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Stratford Extension Project: Submission to Planning and Assessment Commission

Submission
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TAI

Submission

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Introduction

The Stratford Extension Project proposes to extend an existing coal mine in the Gloucester Valley, NSW. The Australia Institute welcomes the opportunity to make a submission to the Planning and Assessment Commission (PAC) relating to the Project. Our submission relates primarily to the economic assessment[1] of the project and the treatment of economic issues within the Department of Planning and Infrastructure (DPI)'s Preliminary Assessment Report (PAR)[2]. We also refer to the proponent's response to submissions (RTS)[3] and a report[4] by lead author, Rod Campbell, which was part of the EIS submission by the Barrington Gloucester Stroud Preservation Alliance and referred to by Gloucester Shire Council.

The PAR concludes that:

> [Despite] *some arguments about the details of the economic assessment of the project, the Department is satisfied that the project would result in economic benefits to the region, State and Australia.* (p56)

Although it notes the existence of these arguments, the DPI has not attempted to engage in or understand them. While some arguments are technical and largely academic, others are simple and directly relate to the merit of the project. These are arguments that we urge the PAC to grapple with in ways which the PAR has not.

Economic benefit and coal prices

The PAR refers to various calculations of economic benefit through the report, such as $84 million worth of royalty payments (p2) and a "net production benefit to Australia" of $145 million (p49). The PAC should be aware that these calculations are all based on coal prices significantly higher than current levels and analysts long term forecasts.

The original economic assessment uses prices of AUD$178 per tonne for metallurgical coal and AUD$111 per tonne for thermal coal. While the specifications of the coal are not provided in the EIS, the PAR describes the coal as "soft coking and thermal" (p2). Current semi-soft coking coal and thermal prices are AUD$129 and AUD$100 respectively. While current talk is of these prices easing further, analysts' long term forecasts are around these levels.[5]

The RTS stated that their forecasts were based on contract prices rather than spot price, a response repeated by the PAR (p50). While this response has some validity for thermal prices, it cannot account for the huge difference in metallurgical coal price. Both the RTS and the PAR go further, saying that as the modelled net present value (NPV) was still positive with a 20 per cent decline in price. They omit to say that it was only just positive – NPV had declined by 84 per cent, to only 23 million.

There is no doubt that at these price levels, the project is marginal, as acknowledged in the PAR:

[1] (Gillespie Economics, 2012)
[2] (NSW DPI, 2013)
[3] (Stratford Coal, 2013)
[4] (Economists at Large, 2013)
[5] (Business Spectator, 2014; CBA, 2013; World Bank, 2014)

> *Accordingly, the project is likely to be under economic pressure as evidenced by Yancoal's decision to suspend operations in the Roseville West Pit and reduce employment from 125 to 71 to reduce its production costs. However, the project has an 11-year life, and coal prices are expected to fluctuate over that time and not necessarily remain at current low values.* (p50)

The PAR offers no justification for why it is willing to accept the proponent's price forecasts, rather than those of market analysts. Proponents have an incentive to be optimistic with their price forecasts in what they tell decision makers and the market. The PAC must ensure that decisions are made in line with economic data that reflects market sentiment rather than proponents' optimism.

The PAR presents unsourced estimates of changes to NPV depending on operating hours (Table 3, p21). The estimates suggest that changing hours of operation could affect NPV by between AUD$21 and AUD$58m. The PAC should place no faith in these estimates as:

- They show only the magnitude of the change, rather than what the NPV has changed from and to. It seems likely that they are based on the initial NPV estimate of $145m, which as discussed above is based on optimistic prices unsupported by other analysts or the market. At current prices they suggest the project is unviable.
- They suggest that slowing production to take one extra year would reduce NPV by $27m. This seems highly unlikely as to achieve the central estimate of NPV $145 means that annual net benefit is around $19.3 million (bearing in mind NPV is discounted at 7% in the central estimate). Deferring some of each year's production to the final 12th year would result in only a fraction of $19.3 million, rather than a still greater sum.
- They suggest that slowing production by one year would cost $27 million, but slowing it by four years would reduce NPV by only $21 million.

No explanation is offered for these counterintuitive results.

The precarious economics of the project are reflected in the proponent's unwillingness to consider changes to operating hours or conditions relating to final voids. With the Stratford mine already operating with marginal viability, any concessions to local amenity are unaffordable. Such a project will not offer benefits to the local or state economy. Without strong financial viability, the proponents are likely to continually lobby for easing of environmental conditions. They will be perpetually expanding or contracting operations depending on the market, as seen in recent months. Rather than providing stable, reliable employment and royalty payments, workers and the government will be at the mercy of the coal price. The PAC should reject this project on this basis alone.

