Queensland Commission of Audit

Final Report - February 2013

Volume 2

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Queensland Commission of Audit

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Volume 2

TABLE OF CONTENTS
FINAL REPORT

VOLUME 1

Transmittal Letter i
Acknowledgements iii
Explanatory Notes iv
Terms of Reference v
Report Linkages to Terms of Reference vii
Table of Contents ix

EXECUTIVE SUMMARY AND RECOMMENDATIONS

Executive Summary 1-3
List of Recommendations 1-27
Glossary 1-51

VOLUME 2

Table of Contents 2-i

PART A: THE ECONOMIC AND FISCAL CHALLENGE

Preface 2-3
A1 Economic Performance and Projections 2-4
A1.1 Performance of the Queensland Economy 2-4
A1.2 Long-Term Projections 2-9

A2 The State Government's Role in the Economy 2-23
A2.1 The Size of Government in the Economy 2-23
A2.2 The Role of Government in the Economy 2-29

PART B: GOVERNMENT COMMERCIAL ENTERPRISES

Preface 2-39

B1 Government Owned Corporations – Governance Model 2-41

B1.1 The Role of Government in Commercial Businesses 2-41

B1.2 Current Governance Model 2-43

B1.3 The Role of Government as Owner and Shareholder 2-47

B1.4 The Role of Government as Policy Maker 2-51

B1.5 The Role of Government as Regulator 2-56

B1.6 Future Governance Model 2-58

B2 Energy 2-59

B2.1 Electricity Sector in Australia 2-59

B2.2 The Queensland Electricity Market 2-63

B2.3 Financial Performance of GOCs 2-77

B2.4 Forward Capital Commitments and Level of Indebtedness 2-81

B2.5 Capital Structure and Credit Rating 2-83

B2.6 Longer-Term Ownership Issues 2-86

B2.7 Potential Value of Energy Sector Assets 2-92

B2.8 Timing Issues 2-93

B2.9 Other Options for Realising Value 2-94

B2.10 Operating Performance 2-98

B3 Public Transport 2-104

B3.1 Institutional Structure 2-104

B3.2 Current Public Transport Services 2-105

B3.3 Public Transport Services – Other Jurisdictions 2-107

B3.4 Current Rail Freight Services 2-109

B3.5 Financial Performance 2-114

B3.6 Future Public Transport Services 2-118

B3.7 Future Rail Freight Services 2-123

B4 Ports 2-128

B4.1 Sector Profile 2-128

B4.2 Current Services 2-130

B4.3 Other Jurisdictions 2-134

B4.4 Financial Information 2-136
B4.5 Future Arrangements 2-143

B5 Regional Bulk Water 2-150
B5.1 Sector Profile 2-150
B5.2 Regulatory Framework 2-155
B5.3 SunWater – Financial Information 2-157
B5.4 Irrigation Channels and Systems 2-161
B5.5 Commercial and Industrial Pipelines 2-162
B5.6 Future Role of SunWater 2-163
B5.7 Future Bulk Water Supply 2-165

B6 Financial Services 2-170
B6.1 Queensland Government Financial Services Providers 2-170
B6.2 Investment Funds Management – Queensland 2-176
B6.3 Investment Funds Management – Other States 2-179
B6.4 Future Approach to Funds Management 2-182

B7 Commercial Business Units 2-185
B7.1 Background 2-185
B7.2 Strategic Framework 2-189
B7.3 QBuild and Project Services 2-190
B7.4 RoadTek 2-191
B7.5 Property Services Group 2-192
B7.6 QFleet 2-194
B7.7 Future Role of Commercial Business Units 2-196

B8 Pricing Regulation 2-198
B8.1 Framework for Pricing Regulation 2-198
B8.2 The Queensland Competition Authority 2-199
B8.3 Pricing Regulation in Australian States 2-202
B8.4 Electricity Prices 2-203
B8.5 Water Prices 2-208
B8.6 Rail Fares and Charges 2-215
B8.7 Port User Charges 2-219
B8.8 Future Regulatory Framework 2-221

PART C: FINANCIAL MANAGEMENT

Preface 2-228

C1 Financial Planning Framework 2-229

C1.1 Long-Term Perspective 2-229

C1.2 Intergenerational Report 2-231

C1.3 State Infrastructure Plan 2-232

C1.4 Consistency in Financial Planning Framework 2-236

C1.5 State Borrowing Program 2-239

C1.6 Project Planning and Management 2-241

C2 Asset Management 2-249

C2.1 The State's Asset Base 2-249

C2.2 Maintenance of the Asset Base 2-252

C2.3 Government Office Accommodation 2-254

C2.4 Government-Owned Employee Housing 2-257

C2.5 Convention and Exhibition Centres 2-263

C2.6 Major Stadiums 2-264

C3 Budget Management Framework 2-270

C3.1 Charter of Budget Accountability 2-270

C3.2 Appropriation 2-276

C3.3 Budget Process 2-284

C3.4 Cash Management 2-289

C3.5 Financial Reporting 2-290

C4 Grant Administration 2-295

C4.1 Background 2-295

C4.2 Scope of Grant Payments 2-297

C4.3 Commission Review of Grants 2-298

C4.4 Effectiveness of Programs 2-305

C4.5 Grant Systems 2-305

C5 Long-Term Systemic Reform 2-309
C5.1 An Efficiency and Productivity Framework 2-310
C5.2 A Queensland Productivity Commission 2-316
C5.3 Regulation 2-323
C5.4 Industry Assistance 2-330
C5.5 Fiscal Sustainability 2-337

Appendices
1 Structure and Performance of the Queensland Economy 2-346
2 Long-Term Projections – Background and Methodology 2-383

Glossary 2-406

VOLUME 3

Table of Contents 3-i

PART D: FRONT-LINE SERVICE DELIVERY

Preface 3-3
D1 Health Overview 3-5
D1.1 Sector Responsibilities 3-6
D1.2 Funding 3-8
D1.3 Performance 3-10
D1.4 Future Direction 3-18

D2 Public Hospitals 3-21
D2.1 Service Profile 3-21
D2.2 Comparative Performance 3-22
D2.3 Service Demand 3-27
D2.4 Contestability 3-28
D2.5 Emergency Departments 3-32
D2.6 Specialist Outpatient Services 3-38
D2.7 Nursing Home Type Patients 3-41
D2.8 Cost Recovery 3-42

D3 Primary and Community Care 3-46
D3.1 Service Profile 3-46
D3.2 Primary Health Care 3-48
D3.3 Community Health Care 3-50
D3.4 Subsidy Schemes 3-52
D3.5 Oral Health Services 3-56
D3.6 Health Call Centre – 13HEALTH 3-59
D3.7 Rural and Remote Health Services 3-60

D4 Mental Health 3-65
D4.1 Service Profile 3-65
D4.2 Comparative Performance 3-67
D4.3 Contestability 3-72
D4.4 Funding Model 3-73

D5 Residential Aged Care 3-76
D5.1 Service Profile 3-76
D5.2 Service Delivery Options 3-82
D5.3 Transitional Considerations 3-85

D6 Health Sector Enablers 3-88
D6.1 Overview 3-88
D6.2 Workforce 3-89
D6.3 Infrastructure 3-93
D6.4 Performance and Accountability 3-96
D6.5 Technology 3-99

D7 Education 3-102
D7.1 Early Childhood Education 3-103
D7.2 Primary and Secondary Education 3-104
D7.3 Comparative Performance 3-108
D7.4 Devolution, Autonomy and Accountability 3-116
D7.5 Role of the Australian Government 3-123
D7.6 Asset Management 3-125

D8 Vocational Education and Training 3-130
D8.1 Service Profile 3-130
D8.2 Comparative Performance 3-136
D8.3 Strategic Framework 3-144
D8.4 Funder Function 3-148
D8.5 Purchaser Function 3-152
D8.6 A Competitive Training Market 3-155
D8.7 Market Design 3-157
D8.8 Provider Function 3-161

D9 Disability Services 3-171
D9.1 Service Profile 3-172
D9.2 Comparative Performance 3-175
D9.3 Service Demand 3-178
D9.4 The National Disability Insurance Scheme 3-180
D9.5 Service Delivery 3-184

D10 Child Safety Services 3-195
D10.1 Service Profile 3-195
D10.2 Comparative Performance 3-202
D10.3 Service Demand 3-207
D10.4 Commission of Inquiry 3-209

D11 Police Services 3-212
D11.1 Service Profile 3-212
D11.2 Comparative Performance 3-214
D11.3 Service Demand 3-218
D11.4 Police Resourcing Strategies 3-223
D11.5 Service Delivery 3-227
D11.6 Workforce Management 3-229
D11.7 Asset Management 3-231

D12 Corrective Services 3-237
D12.1 Service Profile 3-237
D12.2 Comparative Performance 3-240
D12.3 Service Demand 3-244
D12.4 Contestability 3-248

D12.5 Asset Management 3-251
D12.6 Prisoner Transport Services 3-256

D13 Emergency Management 3-260
D13.1 Service Profile 3-260
D13.2 Comparative Performance 3-264
D13.3 Service Demand 3-272
D13.4 Service Delivery 3-281

D14 Housing Services 3-292
D14.1 Service Profile 3-292
D14.2 Comparative Performance 3-295
D14.3 Service Demand 3-301
D14.4 Service Delivery 3-303
D14.5 Asset Management 3-309

D15 Social Inclusion 3-320
D15.1 Service Profile 3-320
D15.2 Comparative Performance 3-326
D15.3 Service Demand 3-329
D15.4 Service Delivery 3-331

D16 Justice and Court Services 3-339
D16.1 Service Profile 3-339
D16.2 Comparative Performance 3-343
D16.3 Service Demand 3-346
D16.4 Service Delivery 3-347

PART E: THE PUBLIC SECTOR

Preface 3-359

E1 Workforce 3-360

E1.1 Overview 3-360

E1.2 Agency Structure 3-361

E1.3 Workforce Profile 3-364

E1.4 Workforce Planning 3-382

E1.5 The Role of the Public Service Commission 3-384

E2 Employment Framework 3-391

E2.1 Overview 3-391

E2.2 Employing Legislation 3-392

E2.3 Industrial Relations Legislation 3-401

E2.4 Awards and Certified Agreements 3-402

E2.5 Fair Work Act 3-407

E3 Classification Framework 3-409

E3.1 Current Classification Framework 3-409

E3.2 Classification Creep 3-412

E3.3 Revised Classification System 3-418

E3.4 Job Evaluation Methods 3-421

E3.5 Advancement within Bands 3-423

E3.6 Appointment to a Level 3-424

E3.7 Attraction and Retention Incentives 3-425

E4 Mobility and Flexibility 3-429

E4.1 Managerial Structures 3-429

E4.2 Current Mobility in the Public Sector 3-434

E4.3 Greater Flexibility for Transfers 3-437

E4.4 SES Mobility 3-438

E4.5 Mobility for Non-SES Officers 3-440

E5 Performance Management 3-442

E5.1 Current Arrangements 3-442

E5.2 Effective Performance Management 3-444

E5.3 Performance of Chief Executives and SES Officers 3-449

E5.4 Wider Application of Performance Management 3-450
E5.5 Managing Misconduct 3-451

E6 Departmental Corporate Services 3-457
E6.1 Background 3-457
E6.2 The Shared Services Model 3-458
E6.3 Performance 3-462
E6.4 Other Shared Services Experiences 3-464
E6.5 Future Arrangements 3-467

E7 Information and Communication Technology 3-473
E7.1 ICT Profile 3-473
E7.2 Performance 3-480
E7.3 Experiences in Other Jurisdictions 3-487
E7.4 Future Strategy 3-489

E8 Government Procurement 3-497
E8.1 Current Arrangements 3-497
E8.2 Service Delivery and Performance Commission Review 3-499
E8.3 Procurement Information 3-500
E8.4 Common-Use Supply Arrangements 3-503
E8.5 Other Jurisdictions 3-505
E8.6 Future Direction 3-505
E8.7 Speciality Procurement Components 3-507
E8.8 Review of Procurement 3-508

Glossary 3-511

PART A:

THE ECONOMIC AND FISCAL CHALLENGE

PART A

THE ECONOMIC AND FISCAL CHALLENGE

PREFACE

The challenge for Queensland is to lift its productivity performance to sustain the economic growth which will improve living standards for its citizens.

For much of the last quarter of a century, Queensland's economic performance has been above the Australian average, driven largely by population growth, increased workforce participation and the development of the State's vast mineral resources.

Queensland cannot rely on these factors alone to drive its economic growth over the next 25 years and beyond.

Queensland's recent economic performance has been sub-par. A disturbing development has been a marked decline in productivity, which has fallen more sharply in Queensland than in the rest of Australia. As a result, Queensland's productivity in 2011-12 was below the level recorded a decade earlier.

Long-term economic projections by the Commission indicate that a significant improvement in productivity is required to ensure fiscal stability and to drive higher economic growth in Queensland.

A productivity gain of around 0.8% to 1.1% per annum in the provision of government services would stabilise the financial position of the State.

A1 ECONOMIC PERFORMANCE AND PROJECTIONS

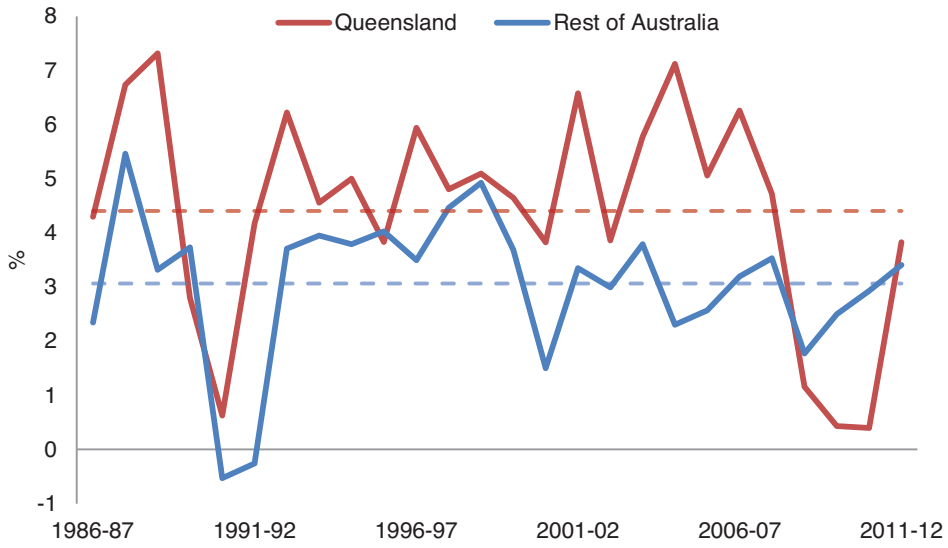
KEY ISSUES

- Over the long-term from 1985-86, Queensland's economy outperformed the rest of Australia, driven by higher growth in population, labour force participation and productivity.
- More recently, Queensland's economic performance began converging towards the average of the rest of Australia.
- In the first half of the decade to 2011-12, Queensland's productivity growth rate slowed. By 2007-08, it had converged to the rate of the rest of Australia.
- In every year since 2007-08, Queensland has experienced a decline in productivity, a significantly poorer outcome than the rest of Australia.
- In 2011-12, Queensland's productivity was below the level recorded a decade earlier.
- The impact on Queensland living standards of the State's recent poor productivity performance has been masked by the effects of higher commodity prices. However, these conditions are expected to moderate back closer to long-term levels in future years.
- Long-term economic projections by the Commission show that Queensland's per capita economic growth rate over the period to 2050-51 could be around half that of the last 26 years. The ageing population is likely to generate significant economic and fiscal challenges for the State.
- Strong and decisive action is necessary to restore Queensland's record of economic and productivity growth. It is necessary to take decisive action to repair state finances and prepare for the challenges posed by demographic change and other factors.

A1.1 PERFORMANCE OF THE QUEENSLAND ECONOMY

Over the long-term from 1985-86,[1] Queensland's economy grew by an average annual rate of 4.4%, compared with an average growth rate of 3.1% for the rest of Australia as shown in Chart A1.1.[2]

Chart A1.1
Gross State Product, annual growth (a)



(a) Dashed lines represent respective long-run average annual growth rates.

Source: Queensland Treasury and Trade

This strong economic growth performance was driven by higher rates of growth in population, labour force participation and productivity. In Queensland, over the period from 1985-86 to 2011-12:

- Population grew by an average annual rate of 2.1%, 0.9 percentage point above that recorded for the rest of Australia.
- Labour force participation (the percentage of the working age population working or looking for work) increased 5.8 percentage points (to 67.1%) compared with a 4.0 percentage point increase in the rest of Australia (to 65.4%).
- Productivity[3] grew by an average annual rate of 0.9%, 0.2 percentage point higher than growth in the rest of Australia.

Queensland's superior economic performance over the last quarter of a century, particularly in the earlier part of the period, can be explained by the greater opportunities for development in Queensland, compared with the more mature economies of New South Wales and Victoria. Low tax rates and strong infrastructure investment made the State a lower cost place for business. Greater job opportunities and higher returns to capital investment, together with non-financial factors affecting quality of life, made Queensland an attractive place to live and invest, driving the growth in population, employment and incomes.

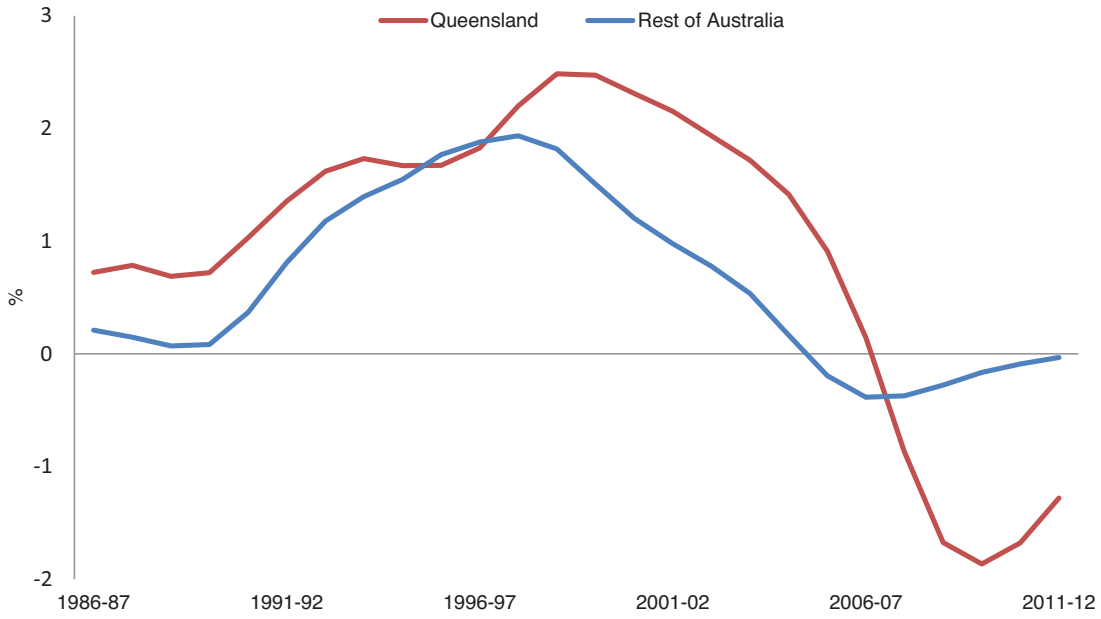
More recently, Queensland's growth performance has been converging towards that of the rest of Australia. While both Queensland and the rest of Australia have experienced slower economic growth in recent years, the moderation in growth has been more pronounced in Queensland. The effect of severe weather in 2010-11, which flooded mining operations, also had a specific effect in Queensland not replicated in the rest of Australia.

Nonetheless, it is evident that Queensland's productivity performance over the recent decade has declined relative to the rest of Australia.

Chart A1.2 shows the annual per cent change in multifactor productivity (MFP) on a trend basis for Queensland and the rest of Australia between 1985-86 and 2011-12.[4] On average over the long-term, Queensland outperformed the rest of Australia in terms of productivity growth. Queensland's MFP grew by an average annual rate of 0.9% over the 26 years to 2011-12, compared with 0.7% for the rest of Australia.[5]

Queensland MFP grew at a faster rate than the rest of Australia for the majority of the period to 2006-07. Productivity gains were particularly strong in the mid-to-late 1990s and Queensland's superior MFP growth continued into the subsequent decade. However, since 2007-08, Queensland's MFP has fallen sharply, and has been lower than the rest of Australia.[6] By 2011-12, MFP for both Queensland and the rest of Australia was below the level recorded a decade earlier.

Chart A1.2
Multifactor productivity growth, trend (a), 1985-86 to 2011-12



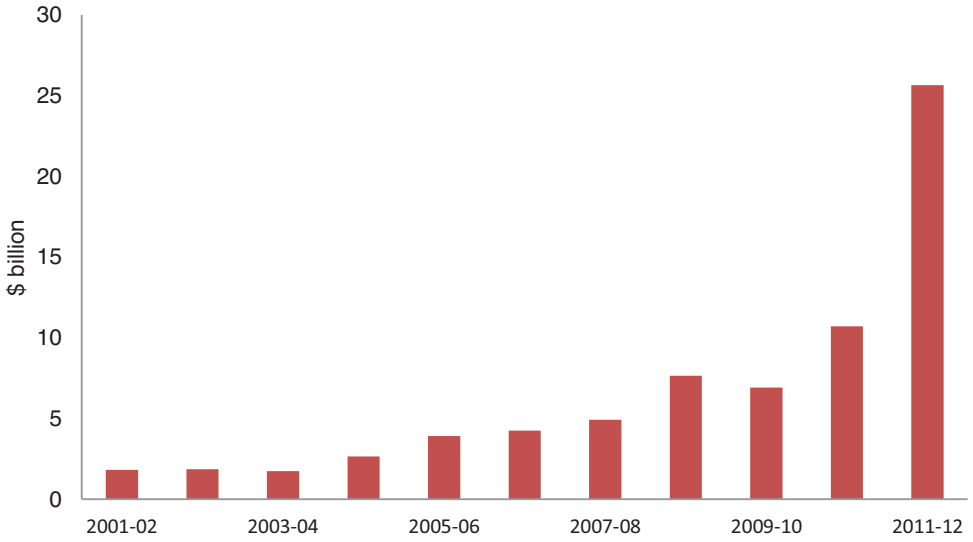
(a) Trend estimates are derived from original MFP data using an 11-term Henderson-weighted moving average.

Source: Queensland Treasury and Trade

The impact on Queensland living standards of the State's recent poor productivity performance has been masked by the flow-on effects from higher commodity prices, which have particularly boosted mining investment and related incomes. However, conditions are expected to revert towards long-term levels in future years.

High commodity prices have had a significant impact on Queensland mining investment, which surged over the past two years and follows strong growth in the latter part of the previous decade (see Chart A1.3). In 2011-12, capital expenditure on mining investment in Queensland was $25.7 billion, some 14 times higher than a decade ago in 2001-02.

Chart A1.3
Capital expenditure, mining, Queensland



Source: ABS 5625.0

The growth in mining investment and the appreciation of the Australian dollar have affected different sectors of the Queensland economy in different ways:

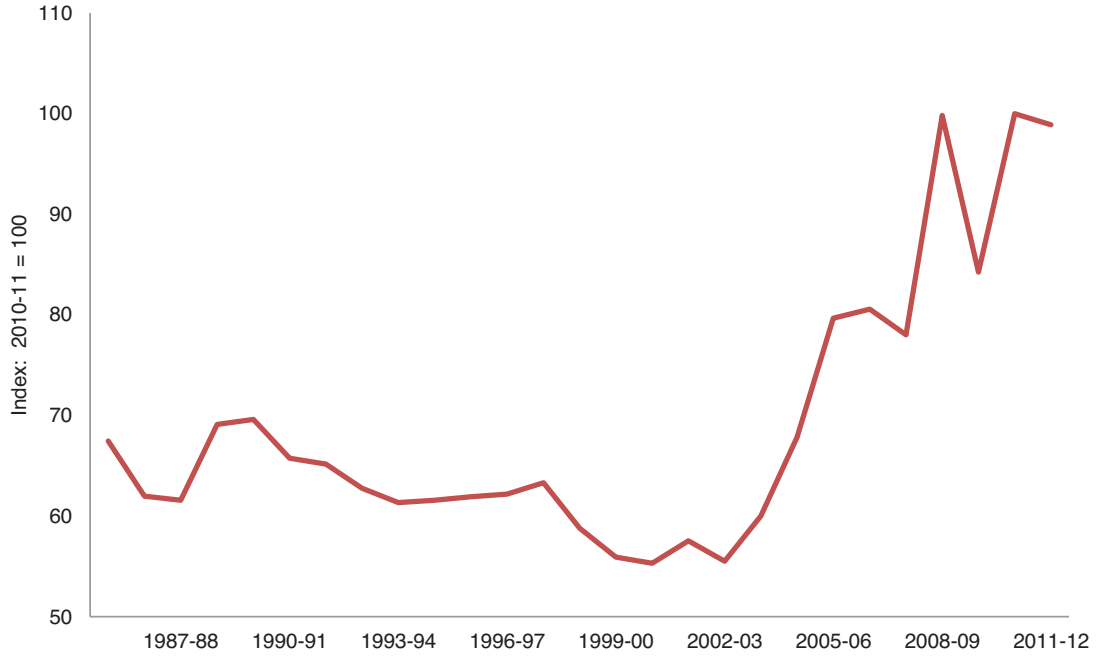
- Construction has grown strongly over the past decade, but the pattern of that growth has changed over time. In the first part of the period, residential construction grew strongly, in response to high population growth. In recent years, engineering construction has been the strongest performer, reflecting investment growth in mining.

- Tourism and to a lesser extent agriculture have faced declining international competitiveness as a result of the high dollar and cost pressures from strong competition from mining for labour and capital.

- Economic growth in regions with strong mining connections has remained high in recent years, while regions relatively dependent on tourism and residential construction have had economic growth lower than the State average.

Chart A1.4 shows Queensland's terms of trade, that is, the prices received for Queensland's overseas exports relative to the prices paid for imports. Following an extended period of relative stability, Queensland's terms of trade rose sharply by 46% between 2004-05 and 2011-12.

Chart A1.4
Queensland terms of trade, overseas trade



Source: Queensland Treasury and Trade

As miners raise production capacity in response to higher prices, the increased global supply will relieve the upward pressure on commodity prices and moderate Queensland's terms of trade back towards historical levels. A return to Queensland's long-run terms of trade will lead to lower rates of growth in gross state income (GSI) per capita.

Even if the terms of trade were to remain unchanged at the current high level, it will make a neutral contribution to future GSI per capita growth. However, if they decline, they will detract from growth in GSI per capita.

While temporary factors, including natural disasters, contributed to Queensland's slowdown in 2011, they were not the cause of the medium-term slowing of growth which converged back to levels of the rest of Australia.

Appendix 1 provides a more detailed analysis of Queensland's economic performance. It also presents additional information on Queensland's industry structure and regional economic performance.

A1.2 LONG-TERM PROJECTIONS

The Commission's Terms of Reference include a requirement to consider long-term systemic reforms that will grow and strengthen the Queensland economy. In Section C1 of this Report, the Commission recommends an Intergenerational Report to provide a rigorous framework to integrate long-term projections for economic, demographic and fiscal trends.

