government's proposed privatisation.

Yet, in the face of the information that has come to light in the past year, Treasurer Fraser has continued to push ahead with proposals to sell off assets despite dramatically better (than he portrayed) economic circumstances (and despite the likelihood that the recent sale of Queensland Forestry interests has been at a major loss – unless some truly creative accounting has yet to be revealed).

Rather than engage in reasoned debate about these matters, Treasurer Fraser has preferred to engage in propaganda. Possibly nothing illustrates this better than the continued publication of statements about a \$15 billion budget shortfall. Even in May 2010, the Government website states:

Like all countries all over the world, the global recession hit this State budget hard.

The worst global recession in 70 years has reduced Queensland's income by \$15 billion over four years ...
(www.qld.gov.au/assetsale/economic-rationale/global-recession accessed, 24 May 2010).

Or perhaps Treasurer Fraser's speech to a CEDA Forum in Brisbane in February 2010 shows how he has still not learned the difference between forecasts and facts. He asserted:

Our finances did take a massive hit.

The facts suggest otherwise.

Yet a real massive 'hit' may occur if the Government proceeds to sell off coal and rail freight businesses just before they are poised to generate enhanced returns from the increased scale of exports. Clearly BHP Billiton and syndicates of miners recognise the potential of those businesses – and are lobbying hard for a trade sale so they (not the Queensland taxpayer) can enjoy the profits that are likely to be generated by those businesses. Conversely, they fear the impact on their profits if a private sector monopoly seeks to impose monopolistic pricing and not reinvest and develop economic infrastructure – a role they see as a responsibility of government.

It is time Mr Fraser admitted the error of his sell offs and put a stop to them for the sake of the State and its citizens.

1. INTRODUCTION

On 2 June 2009 (and confirmed in the 2009-10 Budget released on 16 June 2009) the Queensland Premier and the Treasurer announced an asset sell off program which included the sale of:

- Forestry Plantations, Queensland's softwood business and possibly its hardwood plantations;
- Queensland Motorways Limited's business, incorporating a major upgrade of the Port of Brisbane Motorway;
- the Port of Brisbane Corporation Limited's business and assets;
- QR Limited's above and below rail coal businesses and assets; and
- the Ports Corporation of Queensland Limited's Abbot Point Coal Terminal.

The Government also foreshadowed investigating options for the most appropriate way to offer the sale of Queensland Rail's bulk freight, intermodal, retail and regional freight services to the market.

In trying to justify the decision for the sell off, a Joint Statement of the Premier and Treasurer referred to

the economic meltdown which has punched a \$14 billion hole in government revenue (*Renewing Queensland: Future Investment Plan*, 2 June 2009).

Again, it claimed there was

a \$14 billion hole in our revenue over the next four years (*idem*).

Two weeks later that figure had increased. On 16 June 2009, the 2009-10 Budget Papers referred to a revenue shortfall of \$15 billion. Treasurer Andrew Fraser claimed that the global financial crisis will result in a

colossal drop in forecast revenue of more than \$15 billion across the forward estimates (*2009-10 Budget Paper No. 1*, p. 3).

This was repeated in *Budget Paper No. 2*:

Since the 2008-09 Budget, this downturn has stripped \$15 billion off the forward estimates of the State's key revenue streams of royalties, taxes and GST (*2009-10 Budget Paper No.2*, p. 1).

Subsequent communications repeated and repeated the \$15 billion figure:

What has the global recession meant for Queensland? It's wiped \$15 billion off our revenues (*Caucus Brief*, October 2009).

In the same Caucus Brief

But the global financial crisis wiped \$15 billion from our revenues in about 6 months (*Caucus Brief*, October 2009).

Writing in *The Courier Mail* Premier Bligh stated:

the global financial crisis ... blew a \$15 billion hole in our Budget, and cost us our AAA credit rating ('Queensland asset sell off the only choice: Anna Bligh', 26 October 2009).

In a statement issued jointly with the Treasurer on the same day (unveiling a campaign called the 'The Myths v The Facts') Ms Bligh claimed that:

the global financial crisis cut \$15 billion worth of income from our bottom line ('Bligh unveils The Myths v The Facts', 26 October 2009).

So these claims continued even though (as has now been confirmed) Queensland's finances had improved. In the Queensland Treasury Corporation *Annual Report* (apparently signed around 19 August 2009) QTC's chairman acknowledged that

the worst of the financial crisis appears to be behind us (p. 12).

This so-called \$15 billion loss was not from a decline in **actual** receipts but an adjustment to **forecast** revenues (*2009-10 Budget Paper No. 1*, p. 3).

And it was not for one year but across the '**forward estimates**'. That is, over **four years**.

Even if the Government's early claim of a reduction of \$15 billion in forecast revenues were to be accepted, it failed to adjust its references to the 'bottom line' by its own Budget measures claimed to improve Queensland's fiscal position by some \$5.4 billion over four years (*2009-10 Budget Paper No. 2*, pp. 1-2). On this basis, the 'bottom line' would also be expected to be improved by the budgeted cuts in expenses. In other words, the 'bottom line' would only have been cut by

\$15 billion less \$5.4 billion

or \$9.6 billion (over five years).

In our November 2009 Briefing Paper, it was concluded that there was no financial necessity for the sale of the assets slated for privatisation by the Queensland Government.

The Paper's conclusion on the asset sell offs was based on the fact that at the time that the dire predictions of the Premier and the Treasurer were made about the alleged crisis in state finances, followed by the announcement of the asset sell off, Queensland's finances were substantially better than presented – and were expected to improve further.

Developments since the release of the November 2009 Briefing Paper have confirmed these conclusions. This update presents some of those developments.

2. DEVELOPMENTS SINCE THE NOVEMBER 2009 BRIEFING PAPER

2.1 2009-10 QUEENSLAND GOVERNMENT MID YEAR FISCAL AND ECONOMIC REVIEW

The *2009-10 Mid Year Fiscal and Economic Review* (MYFER), issued in December 2009, presented revised fiscal estimates for the current budget year and the three following years taking into account fiscal and economic developments since the preparation of the 2009-10 Budget.

The MYFER confirmed the belief outlined in our November 2009 Briefing Paper that Queensland's fiscal and economic conditions were in a far better position than was claimed by the Premier and the Treasurer in order to justify their asset sell off.

The Government's own MYFER revealed:

- economic conditions have improved since the 2009-10 Budget (p. 1);
- financial market sentiment has continued to improve (p. 1);
- reflecting improved confidence and better financial conditions, businesses have switched from de-stocking to inventory building (p. 1);
- major trading partner economies are expected to expand by 3½% in 2010, compared with 1½% previously predicted (p. 1);
- major trading partner output is now forecast to return to mid-2008 levels by the second half of 2010, rather than the second half of 2011 as expected at Budget (p. 1);
- prospects of a stronger global economic recovery have also seen commodity prices improve since the time of the Budget (p. 2);
- hard coking and thermal coal contract prices are expected to be settled higher for the 2010-11 Japanese fiscal year compared with prices previously negotiated (p. 2);
- the Queensland economy proved relatively resilient in 2008-09, expanding during a year when most major economies experienced deep recessions and global financial market conditions deteriorated (p. 3);
- the economy is now forecast to expand by 1% in 2009-10, compared with a ¼% contraction forecast at Budget time, while growth is forecast to strengthen to 3½% in 2010-11, above the 2¾% originally anticipated (p. 3);
- the outlook for private consumption has improved (p. 4);
- Brisbane house prices reached new peaks in late 2009 (p. 4);
- greater than expected resilience in employment and wages growth should also support household consumption in the short-term (p. 4);
- leading indicators point to a sharp rise in the construction of new homes over 2009-10 (p. 5);
- a recovery in dwelling investment is still expected in 2010-11 (p. 5);