Royalties and taxes

The PAR accepts the EIS estimate of royalties of $84 million (present value) as estimated in the EIS. This estimate should be rejected by the PAC as:

- It is based on the above optimistic prices. At price levels forecast by the Commonwealth Bank of Australia[6], royalties are reduced to around $10 million per

[6] (CBA, 2013)

year, or $77 million present value (Also using CBA long-run exchange rate forecast of 0.88 USD:AUD and a 7 percent discount rate).[7]

- It assumes the proponent will not claim any deductions to royalties. There are many deductions to state royalties available.[8] We estimate the proponent could claim deductions for at least beneficiation ($3.50 per tonne) and the Australian Coal Association Research Program levy ($0.05 per tonne). This would reduce royalties to around $8 million per year, or $56 million present value. If deductions are applied to the more realistic price forecast, royalties are reduced to around $6m per year, present value of $47 million.
- All of these estimates assume that production will continue at the planned rate despite lower coal prices. This is unrealistic, as outlined in Yancoal's latest quarterly activities report:[9]

> *The operation has made significant changes in 2013 to adapt to weaker market conditions including lower mining rates, a revised mining contract and reduced rosters. A review of reduced mining operations at Stratford in 2014 is continuing. (p5)*

Clearly the PAR's royalty estimates are overly optimistic and the PAC needs to take this into account. We suggest a central estimate of around $6 million in royalties per year, with a present value of $47m. Putting this value in context, it represents 0.3 percent of Treasury's budgeted coal royalties for 2013-14 and 0.0096 per cent of budgeted state revenue.[10]

Federal taxes will similarly be affected by coal prices and delays. Many deductions are also available on company tax, making the 30 per cent rate applied in the EIS overly optimistic. Other researchers suggest mining companies in Australia face effective company tax rates of 13.9 per cent.[11] Taking into account lower profitability through lower coal prices, delayed production and lower effective tax rates, we suggest the EIS federal tax revenue estimate of $39 million (p17) is an overestimate by at least half. Whether or not federal taxes are a matter for consideration is up to the PAC. We remind the PAC that the terms of reference for the EIS refer to benefits to the NSW community rather than a national approach.

Employment

As the PAR has noted, Yancoal have reduced employment at the Stratford mine in response to declining coal prices. As the project is financially marginal at current and long run forecast prices it seems likely that reduced employment levels will be maintained into the future, as suggested in Yancoal's quarterly report.

It is unclear why the PAR has noted the declining employment, but sill embraced the original employment estimates of 250 people. These levels of employment are unlikely to occur until there is a sustained recovery in coal prices, against analysts' expectations. With employment unsteady, it seems likely that fewer workers would relocate to Gloucester and more would drive in and drive out, limiting economic benefits to the local community.

[7] All modelling available on request.
[8] (Macdonald, 2008)
[9] (Yancoal, 2014)
[10] (NSW Government, 2013)
[11] (Richardson & Denniss, 2011)

The PAR (p49) repeats modelling results from the EIS relating to indirect employment and output, although it does not mention these results in its general discussion. We remind the PAC that the type of modelling used to derive these figures has been described as "biased" by the Australian Bureau of Statistics, "abused" by the Productivity Commission and "deficient" by the NSW Land and Environment Court.[12] Further discussion is provided Campbell's submission to the EIS.

Significance

As the PAR notes (p55), under the Mining State Environmental Planning Policy, decision makers must consider the "significance" of the project's target resource. As mentioned above, royalties from the proposal would add 0.3 per cent to total coal royalties and 0.0095 per cent to the state's revenue. Furthermore:

- The project represents 0.5 per cent of NSW coal production.[13]
- The project's targeted resource represents 0.1 percent of NSW estimated recoverable reserves.[14]

Conclusion

It is perhaps most useful to summarise the above in relation to the PAR's own summary on economic benefit:

> *What would not drastically change are the inputs of the project to the Australian economy, although these may reduce or vary somewhat. Coal royalties, Commonwealth taxes, wages, and payment for goods and services would all still be delivered at reasonably stable levels, even in times of low profitability for Yancoal. The main impacts of low coal prices are to displaced workers and Yancoal's return on investment, rather than any substantive change to the Net Benefit to Australia. (p50)*

As discussed above, most points here are incorrect:

- The value of the project to the Australian economy is intimately linked to coal prices. As discussed above, the claimed $145 million in present value benefits to Australia is a heavy overestimate and in fact the project is marginal as shown by recent downsizing.
- Coal royalties in NSW are closely linked to coal prices, calculated at 8.2% of value less deductions.[15] They are also linked to production. With both price and production declining at Stratford, the PAR's estimate of $84 million present value is a heavy overestimate. We suggest a central estimate of $47 million.
- Commonwealth taxes are also heavily influenced by coal price. When producers are not making strong profits, the Commonwealth does not collect any tax.
- Low prices are having an impact on employment levels at Stratford, a problem that will continue if analysts' long run forecasts are accurate.

[12] (ABS, 2011; Gretton, 2013; Preston, 2013)
[13] (NSW Trade & Investment, 2013)
[14] (NSW Trade & Investment, 2013)
[15] (NSW DII, 2008)

The Stratford Extension Project is economically dubious. The flaws in the EIS have been accepted uncritically by the PAR. The PAC should realise that claimed economic benefits through royalties, taxes and employment are unlikely to materialise as estimated. In the context of state finances and the state's coal resource it is insignificant. Given these conclusions and the local objections to the project, we suggest the PAC should reject the application.

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