In order to inform its work, the Commission has undertaken its own economic modelling to develop long-term economic and financial projections for Queensland through to 2050-51. These projections incorporate:

- economic factors, including trends in consumer preferences, domestic and global demand, and future productivity change
- demographic factors affecting age profiles and workforce participation rates
- the impact of economic and demographic factors on revenue and expenditure components of government budgets.

Projections outlined in the remainder of this Section are shown from the base year of 2015-16. By this year, the Government has forecast that it will have closed the fiscal deficit. The modelling looks at the long-term trend and the effect on the fiscal position from that starting point.

To address the uncertainty inherent in long-term economic and financial projections, two scenarios are presented:

- a **lower growth scenario**, which takes a more pessimistic view of long-run economic growth
- a **higher growth scenario**, which takes a more optimistic view of long-run economic growth.

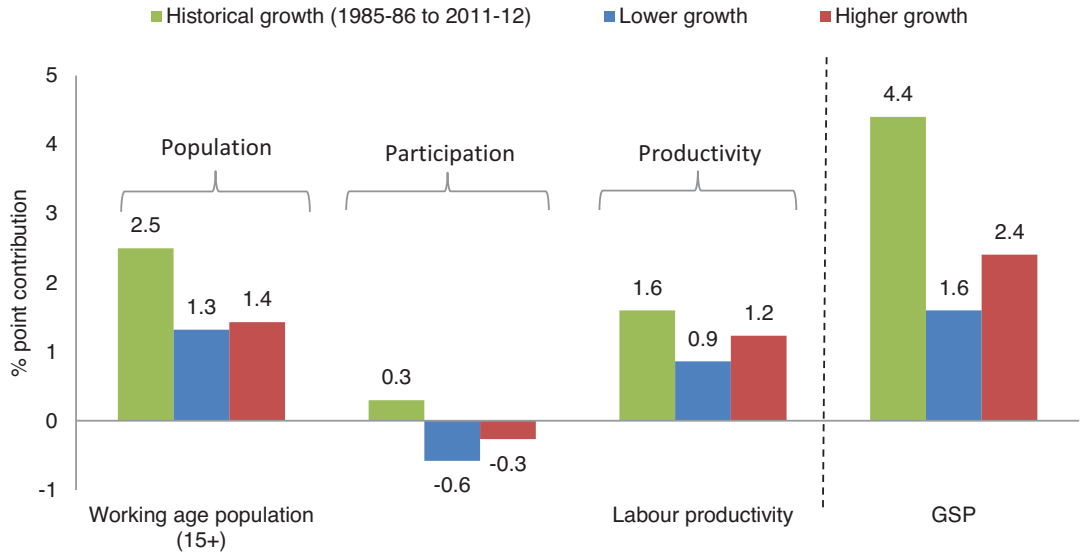
The two scenarios differ in their assumptions on productivity growth, changes in labour market participation rates, and export demand growth.

Appendix 2 provides an explanation of the methodology and assumptions underpinning the productivity, participation and population growth analysis in these projections.

A1.2.1 Demographic and economic challenges

Over the period to 2050-51, a moderation in population growth, declining workforce participation and moderating productivity growth are projected to slow average annual economic growth to between 1.6% (lower growth scenario) and 2.4% (higher growth scenario) over the period. Chart A1.5 shows the decomposition of this projected growth, using the 3Ps analysis (population, participation and productivity) first used at the Australian Government level.

Chart A1.5
Decomposition of historical and projected growth, Queensland, 2015-16 to 2050-51



Source: Commission of Audit

The moderation in population growth is projected to be the most significant factor slowing Queensland economic growth. Over the 26 years to 2011-12, growth in the working age population contributed 2.5 percentage points, on average, to economic growth. This contribution to economic growth is projected to decline to between 1.3 (lower growth) and 1.4 (higher growth) percentage points over the period 2015-16 to 2050-51.

Changes in the age structure of the working age population will also detract significantly from economic growth through the impact on workforce participation. While increasing participation added around 0.3 percentage point per annum to growth over the 26 years to 2011-12, an ageing population is projected to cause participation to decline over the period 2015-16 to 2050-51, detracting around 0.6 percentage point per annum from growth under the lower growth scenario and around 0.3 percentage point under the higher growth scenario.

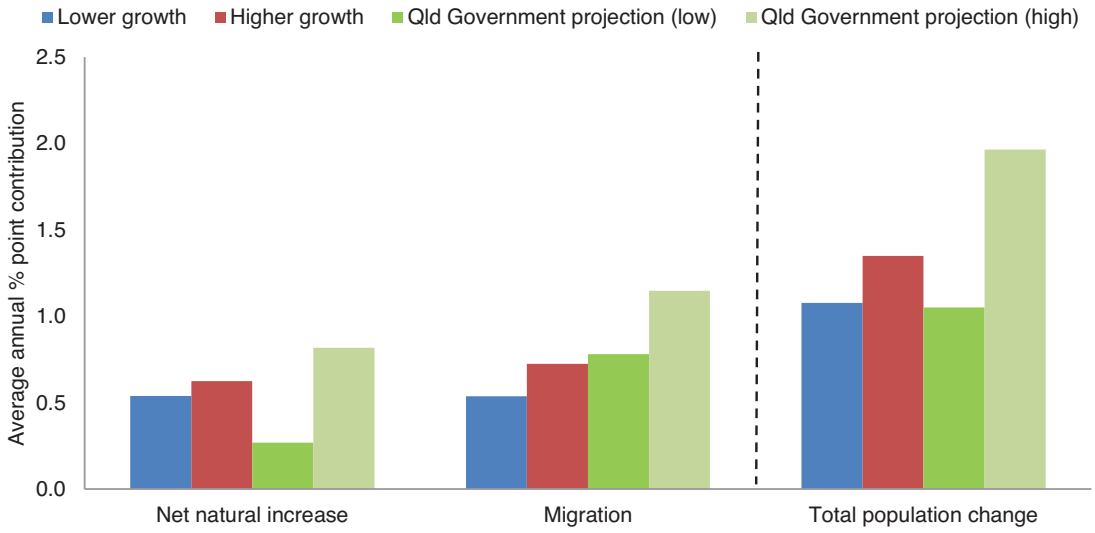
The impacts of a moderation in population growth and declining participation are further compounded by slowing productivity growth. Over the 26 years to 2011-12, labour productivity contributed 1.6 percentage points on average per annum to economic growth. Over the period to 2050-51, this contribution is projected to decline to between 0.9 percentage point and 1.2 percentage points per annum in the lower and higher growth scenarios, respectively.

A growing population

Queensland's population is projected to grow from around 4.6 million persons at 30 June 2012 to more than 7.4 million persons by 2050 under the lower growth scenario and to almost 7.8 million under the higher growth scenario.

Demographic changes resulting from natural increase (births less deaths) are relatively similar in both the lower and higher growth scenarios (see Chart A1.6). However, in the higher growth scenario, there is higher migration to Queensland and consequently higher overall population growth. The Commission's population projections take into account an intercensal error identified by the Australian Bureau of Statistics (ABS), which will result in a downward revision to population estimates for Queensland back to 1991.[7]

Chart A1.6
Population growth, Queensland, 2015 to 2050

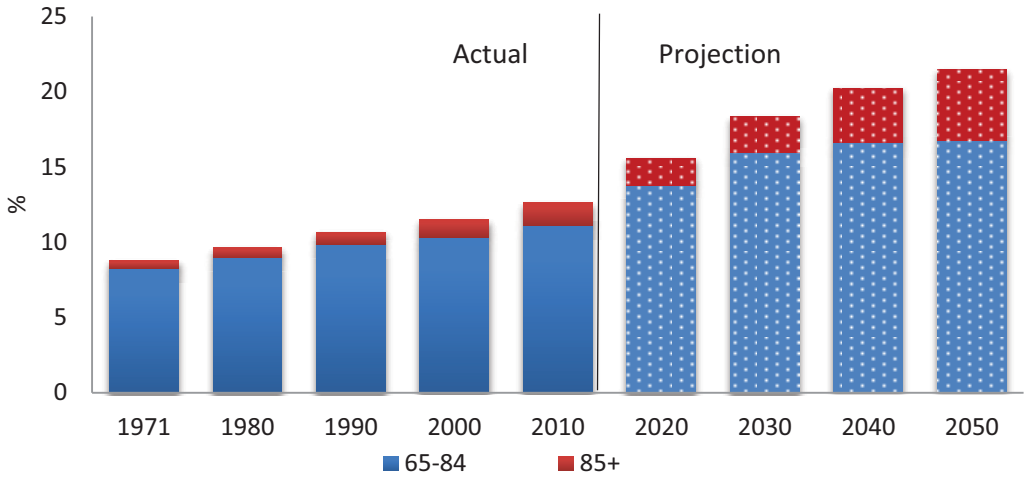


Source: Queensland Government population projections – 2011 edition, ABS 3222.0; and Commission of Audit

An ageing population

Queensland's population is projected to age significantly over the period 2015-16 to 2050-51. Chart A1.7 shows the proportion of those over 65 years increasing from 13% in 2010 to 21% in 2050 for the lower growth scenario. The number of persons aged between 65 and 84 is projected to more than double from 491,000 in 2010 to 1.3 million by 2050, while the number of persons aged 85 and over is projected to increase fivefold from 67,000 to 364,000 persons.

Chart A1.7
Historical and projected proportion of the Queensland population aged 65+ – lower growth scenario



Source: ABS 3105.0.65.001; and Commission of Audit

As the population ages, the proportion of people of working age relative to the overall population will decline. The number of persons aged 15 to 65 to support each person over 65 is projected to decline from 5.3 in 2010 to 2.9 in 2050.

An ageing workforce

The ageing of the workforce is projected to reverse the trend towards increased participation that occurred in the 26 years to 2011-12. Ageing of the workforce is projected to lead to a decline in labour force participation, and therefore detract from economic growth over the period 2015-16 to 2050-51.

As a result of these changes to participation, the labour force is expected to grow more slowly than population over the period 2015-16 to 2050-51. The labour force participation rate[8] in Queensland is projected to fall from 67.2% in 2011-12 to between 57.7% (lower growth) and 65.7% (higher growth) by 2050-51.

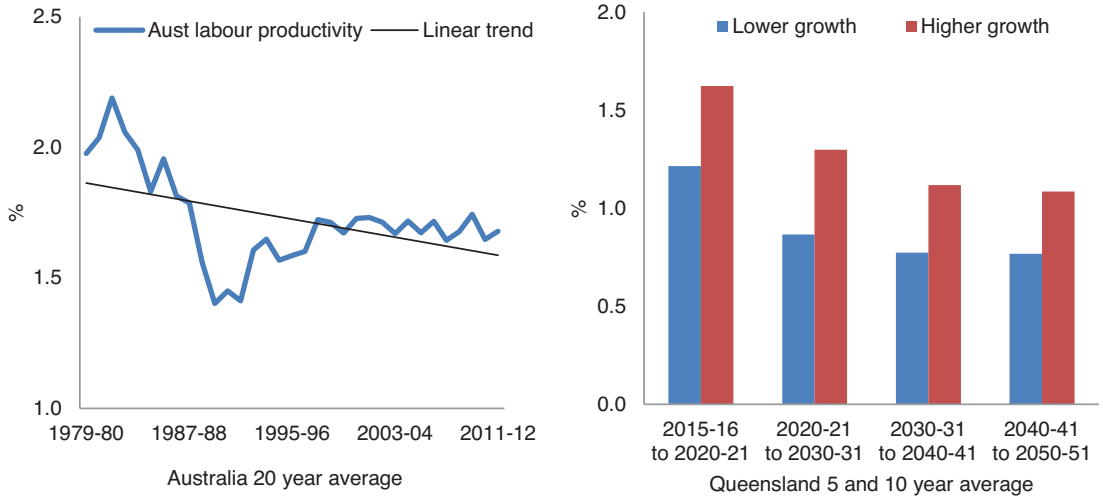
To put this in context, in the 10 years to 2011-12, Queensland's workforce grew by an average of 60,700 persons per annum. Over the period 2015-16 to 2050-51, Queensland's workforce is projected to grow, on average, between 27,418 persons per annum (lower growth) and 43,596 persons per annum (higher growth).

Slowing productivity

Over the period 2015-16 to 2050-51, annual growth in labour productivity is projected to moderate to 0.9% on average under the lower growth scenario and 1.2% on average under the higher growth scenario, down from 1.6% between 1985-86 and 2011-12.

Chart A1.8 shows a more disaggregated picture of Queensland labour productivity projections from 2015-16 to 2050-51, by successive time periods, compared with historical trends for Australia.[9] Over the period to 2050-51, the rate of growth of labour productivity is projected to steadily decline. Labour productivity growth is projected to moderate from an average annual 1.2% (lower growth scenario) and 1.6% (higher growth scenario) between 2015-16 and 2020-21 to 0.8% (lower growth) and 1.1% (higher growth) in the decade to 2050-51.

Chart A1.8
Labour productivity, historical and projected average annual growth



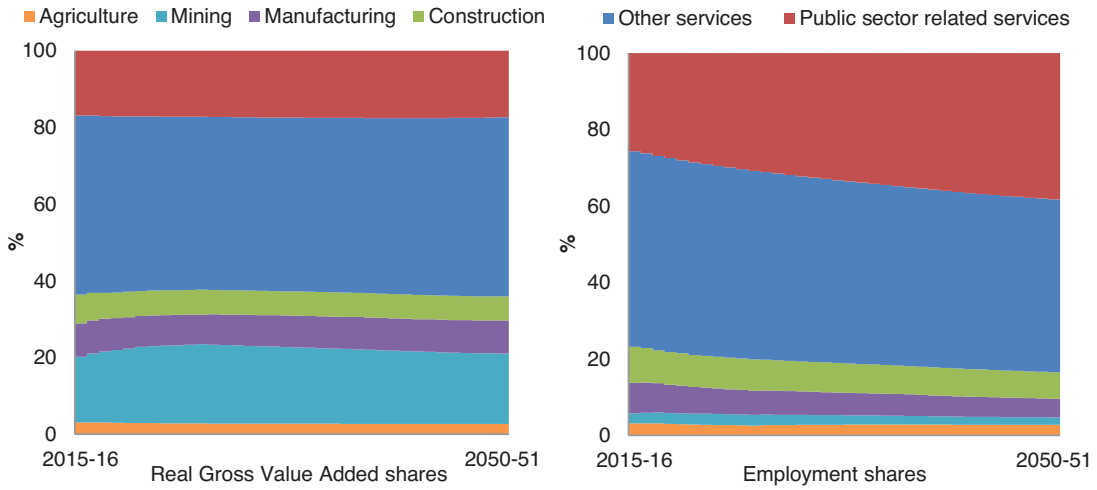
Source: ABS 5206.0, 6291.0; and Commission of Audit

The economy-wide productivity projections are the product of the sector-specific productivity assumptions and projected structural changes in employment towards service industries with lower than average productivity. The resulting productivity projections are broadly consistent with changes to labour productivity growth in Australia over the last 40 years.

Structural changes

The Queensland economy is projected to undergo significant structural change over the period 2015-16 to 2050-51, as shown in Chart A1.9. Following a historically high period of investment (as shown in Chart A1.3) in mining projects, mining output, as measured by real gross value added (GVA), is projected to increase sharply over the next decade. However, employment in the mining industry is projected to remain relatively stable, with the majority of the employment gains having been realised during the investment phase.[10]

Chart A1.9
Industry real gross value added and employment shares, Queensland – lower growth scenario



Source: Commission of Audit

The other key structural change is the projected increase in the share of employment in service industries, particularly those with a high component of public sector provision, notably the public administration and safety, health care and social assistance, and education and training industries. This result reflects historically low measured[11] labour productivity growth in these industries relative to other sectors of the economy and continues trends witnessed over the last few decades.

Similar patterns of structural change in the Queensland economy are projected in the higher growth scenario.

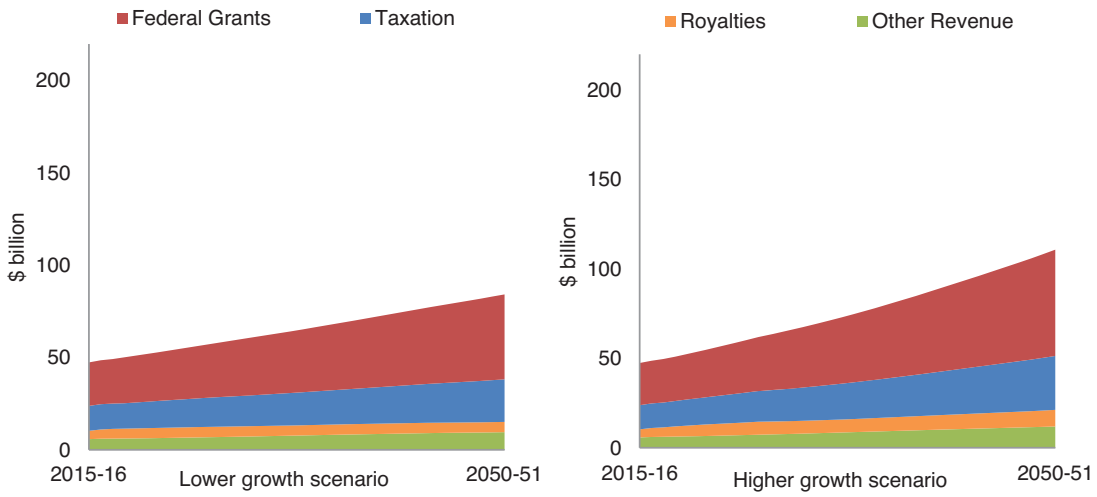
A1.2.2 Fiscal challenges

The combination of slowing economic growth and rising demand for government services, particularly health-related services, will present significant fiscal challenges for the Queensland Government over the coming decades.

Slowing revenues

Slowing economic growth will constrain the ability of all levels of government to raise funds. General Government revenue for Queensland is projected to grow on average between 1.7% and 2.5% per annum over the period 2015-16 to 2050-51 in the lower growth and higher growth scenarios, respectively. This is broadly in line with economic growth (see Chart A1.10).

Chart A1.10
Queensland Budget components – Revenue



Source: Commission of Audit

The Queensland Government raises the majority of its own-source revenue from payroll taxes, transfer duties and royalties. With the exception of royalties, these revenues are projected to grow in line with the broader economy. Royalties are expected to rise substantially over the period to 2020-21, before stabilising.

The other significant source of revenue for the Queensland Government is from Australian Government grants. Non-GST grants are assumed to grow in line with Australian Government revenues. Payment of GST is assumed to rise with GST collections (with total collections being a function of consumption), which is distributed among the states using horizontal fiscal equalisation principles, with relativities assumed to remain constant.

Rising expenses

Over the next four decades, rising demand for government services is expected to place significant pressure on government budgets. The level of spending required will be influenced by:

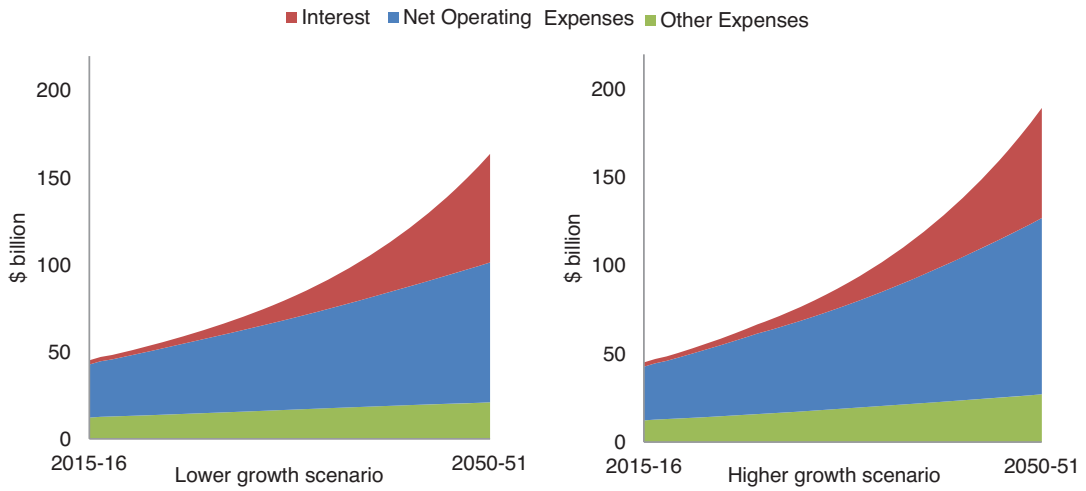
- demands for health care as the population ages
- demands for health care arising from new treatments and improved technology
- community expectations regarding the provision of services
- cost pressures from lower productivity in sectors involved in the delivery of government services, relative to other sectors of the economy.

State Government spending on health care and social assistance is projected to rise from 3.3% of gross state product (GSP) in 2015-16 to between 5.2% (higher growth) and 5.4% (lower growth) of GSP in 2050-51,[12] accounting for over one-third of the increase in net operating expenses.

Without policy action to constrain costs, these factors will result in the cost of government service provision rising faster than general economic growth. On a 'no policy change' basis, General Government net operating expenses are projected to grow on average between 2.8% (lower growth) and 3.5% (higher growth) per annum over the period 2015-16 to 2050-51 (see Chart A1.11), compared with economic growth of between 1.6% and 2.4%.

In absolute terms, General Government net operating expenses grow faster under the higher growth scenario as there is higher population growth and a higher relative cost (per unit) of government service provision than in the lower growth scenario. [13]

Chart A1.11
Queensland Budget components – Expenditure



Source: Commission of Audit

A growing fiscal deficit

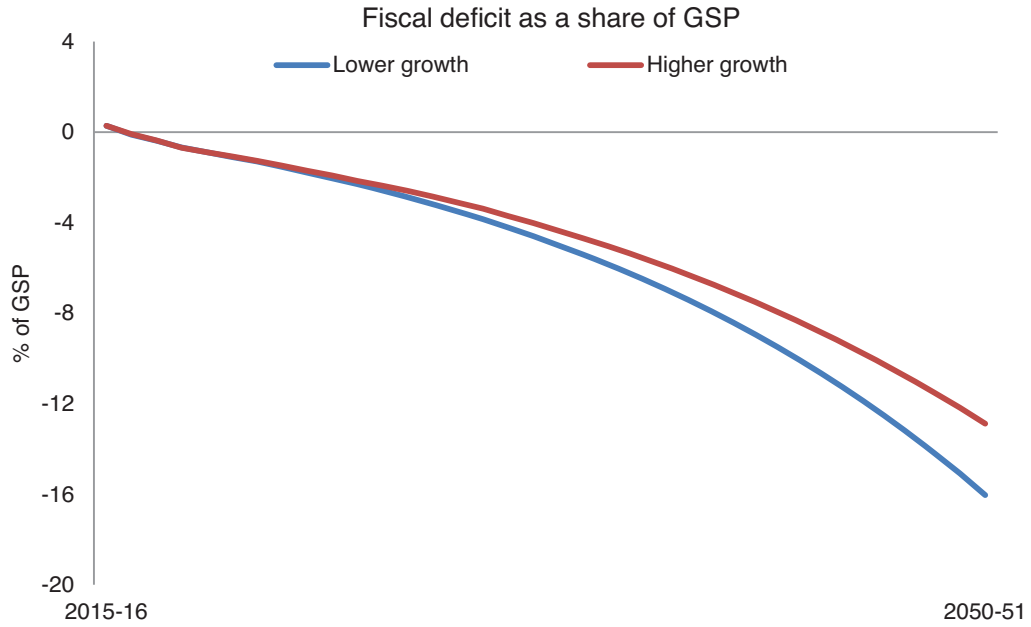
As expenses are projected to grow more rapidly than revenue, in the absence of policy action, there will be a growing fiscal deficit,[14] which for the purposes of this analysis is assumed to be funded from borrowings. Accordingly, interest expense is projected to consume an increasing proportion of State expenditure over the projection period, adding to pressure on the fiscal position. The increasing significance of interest expenses is shown in Chart A1.11.

The projected large fiscal deficit in 2050-51 is not a forecast of what will happen, but rather a projection of what would happen in the absence of policy changes. It illustrates the magnitude of the task which needs to be confronted by policy action.

The Commission's projections take into account the fiscal consolidation over the forward estimates period (that is, to 2015-16), in accordance with the 2012-13 Budget.

Beyond this period, on a 'business as usual' basis, without further sustained policy action, a fiscal deficit is projected to re-emerge, and to reach 12.9% of GSP by 2050-51 in the higher growth scenario and 16.0% in the lower growth scenario (see Chart A1.12).

Chart A1.12
'Business as usual' – Projected fiscal deficit, Queensland



Source: Commission of Audit

A1.2.3 Policy action to address the fiscal challenges

Policy action will be required by Government to address the looming fiscal challenges outlined above. In the absence of action to mitigate rising expenditures, Government would need to increase taxes to sustain its activities or increase debt, or more likely engage in a combination of both. Higher taxes would have adverse consequences for economic activity, as they lead to lower private sector investment and lower productivity growth.

Borrowing to close the fiscal deficit would lead to a huge ramp-up in debt, as shown in Chart A1.14. Long before debt reached the peak levels shown in that chart, financial markets would close and debt would not be sustainable.

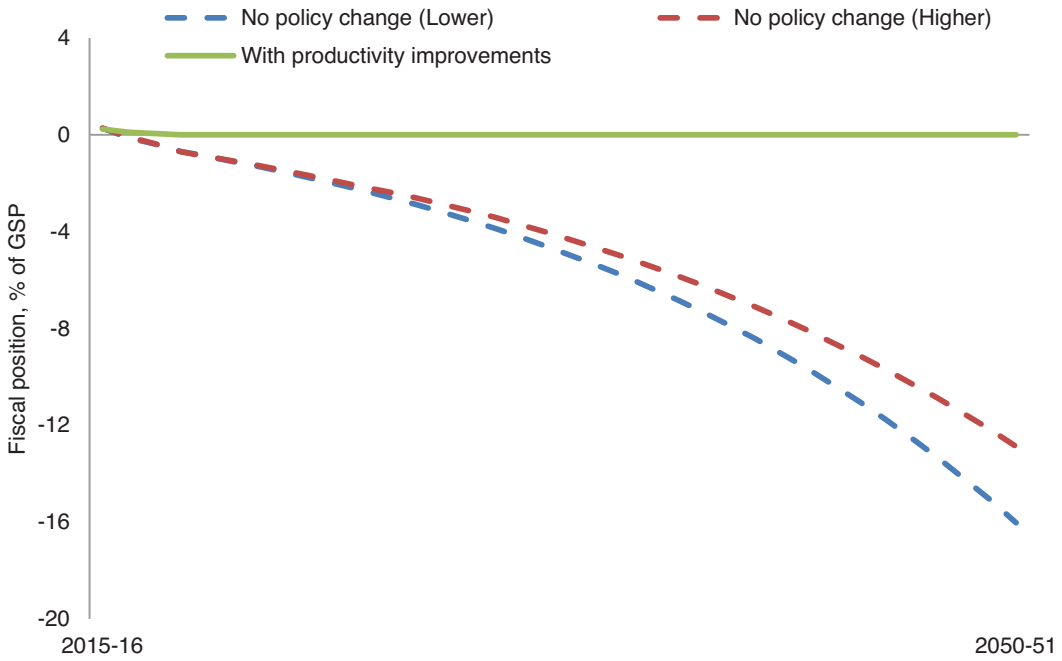
To provide some perspective as to the scale of action required to address these long-term fiscal challenges, the Commission conducted an analysis to determine the magnitude of productivity improvements that would be required to ensure a sustainable financial position for the General Government sector over the period 2015-16 to 2050-51. The analysis was based on the strategy of achieving a zero fiscal balance in the General Government sector on average over the economic cycle, and a stable debt position. This is consistent with the medium-term fiscal strategy recommended by the Commission in its Interim Report.