- rising house prices and some further improvement in credit conditions should also encourage investor activity next year;
- the decline in business investment is not expected to be as large as the 17% originally predicted for 2009-10, with investment forecast to stabilise by 2010-11, rather than fall further as forecast in the Budget (p. 5)
- the faster than expected recovery in the global economy will benefit mining investment (p. 5);
- total exports are expected to fall less in 2009-10 than expected in the Budget reflecting an improvement in the global economic outlook (p. 6);
- the surge in China's demand for Queensland coal, although abating in recent months, has continued for longer than anticipated, reflecting faster than expected economic growth and ongoing consolidation of the Chinese coal industry (p. 6);
- strong growth in overall exports is expected to return by 2010-11, when the global recovery gathers pace (p. 6);
- year-average employment is now forecast to rise marginally in 2009-10, a significant improvement on the forecast fall of ¾% in the Budget (p. 6)
- with economic growth expected to strengthen into 2010-11, jobs growth is forecast to reach 2% next financial year, above the 1¼% forecast in the Budget (p. 6);
- jobs growth is expected to remain marginally below growth in the labour force, though the unemployment rate will only rise slightly in year-average terms to 6½ in 2010-11, well below the 7¼% originally anticipated (p. 6);
- global conditions have recovered earlier and faster than previously predicted (p. 7);
- emerging Asia, which proved resilient during the financial crisis, continues to provide growth opportunities for Queensland (p. 7).

Questions can however be raised about the interpretations placed on this information by the Government, and the fact that these improvements were not fully reflected in the estimates of Budget results. The Government's MYFER stated:

Nevertheless, along with the modest economic growth in 2008-09, this would still represent a three-year period of below trend growth in Queensland (p. 3).

The question should be asked: what 'trend'? Two years earlier the *2007-08 Mid Year Fiscal and Economic Review* bragged:

Queensland economic growth is expected to exceed that nationally for the twelfth successive year ... (p. 1).

In other words, Queensland has been doing very well for a long period of time. In the midst of a global downturn, a return to growth of 1% this year and 3½% next year should have been a cause for celebration. Even 'lower than trend' projected growth rates mean that claims about the need to sell off assets are unjustified.

A strange observation appeared later in the MYFER concerning revenues:

The improved economic position has not translated into a significantly improved revenue outlook, including beyond the current financial year (p. 11).

This statement was not consistent with the data cited earlier in the Report. It seemed like an afterthought, or possibly it was inserted after a request by readers of an earlier draft. Certainly it echoed the extraordinarily exaggerated claims made by Treasurer Fraser to justify the sell offs.

The December 2009 MYFER forecast general government sector revenues to grow at an average annual rate of only 2.8% from 2008-09 to 2012-13. This is despite the fact that in 2008-09 revenues increased by 17.7% over the previous year. The estimated 2.8% average annual increase is even less than the forecasts in the 2009-10 Budget.

In the five years to 2006-07, growth in revenues averaged 11.45% - though granted there was an unusually high increase in 2003-04. However, even excluding that year shows an average increase of 8.1% (*2009-10 Budget Paper No. 2*, p. 184). While growth rates are expected to be lower during a downturn, the MYFER elsewhere confirmed that the downturn was not expected to be as deep or as protracted as previously assumed. The obvious effect of understating forecast revenues is to affect the forecasts of Budget results over the period covered by Budget projections.

In conjunction with an apparent understatement of forecast revenues, the December 2009 MYFER incorporated a series of one-off adjustments of around \$857 million. These were \$365 million in a changed accounting treatment of Commonwealth funding of the Gold Coast Rapid Transit project, \$265 million to be paid to Queensland Water Infrastructure to compensate for non-recoverable expenditure on the abandoned Traveston Dam project, as well as a \$227 million downward revision to royalty estimates due to the appreciation of the \$A-\$US exchange rate. In addition to the \$857 million one-off adjustments was an estimate of expenditure on the asset sales process – acknowledged to be material but buried in aggregate data.

It is not clear whether the forecasts for the general government sector incorporated enhanced dividends from Queensland Rail. On the contrary, the forecasts for the Public Non-financial Corporations Sector were for lower profits than previously forecast largely because of book entries - higher depreciation charges in the books of Queensland Rail following upward revaluations of QR's infrastructure assets from cost to fair value. Yet Treasury's own forecasts (provided to the Queensland Council of Unions in November 2009) showed that **QR's profits after tax are expected to increase from \$86.8 million in 2010 to \$564.2 million by 2013**. That could reasonably be expected to generate extra dividends to the general government sector, as well as the notional taxes paid to Treasury.

2.2 COMMONWEALTH GRANTS COMMISSION REPORT

The 2009-10 Queensland Budget assumed 'a decrease [in Queensland's share] of a further \$3.6 billion over the period 2010-11 to 2012-13' (Budget Paper No. 2, p. 92).

However in its report released on 26 February 2010, the Commonwealth Grants Commission (CGC) advised the Federal Government that there should be an *increase* in Queensland's GST distribution to \$8,384 million in 2010-11 (*Report on Revenue Sharing Relationships 2010*, p. 3). This is an increase in just one year of \$545 million on the CGC's estimate for 2009-10 of \$7,839 million and an increase of \$799 million on Mr Fraser's Budget estimate (p. 108).

More increases in Queensland's GST distribution are expected in subsequent years as confirmed in the 2010-11 Federal Budget brought down on 11 May 2010. It showed that, rather than a fall, Queensland would receive an increase in GST payments and general revenue assistance for Queensland in the period 2010-11 to 2012-13 of \$1.155 billion and \$1.837 billion in the period to 2013-14 (see below).

Table 1
GST payments and general revenue assistance to Queensland

	2009-10	2010-11	2011-12	2012-13	2013-14	Total
	\$m	\$m	\$m	\$m	\$m	\$m
	8,181	8,906	9,097	9,336	10,018	
Change		725	191	239	682	1,837

Source: 2010-11 Commonwealth Budget Paper No. 3, p. 111.

This means that rather than a decrease in Queensland's share of GST revenue of \$3.6 billion over 2010-11 to 2012-13, there will be an increase of \$1.155 billion; and \$1.837 million if 2013-14 is included. So that on this measure alone Queensland's financial position is expected to be better off by nearly \$5 billion (\$4.755 billion) over the three years to 2012-13 than presented by Mr Fraser in his 2009-10 Budget.

2.3 ACCESS ECONOMICS REPORT

In a report prepared for the South East Queensland Council of Mayors, *Queensland Economic and Fiscal Analysis*, dated 26 March 2010, Access Economics provided a much more optimistic outlook for the Queensland economy and the Government's finances than provided in the 2009-10 State Budget of June 2009 and in the State's MYFER released in December 2009. Access Economics stated:

The economic outlook presented by Access Economics is a stronger one than presented by the Queensland government in its latest projections – the 2009-10 Mid Year Fiscal and Economic Review (MYFER), which formed the economic basis behind the budget forecasts at that time. In part that reflects the fact that the Access Economics forecasts have been compiled more recently (and conditions strengthened considerably over the second half of 2009) (p. 6).

Access Economics continued:

The 2009-10 Budget projected Queensland GSP to grow in line with national GDP over 2011-12 and 2012-13. Access Economics believes that Queensland will grow at a significantly faster rate than the national average, buoyed by excellent prospects in resources and high levels of migration ...

