The Australia Institute

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Bulga Optimisation Project

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TheAustraliaInstitute

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Our philosophy

As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

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The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

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Introduction

The Australia Institute welcomes the opportunity to make a submission to the Planning and Assessment Commission on the Bulga Optimisation Project. Our interest relates to the economic assessment of the project.

The original economic assessment of the project was of little value as it was based on flawed modelling and poor application of cost benefit analysis.[1] This assessment did not meet NSW government guidelines and should not have been accepted by the Department of Planning. It was heavily criticised in submissions to the Environmental Impact Statement (EIS).[2] In response, the proponents commissioned Deloitte Access Economics (DAE) to re-do the economic assessment.

The DAE report is a welcome improvement in standards of economic assessment of coal projects in NSW. Transparency around assumptions on coal prices, exchange rate, operating costs and capital costs is much improved on the previous assessment.

There is, however, a significant flaw in the DAE assessment. There is no discussion of important considerations in royalty calculation. The DAE estimate seems to significantly overstate the royalty revenue that would accrue to NSW from the project.

Royalty calculations overstated

As the Bulga Project is foreign owned, the main financial benefits of the project which accrue to NSW are royalties. DAE estimate royalty payments at $565 million present value. As profits accrue to overseas interests, this figure is of more importance than the overall net present value of the project in assessing the net benefit of the project to NSW in line with Director General's Requirements.

The DAE report does not discuss the assumptions behind this important calculation, particularly in regards to the deductions which miners can use to reduce their royalty payments. Deductions from royalties available to coal producers include:

- beneficiation
- levies
- insurance
- other categories such as bad debts.

These have the potential to reduce royalties by over $3.50 per tonne, which is the deduction for a full wash cycle.[3]

DAE provide an undiscounted figure of $1,069 million in royalties over the life of the project. The project is expected to produce 112 million tonnes of product coal over its life. Dividing these two figures gives an expected royalty of $9.54 per tonne.

DAE's price forecasts are for prices between $98 and $115 per tonne (real 2013 AUD). A royalty of $9.54 per tonne represents a royalty rate of 8.2 per cent of the higher end of this

[1] (ECS, 2012)
[2] (Economists at Large, 2013)
[3] (NSW DII, 2008)

range. As 8.2 per cent is the base rate for coal royalties in open cut mines, it appears that DAE have not included consideration of deductions in their assessment.

By not considering deductions, DAE overestimate royalty values and the benefit of the project to the NSW community.

Given the EIS includes mention of a coal handling and preparation plant and includes production of high ash coal, it seems likely the project would be eligible for deductions for a full wash cycle and it will certainly be eligible for a $0.05 per tonne deduction for the Australian Coal Association Research Program levy. Other deductions may reduce benefits for NSW further.

Allowing for the likely $3.55 per tonne deduction makes a substantial difference to royalty revenue. It reduces from $1,069 million to $671million over the life of the project, or a present value of $375 million. We recommend decision makers base their decisions around a financial benefit of present value $375 million and ascertain if other deductions may also apply which would reduce this further.

Conclusion

The likely royalty value of the project of $375 million needs to be balanced against the unquantified impacts of the project. Based on our experience with assessment of the neighbouring Warkworth mine, impacts are likely to be significant. Impacts will be borne locally while revenues will accrue to overseas shareholders and the state government, raising equity issues that must be considered. Extending coal projects also creates entities which have an incentive to lobby for further coal use at the expense of the global climate. Given these potentially significant impacts and equity issues, we recommend against approval of the project.

References

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