In the Commission's analysis, these fiscal objectives are achieved via productivity improvements in sectors involved in the provision of government services, thereby lowering the costs of government service delivery.[15] Those sectors include public administration and safety, health care and social assistance, and education and training, and capture the provision of services by both Government and the private sector.

Under the lower growth scenario, a productivity improvement of around 1.1% each year in government service delivery would be required to maintain fiscal balance through to 2050-51. For the higher growth scenario, the productivity improvement required is 0.8% each year.

Chart A1.13 shows the impact of this policy action on the projected fiscal position. Instead of a worsening fiscal deficit, as shown in Chart A1.12, a stable fiscal position is achieved over the projection period.

Chart A1.13
Projected policy action fiscal position, Queensland (a)

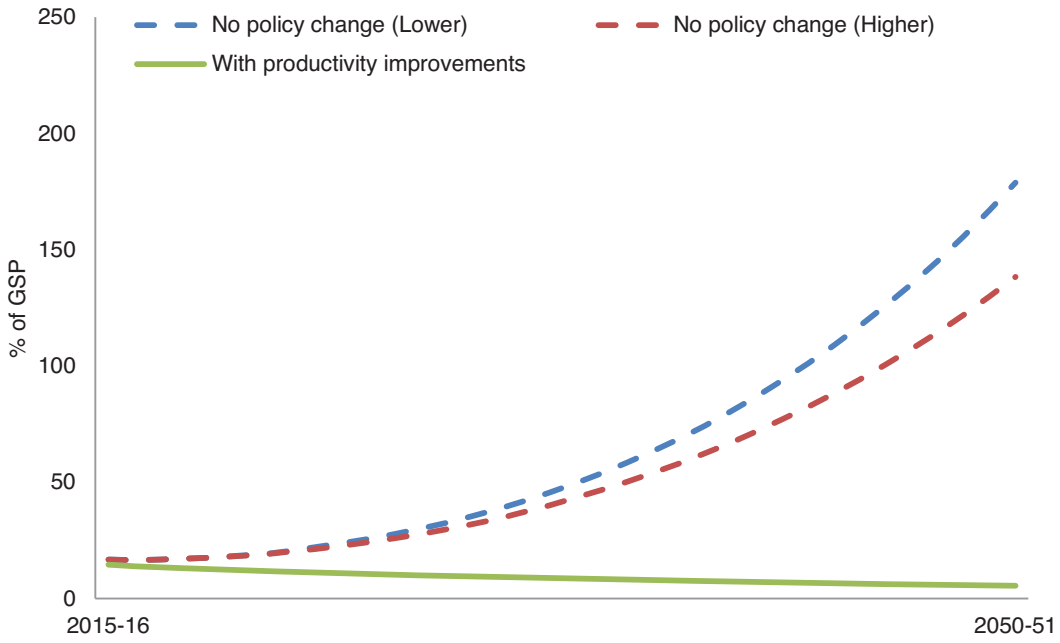


(a) For both the lower growth and the higher growth scenarios, the fiscal position with productivity improvements shows the achievement of a zero fiscal balance (as a per cent of GSP).

Source: Commission of Audit

Because the productivity improvements would close the fiscal deficit, it would also reduce the financing requirement and the accumulation of debt, as shown in Chart A1.14.

Chart A1.14
Projected gross debt to GSP ratio, Queensland (a)



(a) For both the lower growth and the higher growth scenarios, the debt position with productivity improvements shows the achievement of a stable debt position (as a per cent of GSP).

Source: Commission of Audit

Economy-wide impacts

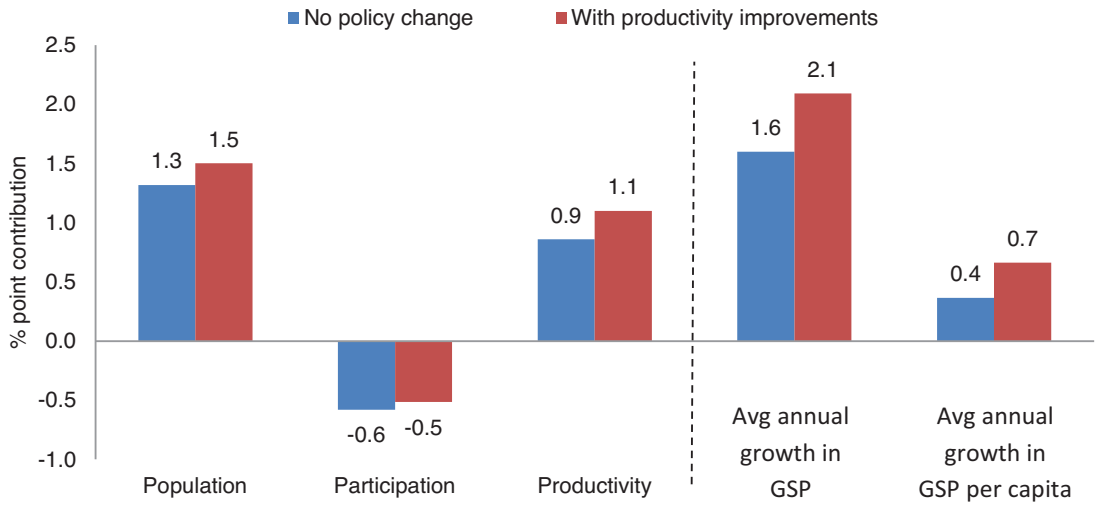
Policies to increase productivity in government service delivery are projected to generate significant positive flow on effects that result in economy-wide productivity gains that are higher than could be attributed solely to sectors involved in government service delivery.

These economy-wide gains occur since productivity improvements in sectors involved in the provision of government services free up significant labour resources for use by the rest of the economy. This allows for the expansion of industries with higher than average measured labour productivity growth (such as mining, agriculture and non-government services such as finance), which would otherwise have been constrained by labour shortages as the population ages and participation rates fall.

Charts A1.15 and A1.16 show the impacts of these economy-wide productivity gains on economic growth for the lower growth and higher growth scenarios, respectively. In the lower growth scenario, the boost to economic growth is projected to be 0.5 percentage point in aggregate terms and 0.3 percentage point in per capita terms. For the higher growth scenario, annual average economic growth is projected to be 0.4 percentage point above the 'no policy change' case, equivalent to 0.2 percentage point in per capita terms.

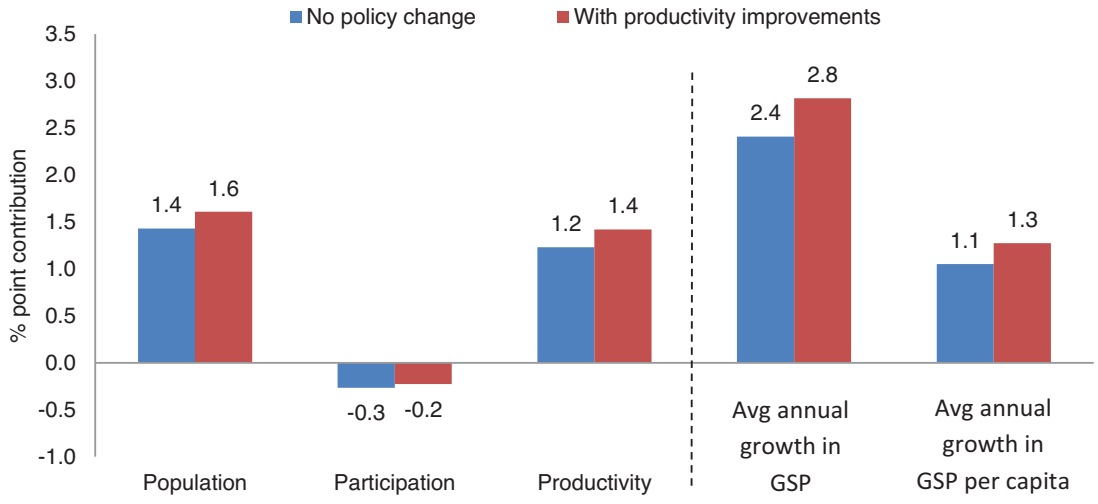
With the larger fiscal deficit in the lower growth scenario (as shown in Chart A1.13), a higher productivity improvement is required to achieve fiscal balance. This results in a slightly larger impact on GSP growth than in the higher growth scenario.

Chart A1.15
Decomposition of growth – lower growth scenario, Queensland, 2015-16 to 2050-51



Source: Commission of Audit

Chart A1.16
Decomposition of growth – higher growth scenario, Queensland, 2015-16 to 2050-51



Source: Commission of Audit

A1.2.4 Conclusion

There are a range of demographic, economic and social factors which will place increasing pressures on the capacity of the State to provide the level of service delivery expected by the people of Queensland in forthcoming decades. Unless policies to address cost pressures are enacted, the projections show that the State will not be able to finance these services because it will accumulate an unsustainable debt position.

A productivity gain of around 0.8% to 1.1% per annum across sectors involved in the provision of government services would be sufficient to maintain fiscal balance through to 2050-51. This productivity gain is equivalent to reducing the unit cost of service delivery by between 26% (higher growth scenario) and 34% (lower growth scenario), relative to what it would otherwise be in 2050-51.

Productivity improvements of this magnitude would lift average GSP growth by around 0.5% per annum (lower growth scenario), equivalent to an extra $8,320 per annum in today's dollars for each Queenslander by 2050-51.[16]

This Report has documented recent significant declines in productivity for the economy as a whole, and in key sectors of government service delivery, such as health. Against this background, the achievement of productivity gains of this magnitude on a consistent year-to-year basis involves significant challenges for the Government. It will require a sustained and widespread effort across all areas of Government.

Strong and decisive action is necessary to restore Queensland's record of economic and productivity growth. It is necessary to take decisive action to repair state finances and prepare for the challenges posed by demographic change and other factors. The measures recommended in this Report are designed to achieve those objectives.

ENDNOTES

[1] Charts that show growth rates over financial years will show the first data point as the year after the base year. For example, economic growth since 1985-86 will show the first data point as the growth between 1985-86 and 1986-87.

[2] *Queensland State Accounts, September Quarter 2012*, Queensland Treasury and Trade.

[3] Multifactor productivity (MFP) – see Appendix 1 for an explanation of why MFP is the preferred measure of productivity performance.

[4] The trending process is consistent with the method used by the ABS in determining productivity growth cycles (see ABS 5204.0, Australian System of National Accounts, 2007-08).

[5] *Queensland Productivity Update: 2011-12*, Queensland Treasury and Trade.

[6] Queensland Treasury and Trade's MFP publication shows that 2007-08 was the end year in the most recent productivity growth cycle (2001-02 to 2007-08). See *Queensland Productivity Update: 2011-12.*

[7] The Commission's population estimates for 2020 are around 100,000 persons below the range of the Queensland Government population projections (2011 edition). However, the Queensland Government 2011 population projections were released prior to the ABS 2011 Census. In a recent publication (ABS 3101.0), the ABS noted an intercensal error of over 100,000 for Queensland between 2006 and 2011. As a result, the ABS has foreshadowed a downward revision to population estimates for Queensland back to 1991.

[8] This definition of labour force participation includes defence force personnel.

[9] The historical rolling 20-year average annual growth of Australian labour productivity utilises the longest available time series data from the ABS.

[10] This divergence in timing between growth in mining employment and output is explained in section 4.2 of Appendix 1.

[11] The issue of measured productivity growth in service industries is explained further in Appendix 2.

[12] These results are broadly consistent with findings from both, Australian Government, '*Intergenerational Report 2010, Australia to 2050: future challenges'*, Australian Government, Canberra, 2010; and Productivity Commission, '*Economic Implications of an Ageing Australia'*, Research Report, Canberra, 2005.

[13] The relative price of government services is higher under the higher growth scenario since the majority of government services are delivered by sectors with lower productivity growth than the market sector. This causes the price of goods produced by the government sector to increase relative to the market sector. Since productivity growth in the market sector is assumed to grow faster in the higher growth scenario, this effect is more pronounced than in the lower growth scenario.

[14] The fiscal deficit is equivalent to the definition of 'net borrowing' used in Government Finance Statistics. It describes the shortfall between income and expenditures in any given year, including interest expenses and capital purchases. The projections do not take into consideration how rising debt levels would affect the State's credit rating and the inferred interest rate on debt.

[15] The volume of government service delivery per capita in any given year is assumed to be the same in both policy change and no policy change scenarios.

[16] Under the higher growth scenario, annual average GSP growth is 0.4 percentage point higher over the period 2015-16 to 2050-51, equivalent to $7,690 per person in 2050-51.

A2 THE STATE GOVERNMENT'S ROLE IN THE ECONOMY

KEY ISSUES

- The Queensland Government's share of the economy has grown faster than in other states.
  - In 2011-12, Queensland Government expenditure represented 14.1% of gross state product (GSP), more than any comparable state.
  - In the decade since 2001-02, average public sector wages in Queensland have increased from 97% of the average of public sector wages in all states to 107% in 2009-10, and remain the highest of any comparable state.
- The role of government should be directed towards the provision of core services that the private sector is unable or unwilling to provide. Where there are private providers, the Government should encourage contestable markets to find the most cost-effective ways of delivering a range of other services.

Government sets the legal and institutional framework in which the private sector operates. That framework can be conducive to economic growth and profitability, or not.

As part of its regulatory framework, Government raises revenue through taxes, fees and charges. These costs impact very directly on economic performance. A large government requires larger resources and ultimately higher taxes and charges.

The way in which a government uses its revenue is also critical to economic performance. It may contribute to developing physical and human capital in more or in less efficient ways. If resources are used to maximum effect, taxpayers obtain value for money and outcomes will be better than the wastage which will otherwise occur.

The Queensland Government is the largest employer and the largest single purchaser of goods and services in the State of Queensland. It therefore has a dominant position in the State economy. How the Government operates has a significant influence on the economic performance of the State.

A2.1 THE SIZE OF GOVERNMENT IN THE ECONOMY

In analysing the size of the State Government in the economy, it is important to recognise the federal framework that shapes the linkages between Australian Government revenue and expenditure and Queensland's revenue and expenditure. As noted in the Commission's Interim Report, own-source revenue represents around half of total General Government revenue for Queensland, with grants from the Australian Government providing the remaining half.

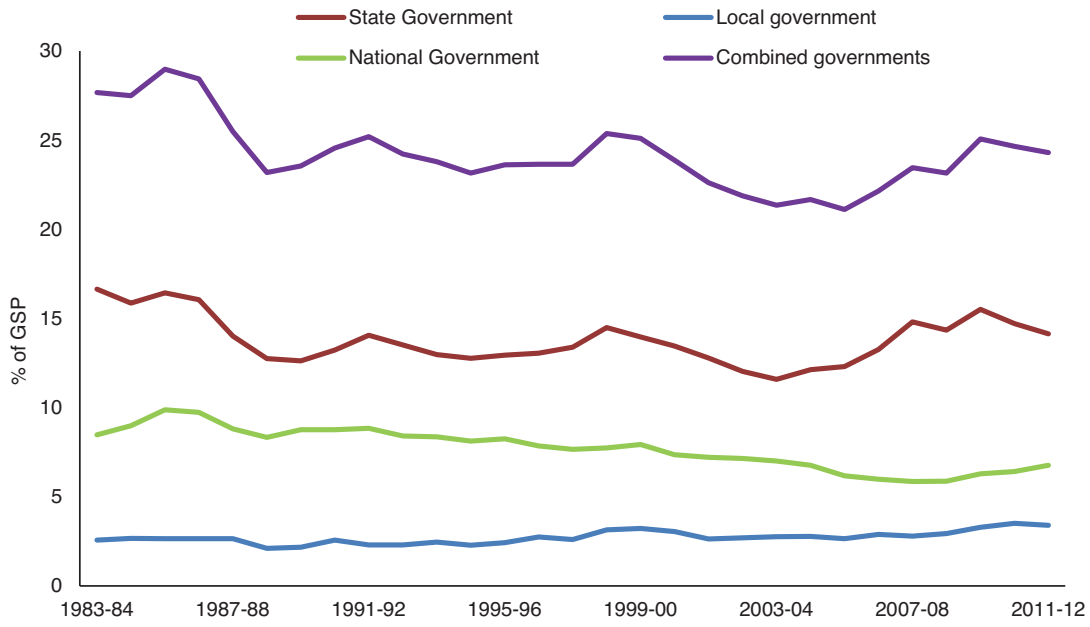
It is also important to recognise that there have been variations over time in the scope of activities undertaken by both the Queensland Government and the Australian Government.

A2.1.1 Government expenditure in Queensland

The following analysis and charts present a long-term perspective on government expenditure as a share of the overall economy, as measured by gross state product (GSP).[1] Presenting data as a share of the economy rather than in dollar terms has three benefits. Firstly, it avoids the difficulties created by comparing dollar values across significant time periods. Secondly, it enables a focus on the share of the economy's resources that a government is appropriating. Thirdly, to the extent that GSP grows with population, it abstracts from the influence of population growth.

As shown in Chart A2.1, the economic footprint of the combined national,[2] state and local governments in Queensland decreased from 27.7% of GSP in 1983-84 to a low of 21.1% of GSP in 2005-06. In the four-year period after 2005-06, the combined economic footprint of governments climbed 4.0 percentage points to a peak of 25.1% of GSP in 2009-10, before easing back to 24.3% in 2011-12.

Chart A2.1
Total government expenditure as share of GSP, Queensland



Source: ABS 5242.0, 5206.0; and Commission of Audit

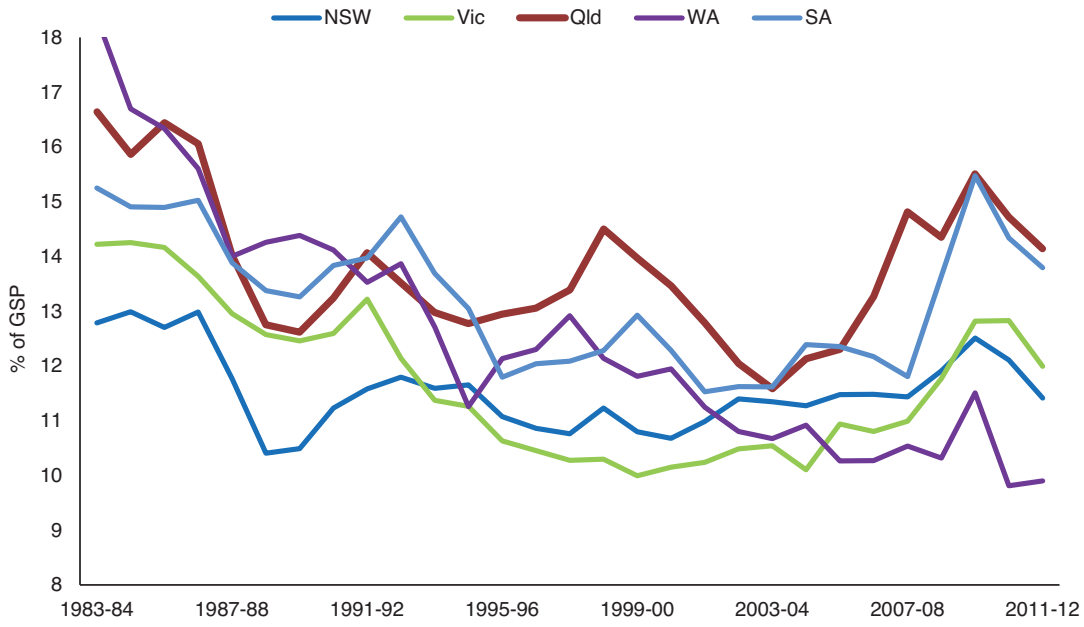
Consistent with the Australian Government, Queensland Government expenditure slowly declined,[3] from a peak of 16.6% of GSP in 1983-84, to a low of 11.6% in 2003-04.

Subsequently, in the six-year period to 2009-10, the Queensland Government's economic footprint increased by 3.9 percentage points, as a share of GSP, reaching a peak of 15.5% of GSP. In contrast, in the same six-year period to 2009-10, expenditure in Queensland by the Australian Government declined by 0.7 percentage point. As a result, the State Government's share of combined government expenditure in Queensland increased from 54% in 2003-04 to 62% in 2009-10.

A2.1.2 State government expenditure, comparison of states

Chart A2.2 compares state government expenditure in each of the states as a share of GSP. Queensland started the 1980s with a higher government expenditure share than New South Wales or Victoria. In part, this may have reflected Queensland's decentralised nature, and the impacts this has on service delivery costs.

Chart A2.2
State government expenditure as share of GSP



Source: ABS 5242.0, 5206.0; and Commission of Audit

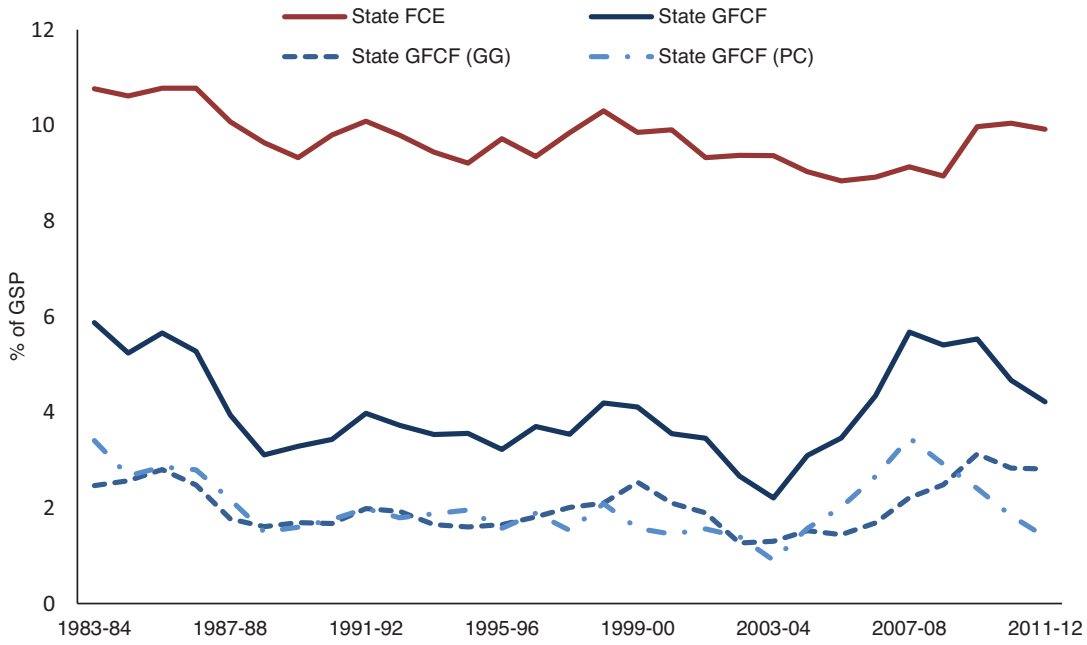
Queensland Government expenditure, as a share of GSP, declined significantly (down 4.0 percentage points) over the six years to 1989-90. By the end of the 1990s, however, Queensland Government spending had increased again as a share of GSP.

The most significant period of growth in Queensland Government expenditure, as a share of GSP, was in the six-year period from 2003-04 to 2009-10. Over these six years, Queensland Government expenditure rose by 3.9 percentage points, to 15.5% of GSP. Even though Queensland Government expenditure had declined to 14.1% of GSP by 2011-12, this was still higher than any other mainland state.

A2.1.3 Queensland Government expenditure, by type

As shown in Chart A2.2, after declining as a share of GSP to a low of 11.6% of GSP in 2003-04, Queensland Government expenditure increased significantly over the eight years to 2011-12. Chart A2.3 shows that this growth in total State Government expenditure included a significant shift in the split between investment and consumption expenditure over this period.

Chart A2.3
State Government expenditure as share of GSP, Queensland



FCE - Final consumption expenditure; GFCF - Gross fixed capital formation; GG - General Government; PC – Public Corporations

Source: ABS 5242.0, 5206.0; and Commission of Audit

Since 1983-84, Queensland Government final consumption expenditure (FCE), as a share of GSP, decreased by 0.8 percentage point (reaching 9.9% of GSP by 2011-12). Over this period to 2011-12, gross fixed capital formation (GFCF), or investment expenditure, decreased by 1.7 percentage points as a share of GSP.

Investment expenditure was scaled back much more than consumption expenditure. As a result, Queensland Government consumption expenditure has risen from 65% of total Government expenditure in 1983-84 to 70% in 2011-12.

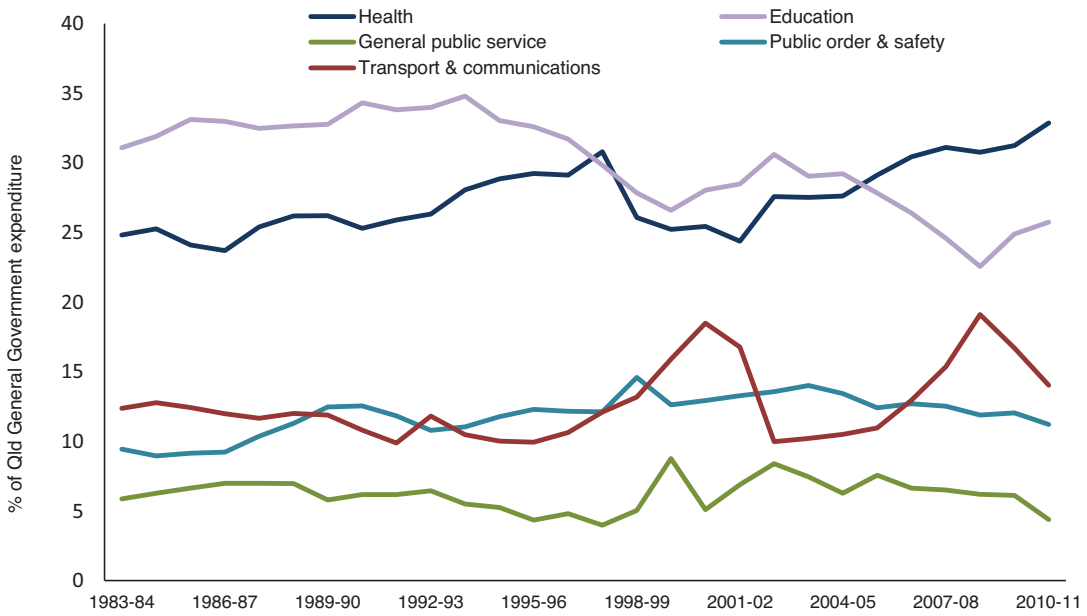
A2.1.4 Queensland Government expenditure, by purpose

There have been significant changes in the pattern of total Queensland Government expenditure (consumption plus investment expenditure) by purpose since 1983-84.[4]

Over the period from 1983-84 to 2010-11, Chart A2.4 shows the following changes in the share of Queensland General Government expenditure:

- Health contributed 24.8% of government expenditure in 1983-84, and had risen to 32.9% of expenditure by 2010-11.
- Transport and Communication expenditure also increased over the period, from 12.4% of government expenditure in 1983-84 to 14.0% in 2010-11.
- Education contributed 31.1% of government expenditure in 1983-84, but had declined to 25.7% of expenditure by 2010-11.