All up, relative to the outlook presented in MYFER and the Budget, Access Economics expects Queensland real GSP to be 3.8% higher by 2012-13 than official forecasts, and Queensland nominal GSP to be 5.2% higher by 2012-13 than those official forecasts (p. 7).

Based on its economic growth projections, Access Economics concluded that by 2012-13 the revenue implications relative to the MYFER would be as follows:

- total taxation revenue in Queensland will be some 13% higher – with taxation revenues expected to be \$763 million higher than the MYFER forecast in 2009-10, building to an additional \$1.5 billion by 2012-13;
- total non-taxation revenue in Queensland will be some 10% higher – with non-tax revenues expected to be some \$2.4 billion higher than projected in the MYFER (although the table on p. 22 of the Access Economics report shows a figure of \$2,859 million – see table below); and
- total revenue in Queensland will be some 10% higher – with an additional \$3.7 billion total revenue than currently allowed for in 2011-12, moving up to \$4.3 billion in 2012-13 (pp. 20-1).

A table provided by Access Economics purported to summarise the projected revenue gains since the December 2009 MYFER from stronger economic growth. An extract of that table is presented below.

Table 2
Projected gains to Queensland budget revenue from stronger economic growth

\$m	2009-10	2010-11	2011-12	2012-13
Taxation revenue	763	450	1,536	1,473
Total non-taxation revenue	833	828	2,209	2,859
Total revenue	1,596	1,278	3,745	4,332

Source: Access Economics, extract from Table 4.1. p. 22.

The table below combines the increases in revenues since the 2009-10 Budget (June 2009) as presented in MYFER in December 2009, with the increases projected by Access Economics since MYFER.

Table 3
MYFER increases over 2009-10 Budget revenues combined with Access Economics projected increases over MYFER revenues

\$m	2009-10	2010-11	2011-12	2012-13	Total
Taxation revenue	871	580	1,692	1,654	4,797
Total non-taxation revenue	819	1,475	2,997	3,522	8,813
Total revenue	1,690	2,055	4,689	5,176	13,610

Source: 2009 Queensland Budget, MYFER, and Access Economics, p. 22.

If the increases in revenues as reported in the Government's MYFER together with the Access Economics forecasts eventuate then ***rather than a loss of \$15 billion in revenues*** as claimed by Mr Fraser, the Government will have ***an increase of nearly \$14 billion over the four years to 2012-13 – a turnaround of \$29 billion.***

Earlier this month in an interview (ABC, Rockhampton, 5 May 2010), Mr Fraser apparently said that the 'Access Economics report predicting improved State revenue is no reason for the Government to reconsider its privatisation plans' and that 'the report is not relevant to the debate' (Paul Robinson, News Editor).¹

The reality is that *Mr Fraser himself made revenue forecasts relevant because it was his own forecast of a '\$15 billion hole' in Budget revenues that was used to justify his privatisation plans.*

2.4 RESERVE BANK OF AUSTRALIA STATEMENTS

In a speech in April 2010, Glenn Stevens, the Governor of the Reserve Bank, confirmed the brevity and mildness of the downturn in the Australian economy as a result of the global financial crisis. He said:

¹ As noted later in this Report, Mr Fraser had welcomed a similar Access Economics Report released in January 2010 which referred to the Queensland economy growing faster than the nation in 2009-10 (Ministerial Media Statement, 'Improved economic forecasts welcome', 27 January 2010).

While several major countries have had one of their most, if not their most, serious recessions in the post-war period, Australia had arguably one of its mildest. We had a relatively sharp but very brief downturn in aggregate demand and economic activity late in 2008, and then returned to a path of expansion during the first half of 2009. ... real GDP grew by 2¾ per cent through last year – a bit below average, but much higher than for most other high-income economies. ...

... the rate of unemployment, at about 5¼ per cent, is more than 2 percentage points lower than we forecast a year ago. The level of employment is 3½ per cent, or some 350,000 jobs, higher than we expected a year ago. GDP growth of 2¾ per cent through 2009 compares with our forecast a year ago of -1 per cent. That is, the level of real GDP today is nearly 4 per cent higher than had been anticipated. ...

... there has been a good outcome for the national economy in a difficult international environment (Address to Regional Business Leaders Forum, 23 April 2010).

This confirms the position in our November 2009 Briefing Paper that by the time of the announcement of the Queensland asset sell off for financial crisis reasons in June 2009, the economy was already on its way out of its mild downturn.

The Reserve Bank has highlighted the importance to Australia of the growth taking place in the Chinese and other Asian economies and their accompanying strengthening of commodity markets and prices (*Minutes of the Monetary Policy Meeting of the Reserve Bank Board*, 4 May 2010). Details on this were provided in its quarterly *Statement on Monetary Policy*:

The strong recovery in Asia has underpinned substantial rises in the prices of Australia's main commodity exports. In particular, prices for iron ore and coking coal have increased sharply over recent months, reflecting strong growth in steel production in China and elsewhere in Asia. As a result, Australia's terms of trade are likely to increase substantially this year to reach the very high levels of two years ago, providing a significant boost to incomes (*Statement on Monetary Policy*, May 2010).

Assistant Governor Philip Lowe commented that these factors have meant that:

... our experience has been much closer to that of many of our major trading partners in Asia, than it has been to that of the other advanced economies of the world. As a result, we are operating closer to full capacity than other developed countries ... (Keynote Speech to Colonial First State Investment Forum, 13 May 2010).

The Bank has also confirmed further expected improvements in the Australian economy. It believes that world growth is expected to be 'at trend pace or a little above in 2010' with growth in Asia continuing 'to be strong, contributing to pressure on prices for raw materials' (Glenn Stevens, *Media Release*, 4 May 2010). Accordingly:

Australia's terms of trade are rising by more than earlier expected, and this year will probably regain the peak seen in 2008. This will add to incomes and foster a build-up in investment in the resources sector. Under these conditions, output growth over the year ahead is likely to exceed that seen last year, even though the effects of earlier expansionary policy measures will be diminishing (*ibid.*)

Assistant Governor Philip Lowe added:

Australia's major export partners are growing strongly, and there are reasonable prospects that they will continue to do so (Keynote Speech to Colonial First State Investment Forum, 13 May 2010).

The Reserve Bank forecasts the Australian economy to grow by around 3¼ per cent over 2010. Beyond this year growth is expected to pick up to be in the range of 3¾-4 per cent (*Statement on Monetary Policy*, May 2010, p. 3).

Table 4
Output growth forecasts
Per cent, over year to quarter shown

	Dec 2009	Jun 2010	Dec 2010	Jun 2011	Dec 2011	Jun 2012	Dec 2012
GDP growth	2.7	2.5	3.25	3.75	3.75	3.75	4
Non-farm GSP growth	2.5	2.5	3.25	3.75	3.75	3.75	4

Source: Reserve Bank, *Statement on Monetary Policy*, May 2010, p. 56.

2.5 2010-2011 FEDERAL BUDGET

The 2010-11 Federal Budget brought down on 11 May 2010 noted that 'the recent downturn in Australia has been particularly mild compared with the experience of the rest of the world' (p. 2-16). Moreover the outlook for the Australian economy is increasingly positive with strong prospects underpinned by an improved global outlook particularly in the developing Asian economies (*2010-11 Budget Statement 2*, pp. 2-3 to 2-4).

According to the 2010-11 Budget Papers:

- the world economy is expected to grow by 4¼ per cent in 2010 and in 2011, led by growth in Asia;

- Australia is expected to benefit from our close trade links to the rapidly growing Asian region, and in particular China;
- the Australian real Gross Domestic Product (GDP) grew by 1.3 per cent in 2008-09, and is forecast to grow by 2 per cent in 2009-10, 3¼ per cent in 2010-11, rising to 4 per cent in 2011-12 – with the economy expected to return to around its full employment level of output;
- exports are forecast to grow solidly in both 2010-11 and 2011-12, as the world economy continues to strengthen and new resources production comes into line. The recovery in exports is expected to be broad-based, but with particular strength in non-rural commodity exports especially iron ore and coal;
- the terms of trade are forecast to rise by 14¼ per cent in 2010-11 to their highest level in 60 years, largely due to strong price rises for Australia's iron ore and coal exports, driven by a recovery in global demand. Commodity prices are expected to moderate somewhat in 2011-12, but still remain at high levels. High commodity prices have caused a substantial supply response and this will increasingly weigh on prices as supply comes on stream. The medium-term projections assume that the terms of trade will fall over the medium term, as world supply increases (2-4 to 2-7). ... Nonetheless, by the end of the forecast period, higher commodity prices will see the terms of trade remain around 80 per cent higher than their average in the decade prior to the commodities boom (p. 2-27);
- the 2010-11 Budget forecasts imply that the economy will return to full capacity within the forecast period (p. 2-37).

In a post-Budget address on 18 May 2010, Ken Henry, Secretary, Commonwealth Treasury, commented on factors which will determine how long the high terms of trade, and underlying export prices, are likely to be sustained. He examined three relevant considerations, namely, the global supply response to high commodity prices; the long term trend of commodity prices; and the industrial development of China and India ('Fiscal Policy and the current environment', pp. 6-12). He concluded that:

we have at least reasonable grounds for believing that strong world demand for Australian commodities and of high terms of trade will be sustained for some time, accepting that the duration of the period of elevated terms of trade is subject to a high degree of uncertainty (pp. 12-13).

The relevance of the rapidly industrialising countries like China and India to Australia is significant. In China, and to a lesser degree India, the catch-up in per capita incomes to those enjoyed by more developed countries has been a major source of growth in demand for Australia's mineral exports. But as Ken Henry noted, both countries still have a long way to go. Referring to GDP

and population estimates constructed by the late Angus Maddison (*Contours of the World Economy 1-2030AD*, 2007), he stated that 'for the first 1,700 to 1,800AD, China and India's share of world GDP may have been greater than that of western Europe and the US.' He continued: 'their share of world GDP began to decline as the industrial revolution took hold in the west. Only in the last four decades has China and India's share of world GDP rebounded strongly. Both have the potential to revert to something close to pre-18th century GDP shares in coming decades. He concluded that the catch-up of China and India 'is certainly possible' (pp. 9-11).

Another factor which may support the sustainability of Australia's strong terms of trade is the consumption of metals. Dr Henry referred to the IMF's 2006 World Economic Outlook which concluded that:

the consumption of metals typically grows with income until incomes reach about \$15,000 to \$20,000 per capita (in PPP adjusted US dollars) as countries go through a period of industrialisation and infrastructure building. At higher incomes, growth typically becomes more 'services driven' and the growth in the use of metals per capita tends to stagnate (p. 11).²

Examples were provided of countries like the US and Japan whose consumption of copper and steel per capita has stagnated as real GDP has grown. On the other hand:

GDP per capita (in PPP adjusted US dollars) for China and India were at around \$8,000 and \$3,000 respectively in 2009. So the potential for substantial catch-up by China and India in non-rural commodity consumption is high (p. 12).

According to the 2010-11 Federal Budget, the Chinese economy is continuing to grow strongly - with its domestic activity combining with external demand. GDP grew by 8.7 per cent in 2009. It is forecast to grow by 10 per cent in 2009-10 and by 9½ per cent in 2010-11 (p. 2-12).

At the same time, the outlook for India is positive with growth of 7 per cent in 2009-10. This is based on improved business and urban consumer confidence, improved weather conditions, and renewed foreign capital inflows (p. 2-12).

The Federal Budget recognised that while the global outlook has improved, there are some important emerging risks associated with sovereign debt issues of European countries such as Greece. In addition a number of

² 'Purchasing Power Parity' or 'PPP' weights are the rates at which the currency of one country would have to be converted into that of another country to buy the same amounts of goods and services in each country. PPP weights are less volatile than market-determined exchange rates, and are preferred because they do not indicate large swings in measures of growth when growth rates in individual countries are stable.

advanced economies have high unemployment rates and financial systems still requiring improvement (pp. 2-12 to 2-13).

At the same time, there are also 'upside risks' to the outlook. According to the 2010-11 Federal Budget:

Just as many observers have underestimated the strength of the rebound to date, there may be the potential for further upward surprises in the near term as forecast levels of activity in the major economies remain well below potential. This scenario may arise through a stronger-than-expected feedback loop between improvements in activity and confidence (p. 2-13).

As previously noted, Queensland with its significant natural resources is in a particularly good position to reap enormous benefits from the strong demand for non-rural commodities, particularly Asia, with accompanying higher prices. Also as noted in the 2010-11 Federal Budget, 'an anticipated expansion of production and export capacity, particularly for the bulk commodities, will allow for strong volumes of growth. ... mine and port expansions on the east coast are expected to support growth in coal exports' (p. 2-24).

The strong demand for its resources now and in the future will benefit the State generally. It will also generate significant revenues from the major items of infrastructure slated for privatisation. All the more reason to retain these assets in public ownership.

Queensland is also expected to benefit from strong growth in investment in new mining-related engineering construction expected as a number of major resource projects commence (p. 2-19). A key area of growth in mining investment will be in liquefied natural gas (LNG) as global demand for gas increases significantly, particularly from Asia. In Queensland large-scale LNG projects include 'coal seam gas to LNG projects including Queensland Curtis LNG, Gladstone LNG and Australia Pacific LNG' (p. 2-21).

Also the Resources Super Profits Tax (RSPT) is expected to have a positive impact on future investment in Queensland. The Federal Government has announced that it will reform the taxation of Australia's non-renewable resources with a uniform resource rent tax – the RSPT. It is to apply from 1 July 2012 at a rate of 40 per cent on the realised value of all resource deposits, with the exception of projects within the scope of the Petroleum Resource Rent Tax (pp.4-23 to 4-25), while providing significant benefits to the industry through the treatment of losses, and other measures. According to the 2010-11 Budget:

in the long run, the Resources Super Profits Tax (RSPT) is expected to lead to an increase in resource sector investment, with the crediting of royalties effectively removing the distortionary effect they have had on investment and production (p. 2-20).

The RSPT has been the subject of a sustained campaign by mining companies. However, Dr Ken Henry, who was chairman of the Federal Government's tax review panel, said that Australia's natural resources are currently subject to 'a plethora of distorting excises and royalties levied by the Commonwealth, State and Territory governments', and that:

In general, royalty adjustments have not kept pace with the value of our resources. Yet there are also many mining projects that are close to being unprofitable but which nevertheless make substantial royalty payments to State governments (Post-Budget Address to the Australian Business Economists, 18 May 2010, p. 21).

The tax review panel recommended that the royalty based arrangements be replaced with a resource rent based tax with the preferred approach being the Allowance for Corporate Capital (ACC). As Dr Henry stated:

The ACC tax is part of a small family of taxes which tax only economic rent. Unlike royalties, which tax gross receipts, the ACC, by taxing only economic rents, or supernormal profit, does not distort production and investment decisions. Further, because it is a tax on rents, it should have no impact on prices.

The ACC recommended by the panel, and subsequently accepted by the Government in the form of the RSPT, would represent world's best practice in charging for the exploitation of non-renewable natural resources (pp. 22-3).

And that:

an ACC with refundability of the tax value of losses in the event of project failure and an uplift equal to the bond rate is also a neutral tax on economic rent or supernormal profit.