Chart A2.4
Queensland Government expenditure, by purpose



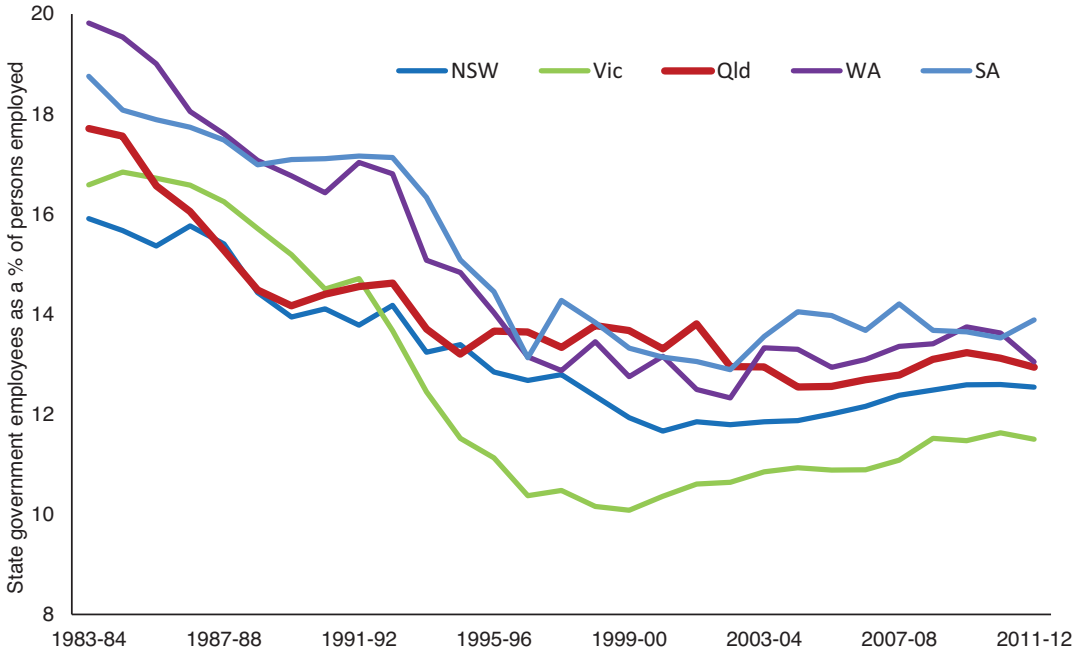
Source: ABS 5204.0; and Commission of Audit

A2.1.5 State government employment, state comparison

Aside from government expenditure, another measure of government's impact on the economy is the public sector's share of total persons employed.

As shown in Chart A2.5, the public sector share of Queensland employment declined through the 1980s and 1990s. However, from 2003-04, the Queensland public sector share of employees increased to 13.2% of persons employed in 2009-10. The public sector share of total employment is higher in Queensland than in New South Wales and Victoria, but lower than in Western Australia and South Australia.

Chart A2.5
Public sector employees as share of total employees

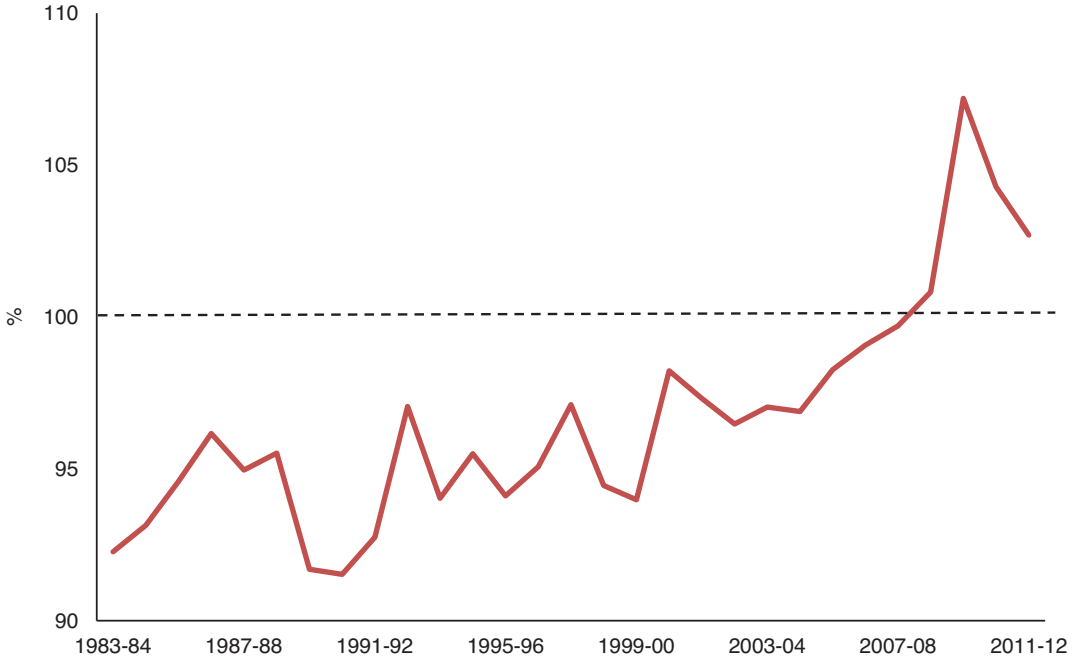


Source: ABS 6248.0, 6202.0; and Commission of Audit

In recent years, Queensland's fiscal position has been affected by the growth in public sector wages, which have been rising relative to other states. As shown in Chart A2.6, through the 1980s and 1990s, the wage rate of Queensland's public sector employees was below the all-states average for state government employees.

In the decade since 2001-02, average public sector wages in Queensland have climbed from 97% of the average of public sector wages in all mainland states, to a peak of 107% in 2009-10. Furthermore, despite the slower growth in Queensland's public sector wages in the last two years, in 2011-12, the average Queensland public sector wage remained above that in New South Wales, Victoria, Western Australia and South Australia.

Chart A2.6
State public sector wages, Queensland relative to all-states average



Source: ABS 6248.0, 5206; and Commission of Audit

A2.2 The Role of Government in the Economy

A2.2.1 Government intervention in the economy

Government resources are used to meet a range of social objectives, such as income support and education. Government resources can also be used for economic purposes. One of these purposes is to correct for market failure, which occurs when markets substantially and systematically fail to allocate resources to their most highly valued use. The main types of market failure include those associated with public goods, externalities, market power and information asymmetries. These characteristics are outlined in Box A2.1.[5]

Box A2.1
Market failure

Public goods

'Public goods' are goods or services to which anyone can simultaneously have access once they are provided, and use by one person does not reduce their availability to others. Producers of public goods are unable to exclude consumers from enjoying the benefits of a good once it is produced, whether each consumer pays for it or not. It may be physically impossible to exclude people, or it may not be economically feasible to do so. National defence and police services are commonly cited examples of a public good.

As a consequence, so long as people believe that others also desire the good and that it is likely to be made available, then each individual is unlikely to contribute voluntarily to the cost of its provision. Therefore, free markets are unlikely to provide, or may produce insufficient quantities of, public goods.

Externalities

An externality occurs when a transaction between parties creates benefits (which are not paid for) or imposes costs (which are not compensated) on others not directly involved in the transaction. The total social or economic costs (or benefits) to the community of an activity are made up of the private costs (or benefits) experienced by those directly engaged in the transaction, plus the external social and economic costs (or benefits) not accounted for by the individuals or firms engaging in the activity.

The implication of externalities, such as a firm polluting its local environment, is that they are not accounted for in the individual firm's decision making and therefore result in too much (where external costs occur) or too little (where external benefits accrue) of an activity taking place from the community's point of view.

Market power

Problems of market power arise from uncompetitive market structures. Lack of competition allows producers to restrict output and set prices higher than at competitive levels, and there is no threat that another producer will enter the market and drive prices down. In these conditions, prices are usually higher than they should be and not enough resources are allocated to production of particular goods or services. Such inefficiencies impose costs on the entire community.

Asymmetric information

Lack of information can result in market failure if consumers cannot obtain adequate information on which to base their decisions to buy and consume. This may lead consumers to make decisions that are not in their best interests. Consumers need adequate information on aspects of products such as price and quality (including any hazards associated with each product) to make rational economic choices.

A2.2.2 Government direct service provision and contestability

There is no universal rule on what should be publicly or privately owned or managed. Governments have in the past owned and operated businesses which today are run by the private sector, including banks and insurance companies, airlines, airports, ports, transport companies, electricity utilities and gas producers. In many cases, governments took a lead role in establishing these entities, because the start-up risks or capital requirements were too large for private enterprise.

However, once such businesses are established and mature, and appropriate regulatory structures are in place, the rationale for public ownership becomes less compelling. Not only does the case for public ownership become weaker, but sometimes the commercial risks of the business make the case for divesting to the private sector stronger. Moreover, given improvements in contracting out and regulation, and deepening of private sector capital markets, many of the original reasons for government provision have lost force.

There are commercial risks to a government-owned corporation competing with private sector operators. Generally, the history and culture of the public sector is less flexible and it does not promote entrepreneurial and commercial skills in the way that private sector competitors promote and value it. This means private sector operators can move faster and with more agility to deal with emerging risks and exploit opportunities. Private investors who understand the risk of an enterprise can assess the risk/reward ratio and trade it for personal gain. Public sector investors (taxpayers) are not in a position to make those decisions.

The challenge for any government is to establish an environment where services are provided efficiently, at lowest cost and least financial risk to the state. There is substantial international evidence that privatised government enterprises operate more cost effectively when they are allowed to operate without interference in the commercial decision-making processes.[6]

Private provision of publicly funded services

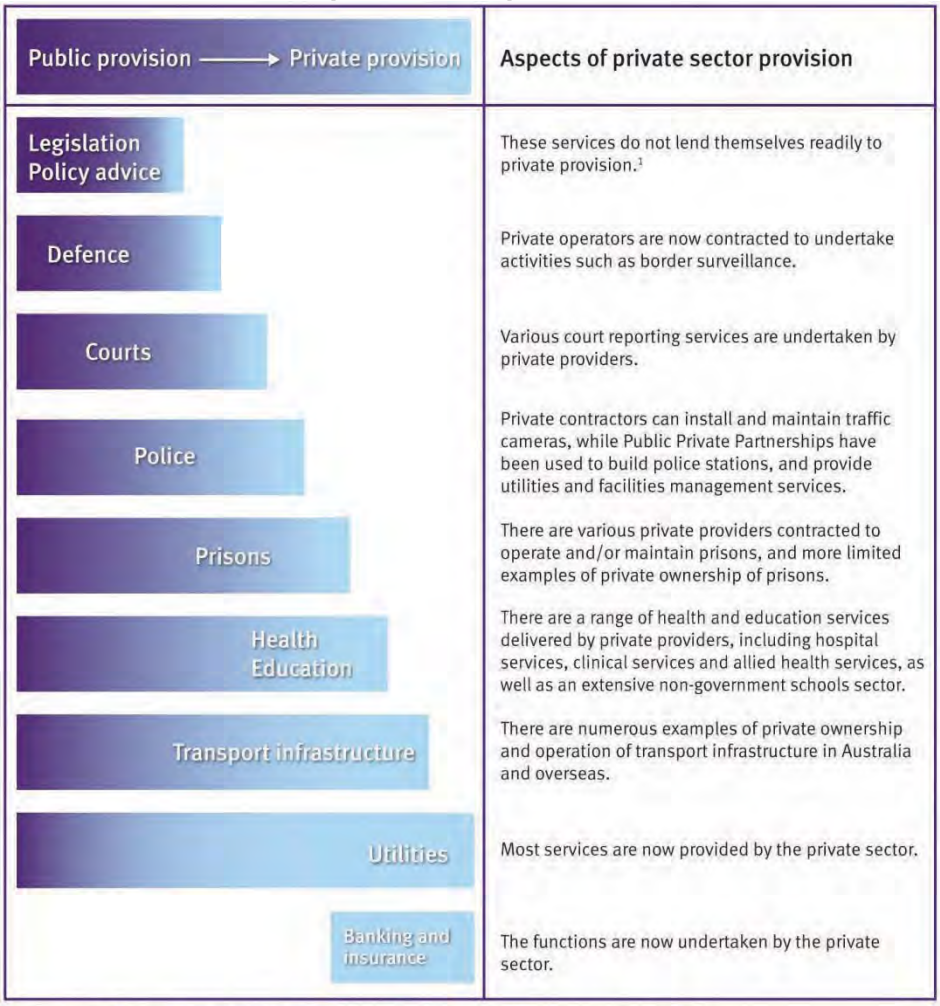
Identification of a service as being the responsibility of government does not necessarily imply that government should directly deliver that service. As in any other field, lack of contestability in the provision of 'public' goods or services can lead to inefficient delivery – either in terms of higher cost or lower quality – compared with what is achievable through a contestable environment.

Generally, the services governments are best suited to provide are those that either are not provided by contestable private markets or, if they are provided, they are not in sufficient quantity. This usually results from an under-allocation of resources in the economy to the provision of goods and services that have a 'public good' value to the community as a whole, but not to an individual provider.

There is a continuum in how services can be provided, from pure public provision to complete private provision. The way in which a particular service is delivered can vary over time, for example, due to developments in market maturity and technology.

This is illustrated in Figure A2.1, which shows that the private sector is now increasingly involved in delivering services which were once the domain of the public sector.

Figure A2.1
Private provision of public services



1 However, it is possible to obtain policy advice from sources other than the public sector.

Source: Commission of Audit

As shown in Figure A2.1, some services, such as legislative services, are provided by the public sector, as they involve the application of law and relate wholly to the delivery of public goods rather than private benefit.

Other functions with a strong public good element include defence, courts and front-line policing services. However, recent experience has shown that even elements of these functions can be delivered effectively by the private sector (for example, border security surveillance, private operators of roadside speed cameras, etc.).

While functions such as education and health have traditionally been provided by the public sector, increasingly there are private sector and private not-for-profit organisations providing these services. There is also an increasing involvement of the private sector in the management and operation of prisons, both in Queensland and elsewhere.

Further towards the 'private' end of the spectrum are services which governments have an interest in ensuring are provided, but no longer need to provide directly. These include:

- commercial infrastructure, such as roads (now often built and operated by private operators), ports and airports
- banking and insurance services
- utilities, such as electricity, transmission and distribution, or water and sewerage services.

In Australia, government direct provision of 'public' services has declined, partly in recognition that socially desirable outcomes can be achieved efficiently through regulated or purchased private provision. In recent years, this has become increasingly the case in services such as health, education, police, prisons and public transport, including through public–private partnerships and franchising or other contracting arrangements.

The Commission has developed principles as a guide to manage and deliver services. These are outlined in Box A2.2.

Box A2.2
Key principles to manage and deliver services

Focus on core services

Government should not perform commercial functions which other parties are better placed to deliver at equal or lower cost. It should focus on those activities which others cannot or will not undertake.

Facilitate contestability in service delivery

Better value for money in the delivery of front-line services can be achieved through contestability, as this will encourage more efficient and more innovative service delivery, whether by the public sector or the private sector (public sector service providers should not be immune from competitive pressures).

Better demand management

Demand pressures need to be managed to ensure that services are directed to or targeted at those most in need.

Greater workforce flexibility

There is a need for greater workforce flexibility and mobility, so that resources can be readily redirected to areas of highest priority – by removing restrictive workplace practices which add unnecessary costs without delivering improved output. Industrial relations and enterprise bargaining arrangements should not fetter the ability of managers to manage.

Capacity building

A dynamic and responsive public sector needs to build new skills and capacity, particularly in relation to contract management and engagement of private sector providers.

Lower overhead costs

The overhead administrative and corporate costs of supporting front-line service delivery need to be reduced, through renewal of public service practices, and the contestable provision of functions such as corporate services and ICT services. Highly centralised, 'one size fits all' administrative support services have led to excessive costs which represent very poor value for money.

Strengthen financial management

Public administration requires the highest standards of financial management, based on principles of transparency and accountability, to ensure limited financial resources can be directed to meeting government priorities on a sustainable basis.

Build productive capacity

Queensland's future economic prosperity will depend on strengthening the productive capacity of both the public and private sectors.

From these principles, the Commission recommends that in service delivery the Queensland Government:

- provide core services such as policing, public safety, emergency and justice services, which have a strong public good element

- work more closely with non-government providers to find the most cost-effective ways of delivering a range of other social services, including public education, public transport, health, housing and community support services, primarily for those most in need in society

- ensure other public services with a strong commercial element are provided by private or other non-government providers where they are capable of doing so in a competitive market environment.

Much of the projected growth in state government expenditure is concentrated in areas which are contestable, such as health and education. Contestability in the provision of these services can improve the efficiency of delivery, thereby reducing the fiscal burden of meeting growing demands for services.[7] Throughout this Report, the Commission has identified government services which should be delivered under contestable market arrangements.

ENDNOTES

[1] The Australian Bureau of Statistics produces data on the scale and pattern of government expenditure in two different classification systems: Government Finance Statistics (GFS) and Australian System of National Accounts, Production and Income Accounts (ANA). In the Commission's Interim Report, the focus was on the state budget perspective of recurrent and capital expenditure, and therefore GFS data were used. In contrast, this section of the Final Report is focussed on economic activity, and therefore uses ANA data, which is based on an economic classification of government activity.

[2] The ANA provides data on general government activity by: (a) subsectors (National, State and Territory, and Local government); (b) institutional sector (General Government and Public corporations); (c) transaction type (final consumption or capital formation); and (d) purpose (for example, Defence, Education, Health, etc.). The National subsector includes units controlled by both Commonwealth and State governments that therefore cannot be allocated, as well as units such as public universities that are solely under the jurisdiction of the Commonwealth.

[3] There was a short spike in 1998-99, at 14.5% of GSP, as growth in State Government expenditure significantly outpaced GSP growth.

[4] The switch from cash to accrual accounting in Government Finance Statistics from 1998-99 required the removal of depreciation from the ABS consumption expenditure data to provide consistency across the full period from 1983-84. Also, the category 'Other economic affairs' was allocated to 'General public service'.

[5] Sourced from J Stiglitz, *The Economics of the Public Sector*, 2000.

[6] For example, see J Nellis and S Kikeri, 'Privatization in Competitive Sectors: The Record to Date', World Bank Policy Research Working Paper No. 2860, June 2002; and Megginson and Netter, 'From State to Market: a Survey of Empirical Studies on Privatization, *Journal of Economic Literature*, 2002.

[7] G Sturgess, 'Diversity and Contestability in the Public Sector Economy', NSW Business Chamber, 2012.

PART B:

GOVERNMENT COMMERCIAL ENTERPRISES

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PREFACE

The Government must make better use of its balance sheet, by releasing capital locked up in mature assets to pay down debt, lower interest costs and free up funds for investment in new infrastructure (for example, flood prevention).

The Commission has reviewed the 12 Government Owned Corporations and the industry sectors in which they operate, as follows:

- Energy – CS Energy, Stanwell, Powerlink, Energex and Ergon
- Public transport – Queensland Rail Limited, as well as bus and ferry services
- Ports – Far North Queensland Ports Corporation, North Queensland Bulk Ports Corporation, Port of Townsville and Gladstone Ports Corporation
- Regional bulk water – Sunwater, as well as other state and local government owned water businesses
- Financial services – Queensland Investment Corporation (QIC), as well as other government financial services providers, including Queensland Treasury Corporation (QTC) and statutory authorities undertaking investment funds management functions to support long-tail liability management responsibilities.

In addition, the Commission has separately reviewed the role of other commercialised business units (CBUs) operating within the Queensland Government. Since the Commission's Interim Report, the Government has made a number of changes to CBUs, including some closures, and the scaling back of functions in other CBUs. The Commission has considered the need for further changes to CBUs to deliver additional benefits for the State.

The Commission proposes the following principles to guide policy on government commercial enterprises.

Commercial assessment tests for government commercial enterprises

1. There is no necessity for government to own assets that compete with other private services in workably contestable markets. Where governments own such assets (which is usually as a result of legacy arrangements), they should continually monitor the value proposition for those assets to evaluate whether the continued investment generates the optimum value outcome for the state taking into account other uses to which that capital could be put.

2. There is no need for governments to own commercially sustainable businesses which have monopoly characteristics, provided that there is an effective regulatory oversight governing the behaviour of private providers of these services. Any case to retain government ownership of these assets should be driven by value reasons and other whole-of-government considerations.

3. Even where government is responsible for delivering services, it can do so through its own agency or through non-government providers, and delivery should be subject to contestability to the greatest extent possible.

B1 GOVERNMENT OWNED CORPORATIONS – GOVERNANCE MODEL

KEY ISSUES

- The governance model for Government Owned Corporations (GOCs) in Queensland was developed in the early to mid-1990s, and has remained largely unchanged since that time, despite significant changes in the commercial and economic environment.
- The network infrastructure that comprises the bulk of current GOC assets was built as a government service – usually a monopoly. It was not designed to be a commercial operation. Costs were shared between users and taxpayers.
- The purpose of establishing GOCs was to move the operations of these government infrastructure bodies from a non-commercial to a commercial basis. The *Government Owned Corporations Act 1993* presented a framework under which the GOCs would undertake this transition.
- For most GOCs, the transition has long been completed. The GOC governance arrangements need to be updated.

B1.1 THE ROLE OF GOVERNMENT IN COMMERCIAL BUSINESSES

Over the last 20 years, the Australian Government has divested most of the large scale business entities that were once in government ownership, for example Qantas, Telstra, Commonwealth Bank and major airports. By and large, these businesses were operating in mature competitive markets and there was no justification for continued government ownership. Similarly, the Victorian Government divested significant business enterprises during the 1990s, especially in the electricity sector.

Some state governments still retain ownership of a range of significant business entities, although there is a divestment process currently underway for electricity generation assets in New South Wales. Most of the commercial businesses still in state government ownership have the following characteristics:

- They are responsible for the provision of state-wide network infrastructure in the energy, transport and water sectors, and therefore hold assets of significant financial value.
- The network infrastructure comprises what has traditionally been seen as critical services important to the functioning of the economy, such as energy, transport and water.
- Some elements of the network infrastructure exhibit monopoly characteristics and, having invested in these assets, the community – rightly – expects to be protected from exploitation of monopoly power through a rigorous and effective regulatory framework.

When initial investments were made in the development of these networks, achieving a commercial return for the taxpayer was not a high priority, as there were broader social and economic development objectives. This was particularly so when there was limited or no competition for the government providers.

The original rationale for the construction of network infrastructure prevailed within government up until the early 1990s. The role of government was seen to be to expand and maintain the networks to support critical economic infrastructure and address isolation in remote communities.

Over time, as competition to government providers emerged, governments came to realise that the significant value invested in the network infrastructure required a separate and more active governance regime to ensure that the community received an appropriate return on this investment.

By the early 1990s, a number of developments resulted in government placing greater importance on commercialisation of its network assets. These developments included:

- Once networks had been established, the focus shifted to the efficient management of the network infrastructure and delivery of network services.

- With increasing demands on government for other services, achieving a return on investment in network infrastructure became more important.

- Greater private sector involvement in network infrastructure required the removal of government policies that provided a competitive advantage to government-owned networks.

These developments, among others, resulted in a shift in the policy framework for government network businesses from one that was principally focussed on non-commercial criteria (that is, the creation of economic and social infrastructure) to commercial criteria (that is, efficiency, a commercial rate of return on network assets and competitive neutrality). The shift in the policy framework to a greater commercialisation focus occurred in three stages:

- initial separation of government ownership and operation of government business activities through discrete corporatisation
- formalisation of corporatisation through legislation
- application of National Competition Policy (NCP).

As part of this policy framework, governments – both state and federal – introduced a structured corporatisation policy framework in the early to mid-1990s that formalised:

- the separation of ownership of government business entities from their operation
- an annual financial return to government on its investment through dividends
- achievement of competitive neutrality with the private sector
- an ownership structure that would facilitate divestment of the business units at some future point in time.

In Queensland, the Government Owned Corporation (GOC) model was established to enable government business entities to operate on a commercial basis at arm's length from government. The original purpose of the introduction of the *Government Owned Corporations Act 1993* (Qld) (GOC Act) and the establishment of GOCs was the transition from a non-commercial to commercial policy framework for government network infrastructure. The GOC framework therefore embodies elements of both the new commercialised policy framework and the previous non-commercial policy framework.

The GOC model in Queensland has remained largely unchanged since its inception in the mid-1990s. For so long as GOCs remain in government hands, the maintenance and modernisation of the GOC framework is essential to ensure continued separation of the roles of government as owner, operator and regulator of network assets.

B1.2 CURRENT GOVERNANCE MODEL

The Commission's Interim Report outlined the structure of the State's GOC sector, comprising 12 entities covering energy, transport, water and financial services. It noted that the intent of the GOC model, to provide some autonomy to the operations of GOCs, inevitably will conflict with other roles of government. These are the Government's role as:

- the GOC owner (shareholder)
- policy maker
- regulator
- operator and service provider (through the GOC board and management).

As well as being the owner of GOCs, the Government also performs other roles that impact on GOC performance. These are the Government's core roles, firstly as a policy maker and secondly as a regulator.

The Government performs general and specific roles with regard to policy and regulation that apply to GOCs. Generally, government policy and regulation that applies across the State will also apply to GOCs. This includes environment regulation, planning and development laws and taxation policies.

In addition, GOCs will be subject to specific policy and regulatory regimes, often through legislation. This includes, for example, regulation of pricing through the Queensland Competition Authority (QCA) and access regimes for monopoly infrastructure. Other GOCs, such as in the transport sector, have their own pricing arrangements for the services provided to government.

The legislative structure applying to Queensland GOCs includes both state and federal laws:

- the legal, financial and operational separation of GOCs from the General Government sector is provided under the GOC Act

- GOCs are also national corporations for the purposes of the *Corporations Act 2001* (Cwlth)

- as national corporations, the GOCs are subject to independent regulation by the Australian Securities and Investments Commission (ASIC).

The GOC Act establishes the corporate governance framework for GOCs and serves to create the formal separation of ownership of the assets from day-to-day management of the assets, while retaining the mechanisms for the owners to direct the board on specific elements of day-to-day operations.

The GOC Act requires each GOC to have two shareholding Ministers: the GOC Minister and the portfolio Minister who make decisions in accordance with statutory responsibilities in the GOC Act. The portfolio Minister is typically the Minister responsible for administering the legislation that established the GOC. Shareholding Ministers hold shares in the GOCs on behalf of the Government and ultimately the public.

Apart from the GOC Act, other Queensland legislation applying to GOCs is shown in Table B1.1.

Table B1.1
Other Queensland legislation applying to GOCs

Public Service Act 2008 (Equal Employment Opportunity provisions only)
Right to Information Act 2009
Crime and Misconduct Act 2001
Financial Accountability Act 2009
Public Interest Disclosure Act 2010
Public Records Act 2002

Source: Queensland Treasury and Trade

The main elements of the current GOC framework, outlined in Figure B1.1, are:

- the legislative structure that establishes GOCs as separate legal entities operating at arm's length from government

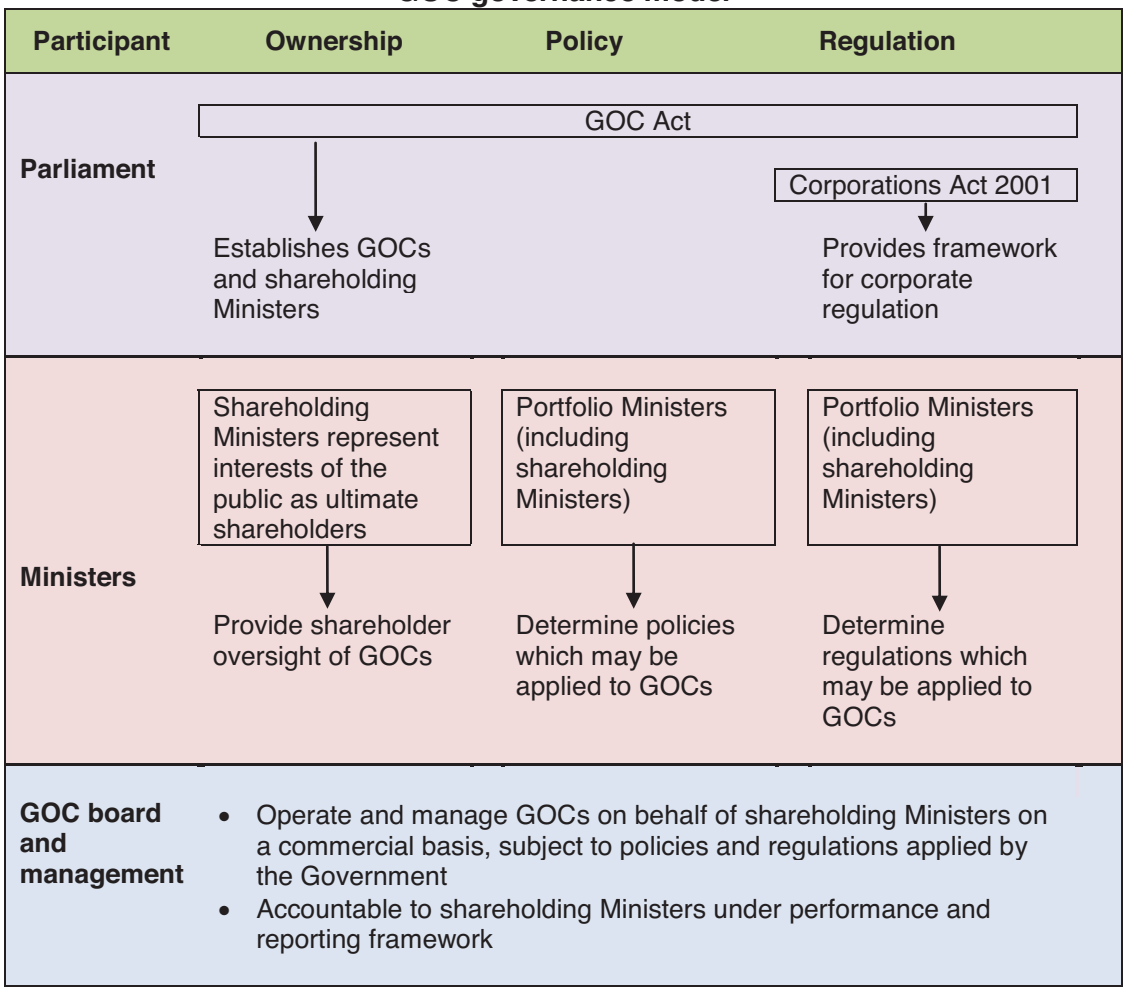
- the Government's role as guardian of the public's beneficial ownership of GOC assets, which is entrusted to government and administered by the shareholding Ministers

- the Government's role as a policy maker, including laws and directives applied to GOCs to deliver government policy objectives

- the Government's role as regulator of commercial activities within the State, particularly monopoly assets

- the role of the GOC board and management as the GOC operator and service provider.

Figure B1.1
GOC governance model



Source: Commission of Audit

The GOC Act outlines the role of a GOC board to include:

- responsibility for the GOC's commercial policy and management
- ensuring the GOC acts in accordance with its Statement of Corporate Intent (SCI) and carries out the objectives outlined in its SCI
- accounting to shareholders for its performance
- ensuring the GOC performs its functions in a proper, effective and efficient way.

GOCs are subject to a performance management and reporting framework which establishes a clear line of sight from the Queensland public, the ultimate owners of the GOCs, through to the performance management and reporting process. Key aspects of the framework include:

- Shareholding Ministers' strategic expectations letters – outline high-level expectations for the following financial year and guidance for the next five years in advance of GOCs' business planning period.

- Corporate Plans – prepared annually by GOCs and consider the medium to long-term outlook for the business focussing on the next five years.

- Statements of Corporate Intent – prepared annually by GOCs and represent a performance agreement between a GOC's board and shareholding Ministers for the following financial year.

- Forecast Report – prepared annually by GOCs and reflects high level agreed objectives and forecasts of the GOC for the coming financial year, for publication on their websites.

- Quarterly Report – prepared by GOCs and reports on their operations for the relevant quarter and progress in meeting financial and non-financial performance targets established in their SCIs.

- Interim Report – prepared by GOCs in February and provides a summary of performance for the first half of the financial year for publication on their websites.

- Annual Report – prepared by GOCs following financial year end. It contains a comprehensive review of the GOC's operations, governance and performance, including annual financial statements. Annual reports are lodged with ASIC, tabled in Parliament and published on GOC websites. For tabling, GOCs include their SCI for the same year with commercially sensitive material deleted.

The GOC Act also contains a specific provision for the delivery of Community Service Obligations (CSOs) through GOCs and requires these to be detailed in the corporation's SCI and Corporate Plan. This is essential for transparency, but also acts as a signal that Government continues to consider the delivery of non-commercial policy objectives a legitimate role for GOCs under a commercialised policy framework.

While the financial operations of GOCs are reported separately from those of General Government, the General Government sector, as owner, must ultimately bear the financial cost of GOC operations. These costs include:

- capital injections from the General Government sector, either for recapitalisation or for major capital investment
- losses incurred by GOCs, to the extent that these losses cannot be funded internally (or through borrowings)
- the cost of GOC borrowings, which are undertaken by the General Government sector through Queensland Treasury Corporation
- the cost to the Budget of (non-commercial) policy decisions which are delivered through GOCs, such as CSOs and concessional pricing arrangements
- the opportunity cost of a significant investment (in network assets) that might generate a higher economic or social return if invested elsewhere by government.

An objective of the GOC framework is to ensure that these costs remain transparent to the owners of the network assets and the public, such that informed decisions can be taken on future investment and retention of the assets.

B1.3 THE ROLE OF GOVERNMENT AS OWNER AND SHAREHOLDER

B1.3.1 The role of shareholding Ministers

The governance of GOC ownership in Queensland is broadly similar to other states and that of the Australian Government, and comprises the following elements:

- The ultimate beneficial owners of GOC assets are the Queensland public, represented by the Government it elects.
- The Government appoints two specific shareholding Ministers as guardians and to act in the interests of the public as owners of the assets.
- The Governor in Council, on the advice of the Government, appoints an independent board of directors to oversee the performance of the GOC on behalf of the owners.
- The shareholding Ministers receive the information they require from the GOC Board to monitor the performance of GOCs and ensure they are operating in the best interests of the owners through Corporate Plans, statements of corporate intent and regulator financial and performance reporting.

Table B1.2 shows the GOC governance arrangements in Queensland, including the dual shareholding Minister model:

- The appointment of the Treasurer as a GOC Minister is to provide a degree of independence in the role of the shareholder from the other policy and regulatory responsibilities of government. By having no direct portfolio responsibilities for a GOC, the Treasurer can act in the interest of the beneficial owners at arm's length from other Ministers.
- The portfolio Ministers, being directly accountable for the operation of GOCs within their portfolios, have a joint accountability as the other shareholding Ministers.

Table B1.2
GOC governance arrangements

Industry sector	GOC	Date corporatised	Date converted to company GOC	Shareholding Ministers
Energy				
Generation	CS Energy	1 July 1997	All created as company GOCs at time of corporatisation	Treasurer; Minister for Energy and Water Supply
	Stanwell Corp Ltd	1 July 1997[1]		
Transmission	Powerlink Queensland [2]	1 July 1997		
Distribution	Energex Ltd	1 July 1997		
	Ergon Energy Corporation	1 July 1999		
Transport				
Ports	Far North Queensland Ports Corporation Ltd	1 July 1995	1 July 2008	Treasurer; Minister for Transport and Main Roads
	Gladstone Ports Corporation Ltd	1 July 1994	1 July 2008	
	North Queensland Bulk Ports[3]	19 June 2009	1 July 2009	
	Port of Townsville Ltd	1 July 1995	1 July 2008	
Rail	Queensland Rail Limited	1 July 2010	1 July 2010	
Water	Sunwater Ltd	1 October 2000	1 July 2008	Treasurer; Minister for Energy and Water Supply
Other	Queensland Investment Corporation Ltd	1 October 1994	30 September 2008	Premier; Treasurer

1 Tarong Energy Corporation Ltd converted to a subsidiary of Stanwell Corporation Limited on 1 July 2011.
2 Queensland Electricity Transmission Corporation Limited.
3 Previously Ports Corporation of Queensland (1 July 1994) and Mackay Port Authority (1 July 1995).

Source: www.ogoc.qld.gov.au, accessed January 2013

This is broadly the model that is followed in other states and by the Australian Government. In Victoria, there is no formal shareholding Minister. Either the Treasurer or the portfolio Minister can be the shareholding Minister.

The dual shareholding Minister model attempts to ensure both independence and accountability in the ownership and operation of GOCs:

- The role of the GOC Minister is to protect the general public interest, as reflected in the value of the businesses.

- The role of the portfolio Minister is to determine the extent to which broader policy and regulatory interests of the portfolio should apply to GOCs.

In any shared accountability model, there is a difficulty in identifying who is ultimately responsible for decisions.

Frequently, Ministers can be at odds with each other – one trying to maximise shareholder value and the other trying to achieve policy objectives such as Community Service Obligations (CSOs). In the event of disagreement, the resolution of these issues requires a Cabinet decision.

The Commission does not recommend that there be no CSOs. Rather, the Commission recommends that, where they are imposed, they be done deliberately, transparently, and with full information, and that this be done at a whole-of-government level by Cabinet decision.

With Cabinet imposing the policy framework, the shareholding Minister can concentrate on developing shareholder value within that framework. There is no need for a second portfolio Minister once policy has been set by Cabinet. The dual Ministerial structure and the division of accountability that comes from it can be avoided.

Recommendation

1 A single shareholding Minister be appointed for all Government Owned Corporations (GOCs). The responsibility of the shareholding Minister would be to act in the interests of the Queensland public, as ultimate owners of the GOC assets, to protect and enhance shareholder value of GOC assets.

B1.3.2 Office of the shareholding Minister

To assist the evaluation of GOC performance by shareholding Ministers, an Office of Government Owned Corporations (OGOC) was established in Queensland Treasury to undertake detailed scrutiny of financial and other reports provided by GOCs to the shareholder.

In the absence of the same level of market scrutiny and reporting on GOC performance as would happen with public companies, OGOC sought to fulfil this role by ensuring the shareholding Ministers were informed as to individual GOC performance, as well as comparisons with other similar government and private sector businesses.

However, the role of OGOC expanded beyond its intended role of GOC scrutiny. An increasing tendency of government to deliver policy and regulatory objectives through GOCs resulted in OGOC becoming an enforcer of these objectives, while continuing to monitor and report on GOC financial performance. This led to some confusion as to the appropriate role of OGOC.

OGOC was disbanded as part of a restructure of Queensland Treasury and Trade (QTT) in September 2012. In broad terms, its functions have been absorbed into the Commercial Monitoring Branch of QTT.

There is an ongoing need for a small commercial unit to support and advise on the commercial operation of GOCs. The Commission recommends that this unit report directly to the shareholding Minister.

To support a stand-alone shareholding Minister, an Office of the shareholding Minister should be established. The Office would absorb the functions currently undertaken by the Commercial Monitoring Branch, and would advise the shareholding Minister on:

- financial performance of GOCs and factors impacting that performance
- measures to protect and enhance shareholder value of GOCs
- impacts on shareholder value of policy and regulatory decisions applied to GOCs.

It should have no role in applying, or monitoring compliance with, such policy and regulatory decisions.

Recommendation

2 An Office of the shareholding Minister be established to support the Minister discharging shareholder responsibility on behalf of the Queensland public.

B1.3.3 Appointments to Boards

Directors are appointed to a GOC board by the Governor in Council under section 89 of the GOC Act. Terms are typically for three years. Directors can be reappointed by the Governor in Council after expiration of the appointment term. There are no legislative restrictions as to the maximum period for which a person can serve as a GOC director.

QTT undertakes the following functions in the board appointment process:

- receiving CVs from potential directors
- maintaining a register of potential directors
- engaging with GOC chairs regarding the skill sets required for their boards
- canvassing options for board renewal
- undertaking pre-appointment checks on preferred candidates and preparing and submitting all documentation to shareholding Ministers for their consideration of the candidates.

The process for final selection of candidates by shareholding Ministers for submission to Cabinet and then Governor in Council may not always be conducted uniformly. The shareholding Ministers effectively fulfil this role when recommending potential directors to Cabinet and the Governor in Council for appointment.

As the GOCs have responsibility for managing significant assets and funds (as is the case with Queensland Investment Corporation), the shareholding Ministers have an important responsibility in assessing director competencies and considering board renewal as part of board succession planning.

GOC boards generally are diligent in acquitting the duties and obligations for which they are responsible. Nevertheless, the process by which individual chairs and directors are appointed should be reformed to ensure that those charged with the responsibility of leading the GOCs have the skills and experience to do so.

The Australian Securities Exchange (ASX) Corporate Governance Principles state that board renewal is critical to performance, and directors should be conscious of the duration of each director's tenure in succession planning. Further, board nomination committees should consider whether succession plans are in place to maintain an appropriate balance of skills, experience and expertise on the board.

Inadequate board succession planning and renewal could result in boards becoming stale and the businesses outgrowing the skills of existing directors. This is particularly so where directors have served on a board for a long time or where the business has changed significantly since the director was first appointed, thus requiring a different set of skills from its directors.

The situation could arise where a few directors serving on a GOC board with terms expiring simultaneously may all decide to not seek re-appointment. This could result in significant disruption to the business and result in a loss of 'corporate memory' on the GOC board. This poses a material risk given the Australian Institute of Company Directors (AICD) indicates it takes three to seven years for a director to learn the company's business and add value to the board.

To ensure GOC boards are effective in fulfilling their duties with a suitable cross-section of directors with the requisite skills and experience, consideration could be given to:

- setting standards against which candidates are selected
- allowing GOC boards the opportunity for formal input through the establishment of nomination committee functions and recommendation of candidates to shareholding Ministers
- introducing a maximum term in order to provide for effective board renewal.

Recommendation

3 The* Government Owned Corporations Act 1993 *be amended to provide for a maximum term for the Chair and members of a Government Owned Corporation board of no more than 10 years.

B1.4 The Role of Government as Policy Maker

In addition to general economy-wide policy and regulatory regimes, the Government may direct GOCs to deliver specific government policy outcomes. For example, the Government may direct GOCs through legislation or policy directions to deliver non-commercial policy goals, such as income support, employment creation or specific environmental objectives.

The Government's role as policy maker will regularly intersect with its role as owner of GOC assets and with delivery of GOC services.

In principle, all government policies that apply generally to commercial enterprises without discrimination should also apply to GOCs without discrimination. GOCs should be afforded no different treatment under taxation policies, environment protection laws and industrial relations policies than other businesses operating in private markets.

In practice, this has not been the case. This intersection of the Government's ownership and general policy interests has been applied inconsistently with respect to GOCs. Government policies impact on GOCs in a number of ways:

- Some aspects of state-wide policies that apply to all Queensland businesses, such as state taxation policies, apply equally to GOCs.

- Some policies that apply only to public sector agencies are also applied to GOCs, such as right to information legislation, even though these policies are not applied to private sector competitors of GOCs.

- GOCs are directed to deliver government policy objectives, of a non-commercial nature:

  - where these are transparent and fully compensated for by government – as in the case of CSOs – government has a framework to manage any conflict

  - where these are non-transparent and not fully compensated for by government, the actual cost to government – and the GOC – of delivering the CSO may not be apparent to government when the policy decision is made.

Conflict will arise in the application of policy decisions where the Government simultaneously seeks to realise a commercial return on its investment in GOCs, while at the same time regarding GOCs as a vehicle for delivering government policies which may not accord with commercial practice.

The existence of this conflict of itself is not problematic, so long as a governance framework exists and is applied appropriately and consistently to manage the conflicts. The Commission considers the current GOC governance model requires modernisation and strengthening to ensure more effective resolution of these conflicts in the future.

There are several examples where this conflict has not been managed effectively under the existing GOC governance framework, as outlined below.

B1.4.1 Application of non-commercial public sector policies to GOCs

There has been an increasing trend in the application of non-commercial whole-of-government policies and initiatives developed for government departments being applied to the GOC sector without due regard to the financial and commercial impact on GOCs of these policies.

In many cases, neither OGOC nor the portfolio departments were consulted in the development of the policies or the decision to apply them to the GOC sector. As a result, difficulties and complexities have arisen with the application of these policies to the GOCs.

Three different processes could be undertaken to apply policies to GOCs which have different legal, reporting and application consequences.

Firstly, shareholding Ministers may formally notify a public sector policy to a GOC under section 114 of the GOC Act. The GOC's board of directors is required to ensure the GOC and its subsidiaries comply with the policy. Under this process, shareholding Ministers must be satisfied that it is necessary in the public interest for GOCs to comply with the policy:

- A formal process must be completed which involves consultation with the GOC boards, the consideration of whether carrying out the policy would not be in the commercial interest of the GOC, the issuing of a notification and gazettal of this notification.

- This process is time consuming and resource intensive on both GOCs and shareholding departments and imposes a statutory obligation on the GOCs.

Secondly, shareholding Ministers may decide that the policy be included within a statement of compliance in a GOC's Statement of Corporate Intent (SCI). Although less formal than the policy notification process, the inclusion of a policy in a GOC's SCI still provides significant status for the policy and mandates GOC compliance. Under this process, there is public disclosure of the policies applied and simple tracking of all policies applied. This method has been used to apply policies specifically developed for GOCs, for instance 'GOC Air Travel Policy 2009', which avoids the difficulties and conflicts that may arise from GOC compliance with the entire government policy.

Thirdly, shareholding Ministers may write to the GOC's board and request that a GOC complies with the spirit and intent of a policy or initiative in pursuing best practice approaches, as was done for the 'Recycling Policy for Building and Civil Infrastructure'. While this application method has no legal force, it has been used for communicating policies which have parts that would be inappropriate, costly or against the commercial imperative for a GOC to adopt it in its entirety and where the department advocating the policy is not able to fund the GOC to undertake non-commercial activities. Under this method, GOCs can adopt the policy in a manner which supports and is appropriate for their organisation.

As at January 2013, GOCs were subject to 21 Government policies as outlined in Box B1.1.

Box B1.1
Government policies applying to GOCs

- GOC Governance arrangements for Chief Executives and Senior Executives 2009
- GOC Wages Policy 2012 and GOC Bargaining Guidelines
- Biannual Reporting: Guidelines for the Preparation of Interim Reports (2009)
- Code of Practice for Government Owned Corporations' Financial Arrangements (2009)
- Code of Practice for the Building and Construction Industry March 2012
- Corporate Entertainment and Hospitality Guidelines (2008)
- Corporate Governance Guidelines for Government Owned Corporations (2009)
- Cost of Capital Principles – Government Owned Corporations (2006)
- Government Owned Corporations Air Travel Policy (2011)
- Government Owned Corporations guidelines for Joint Venture Agreements (2011)
- Government Owned Corporations Release of Information Arrangements (2010)
- Guidance for Chief Executive Officers – Agreement Making and Industrial Relations in Government Owned Corporations (2010)
- Guidelines for Export of Services by Government Owned Corporations (2001)
- Guidelines for Preparing Forecast Reports (2010)
- Guidelines for the Issue of Harbour Towage Licences (2010)
- Investment Guidelines for Government Owned Corporations (2011)
- Key Shareholder Requirements for Constitutions (2006)
- Local Industry Policy: A Fair Go for Local Industry (2010)
- Minimum Disclosure Requirements for Directors and Chief and Senior Executives of Government Owned Corporations (2009)
- Queensland Port Government Owned Corporations – Local Government General Rates Equivalents Regime: Guidelines for Assessment, Collection and Payment (2000)
- State Procurement Policy (2011)

Source: Queensland Treasury and Trade

The policy directions outlined in Box B1.1 take two forms:

- those specific to GOCs, such as guidelines for the preparation of statements of corporate intent
- public sector wide policies, intended to apply to public sector agencies generally and which are also applied to GOCs.

The first type of policies applied to GOCs – those specific to GOCs – are in principle consistent with the GOC model. The shareholding Minister is entitled to seek information from a GOC to make informed decisions as to the performance of the GOC against the shareholder's expectations. A defined policy process is also required for directing GOCs to deliver community service obligations.

However, the nature and extent of the specific policies outlined in Box B1.1 extend beyond the specific remit of the shareholding Minister and into areas of day-to-day management. Some of these, such as guidelines on air travel and release of information, may have only limited impact on GOC performance, but compromise the effectiveness of the GOC model.

Directions from the shareholding Minister which prescribe restrictive workplace practices and remuneration arrangements inconsistent with the commercial practices of competitor businesses will erode the returns that GOCs are able to generate, and are likely to be the most damaging to shareholder value. This damage arises where management is constrained in its ability to make commercial decisions regarding both the level and allocation of staffing resources, particularly where a restructure of business operations is required.

The second type of policies is public service wide policies and guidelines that also are applied to GOCs. There will be expectations in the community that Government policies should be applied consistently across all Government agencies, including GOCs. However, directions to GOCs to implement policies of this type on the same basis as core departments of State are not necessarily an appropriate way to deal with these expectations. It is also inconsistent with the objectives of the GOC model.

As a governance framework, this tension should be addressed in the GOC model through a clear delineation of accountabilities between the shareholding Ministers and GOC boards.

GOC boards should be allowed to exercise their own business judgements in the conduct of the enterprise rather than the Minister intervening to second guess management. The Minister should hold the GOC accountable through the board with the ultimate power to appoint or dismiss directors much like private shareholders in a public corporation.

The development of corporate social responsibility policies with public companies reflects this trend among listed companies. Shareholders can and do hold public companies to account for ensuring that the decisions of management accord with community standards in relation to corporate social responsibilities.

In principle, the Government should seek to minimise the extent to which policies are imposed on GOCs which place them at a competitive disadvantage in the market. Where the Government directs that GOCs must follow certain policies, rather than leaving these up to the judgement of GOCs to apply, the cost of implementing the policies on the financial performance of GOCs should be costed and provided to Cabinet by the shareholding Minister.

As part of this role, the shareholding Minister should present a submission to the Cabinet Budget Review Committee (CBRC) during the annual budget process documenting all Community Service Obligations and other non-commercial policy objectives with which GOCs are required to comply. The submission would present the estimated cost of the CSO and non-commercial policy directives and their impact on:

- the Budget
- the financial performance of GOCs (especially dividends and tax equivalent payments).

This information should be included in the annual budget papers, and would provide a more informed and transparent basis on which to evaluate the impact on shareholder value.

Recommendation

4 The shareholding Minister prepare a report to be included in annual budget documentation showing all Community Service Obligations (CSOs) and other non-commercial policy objectives that Government Owned Corporations (GOCs) are required to perform at the direction of Government. The report would present the estimated cost of the CSOs and non-commercial policy directives and their impact on:

- ***the Budget***
- ***the financial performance of the GOCs (especially dividends and tax equivalent payments).***

B1.5 THE ROLE OF GOVERNMENT AS REGULATOR

The Government also fulfils a further role as a regulator. The same conflicts arise as occur with its role as policy maker.

The intersection between the Government's role as regulator and that of owner takes two forms:

- State-wide regulations that apply to all businesses operating in Queensland, such as building and planning laws.
- Regulations that apply specifically to GOCs or the industry sectors in which they operate, such as the regulation of prices in electricity, water and transport sectors.

It is this second class of regulations that is likely to have the greatest impact on the financial performance of GOCs. Most of these regulations are delivered through CSOs, which the shareholding Ministers are required to agree with GOCs under the GOC Act. Examples of these CSOs include:

- the uniform electricity tariff that applies to Ergon electricity customers
- non-commercial pricing of water for irrigation
- passenger rail fares below full cost recovery
- non-commercial pricing for the transport of certain agricultural products by rail.

In addition to these arrangements, there is a range of non-commercial legacy agreements entered into by previous governments, mostly to achieve policy objectives unrelated to that of the GOC. Examples of these arrangements are outlined below.

- Nominal or non-commercial fees apply to the sugar industry for access to rail and port infrastructure. (The sugar industry is required to pay only a peppercorn rent for access to storage and loading facilities at the Port of Townsville.)

- Non-commercial rail access charges apply for both mineral and agricultural commodities transported along Queensland Rail's regional rail network.

- The Gladstone Interconnection and Power Pooling Agreement obligates CS Energy to pay the owners of the Gladstone Power Station an annual fee for access to a proportion of the station's generation capacity to trade in the national electricity market (NEM). Currently, profits from trading the station's output are substantially less than the access fee.

In some instances, it may be appropriate for regulatory objectives to be delivered through GOCs, where this is efficient to do so. As with policy directives, where this occurs, the cost of imposing regulatory directives on GOCs needs to be determined and made fully transparent. It should be the role of the shareholding Minister to ensure that other Ministers are fully aware of the cost of regulation on GOCs and how this will affect operating performance, annual dividend payments and therefore the value of the GOC for the shareholder.

For the larger, established CSOs, this does occur through the GOC model via the provisions in the GOC Act.

Developments in technology and income support mechanisms mean that many of the income support and social welfare objectives traditionally delivered through GOCs can now be directly delivered to intended recipients. Direct assistance is not only likely to be more efficient, but also it can more closely target the cost of concessions and support to intended recipients. This should be the future approach to deliver income support mechanisms to GOC customers.

It would be preferable for CSOs and other non-commercial policy objectives currently delivered through GOCs (for example, concessional pricing for particular consumer groups) to be converted into assistance payments which are paid directly from the Budget to target groups. This would enable better management and closer public scrutiny of what are currently the hidden costs of these policy choices.

Recommendation

5 The shareholding Minister identify Community Service Obligations or non-commercial policy objectives currently delivered through Government Owned Corporations, such as concessional prices, that could be converted to assistance payments paid directly from the Budget to target customers.