Under an ACC, instead of allowing investment to be immediately expensed ... the deduction or tax credit is deferred to a later period. This can be done by allowing losses to be carried forward, allowing assets to be depreciated over time or some combination of both (pp. 23-4).

In summary, according to Dr Henry,

The RSPT has important economic effects. By rebating royalties, providing a generous exploration rebate, and financing a cut in the company income tax rate, it reduces significantly several of the features of the present tax system that act to discourage mining investment. The RSPT itself, being a neutral tax, should have little impact on mining investment. Overall then, mining investment is encouraged (p. 30).

Federal Treasurer, Wayne Swan, observed:

Between the company tax cut and the resources super profits tax, we're expecting GDP to increase by 0.7 per cent ('Reform vital to Australia's future', *The Sydney Morning Herald*, 22-23 May 2010).

3. QUEENSLAND'S ECONOMIC AND FINANCIAL PROSPECTS

3.1 Treasurer Fraser marked down the Queensland economy to justify his privatisation plans

As stated in our November 2009 Briefing Paper, at the time of the June 2009 State Budget and the announcement of the asset sell offs, Treasurer Fraser marked down the Queensland economy and the Government's revenues by exaggerating the impact of the global financial crisis on Queensland.

Access Economics came to the same conclusion in its report in March 2010 (p. 7). Also the Federal Government, in its 2010-11 Budget brought down on 11 May 2010, conceded that its last year forecasts for the Australian economy were too pessimistic (p. 2-23). Similar concessions have been made by the Reserve Bank in various statements.

At the time of the 2009 Budget, Mr Fraser went out of his way to emphasise that the privatisation decision was necessary due to the impact of the global financial crisis.

Yet, it would appear that even he may not have believed his own rhetoric. While claiming that 'the effects of the global recession have driven the budget into deficit with a \$15 billion wipeout in revenues' and predicting job losses, Mr Fraser was saying:

Despite the global recession, Queensland is still expected to record growth in 2008-09 of ½% - to once again stay ahead of the nation.

Even with full impact of the global recession forcing a marginal contraction of ¼% in 2009-10, Queensland remains well placed for a strong recovery with growth again expected to stay ahead of the nation. ...

The Queensland economy is forecast to recover by 2¾% in 2010-11, which has it ahead of the expected trajectory of the nation's economy (*Media Statement*, 16 June 2009).

Also while predicting a continuing increase in unemployment, as an impact of the global financial crisis and so the need for the asset sell off, by September 2009 - just three months after Mr Fraser's exaggerated statements, Queensland was experiencing job growth. Even Mr Fraser could not hide this fact:

Job creation rose for the second consecutive month ... 1900 jobs were created in Queensland in October, following the 600 jobs created in September (*Media Statement*, 12 November 2009).

In December 2009, things were looking even better as outlined in the Queensland Government's own *Mid-Year Fiscal and Economic Review* (MYFER) discussed above. At that time, while still clinging to his claim that Queensland had been 'hit hard by the global financial crisis' and claiming that the 'asset sales program ... is critical to restoring strength to the state's finances', Mr Fraser conceded that:

Queensland Treasury's new economic forecasts reveal an improved outlook for Queensland's major trading partners, the state's economic growth and unemployment.

There is no doubt that Queenslanders should be optimistic about our medium to long-term prosperity (*Media Statement*, 4 December 2009).

By January 2010, Mr Fraser was saying that 'there has now been five straight months of job creation in Queensland' and was welcoming an Access Economics report forecasting the Queensland economy 'to grow faster than the nation in 2009-10' (*Media Statement*, 27 January 2010).

In February 2010, confidence had so improved in the Australian economy that the Australian Government announced that it would no longer offer a guarantee on new State and Territory borrowings (that is new securities issued) after 2010.

Treasurer Mr Fraser admitted that Queensland Treasury Corporation successfully issued a bond line in January 2009 without the guarantee. Nevertheless, he was making foolish statements such as 'It's absolutely critical that the asset sales program be completed to give our balance sheet a strong footing for the future' (*Media Statement*, 7 February 2010).

Moreover, according to the Reserve Bank, both NSW and Queensland – the two States which made use of the guarantee – have issued 'several new unguaranteed securities of significant size, cheaper than if they had used the guarantee'. NSW has also offered investors the capacity to switch from some existing guaranteed debt into unguaranteed securities. The unguaranteed debt trades about 15 basis points higher in yield than the former. For Queensland, with a lower credit rating, the spread between guaranteed and unguaranteed debt is about 20 basis points (*Statement on Monetary Policy*, May 2010, pp. 37-8). So that, contrary to Mr Fraser's exaggerated claims of

the impact of the loss of the State's triple A credit rating, the interest cost difference on unguaranteed debts when compared with triple A NSW is just five basis points.

In subsequent months, jobs growth continued and unemployment was falling (*Media Statements*, 11 February 2010, 11 March 2010, 8 April 2010).

By May 2010, in a joint statement, the Premier and the Treasurer were claiming Queensland to be

the biggest jobs generator in Australia last month, creating more than on third of new jobs ... we've created jobs for Queenslanders for nine straight months now (*Media Statement*, 13 May 2010).

Meantime, while the Treasurer as recently as February 2010, in a speech to CEDA was continuing to defend the sell off proposal by claiming that the State's 'finances did take a massive hit' (3 February 2010), his own Department was saying

Following the impact of the financial crisis in late 2008, ... Queensland's economy has gathered momentum over 2009. While business and medium-to-high density dwelling construction remained weak in September quarter 2009, a resilient trade sector resulted in continued growth in the economy as a whole, while the December quarter saw a further recovery in key sectors such as house construction and coal exports (Queensland Treasury, *Queensland Economic Review*, February 2010, p. 1).

... with leading indicators suggesting a further recovery in economic activity will occur through 2010 (p. 2).

In March 2010, Treasury referred to the improved outlook for Queensland's commodity exports including increased volumes and prices. Coal exports are a case in point, with infrastructure expansions already undertaken or underway:

... strong resource demand from China has bolstered Queensland's coal export volumes so far this financial year. ... In the first seven months of 2009-10, hard coking coal exports from Queensland increased at an annual rate of 18.7%. Thermal coal exports – used primarily in electricity generation – rose by a more modest 7.5%.

Looking to 2010-11, the coal outlook for Queensland is positive. Numerous port and infrastructure expansions such as the expansion of the Abbot Point and Hay Point coal terminals, as well as new mines, such as the Carborough Downs longwall coking coal mine, will continue to boost domestic capacity. Continued demand from India and China, as well as recovery in industrial production in developed economies, will also be driver of coal demand.

The outlook for coal prices in 2010-11 is also positive. ... export earnings are expected to grow again in 2010-11, as export volumes and world commodity prices benefit from a return to global economic growth (*Queensland Economic Review*, March 2010, p. 4).

By April 2010, Treasury was confirming that the turning point for the global financial crisis was March 2009 with benefits for the Queensland economy – note **March 2009**, three months before Mr Fraser was using the crisis as the reason for his privatisation proposal:

Early March 2009 marked the turning point in the global financial crisis, with most financial market indicators having rebounded since then. ...

On balance, the recovery in financial conditions over the past year, in terms of access to finance, household wealth and export earnings, has supported Queensland economic conditions (*Queensland Economic Review*, April 2010, pp. 1, 7).

All this before the sale of any public assets!