B1.6 FUTURE GOVERNANCE MODEL

The adoption of a single, stand-alone shareholder model would ensure that shareholder interests in GOCs are assessed separately and independently from other policy and regulatory issues. In later sections of Part B of this Report, the Commission recommends the eventual divestment of a number of GOCs. If these recommendations are adopted, there would be a significantly reduced role for the Queensland Government in relation to the governance of GOCs.

In the meantime, the performance of GOCs would be enhanced by revised governance arrangements which:

- reform restrictive workplace practices which fetter the capacity of GOCs to keep costs competitive
- limit the extent to which government policies fetter the capacity of GOCs to operate on a fully commercial basis
- make transparent the full cost of any government policy requirements, so that the impact on the financial performance of GOCs is clearly understood.

It has been a considerable period of time since GOC governance arrangements have been subjected to comprehensive review. This is undesirable. Within five years, a further review of governance arrangements for ongoing GOCs should be undertaken, once government decisions relating to the Commission's other recommendations on GOCs have been implemented.

Recommendation

6 Governance arrangements for Government Owned Corporations (GOCs) be further reviewed to assess their continuing relevance and applicability once any Government decisions relating to the Commission's other recommendations on GOCs have been implemented.

B2 ENERGY

KEY ISSUES

- Over the past 20 years, the Australian electricity sector has been substantially reformed, moving from a non-commercial environment (where electricity was delivered as a public service) to a commercial national electricity market operating within an environment of competitive pressures and economic regulation.
- The State's energy sector Government Owned Corporations (GOCs) form part of the National Electricity Market, which has evolved from reforms first instigated by the Council of Australian Governments during the 1990s. These policy reforms have established uniform market-wide controls over wholesale electricity and network pricing, which are the main determinant of retail electricity prices for consumers.
- The price of electricity generated and sold into the national wholesale electricity market is not set by the State Government.
- Continued ownership of energy sector assets exposes the Government to complex commercial risks, which it is poorly placed to respond to as an owner. Ongoing acceptance of these risks has eroded financial returns to the Government, and the value of its investments in these assets.
- The energy GOCs are placed at a competitive disadvantage by non-commercial policy and regulatory requirements imposed by government.
- Ownership of these assets represents a very substantial investment of public capital, and will require further substantial capital investments exceeding $14.3 billion to 2016-17 to sustain the businesses. In other states, these assets mostly are owned by the private sector, or are in the process of being transferred to the private sector.
- Delivery of government policy objectives for the energy sector through ownership of GOCs is inefficient, lacks transparency, is inconsistent with the aims of the national energy reform agenda, and creates conflicting objectives for the GOCs.
- Realising the value of the State's investment in the energy GOCs represents one of the few opportunities to generate the necessary funds to significantly reduce State debt, and to avoid spending large sums on new capital investment for network expansion.

B2.1 ELECTRICITY SECTOR IN AUSTRALIA

Over the past 20 years, the Australian electricity sector has been substantially reformed. The sector has moved from a series of wholly state-owned, vertically integrated, electricity monopolies operating in a non-commercial environment, to the present structure, which consists of:

- generation and retailing entities operating in a competitive market
- transmission and distribution entities subject to economic regulation.

In the various National Electricity Market (NEM) regions, all of these activities are undertaken by corporate entities, held in various combinations of private and public ownership.

Prior to the early 1990s, state-owned electricity authorities were responsible for generation, transmission, distribution and retailing of electricity to consumers. These authorities were focussed on supply in their own regions, in isolation of other regions, and usually had access to guaranteed investment capital, resulting in substantial over-investment in capacity.

Reforms since that time, in part, have been focussed on ensuring that appropriate controls and market signals are created to inform more efficient investment practices. This change has been part of a worldwide trend towards the restructuring of government business enterprises targeted towards increased efficiency and lower prices.[1]

A key reform initiative was the formation of a national wholesale market for the supply of electricity to retailers and end-users in Queensland, New South Wales, Victoria, South Australia, Tasmania and the Australian Capital Territory. The NEM began operating in December 1998, encompassing the transmission and sale of electricity between states as well as between generators and consumers. Queensland was physically connected to the NEM via the Queensland-New South Wales interconnector in 2001, and Tasmania joined the NEM in 2005.

In 2001, the Council of Australian Governments (COAG) determined that a unified and competitive national energy market would improve the delivery of benefits to energy users. The COAG governments, including Queensland, committed themselves to a set of objectives enunciated in the 'National Energy Policy Framework' to attain this goal and charged the Ministerial Council on Energy (MCE) with key elements of its delivery. This framework included the aims of establishing an efficient, competitive and sustainable energy market, encouraging efficient economic development and private sector investment, and competitive pricing of reliable electricity supplies for consumers.

Following this agreement, all NEM states legislated to apply a uniform 'National Electricity Law', including the national electricity objective, which is:

> *"To promote efficient investment in, and efficient operation and use of, electricity services for the long term interest of consumers of electricity, with respect to:*
>
> *a. Price, quality, safety, reliability and security of supply of electricity; and*
> *b. The reliability, safety and security of the national electricity system."*

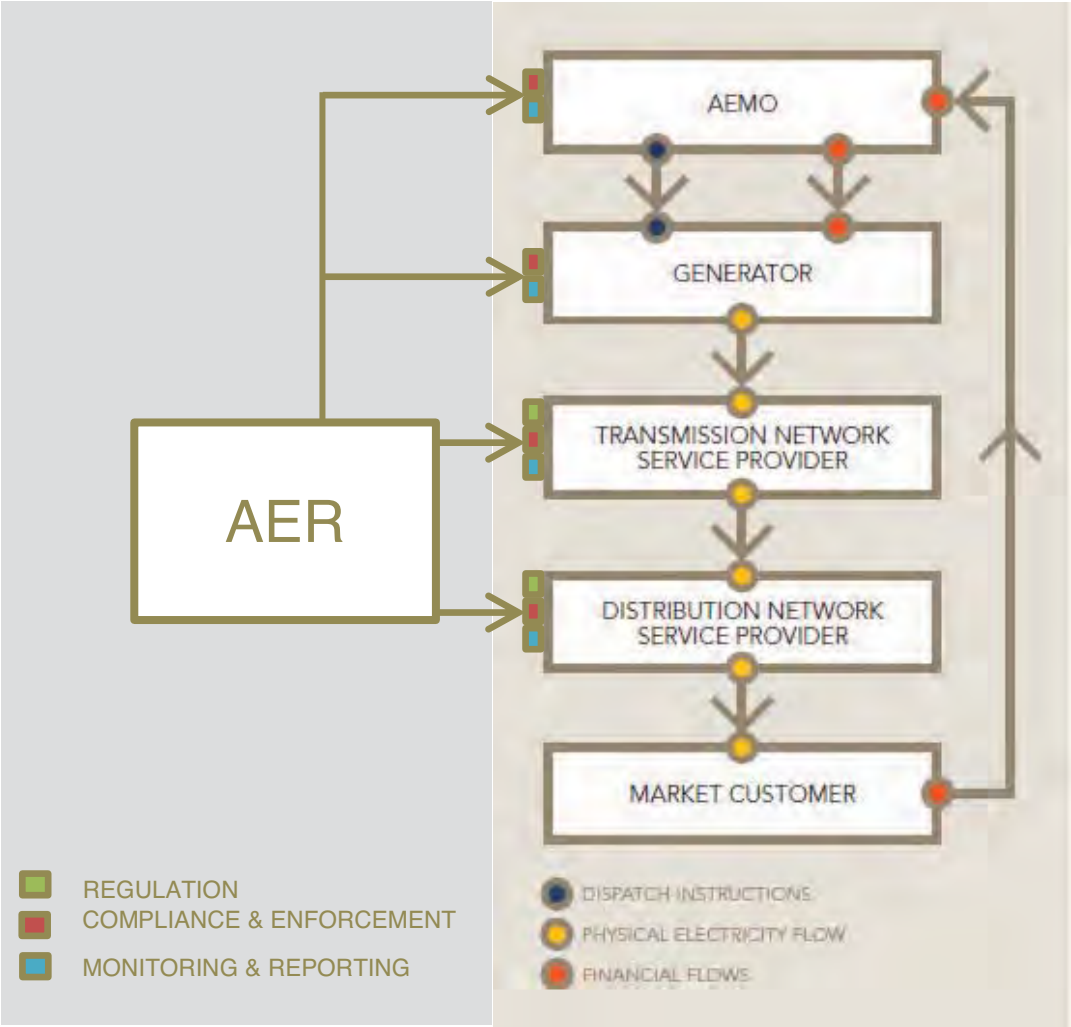
In 2003, the MCE reported back to COAG on the progress of reforms and recommended the formation of a NEM in its current form, through the establishment of the Australian Energy Markets Commission (AEMC) and the Australian Energy Regulator (AER) to develop and to regulate the market, respectively.[2]

Since this time, these entities (along with the Australian Energy Market Operator (AEMO)) have operated the NEM in accordance with the policy directions set by the Standing Council on Energy and Resources (SCER). Day-to-day operation of the wholesale electricity market, which determines the revenue of the generation sector, is mostly undertaken by AEMO. The AER undertakes economic regulation of transmission and distribution network revenues.

B2.1.1 The National Electricity Market

The key operating environment for energy sector Government Owned Corporations (GOCs) is the NEM, which is controlled by the AEMO as both the power system controller and market administrator. The AER has oversight of this market, both in ensuring compliance with rules that govern NEM operation and in economic regulation of transmission and distribution participants in the NEM. Key relationships between these entities are outlined in Figure B2.1.

Figure B2.1
General interactions between AER/AEMO and NEM participants



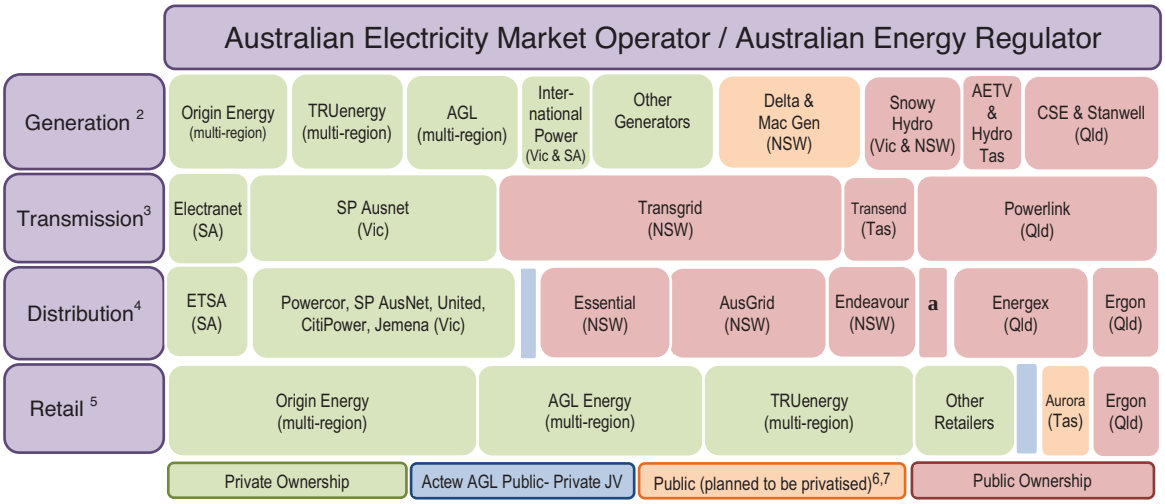
Source: Adapted from AEMO publication – An introduction to Australia's National Electricity Market 2010

The essential task of regulatory bodies is to oversee the system of procurement in four key channels: generation, transmission, distribution and retail. Procurement of services within each channel is designed to be independent of ownership, and examples of private and public ownership reside within each.

Figure B2.2 depicts current ownership patterns in energy delivery channels in the NEM, featuring a significant number of entities that are in both public and private ownership, public-private joint ventures or about to be privatised. Queensland's energy GOCs account for a significant proportion of the market remaining in public ownership in each category and represent:

- 14% of registered generation capacity in the NEM
- 24% of the power transmitted on electricity transmission networks
- 21% of the total number of distribution network customers
- 6% of small customer retail market share.

Figure B2.2
Ownership patterns in energy delivery channels in the National Electricity Market by indicative market share[1]



a Aurora Energy distribution
1 Box width indicates market share on the basis outlined in notes below.
2 Indicative generation market share was determined by the proportion of total NEM registered generation capacity controlled by the relevant entity.
3 Indicative transmission market share was determined by the share of the total electricity transmitted. Assets which are primarily transmission in nature operated by AusGrid and by ActewAGL were recognised with distribution assets, consistent with the source AER publication.
4 Indicative distribution market share was determined by the share of total distribution customer numbers.
5 Indicative retail market share is determined by scaling regional small customer market share by the proportion of NEM total energy transmitted in that region. 2.9TWh of NSW NEM region total energy was allocated to the ACT for this purpose, equating to the total 2011 energy usage stated in the ActewAGL 2011-12 pricing proposal to the AER.
6 Privatisation of Aurora Energy's retail activities is provided for by the *Electricity Reform Bill 2012 (*Tas*).*
7 Sale of NSW generation assets is provided for by the *Electricity Generator Assets (Authorised Transactions) Act 2012 (*NSW*).*

Source: Commission of Audit, compiled from AER 2012 State of the Energy Market report

With the prospective sale of government-owned generation in New South Wales and retail assets in Tasmania, private ownership will be the dominant model for generation and retail electricity businesses across the NEM.

The wholesale generation market is fully competitive, with mandatory pool trading of all substantial generation. The wholesale spot market is backed by a well-established market in financial contracts used to manage price and volatility risks.[3] Retail markets are subject to increasing competition, while the interposing transmission and distribution entities remain as natural monopolies subject to revenue regulation by the AER.

B2.1.2 Regulation of transmission and distribution assets

Transmission and distribution entities remain in government ownership in Queensland, Tasmania and New South Wales, but are privately owned in South Australia and Victoria. All entities operate under a corporate structure and are subject to revenue regulation by the AER on the same footing, irrespective of whether they are in public or private ownership.

This system of regulation is maturing rapidly, although currently there is significant public debate as to whether past investment and pricing decisions represent an efficient minimum. This debate was triggered by increased system charges being passed through to consumers, as a consequence of significant increases in network costs allowed by the AER.

A key problem being addressed in this debate is how to identify the cost of efficient network provision, and to identify the level of security and reliability customers will accept in order to minimise these costs.[4]

In its draft report on Electricity Network Regulatory Frameworks, the Productivity Commission has indicated that regulation should place a greater emphasis on consumer consultation, and to the provision of commercial incentives for the market to discover efficient network spending.[5] The AEMC has since modified the National Electricity Rules to improve the capacity of the regulator to incentivise network service providers to invest capital efficiently, and made greater provision for public consultation.[6]

B2.1.3 Retail price controls

Retail markets are mostly open to full competition, although constrained in some jurisdictions by various price controls. The Australian Government's 2012 Energy White Paper identified that control over retail prices continues to be an area of unfinished and necessary reform which has not been fully implemented, and notes the need for all governments to commit to the removal of retail price control.

Through COAG, all governments have agreed upon a path to full competition based upon assessment by the AEMC of the effectiveness of competition demonstrated in each state.[7] In 2013, the AEMC is scheduled to report upon the effectiveness of retail competition in Queensland and may recommend a path for existing price controls to be removed, depending upon the outcomes of its investigations.

In addition, state governments were expected to implement a package of reforms under the National Energy Retail Law from 1 July 2012. The reforms aim to streamline national retail regulation to support an efficient retail market with appropriate consumer protection. Tasmania and the ACT implemented the reforms during 2012, while South Australia and New South Wales set target implementation dates of 1 February 2013 and 1 July 2013 respectively. Victoria has undertaken to implement the Law no later than 1 January 2014.[8]

B2.2 THE QUEENSLAND ELECTRICITY MARKET

B2.2.1 Overview

The Queensland electricity sector was restructured substantially from 1 July 1997 in preparation for the introduction of a competitive electricity market, to create:

- three generator companies, CS Energy Limited (CS Energy), Stanwell Corporation Limited (Stanwell) and Tarong Energy Corporation Limited (Tarong), which were subsequently consolidated into the two existing companies in 2011
- a transmission company, the Queensland Electricity Transmission Corporation, trading as Powerlink Queensland (Powerlink)
- seven regional distribution companies and three new retail supply companies, which were consolidated into Ergon Energy Corporation Limited (Ergon) and Energex Limited (Energex).

In parallel with these structural changes, there has been a progressive introduction of retail competition:

- In 1998, large 'contestable' customers (consuming greater than 40 GWh per annum) were given the capacity to choose their supplier of electricity.

- In 2007, the Government sold the majority of its retail businesses to Origin Energy and AGL Energy. Ergon Energy Queensland (EEQ), a subsidiary of Ergon, retained the balance of regional retail customers.

- In 2007, the Queensland Government introduced full retail contestability; however, consumers were able to choose whether to enter the contestable market or to remain on non-market contracts at notified tariffs set by the Queensland Competition Authority (QCA).

- From 1 July 2012, large customers (consuming greater than 100 GWh per annum) in South East Queensland were no longer able to access non-market contracts.

The period since formation of the energy GOCs has witnessed substantial market changes. The introduction of full retail contestability, compulsory trading of wholesale generation in a national market, private sector competition in the generation and retail sector, and the development of sophisticated markets in energy-based hedging instruments has substantially changed the environment which GOCs operate in.

Generation

The Queensland electricity generation industry features both public and privately owned generators. While state-owned generators remain a majority supplier in the Queensland market (representing around 64% of supply[9]), overall market share is diminishing as new privately owned generation capacity is commissioned. A summary of generation capacity and utilisation in the Queensland NEM region is provided in Table B2.1.

Table B2.1
Generators by fuel type with nameplate capacity and average utilisation

Station	Owner	Fuel	Capacity (MW)	Utilisation[1] 2011-12 (%)
Gladstone	NRG[2]	Coal	1,680	50
Stanwell Power Station	Stanwell	Coal	1,400	60
Tarong Power Station	Stanwell	Coal	1,400	57
Millmerran Power Plant	Intergen	Coal	852	79
Callide C Power Station	CSE[3]	Coal	840	6
Kogan Creek	CSE	Coal	744	72
Callide B Power Station	CSE	Coal	700	65
Darling Downs Power Station	Origin	Gas	644	58
Braemar	Alinta	Gas	519	40
Braemar 2	Arrow	Gas	519	22
Wivenhoe Power Station	CSE	Water	500	0
Tarong North	Stanwell	Coal	443	71
Mt Stuart Gas Turbine	Origin	Gas	423	0
Swanbank E	Stanwell	Gas	385	62
Oakey Power Station	ERM[4]	Liquid fuel/Gas	282	1
Yabulu Gas Turbine	AGL	Gas	242	39
Collinsville Power Station	Ratch[5]	Coal	195	13
Yarwun Power Station	Rio Tinto	Gas	154	101
Condamine Power Station	QGC	Gas	144	46
Roma Gas Turbine Station	Origin	Gas	80	2
Kareeya	Stanwell	Water	81	63
Barron Gorge	Stanwell	Water	60	52
Barcaldine Power Station	Ergon	Gas	55	3
Mackay Gas Turbine	Stanwell	Liquid fuel	30	0

1 Utilisation is calculated on the basis of the plants nominal 'nameplate' capacity. In some cases the actual generating capacity may exceed this amount, and utilisation may exceed 100%.
2 Power output from the Gladstone power station is managed by CSE under a power purchase agreement.
3 The electricity output of one of the two generating turbines of Callide C is traded by Intergen under a power purchase agreement.
4 Power output from the Oakey power station is subject to a power purchase agreement with AGL.
5 The output of Collinsville power station was previously traded by Stanwell under a Power Purchase Agreement. This agreement was ended on 30 June 2012.

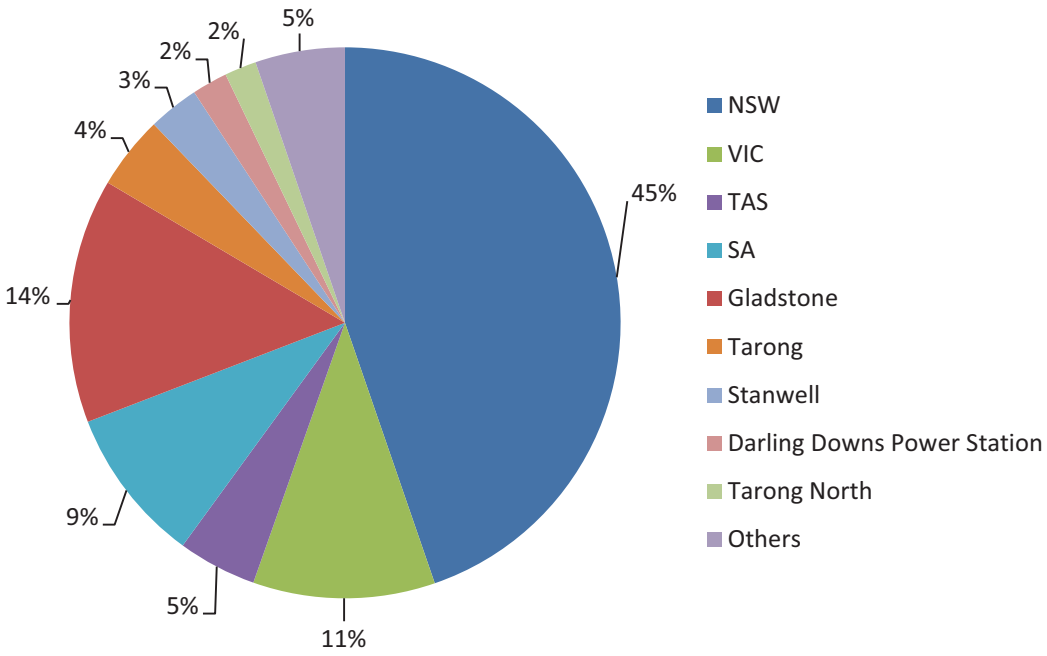
Source: Data Amalgamated from AEMO Electricity Statement of Opportunities and generation data for financial year 2011-12

Despite dispatching the majority of energy generated in Queensland, the nature of the generating plant in public ownership (mostly baseload, coal-fired generators) is such that they are poorly positioned to influence wholesale price outcomes most of the time. As shown in Chart B2.1, the proportion of time during 2011-12 in which Queensland Government-controlled power stations set nodal prices was disproportionately low (26%) in comparison to its total generation (64%).

Importantly, baseload generators also are unlikely to be price setters in high price/demand periods which are most influential in setting the average wholesale price and the appetite for financial instruments to hedge pricing risks.

In an environment where baseload generation continues to be in over-supply,[10] it is unlikely that the government-owned generator fleet will attain any increase in market influence over pricing in the foreseeable future.

Chart B2.1
Price setting plant for Queensland node, proportion, 2011-12



Source: Chart provided by Queensland Treasury Corporation, based upon third party data

Transmission and distribution service

Powerlink, Energex and Ergon own and operate monopoly transmission and distribution networks in NEM connected areas of Queensland. These distribution and transmission businesses are subject to revenue regulation by the AER, aside from a minority of projects for individual large customers which are delivered on a negotiated commercial basis.

Ergon also is responsible for energy delivery (including generation) in certain remote and isolated areas of Queensland which are not connected to the NEM. The cost of providing this service is underpinned by Community Service Obligation (CSO) payments made by the State to Ergon via EEQ.

Retailers

The State was previously responsible for electricity retailing across Queensland. However, the businesses undertaking this activity were sold in early 2007, with the exception of the EEQ retail load. Full retail contestability was introduced on 1 July 2007, allowing electricity customers to choose their electricity retailer by entering into a market contract, or (for small customers) to remain a 'non-market' customer on notified tariffs.

Origin and AGL, who were the successful purchasers of retail portfolios in 2007, continue to service the majority of the Queensland market. However, the opening to competition has enabled a number of other retail market participants to emerge since that time.[11]

The specification of notified tariffs allows a measure of control over retail pricing by setting a benchmark electricity price for new electricity contracts where a customer elects to be 'non-market'. Retail competition is only feasible where it can be undertaken on an economic basis below the notified tariff.

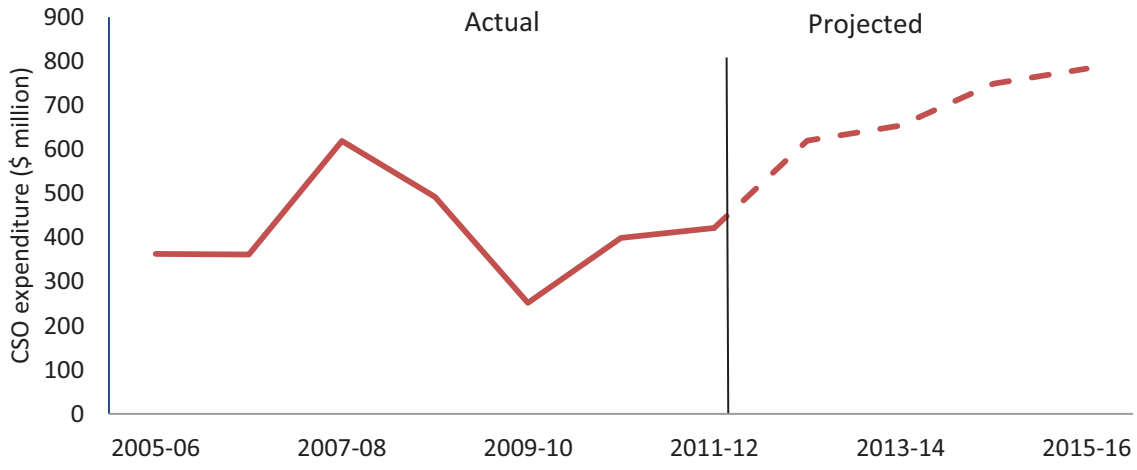
Notified tariffs are generally set by the QCA after consideration of AER approved network charges, and estimated energy and retailing costs. The State's 'uniform tariff policy' dictates that notified electricity tariffs are set with reference to the efficient cost of delivery in South East Queensland, but apply across the whole State.

For large geographic areas outside of South East Queensland, the cost of electricity supply is above this benchmark. In these areas, EEQ (the non-competitive supplier of last resort) delivers electricity with the support of a CSO to make up the difference between the cost of supply and revenue recovered at the notified tariff.

For so long as control over retail prices remains a policy objective, it will entail either intervention in, or subsidisation of, markets, or both. Where subsidies are provided, a key concern should be to ensure that assistance is tightly targeted at consumers with the greatest need, and provided through direct means, rather than energy policy settings. This is to ensure that efficient market signals are preserved to the extent possible for the majority of the market, and to ensure that taxpayers' funds are only directed towards the most needy consumers.

The uniform tariff policy and the current settings for associated CSO payments, under which consistent electricity prices are applied to users across an enormous geographic area, gives rise to an increasing and somewhat unpredictable requirement for subsidisation of energy costs by taxpayers. Chart B2.2 outlines the actual and predicted CSO cost to the State, showing significant year to year variation in CSO amounts paid in prior years and a steady escalation of expected costs going forward.

Chart B2.2
Uniform tariff CSO, actual and forecast



Source: Queensland Treasury and Trade

The subsidisation of energy costs by taxpayers under the uniform tariff policy is made via payments to Ergon on the basis of the difference between costs incurred and revenue recovered at benchmark tariffs by Ergon. Under the *Electricity Act 1994*, Ergon is prevented from competing for existing or potential customers. Under these arrangements:

- Retail competition within the Ergon Service area is limited (due to lack of access by competing retailers, and constraints on competitive behaviour by Ergon).

- Ergon is not incentivised (or permitted) to engage in commercial competition, which may erode its value as a retail entity and the value of its retail portfolio over time.

- Underwriting of the difference between costs and fixed revenues by the CSO does not maximise the direct incentives for cost reductions, as there is neither capacity to increase profit by exceeding cost benchmarks nor a reduction in profit where costs increase.

If Ergon was allowed to compete for customers under existing CSO arrangements, additional ring fencing or other controls would be required to demonstrate that CSO funding is not being used to enhance the competitive position of Ergon relative to other retailers.

B2.2.2 Recent trends

Electricity demand and wholesale prices

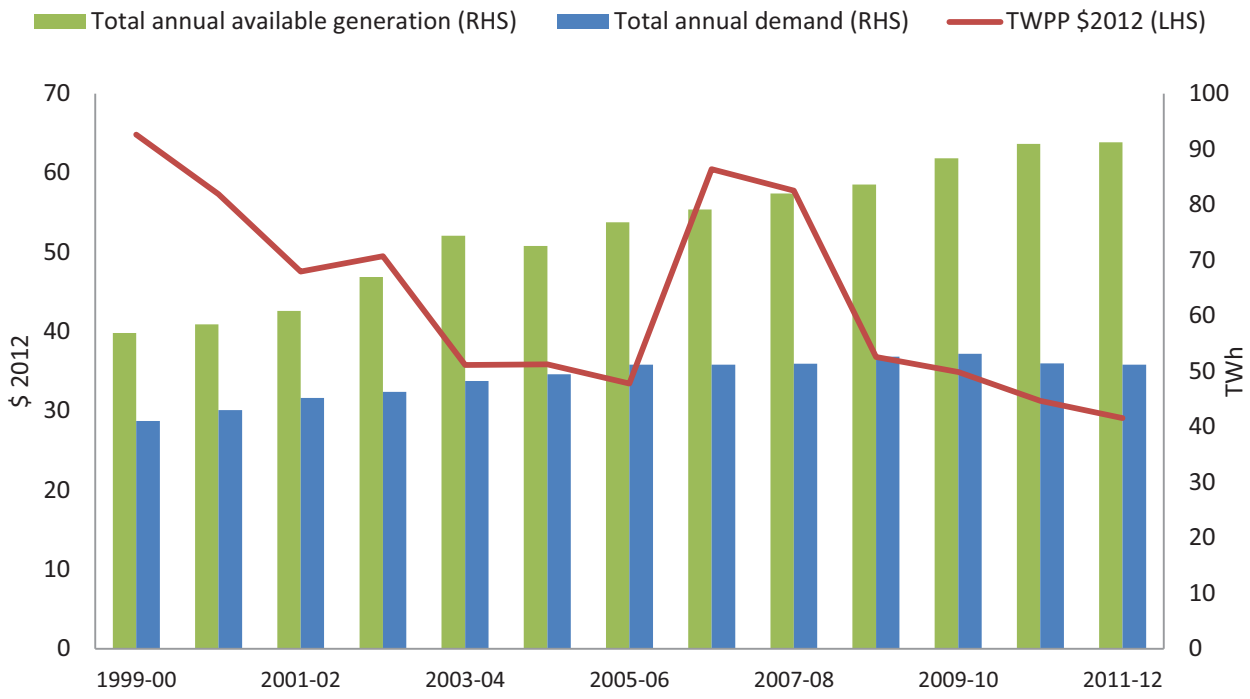
The Queensland NEM region experienced steady annual growth in total electricity demand, and higher rates of annual growth in maximum summer demand for each year until 2009-10.[12] In the last two financial years, both total energy and maximum demand have fallen from 2009-10 levels, due to the effects of climate (extreme events and relatively mild temperatures overall), economic conditions, consumer response to increasing prices, energy efficiency initiatives, and increasing usage of embedded generation (for example, roof-top photovoltaic (PV) systems). As a result, average wholesale electricity prices in Queensland fell to their lowest historic level in 2011-12.[13]

Against this demand background, historically there has been a number of factors encouraging new entrants to the electricity generation sector in Queensland:

- ongoing forecasts of increasing future demand
- availability of 'ramp up' gas from gas field developments, and the Queensland Gas Scheme which encouraged new gas generation
- scheduled retirement of some ageing generation assets
- deregulation of retail markets and the emergence of the vertically integrated electricity retailer, who owns or controls generator assets as a physical hedge against its retail electricity commitments.

As illustrated in Chart B2.3, increases in available supply have exceeded increases in electricity demand for Queensland in the period since wholesale trading commenced in the NEM, with consequent downward pressure on wholesale electricity prices.[14] The wholesale time-weighted pool price (TWPP) shows a long-term decline, apart from a spike in 2006-07 and 2007-08 caused by drought related shortages of water available to cool baseload generators.

Chart B2.3
Queensland wholesale electricity cost (time weighted pool price) with total annual demand and supply



Source: Queensland Treasury Corporation

A factor contributing to the decline in average price has been the emergence of gas-fired plant in the new generator fleet and the nature of its ownership:

- Gas-fired plant can increase generation quickly to meet emerging demand when the prevailing price exceeds short-run marginal cost.

- If the plant is to be an effective physical hedge to a vertically integrated owner, it must be priced to ensure dispatch as price increases.

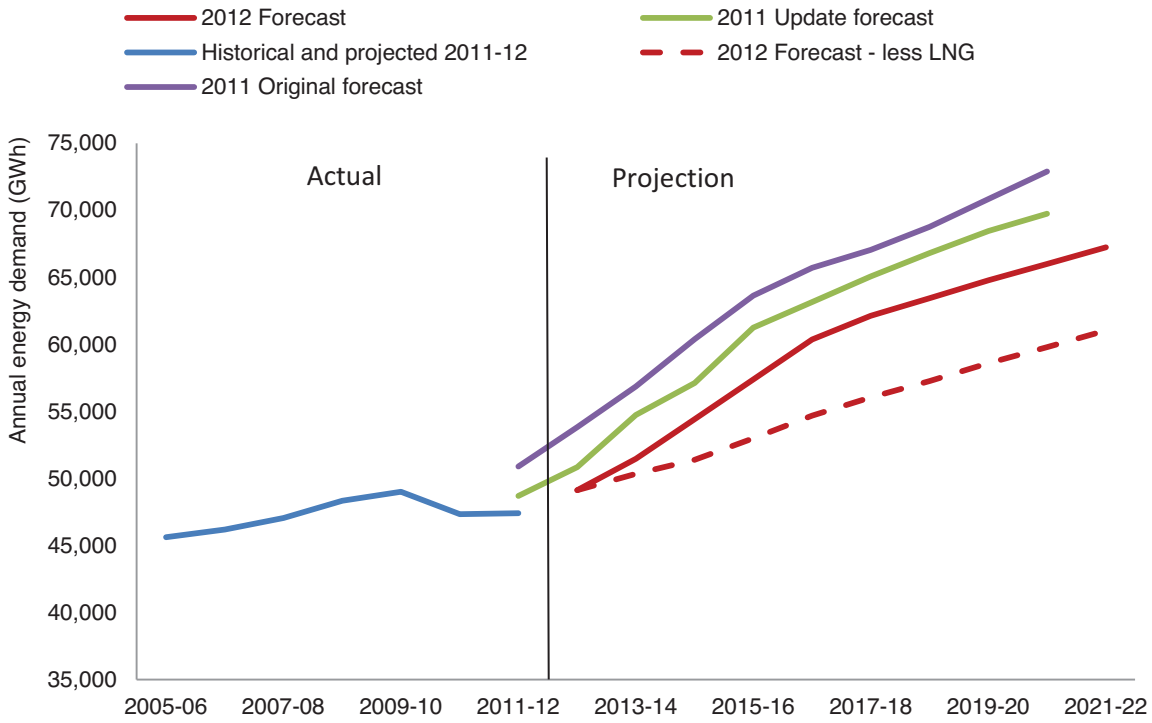
These two factors mean that, while prices often are still set by coal-fired baseload power stations, new generation will quickly respond to infrequent periods of high demand and will dampen the tendency for high price periods to occur. A lack of high price periods translates to lower average prices.

For base load generators, who typically dispatch a large proportion of their generation at prices at or below their short-run marginal cost, high price events represent an opportunity to recover either fixed costs or a profit from the market. Diminution of these events affects the average profitability of these generators.

The most recent projections of electricity demand[15] predict a return to increases in underlying demand, with substantial additional growth in demand contributed by the emerging liquefied natural gas (LNG) export industry and grid connections for new large scale mining projects. The demand predictions of both Powerlink and AEMO show a similar trend. However, the Powerlink forecast is somewhat higher, due to different underlying assumptions of economic growth rates and differing views as to the contribution of new LNG and mining growth.

Chart B2.4 shows a comparison of Powerlink 2012 demand forecasts with previous forecasts, showing the contribution of LNG assumptions to total demand growth.

Chart B2.4
Projected electricity demand



Source: Powerlink Queensland 2012 Annual Planning Report

While these new projections foreshadow robust demand growth, they represent substantial reductions on previous growth predictions published in 2011 and prior years. Ongoing underperformance against predicted demand has highlighted the downside risk of demand not eventuating and may have contributed to the present state of oversupply in the generation sector.

Increases in electricity supply and, in recent years, slowing growth in electricity demand have translated into ongoing decreases in real wholesale electricity prices. These declines in average prices have had a significant impact upon the profitability of state-owned generators.

The changing nature of the generation marketplace- primarily the emergence of the vertically integrated retail/generation model illustrates the nature of commercial risks faced by the generator assets owned by the State. As new competitors emerge, the value of state-owned generators can be substantially diminished.

Australian Government policy intervention

Australian Government policy to subsidise renewable energy sources and to price carbon emissions from the energy sector adds to the commercial risks faced by the State's electricity generation assets:

- Carbon pricing reduces the competitiveness of coal-fired generation and imposes a large direct cost which may not be fully recovered from the wholesale market.

- Renewable Energy Target (RET) schemes 'carve out' energy demand which can only be met by renewable generation, reducing the size of the market for conventional generators to supply.

The RET scheme requires energy retailers and other liable parties to source a portion of their energy requirements from renewable generation. The scheme is split to differentiate between:

- large-scale generation certificates (LGCs), produced by large-scale renewable generators, such as wind, geothermal and large scale solar arrays

- a small-scale renewable energy scheme (SRES), generated by small household solar PV and solar hot water heaters.

Annual LGC surrender targets are scheduled to build up to 42TWh per annum by 2020 (a value based on 20% of forecast energy demand at the time when the target was set, even though demand forecasts have since fallen). SRES surrender targets are calculated each year, with an annual surrender rate intended to align with the rate of SRES production.

The requirement to purchase electricity from these sources has the effect of excluding traditional generation technologies from meeting a large portion of future demand and shrinking the market in which these traditional generators can compete.

The recently commenced carbon pricing scheme of the Australian Government requires major emitters of greenhouse gases, including electricity generators, to acquire and surrender permits to offset carbon emissions. The impact of this on state-owned generators includes:

- the cost of purchasing carbon permits, which will represent one of the single largest operating expenses for the merchant generators during the three-year 'fixed price' period
- exposure to significant price uncertainty during the 'floating' carbon price period which follows
- loss of its competitive position with respect to renewable and gas-fired generators which face a lower carbon price impact.

In 2010-11, the assets of the generating businesses owned by the State were impaired by $1.7 billion for accounting purposes, most of which was attributable to the carbon tax.

If the carbon trading scheme is successful in achieving its aims, it will force ongoing reductions in generation and profitability and an early end to the economic life of the State's coal-fired generation assets.

State policy intervention

State intervention adds to the commercial risks faced by the State's electricity generation assets:

- Rooftop PV incentives may contribute to increased requirements for network investment and depress daytime off-peak demand.

- Gas Electricity Certificate (GEC) schemes 'carve out' energy demand which can only be met by gas-fired generation, reducing the size of the market for other generators to supply and potentially increasing competition for limited domestic gas supplies as export gas markets become available.

- Other interventions, such as the Tariff 11 price freeze and overlapping specification of allowable service costs, impose financial risks on energy GOCs and the Government.

The Queensland GEC scheme requires Queensland electricity retailers and other liable parties to source 15% of energy in each year from 2008 to 2019 from new gas-fired generation, effectively excluding from a substantial part of the electricity market traditional coal-fired generators and other elements of the generation fleet which existed before commencement of the scheme.

The Queensland solar feed-in tariff allows connections with solar PV arrays established before 9 July 2012 at $0.44 / kWh for electricity fed back to the grid. The feed-in tariff was priced in excess of the cost of supply from alternative generation technologies to provide an incentive to install these systems. Under this incentive, in addition to those provided by the Australian Government SRES, installed capacity of embedded small solar systems rose to 461 MW in early 2012. This has contributed to:

- apparent reductions in delivered demand, as the embedded PV supply nets off against total demand, displacing other (mostly non-renewable) generation
- price increases for customers without PV, both to meet feed-in tariffs paid to PV producers, and also as the cost base for distribution and transmission is spread over a smaller volume of total energy delivered.

A net feed-in tariff which exceeds the standard tariff for grid purchase of energy also incentivises households to minimise energy use during daylight hours and shift energy demand to morning and evening peaks. Over time, this trend can contribute to increased network requirements by exacerbating morning and evening demand peaks.

For systems committed from 9 July 2012, or for existing systems where the account holder changed, embedded small solar systems will be eligible for an $0.08 / kWh feed-in tariff until such time as a new rate is determined based upon current investigations by the QCA. Potential changes to the quantum and method of feed-in tariff calculation may reduce subsidisation of small-scale solar energy by other electricity consumers.

In response to concerns about increases in household electricity costs, the Government mandated a freeze in charges under the main domestic tariff (Tariff 11) for 2012-13, aside from the estimated cost pass through of additional wholesale energy costs arising from the Australian Government's carbon pricing regime.

Under these arrangements, a CSO in respect of the Tariff 11 freeze is paid to Energex, which is prevented from passing on a sufficient portion of recoverable network revenues to offset underlying increases in the retail cost of energy. As the Ergon CSO is effectively paid on the difference between Ergon costs and the regulated tariff, the Tariff 11 freeze also has the effect of increasing the amount payable under the Ergon CSO.

The Tariff 11 freeze limits energy price increases to domestic consumers in the immediate term. However, this does not address the underlying cost increases in network and transmission services, movements in wholesale energy costs, and the cost of meeting gas and renewable energy permitting requirements.

A freeze can only be imposed for a short or limited duration.

Non-commercial policy impositions by owners

Since the formation of energy sector GOCs, an array of legislation, policies, limitations and expectations has been progressively imposed on these entities. Through their annual Statement of Corporate intent, the GOCs were previously required to comply with 25 separate policies, 21 of which still apply, as listed in Box B1.1 of Section B1.

In addition, GOCs were required to comply with a statement of strategic expectations handed down from shareholding Ministers each year, and an employee and industrial relations plan which largely duplicated other government oversights of the GOC's industrial relations practices. These policies have imposed close administrative control of a range of GOC activities, from procurement standards to sports sponsorships.

As entities incorporated under the *Corporations Act 2001* (Cwlth), the GOCs must protect employee conditions in accordance with federal legislation, and with employee conditions determined by an enterprise agreement administered by Fair Work Australia. However, GOCs have been subject to other constraints on industrial relations which were imposed by the State as owners, for example:

- the 2012 GOC Wages Policy
- GOC Bargaining Guidelines 2010
- GOC Arrangements for Chief and Senior Executives 2009
- Minimum Employment, Industrial Relations and Job Security Principles for GOC Employees (2009)
- Guidance for Chief Executive Officers – Agreement Making and Industrial Relations in GOCs (2010).

These requirements were in addition to the *Government Owned Corporations Act 1993* (GOC Act) requirement that an annual employee and industrial relations plan must be developed in consultation with employees, 'interested industrial organisations', the then Office of the Public Service, and be subject to any directions from shareholding Ministers.

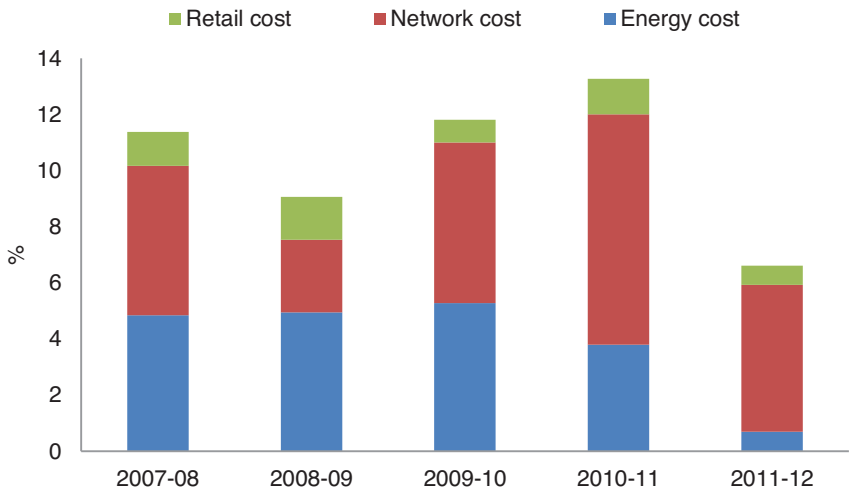
This set of requirements is both administratively onerous and limiting to the workplace arrangements which GOCs can negotiate with their employees.

In recent times, progress has been made in reducing these requirements. For example, the policy 'Minimum employment, industrial relations and jobs security principles for GOC employees 2009' no longer applies. Instead, reliance will be placed on normal workplace protections and the additional requirements under the GOC Act.

Trends in the retail sector

Key features of the retail sector have been increases in benchmark retail tariffs and increasing participation in retail competition by consumers. As shown in Chart B2.5, steady increases in notified tariffs, largely as a result of higher network charges, have impacted retail costs for non-market consumers. Consumers on market contracts have faced equivalent increases, except to the extent that these are offset by price reductions offered by retailers in competition for market customers.

Chart B2.5
Contributions to increases in benchmark retail cost index



Source: Queensland Competition Authority

Chart B2.6 shows changes in the proportion of both large and small retail customers in Queensland on market contracts. In the South East Queensland (SEQ) zone, the proportion of customers on market contracts is significantly higher than the Queensland average (Table B2.2), noting that since June 2012 large customers in SEQ no longer have access to non-market contracts.

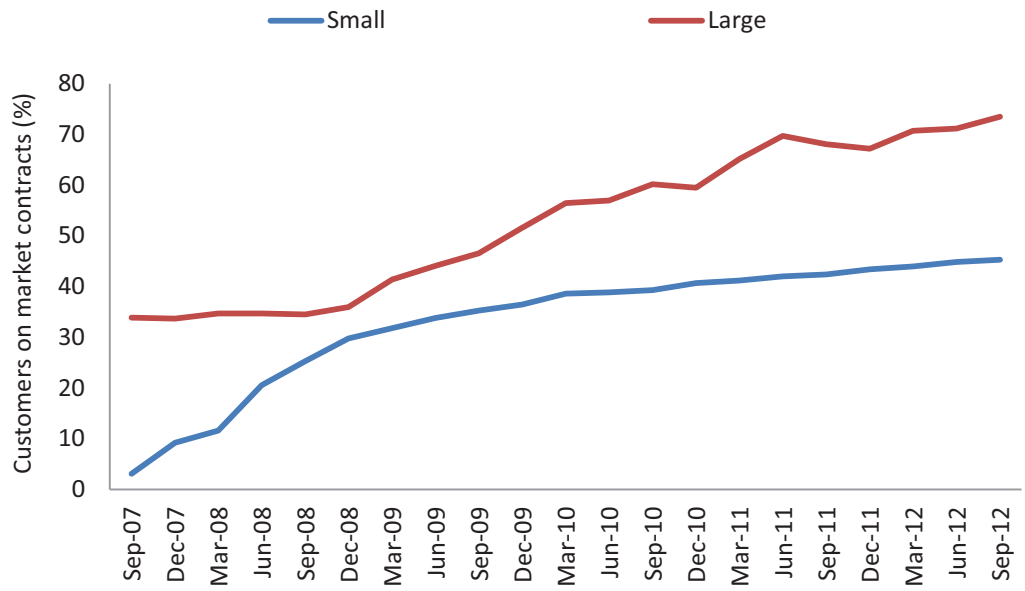
Table B2.2
Proportion of retail customers on market contracts[1]

	SEQ	Queensland
Small customers	66%	43%
Large customers	96%	67%

1 Proportions as at 31 December 2011.

Source: Queensland Competition Authority Final Determination for Retail Electricity Prices 2012-13

Chart B2.6
Proportion of retail customers on market contracts

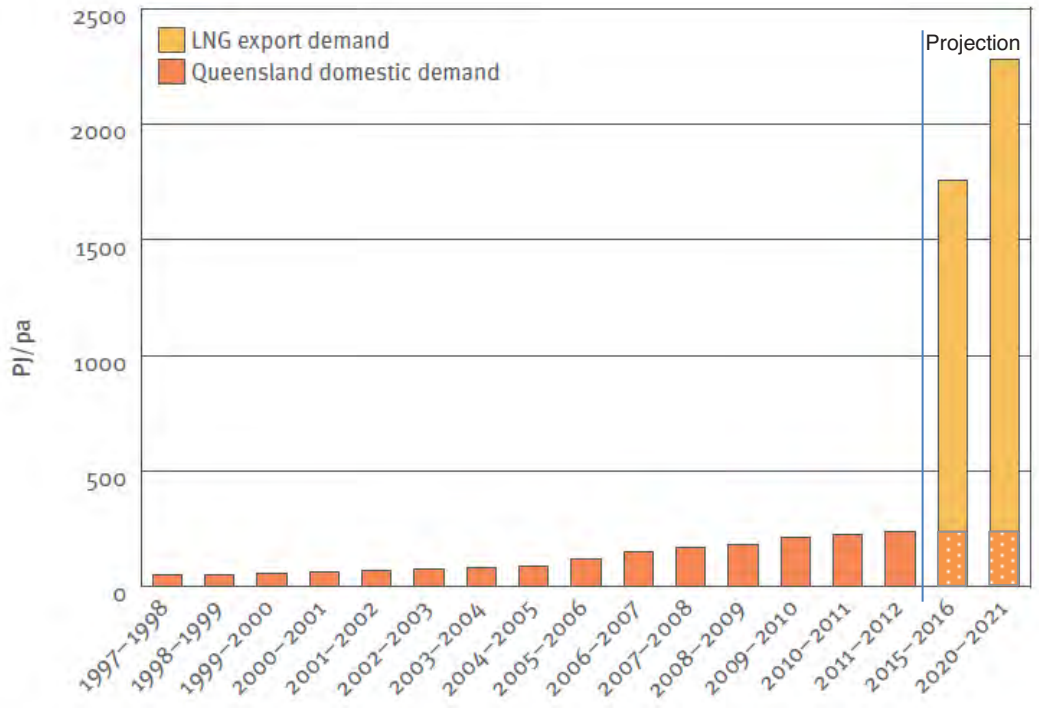


Source: Queensland Competition Authority

Impacts of LNG demand on Queensland electricity market

A multi-billion dollar program of infrastructure development is currently underway in Queensland, which is scheduled to culminate in large-scale export of liquefied natural gas (LNG) beginning around 2015-16. The scale of likely export gas developments in the context of historic domestic usage is shown in Chart B2.7.

Chart B2.7
Historic and projected gas development in Queensland



Source: Department of Energy and Water Supply, 2012 Gas Market Review

A substantial demand for electricity will result from many of the processes in the LNG export chain, such as pipeline compression, gas extraction and water treatment, with flat load requirements for each gas pipeline 'chain' estimated at around 300 MW.

For the energy sector, the LNG export industry is anticipated to have a number of important effects which commence around 2014-15:

- upward pressure on fuel costs for gas-fired competitors
- upward pressure on wholesale electricity prices, with increased demand for electricity required for gas extraction and pipeline compression
- commercial opportunities to establish non-regulated connections for transmission and distribution entities.

B2.2.3 Asset utilisation risks

The level of utilisation of energy sector assets is dependent upon the total volume of demand, and how uniformly this demand is spread.

Where demand is characterised by large 'spikes' in demand for the same level of total volume required, networks must be built to accommodate these peaks, but they suffer an overall fall in average utilisation. Similarly, additional generation units are required to service peak demand, but will not generate for the majority of the time.

Energy system planning usually requires networks and generation fleets to be constructed ahead of anticipated demand, to avoid shortfalls in supply as demand increases. Where predicted increases in demand fail to materialise, or demand decreases, networks and generators suffer from lower utilisation.

In the generation sector, which is directly exposed to energy markets, underutilisation of assets has a direct financial impact and is a significant source of commercial risk. Utilisation of the state's baseload coal generators has been low in recent years, resulting from low consumption and offsets from subsidised renewable generation.

For the state-owned coal-fired generators, this has been exacerbated by policy initiatives which mandate that renewable (the RET scheme) and gas (the GEC scheme) generators meet a portion of demand. Low levels of asset utilisation have significantly impacted financial returns from generators over recent years. Stanwell Corporation recently has mothballed two units (700 MW) of its Tarong Power Station in an effort to increase the average utilisation of its remaining fleet.

Network capacity is a key determinant of network costs to be passed on to customers. Where average utilisation is low (due to lack of demand, or the requirement to build to large demand peaks), the average cost per unit of energy faced by customers will be relatively high.

At the extremities of the distribution network, there may also be limited instances where emerging technologies allow 'off grid' energy supply to be established in competition with conventional distributed supply, also reducing the utilisation of particular network assets. This risk is currently small, but may become increasingly important if regional customers are exposed to the real cost of energy supply, rather than the subsidised cost experienced under the uniform tariff policy.

Under the current system of revenue regulation for networks, there is little commercial risk posed by underutilisation, as costs are still recovered from users. However, longer term, it is doubtful that consumers can continue to pay the full cost of assets which have little prospect of full utilisation. This would result in the need to devalue these assets or remove them from the regulated asset base for network entities, with consequent financial risk for the network entity and therefore the Queensland Government.

The ongoing risk of asset underutilisation, especially in the face of new competing technologies or policy changes, highlights the longer-term risk of stranded assets, and the need for energy GOCs to continuously adapt their business model to allow for these changes in their market environment.

B2.3 Financial Performance of GOCs

Key profit metrics for the State's energy sector GOCs are shown in Table B2.3.