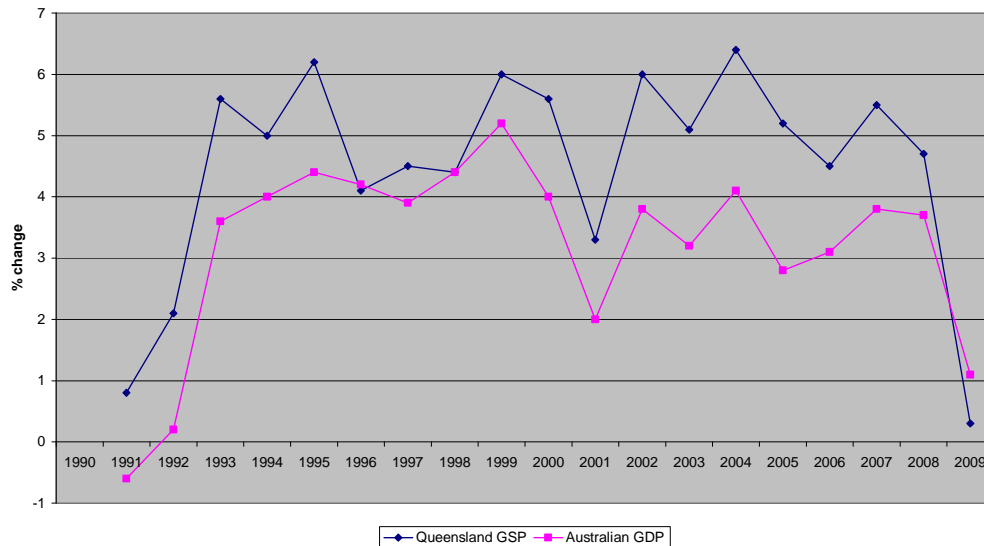
3.2 The Queensland economy solid with good prospects

As noted above, Australia's economic and financial prospects have significantly improved since our Paper was released. Confirmation of this fact has been provided in statements by various officials including by the Reserve Bank and by the Federal Government in its 2010-11 Budget.

With its significant share of the nation's resources sector (providing about 40 per cent of the value of mining production in Australia - Mr Fraser, *Media Statement*, 2 May 2010), it is expected that Queensland will perform better than the national average. This is the norm for Queensland as shown by the growth in its share of national output and population. The growth rates in Queensland's output have been higher than the national levels for many years as shown in the following chart (Australian of Bureau Statistics, *5220.0 Australian National Accounts: State Accounts*, Time Series Workbook, 22 December 2009).

Chart 1

Changes in Gross State Product and Gross National Product



As shown above, in the last two decades, Queensland's Gross State Product grew at a higher rate than the national rate in every year bar two. Queensland growth averaged 4.5 per cent per annum compared with an annual national average of 3.2 per cent.

The positive prospects for population growth and the resources industry will confirm this improved performance for Queensland, with Australia's mining resource production concentrated in Queensland and Western Australia.

3.3 Queensland and Federal Government investment in infrastructure will increase economic capacity

In addition to the Queensland Government's infrastructure spending in recent years, the Queensland economy has been and is expected to continue to benefit from the Federal Government's commitment in its 2010-11 Budget to increase its investment in the nation's transport infrastructure including roads, rail and ports.

Queensland is benefiting from the funds provided under the Federal Government's Nation Building Program for improvements in transport infrastructure. Under the Nation Building Program, the Commonwealth will provide \$2.7 billion to the States in 2010-11 for on-road and rail infrastructure (*Budget Paper No. 3*, pp. 87-93). The various payments to Queensland under this Program during 2009-10 to 2013-14 are as follows.

Table 5
Estimated Payments to Queensland for the National Partnership on
the Nation Building Program

Payment	2009-10	2010-11	2011-12	2012-13	2013-14	Total
Investment - road	1,420.5	539.7	966.0	1,103.4	744.3	4,773.9
Boom gates for rail crossings	28.5	-	-	-	-	28.5
Black spot projects	24.3	12.1	12.1	12.1	12.1	72.7
Off-network projects	36.9	65.3	54.3	4.5	-	161.0
Off-network projects supplementary	54.4	-	-	-	-	54.4
Improving the national network	48.3	-	-	-	-	48.3
Heavy vehicle safety and productivity	2.0	4.5	4.9	-	-	11.4
Improving local roads	0.4	-	-	-	-	0.4
Roads to recovery	71.2	71.2	71.2	71.2	71.2	356.0
Total	1,686.5	692.8	1,108.5	1,191.2	827.6	5,506.6

Source: 2010-11 Budget Paper No. 3, 11 May 2010, pp. 87-9.

In addition, the Commonwealth will provide \$869.4 million to the States in 2010-11 for nationally significant infrastructure projects for metropolitan rail networks, national road priorities and port infrastructure. The details of payments to Queensland over 2009-10 to 2013-14 are as follows.

Table 6
Estimated Payments to Queensland for the National Partnership on
the Nation Building Program for the Future

Payment	2009-10	2010-11	2011-12	2012-13	2013-14	Total
Major cities – rail	20.0	-	-	-	-	20.0
Building Australia Fund – rail	365.0	-	-	-	-	365.0
Building Australia Fund – road	-	-	-	400.0	-	400.0
Total	385.0	-	-	400.0	-	785.0

Source: 2010-11 Budget Paper No. 3, 11 May 2010, p. 90.

Other federal transport related payments to be received by Queensland include:

- under the Regional and Local Community Infrastructure Program: \$94.7 million in 2009-10 and \$42.2 million in 2010-11;
- under the *Interstate Road Transport Act 1985*: \$5.7 million, \$6.5 million, \$6.8 million, \$7.1 million, and \$7.4 million for the years 2009-10 to 2013-14; and
- under the Jobs Fund: \$4.5 million in 2009-10 and \$53.4 million in 2010-11 (pp. 91-2).

This means that, between 2009-10 and 2013-14, Queensland will receive total Federal funding for infrastructure of \$6,519.9 million.

Queensland will also benefit from the Federal Government's announcement that it will be reinvesting some of the proceeds from the RSPT into an Infrastructure Fund for the States. The Fund is expected to deliver \$700 million to the States in 2012-13 and grow over time (*Budget Paper No. 3*, p. 1). This is in addition to the increase in investment in the State expected as a result of the actual introduction of the RSPT (discussed above).

4. IMPACT OF ECONOMIC IMPROVEMENTS ON THE QUEENSLAND BUDGET

As previously mentioned, in the 2009-10 Budget, and in various other statements, Treasurer Andrew Fraser claimed that the global financial crisis will result in a 'colossal drop in forecast revenue of more than \$15 billion across the forward estimates' (*2009-10 Queensland Budget Paper No.1*, p. 3).

Our November 2009 Briefing Paper noted that the so-called \$15 billion was not an actual loss but a **forecast** reduction in revenues. Moreover, this so-called loss was not for one year but across the **forward estimates**. That is, over four years. The claims also ignored the measures announced by the Government in the last Budget that it claimed would improve the fiscal position by \$5.4 billion over the forecast years.

However, the projected revenue figures presented in the 16 June 2009 Budget were overtaken by the actual revenue results for the year ended 30 June 2009 as presented in the audited *Report on State Finances of the Queensland Government 2008-09*. Revenues turned out to be \$37,008 million or \$1,134 million higher than shown in the Budget Papers. It remains unclear how Treasurer Fraser's estimates were out by \$1,134 million, after 50 weeks of the 52 week financial year.

At the same time, the Budget Papers proudly stated that 'Queensland will retain its competitive tax status, with per capita state tax estimated at \$2,087 in 2009-10, compared to an average of \$2,517 for the other states and territories' (p. 87).

As noted previously, claims about the so-called \$15 billion black hole in the Budget were used repeatedly as justification for the Government's asset sell off. The fact is that at the time of the dire predictions made by the Premier and the Treasurer followed by the announcement of the asset sell off, Queensland's finances were better than presented.

Developments since then have confirmed questions raised about the credibility of the projections contained in the 2009-10 Budget, and in the December 2009 MYFER.

The facts are that not only were Queensland's finances better than presented, but also Queensland's revenues are expected to increase significantly - in contrast to the doom and gloom scenario presented by Mr Fraser, and repeated (and repeated) regardless of the weight of evidence.

4.1 Improvements in government revenues

As described above, improvements in revenues are expected from a number of sources.

For a start, an increase is expected in Queensland's GST distribution. Instead of the 2009-10 Budget's assumption of a \$3.6 billion reduction over 2010-11 to 2012-13, (Budget Paper No. 2, p. 92), the 2010-11 Federal Budget showed that Queensland would receive an increase in GST payments and general revenue assistance of \$1.155 billion to 2012-13, and \$1.837 billion in the period to 2013-14.

This means that on this measure alone Queensland's financial position is expected to be better off by nearly \$5 billion (\$4.755 billion) over the three years to 2012-13 than presented by Mr. Fraser in his 2009-10 Budget.

In addition, all recognised sources including the Reserve Bank and the Federal Government have confirmed that the Australian economy has performed and is forecast to perform much better than assumed by Mr Fraser and the Queensland Government in the 2009-10 Budget and also in the December 2009 MYFER. The expected improvement in Australia's mineral exports is likely to play a significant part in the financial position of Queensland.

As noted above, Access Economics has stated that Queensland Government revenue is expected to grow at a faster rate than outlined in the MYFER in the years up to 2012-13.

Taking the Queensland Government's own data in the MYFER and that of Access Economics and relating them to the 2009-10 Budget figures, results in an ***expected increase in revenues of some \$14 billion over the four years to 2012-13, rather than a loss of \$15 billion in revenues as claimed by Mr Fraser – a turnaround of \$29 billion.***

This estimate is expected to be even greater with the further economic improvements that have taken place since March 2010.

4.2 'Sale' of Queensland Forests

The June 2009 Budget referred to the potential sale of Forestry Plantations Queensland's softwood business and possibly its hardwood plantations. As part of a campaign to justify the sale, it was claimed that 'the business requires \$100 million of Government investment over the next five years'. This claim was not explained, justified – or, arguably, justifiable. Our November 2009 Briefing Paper noted that FPQ's last available balance sheet showed that the aggregate value of all of its property, plant and equipment was only \$98 million, of which \$44 million was attributed to land, \$18 million to buildings and \$17 million to access roads. FPQ's Annual Report made no mention of any planned expansion or of the need to make major investments in new equipment, but it explained that the business utilises contractors. It was difficult to comprehend the reasons for a capital injection of \$100 million. The June Budget Papers made no mention of any 'required' expenditure. It seemed that this need for \$100 million equity injection was only identified when the Government set about constructing a case for asset sales.

Yet the Government continued to assert that FPQ required major additional capital investment – though qualifying the claim only slightly: FPQ required 'up to \$100 million of ongoing Government investment over the next five years' (*Queensland Assets Sale – Sale of Forestry Plantations Queensland*, undated).

Our Briefing Paper also noted that 'a case could be mounted that certain activities – such as state-owned forestry operations – are hardly part of the core business of governments, and justifiably could be sold so that the proceeds could be re-invested elsewhere'.

Later in November 2009, Treasurer Fraser announced that the timber business was 'to be put to market' (*Media Release*, 26 November 2009). On 18 May 2010 he told Parliament that he had 'signed contracts for the transaction for the commercial timber business', for a 'sale price' of \$603 million (more than the \$500 million previously forecast). He was also at pains to claim that the State was not selling the Crown plantation land on which the business is located 'only the right to manage, harvest and re-grow the plantation timber' (*Parliamentary Debates*, 18 May 2010).

FPQ's balance sheet at 20 June 2009 showed total equity (total assets less total liabilities) of \$1.14 billion – the main asset item being 'plantation growing timber' valued at \$1.167 billion. It appears from Treasurer Fraser's statement to Parliament and from his media releases that the Government is handing over all of this growing timber as part of the \$603 million transaction.

Mr Fraser told Parliament that the result 'dismissed the hysteria of those opposite about a so-called firesale'. However he has not explained in detail what impact this transaction will have on the State's consolidated balance sheet.

On the face of it, if the transaction involves transferring the rights to FPQ's inventory, roads works and some freehold land, it could lead to the recording of a loss of some hundreds of millions of dollars this financial year.

4.3 Proposed sale of Queensland Rail

It will be recalled again that our November 2009 Briefing Paper referred to Treasury data provided to union representatives that indicated that after system expansions and increases in capacity by the Queensland Government, the profits of Queensland Rail (QR) were expected to escalate from \$86.8 million in 2009-10 to no less than \$564.2 million in 2012-13. Those figures were after the notional tax that is paid to Queensland Treasury at prevailing corporate tax rates. Major elements of those system expansions were being funded by sums already allocated in the 2009-10 Budget, so that \$2.1 billion was to be spent on capital works before a sale transaction takes place.

In December 2009 the Queensland Government announced an initial public offering (IPO) of shares in QR, with a first offer planned in the second half of 2010. This would involve the sale of both the 'below rail' (the rail lines and infrastructure) and 'above rail' (rolling stock and contracts) businesses.

At that time, Premier Bligh estimated the value of QR's coal and freight assets at \$7 billion (Tony Moore, 'Private companies to bid for state's coal rail', *Brisbane Times*, 9 March 2010).

It was not surprising that industry was interested in getting its hands on these strategic assets. First to come along was BHP Billiton which on 11 December 2009 lodged an offer for Queensland's coal freight network (Matthew Stevens, 'BHP behind bid to buy Queensland Rail', *The Australian*, 16 December 2009). Details of this bid have not been made available. This offer was rejected.

By March 2009 coal companies realising the benefit of purchasing a strategic asset and fearing that a public (benevolent) monopoly would be replaced by a private monopoly with the entire rail freight business in the hands of a competitor, formed a consortium (styled the 'Queensland Coal Industry Rail Group') aiming to buy only the freight rail lines – not the associated rolling stock. A third party – most likely the Australian Rail Track Corporation – would operate the infrastructure. At the same time the State's entire rail network was being valued at \$3 billion – down from the \$7 billion estimates a few months earlier.

The mining industry is fearing that a private monopolistic ownership would have little incentive to invest in infrastructure leading to restrictions to future network capacity. As Asciano put it, in a submission to the ACCC:

A privatised QR would have a fiduciary duty to maximise its value for shareholders by, amongst other things, minimising above-rail competition provided it remained with the law (Matthew Stevens, *ibid.*)

In relation to the coal supply chain, Asciano suggested that there is a real incentive for an integrated operator to constrain 'natural renewal and capacity improvements' and that 'this would be particularly the case with a privatised QR' (*ibid.*).

The Federal Resources Minister, Martin Ferguson, has entered the debate stating:

... if we don't get this right, we will hold back exports which will undermine royalty receipts to the Queensland Government.

I am not confident that the Queensland Government's proposal will deliver the necessary investment (ABC, *7-30 Report*, 24 March 2010).

5. CONCLUSIONS AND FINAL OBSERVATIONS

In June 2009 Treasurer Fraser claimed that there was a projected \$15 billion 'hole in the budget', arising from a forecast shortfall in revenues over four years. Yet, as his own Treasury Department now acknowledges, economic recovery had started as early as March 2009. In further confirmation, the Reserve Bank has reported that Australia experienced

a relatively sharp but very brief downturn in aggregate demand and economic activity late in 2008, and then returned to a path of expansion during the first half of 2009. ... real GDP grew by 2¾ per cent through last year – a bit below average, but much higher than for most other high-income economies. ...

Mr Fraser had equated a pessimistic \$15 billion projected revenue shortfall with \$15 billion in debt – and made a series of false claims about the interest costs of maintaining this (yet-to-be incurred) debt on Queensland's finances – exaggerating the impact by referring to pessimistic forecasts over the next four years on the assumption that \$15 billion worth of borrowings would be drawn down immediately.

This alleged 'hole in the budget' of \$15 billion was then used by Premier Bligh and Treasurer Fraser to announce the privatisation of key public assets.

Yet such claims were – and remain – misleading and deceptive:

- Cuts in budget spending in the last Budget were claimed to improve the fiscal position by \$5.4 billion over four years – so the claimed shortfall would at worst have been \$9.6 billion over four years.
- The last Budget appears not to have made sufficient allowance for an increase in revenues derived from dividends from public trading corporations – notably Queensland Rail. Treasury papers obtained in November 2009 revealed that the profits of Queensland Rail were expected to escalate from \$86.8 million in 2009-10 to no less than \$564.2 million in 2012-13 – and those figures were after notional taxes (at the corporate tax rate) which are payable to Queensland Treasury.
- The Queensland Government's fiscal position has continued to improve through increases in own-source revenues. These include increases in Queensland's royalties from exports of coal and bauxite which the Commonwealth Grants Commission has estimated will improve Queensland's circumstances by \$314.6 million in the coming year (p. 12), and those and other revenues are expected to improve over the next few years.

- The Queensland Government's fiscal position has also improved through increases in Commonwealth distributions. Following recent determinations by the Commonwealth Grants Commission, Queensland can expect an increase in GST distributions. Rather than a decrease in Queensland's share of GST revenue of \$3.6 billion over 2010-11 to 2012-13 (as predicted by Treasurer Fraser in 2009), there will be an increase of \$1.155 billion to 2012-13, and \$1.837 million if 2013-14 is included. So that on this measure alone Queensland's financial position is expected to be better off by nearly \$5 billion (\$4.755 billion) over the three years to 2012-13 than presented by Mr Fraser in his 2009-10 Budget.
- In December 2009 the Government's *Mid Year Fiscal and Economic Review* reported a substantial improvement in economic conditions.
- A subsequent report from Access Economics (26 March 2010) found that the economic outlook was stronger than presented by the Queensland Government in its latest projections – the 2009-10 Mid Year Fiscal and Economic Review (MYFER) – reflecting the fact that the Access Economics forecasts were compiled more recently, and that conditions strengthened considerably over the second half of 2009.
- Access Economics concluded that by 2012-13 total taxation revenue in Queensland will be some 13% higher – with taxation revenues expected to be \$763 million higher than the MYFER forecast in 2009-10, building to an additional \$1.5 billion by 2012-13; total non-taxation revenue in Queensland will be some 10% higher – with non-tax revenues expected to be some \$2.4 billion higher than projected in the MYFER; and total revenue in Queensland will be some 10% higher – with an additional \$3.7 billion total revenue than currently allowed for in 2011-12, moving up to \$4.3 billion in 2012-13.
- Support for a generally optimistic economic outlook – particularly for Queensland as a major exporter of commodities - is provided by the recent Commonwealth Government's 2010-11 Budget Papers. They report that the world economy is expected to grow by 4¼ per cent in 2010 and in 2011, led by growth in Asia; Australia is expected to benefit from our close trade links to the rapidly growing Asian region, and in particular China. The recovery in exports is expected to be broad-based, but with particular strength in non-rural commodity exports especially iron ore and coal. The terms of trade are forecast to rise by 14¼ per cent in 2010-11 to their highest level in 60 years, largely due to strong price rises for Australia's iron ore and coal exports, driven by a recovery in global demand. Commodity prices are expected to moderate somewhat in 2011-12, but still remain at high levels.
- This report has combined the increases in revenues since the 2009-10 Budget as presented in MYFER in December 2009, with the increases projected by Access Economics since MYFER. This shows that **rather than a loss of \$15 billion in revenues** as claimed by Treasurer Fraser,

the Government will have ***an increase of nearly \$14 billion over the four years to 2012-13 – a turn-around of \$29 billion.***

Queensland also stands to benefit from the Federal Government's announcement that it proposes to reinvest some of the proceeds from the Resources Super Profits Tax into an Infrastructure Fund for the States. The Fund is expected to deliver \$700 million to the States in 2012-13 and grow over time (Commonwealth *Budget Paper No. 3*, p. 1).

Mr Fraser's dire predictions about the impact of the global financial crisis on Queensland, and his use of them to support his asset sell off, were wrong when he made them in June 2009 and they even more wrong now. Developments since then support the contention in our November 2009 Briefing Paper that there is no financial case for the Government's proposed privatisation.

Yet, in the face of the information that has come to light in the past year, Treasurer Fraser has continued to resist all efforts to encourage reconsideration of the sell off proposals in light of dramatically better economic circumstances.

Indeed with his encouragement, the Bligh Government has pushed ahead with proposals to sell off assets (despite the likelihood that the recent sale of Queensland Forestry interests has been at a major loss – unless some truly creative accounting has yet to be revealed).

Rather than engage in reasoned debate about these matters, Treasurer Fraser has preferred to engage in propaganda. Possibly nothing illustrates this better than the continued publication of statements about a \$15 billion budget shortfall. Even in May 2010, the Government website states:

Like all countries all over the world, the global recession hit this State budget hard.

The worst global recession in 70 years has reduced Queensland's income by \$15 billion over four years ...
(www.qld.gov.au/assetsale/economic-rationale/global-recession accessed, 24 May 2010).

Or perhaps Treasurer Fraser's speech to a CEDA Forum in Brisbane in February 2010 shows how he has still not learned the difference between forecasts and facts. He asserted:

Our finances did take a massive hit.

The facts suggest otherwise.

Yet a real massive 'hit' may occur if the Government proceeds to sell off coal and rail freight businesses just before they are poised to generate enhanced

returns from the increased scale of exports. Clearly BHP Billiton and syndicates of miners recognise the potential of those businesses – and are lobbying hard for a trade sale so they (not the Queensland taxpayer) can enjoy the profits that are likely to be generated by those businesses. Conversely, they fear the impact on their profits if a private sector monopoly seeks to impose monopolistic pricing and not reinvest and develop economic infrastructure – a role they see as a responsibility of government.

One can only speculate at the reason why a politician with responsibility for the management of Queensland's finances would prefer to continue a propaganda campaign rather than recognise the force of new facts. Why he would continue to use empty rhetoric rather than admit that the economic conditions have changed. Why he would continue to assert that 'we had to make tough choices' when it is easier to sell off government business than to manage them responsibly. Why he would misrepresent the task of financial management by offering statements such as

we have to choose between investing in expanding the rail network or investing in schools (Andrew Fraser, 'A stronger Queensland for the future', CEDA Forum, February 2010)

when Governments are able to do both – particularly if one of those investments is likely to generate positive cash flows.

It could be a lack of confidence in his understanding of finances – some who are uncertain about their technical competence often tend to compensate by being strongly assertive.

It could be that he has been persuaded about the wisdom of the sell off option by those who have most to gain from the transactions – the merchant bankers and financial consultants who are experts at massaging politicians' egos.

It could be a fear of losing an argument – as if all that was at stake was a concern about his own reputation.

'There is no shame in being wrong, only in failing to correct our mistakes'
(George Soros).

27 May 2010