Table B2.3
Financial performance of energy sector GOCs: 2007-08 to 2011-12
($ million)

	2007-08	2008-09	2009-10	2010-11	2011-12
Stanwell					
EBIT	179.4	281.7	237.4	20.5	204.7
EBIT *less coal rebate*	118.8	94.3	153.7	-98.4	-9.5
NPAT	135.6	195.6	149.5	-12.0	79.9
CS Energy					
EBIT	135.6	214.8	13.5	-797.4	-6.1
NPAT	59.0	93.8	-47.6	-614.6	-51.5
Tarong[1]					
EBIT	106.5	153.4	159.2	-622.5	-
NPAT[a]	56.7	85.1	91.6	-465.7	-
Total Generation Sector					
EBIT	421.4	650.0	410.1	-1,399.4	198.6
NPAT	251.3	374.5	193.4	-1,092.3	28.4
Powerlink					
EBIT	294.7	353.9	379.5	443.4	535.0
NPAT	103.1	121.9	128.6	157.2	203.8
Energex					
EBIT	395.3	388.2	485.2	626.0	731.0
NPAT	140.8	128.5	185.2	234.7	282.4
Ergon					
EBIT	410.1	407.9	478.0	744.1	777.8
NPAT	162.9	129.3	166.5	321.6	319.8
Total distribution & transmission sector					
EBIT	1,100.1	1,150.0	1,342.7	1,813.5	2,043.8
NPAT	406.8	379.7	480.3	713.5	806.0

EBIT = Earnings before interest and tax, NPAT = Net profit after tax
1 The performance of Tarong Energy in 2007-08 excludes profits arising from the sale of wind farm assets.

Source: GOC annual reports and Queensland Treasury and Trade

B2.3.1 Generators

Financial performance of the generator GOCs has declined markedly over the past several years due to declining prices in wholesale electricity and contract markets, which have exerted downward pressures on revenues.

The impact of carbon taxes on future revenues, and the expectation of continuing low prices in the short term, have led to significant impairments to generation asset values, with a significant impact on reported returns in 2010-11.

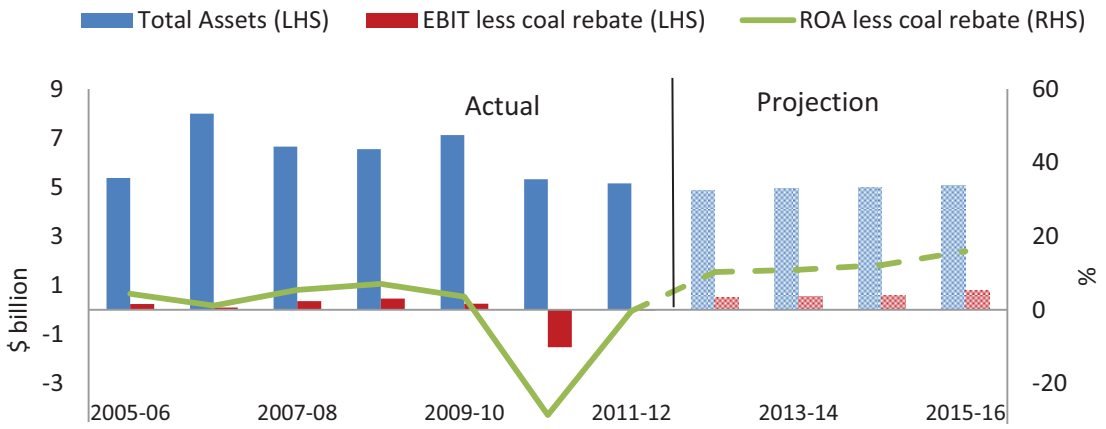
Forecast financial performance remains subdued in the near term, due to ongoing lack of demand in comparison with regional generation capacity and the impact of the carbon tax, which is likely to become one of the largest single classes of expenditure for the generator GOCs and may only partly be recovered from market prices.

In the medium term, there is potential for an improvement in financial performance as a result of increases in electricity demand imposing an upward influence on pricing, and a possible reduction in competitive pressure from new gas-fired generation as the completion of LNG export facilities opens an alternative market for gas fuel.

Projected financial results for the generator GOCs shown in Chart B2.8 are predicated on a forecast improvement in wholesale electricity markets. There remain significant uncertainties in the market place:

- the form and price (and potential for repeal of) carbon pricing schemes
- the impact of RETs and subsidised renewable generation, or other schemes which exclude traditional generators from parts of the electricity marketplace
- the occurrence and timing of projected new demand, and the extent to which it is offset by new supply
- ongoing average spot price, price volatility, and demand and liquidity in the electricity contract market.

Chart B2.8
Assets, earnings and return on assets for generator GOCs



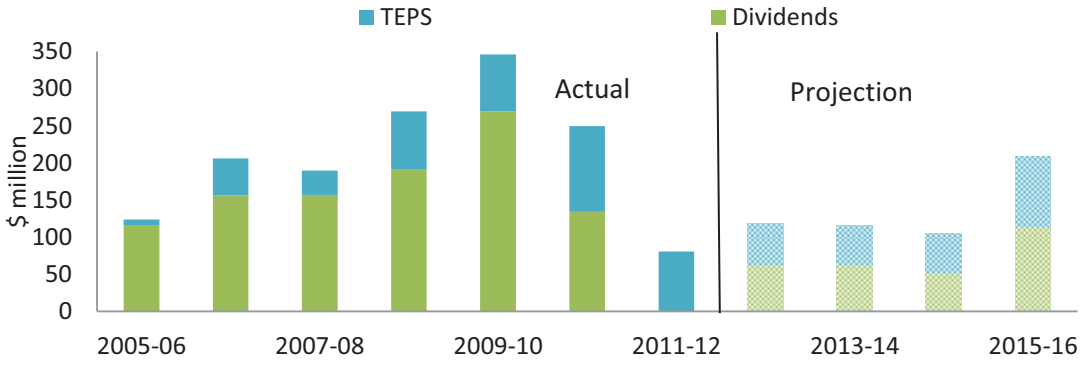
Source: Organisation annual reports and Queensland Treasury and Trade

The projected earnings shown in Chart B2.8 exclude significant revenues received by Stanwell Corporation for the export of coal (approximately $200 million per annum). These revenues are excluded as they relate to non-core assets, and obscure the performance of its underlying generating assets. Coal export revenues have allowed Stanwell Corporation to maintain satisfactory financial metrics despite the underlying performance of its generation activities in recent years.

CS Energy is more exposed to market performance and cashflow drains arising from operation of the Gladstone Interconnection and Power Purchasing Agreement. As a result, it has required significant equity injections ($300 million) to maintain financial integrity since the 2011 generator restructure. The amount of this equity injection exceeds combined forecast dividends from the generator GOCs over the next four years.

Chart B2.9 shows past and future projected returns from the generator GOCs to the Government from both dividends and tax equivalent payments. For the period 2011-12 to 2014-15, these returns are almost entirely due to coal rebate revenues rather than the performance of generator assets. Total returns to owners will only return to previous levels if forecast increases in market demand and pricing occur.

Chart B2.9
Dividends and tax equivalent payments from generator GOCs (cashflow)



TEPS = Taxation Equivalent Payments

Source: Corporate annual reports and Queensland Treasury and Trade

B2.3.2 Provision for carbon tax impacts on dividend and tax equivalent payments

The generator GOCs are likely to experience a large financial impact from the introduction of the Australian Government's *Clean Energy Act 2011.* This was noted in the Commission's Interim Report. At that time, it was not possible to validate the impacts on the dividend and tax equivalent payments of the generator GOCs, as the required information was not available to assess the 'with' and 'without' carbon price forecast results.

On the basis of subsequent information and analysis, Deloitte Access Economics (DAE) has estimated the potential reduction in dividends and tax equivalent payments as shown in Table B2.4. The table also shows the 2011 Queensland Treasury estimates from its study 'Carbon Price Impacts for Queensland'.

Table B2.4
Projected impact of carbon tax on dividend and tax equivalent payments by generator GOCs ($ million)

	2012-13	2013-14	2014-15	2015-16	Total
Treasury 2011	-157	-248	-276	-276	-957
DAE 2012	-49	-47	-86	-146	-327

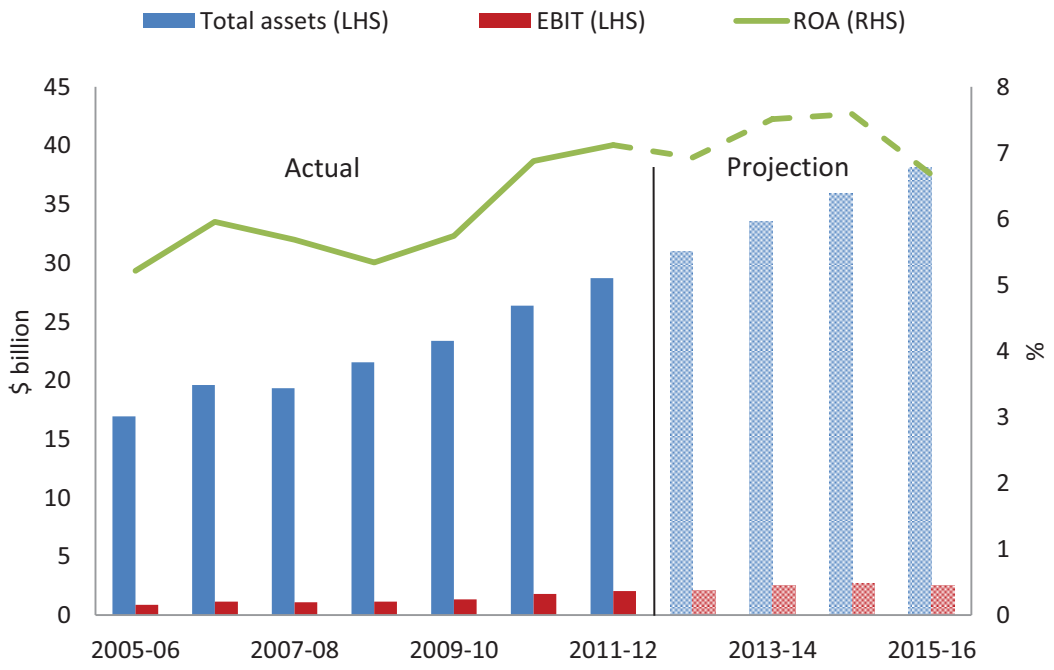
Source: Deloitte Access Economics

The revised demand forecast reported in this table provides a more contemporary estimate of likely impacts, but is not directly comparable to the original estimates by Queensland Treasury and Trade. This is due to changes in projected electricity demand and other forecast parameters. In particular, to align with revised 2012 AEMO projections, forecast maximum demand in the DAE modelling was reduced compared with the previous Queensland Treasury and Trade modelling.

B2.3.3 Transmission and distribution

Transmission and distribution assets have provided stable and predictable returns to the Government, with financial results largely aligned with each regulatory reset period and growth in the regulatory asset base (Chart B2.10).

Chart B2.10
Equity, earnings and return on assets by distribution and transmission sector[1, 2]

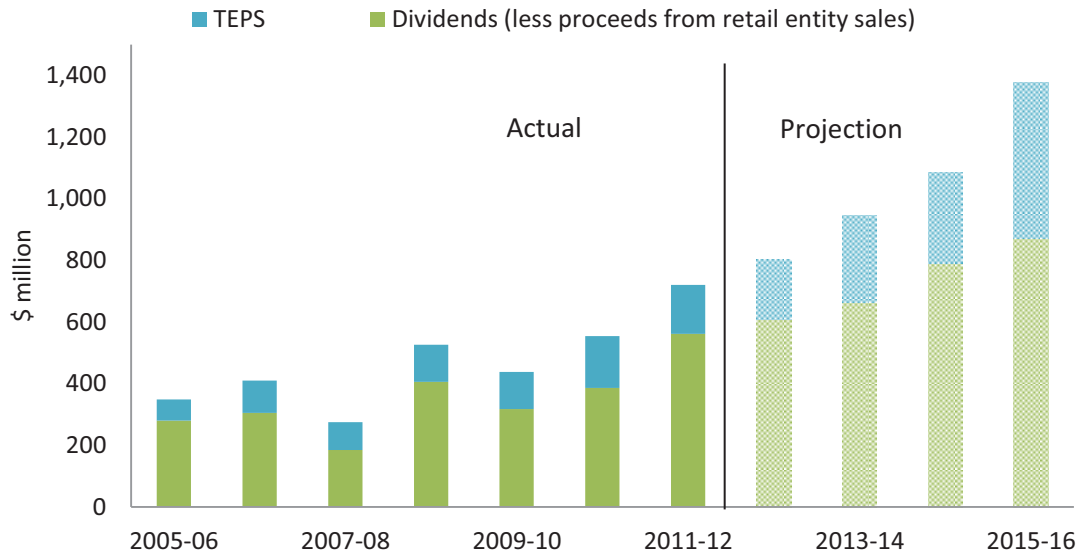


1 Results exclude profit realised on sale of retail assets.
2 Results include the residual retail business held by Ergon but supported by a CSO.

Source: Organisation annual reports and Queensland Treasury and Trade

Chart B2.11 shows past and projected returns from the distribution and transmission sector to the Government from both dividends and tax equivalent payments. Total returns are forecast to increase, commensurate with increasing levels of capital invested.

Chart B2.11
Returns to owners from the transmission and distribution sector (cashflow[1])



TEPS = Taxation Equivalence Payments
1 Excludes dividends pertaining to the return of capital from retail asset sales.

Source: Organisation annual reports and Queensland Treasury and Trade

B2.4 Forward Capital Commitments and Level of Indebtedness

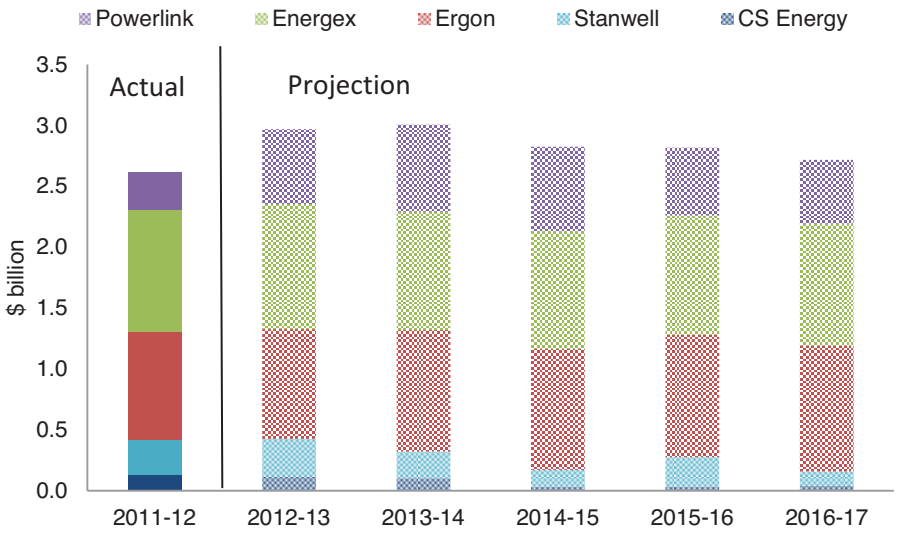
The Commission has reviewed the forward capital commitments of the energy GOCs.

The generator GOCs have a limited program of forward capital expenditure, mainly associated with required maintenance of generator assets and associated infrastructure.

In contrast, there are substantial capital investment programs planned for the transmission and distribution entities, building on the growth in their assets which has occurred over the last five years.

Chart B2.12 shows the total projected capital expenditure nominated by energy sector GOCs in their current corporate plans, the aggregate amount exceeding $14.3 billion in the current planning horizon for the GOCs. While around half of this amount can be met through the reinvestment of depreciation and amortisation provisions, the quantum of new investment nonetheless represents a significant demand on the State's available funds for investment.

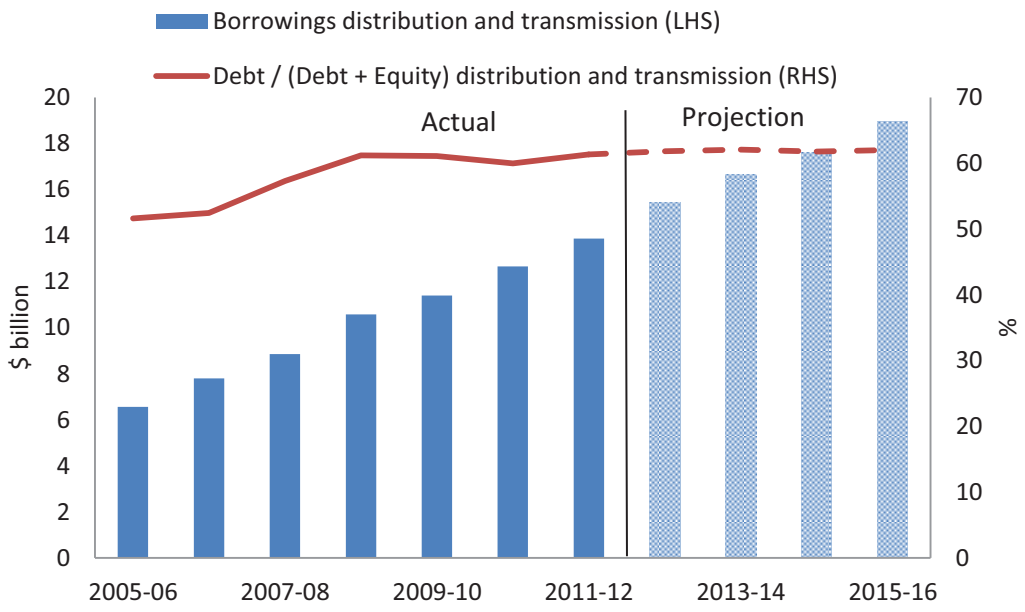
Chart B2.12
Projected capital expenditure for energy sector GOCs



Source: Queensland Treasury and Trade

Required capital investments in the transmission and distribution sector are projected to be met in part by additional borrowings, with sufficient internal funds being used to maintain targeted gearing ratios over the period (Chart B2.13).

Chart B2.13
Total long-term debt for the distribution and transmission sector



Source: Annual Reports and Queensland Treasury and Trade

The projected debt of the transmission and distribution entities grows substantially throughout the projection period. It represents the majority of GOC sector borrowings, and a significant proportion of total State debt.

In addition to the magnitude of the debt carried by these organisations, in the context of the State's capital resources, some additional repricing and refinancing risks arise due to the pricing model currently used by the AER to calculate a benchmark cost of debt allowance. In order to achieve a cost of debt which is consistent with the regulatory model, it is necessary for these businesses to refinance their debt portfolio during the same 40-day reference period which is used by the regulator.

Energex and Ergon are projected to require around $12.6 billion of debt refinancing at their next regulatory reset. The task of issuing this concentrated refinancing requirement in addition to normal government financing requirements, in an environment adversely affected by a sustained reduction in debt market liquidity over the last few years, creates repricing and refinancing risks for the businesses and the State.

Uncertainty around the capacity to achieve the required volume of transactions within the reset period increases the risk of experiencing a mismatch between the actual and benchmark cost of debt. Aligning the average debt term with the length of the regulatory control period requires large volumes of debt with specific maturity dates to be pre-issued towards the end of each regulatory control period. Any lack of liquidity in the market place within these specifications creates refinancing risk for both Energex and Ergon.

The AEMC has recently advised[16] that it will allow the AER greater flexibility in the approach used to determine a benchmark cost of debt. This flexibility would allow the AER to adopt an approach which allows for these risks to the distribution entities.

B2.5 Capital Structure and Credit Rating

Since the Commission's Interim Report, Queensland Treasury and Trade has engaged the Queensland Treasury Corporation (QTC) to perform new benchmark capital structure reviews for each of the GOCs.

The capital structure reviews consider both the overall potential of the sector in which the GOC trades, and the stand-alone strength of the GOC within that sector. Key financial metrics considered include earnings interest coverage and debt to capital ratios.

Table B2.5 outlines the financial criteria adopted to assess whether each entity would be able to justify a 'stand-alone' credit rating of BBB, or better.

Table B2.5
Summary of credit review ratings criteria for GOCs

Financial measure	Target range - generation sector	Target range - transmission and distribution sector
Earnings before interest, tax, depreciation and amortisation interest coverage	3.5 to 5.5 times	2.0 to 3.0 times
Earnings before interest and tax interest coverage	2.5 to 4.0 times	1.5 to 2.5 times
Ratio of debt to capital	Less than 40%	Less than 65%

Source: Queensland Treasury and Trade, amalgamated from QTC reports

The capital structure reviews assessed the average level and trajectory of these metrics over a five-year planning horizon for each entity. Where contingent market events or major capital programs were identified, some scenario analysis was also performed to indicate whether metrics could be maintained under a range of likely business outcomes.

Table B2.6 summarises the outcomes of the latest QTC capital structure review performed for each of the GOCs. Transmission and distribution sector entities exceed benchmark financial requirements for the targeted 'investment grade' rating, while Stanwell Corporation relies upon coal export revenues, rather than the performance of core generation business, to meet benchmarks. CS Energy falls short of benchmark financial requirements for at least the near term.

Table B2.6
Summary of credit review ratings for GOCs

Entity	Assessment with respect to investment grade rating
Stanwell	Meets requirements
CS Energy	Sub requirements
Energex	Exceeds requirements
Ergon	Exceeds requirements
Powerlink	Exceeds requirements

Source: Queensland Treasury and Trade, amalgamated from QTC reports

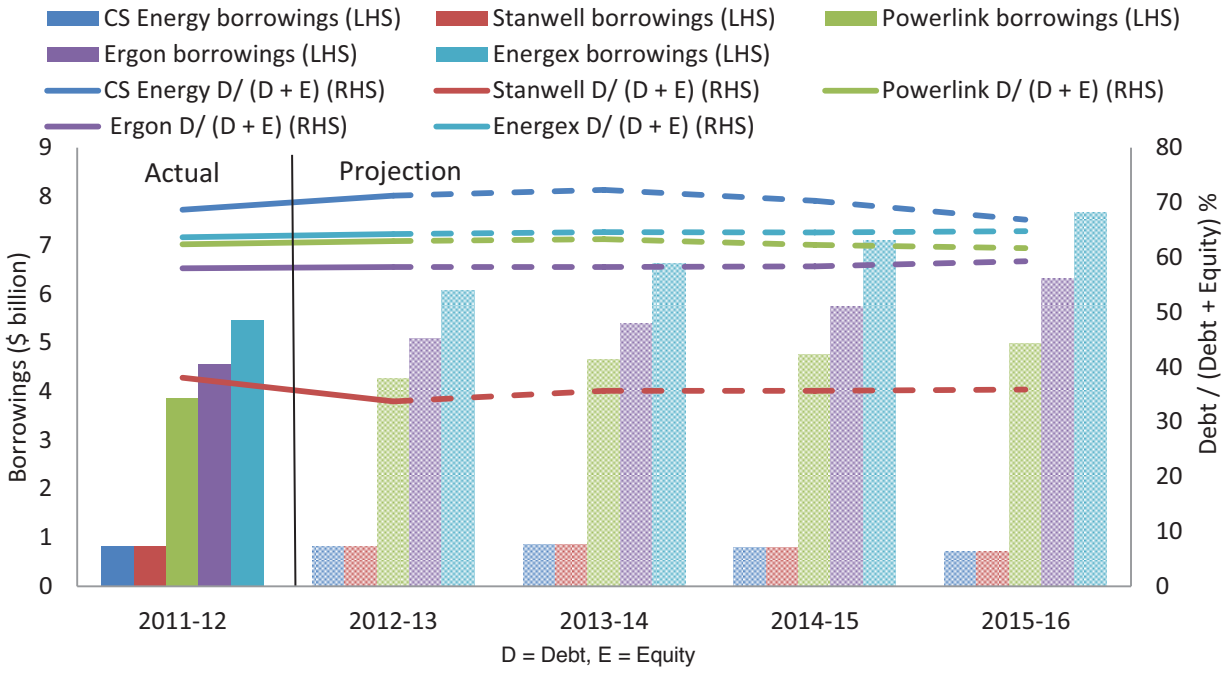
Table B2.6 shows that CS Energy is unlikely to meet the financial criteria adopted in the QTC credit review. CS Energy is a price taker currently facing increasing input costs in an environment of decreasing average wholesale electricity price. Therefore credit metric targets would need to be at a conservative setting to offset market and other competitive risks in the generation sector. Short to medium-term credit metrics fall well outside of the target range established, with substantial injections of equity needed to meet target metrics within the analysis period.

The equity injections required for CS Energy to meet investment grade targets within the next two years would be in the order of several hundred million dollars. This would be in addition to the $300 million of equity injections recently made. A key issue for the Government is the scale of the investment required to make an appreciable improvement in financial metrics, given that a BBB stand-alone credit rating may not be achievable until there is greater certainty around projected business improvement.

Over a five-year period, returns from CS Energy are projected to improve substantially, and move CS Energy's financial position back into the required settings. However, this return to profitability is highly dependent upon forecast improvements in total energy demand in Queensland.

The current and projected levels of indebtedness for each of the energy sector GOCs, in addition to the ratio of debt to debt plus equity, is shown in Chart B2.14.

Chart B2.14
Projected borrowings and gearing for energy sector GOCs



Source: Queensland Treasury and Trade

A comparison with privately owned companies in the energy sector shows variation in gearing around the regulator's benchmark 60% ratio for distribution and transmission entities, in both publicly owned entities and companies holding significant electricity infrastructure assets (Table B2.7), and that gearing is substantially lower on average for the generator businesses.

Table B2.7
Credit metrics for the combined energy sector GOCs

Company	Activities	Net debt / (Net debt + Equity)
Network service providers		**(%)**
SP Ausnet	Victorian Transmission / Distribution	78
DUET	Majority owner of United Energy	77
SPARK	Part owner of Citipower, Powercor	41
Transgrid	Transmission	47
Ausgrid	Transmission and distribution	80
Essential Energy	Distribution	69
Endeavour Energy	Distribution	64
Generation and Vertically Integrated Retail/Generation		**(%)**
MacGen	Generator	43
Delta	Generator	77
Origin	Electricity retail and generation	29
AGL	Electricity retail and generation	38

Source: Relevant annual financial reports for 2011-12

B2.6 LONGER-TERM OWNERSHIP ISSUES

B2.6.1 Divestment of assets

From the foregoing analysis, the Commission has concluded that:

- Continued ownership of energy sector assets exposes the Government to complex commercial risks, which it is poorly placed to respond to as an owner. The emergence of these risks has already eroded financial returns to the Government, and the value of its investments in these assets.

- The energy GOCs are placed at a competitive disadvantage by non-commercial policy and regulatory requirements imposed by government.

- Ownership of these assets represents a very substantial investment of public capital, and will require further substantial capital investments to sustain the businesses in the future. In other states, these assets mostly are owned by the private sector, or are in the process of being transferred to the private sector.

Furthermore, delivery of Government policy objectives for the energy sector through ownership of GOCs is inefficient, lacks transparency, is inconsistent with the aims of the national energy reform agenda, and creates conflicting objectives for the GOCs.

Accordingly, the Commission considers that the Government should realise the capital locked up in its energy GOC's, thereby:

- distancing itself from commercial risks in the sector
- fulfilling the principles and objectives outlined in the national energy reform agenda, and Queensland's commitments towards these objectives
- avoiding the need to inject new capital into the businesses
- freeing funds to relieve debt and allocate to more urgent social and economic priorities.

The Government should distance itself from day-to-day oversight of the energy sector, which successive Queensland Governments have agreed should reside with the regulating bodies (such as AEMC and AEMO) established in pursuit of a unified national energy policy. This would enable the Government to concentrate on strategic policies for the energy sector to achieve its desired objectives.

The desirability of divestment of government ownership interests in the energy sector was flagged by the 1996 Queensland Commission of Audit. It estimated that, in 1996 dollar terms, withdrawing the $12.5 billion in energy investments from the sector would deliver an annual benefit of $1.1 billion to the State at the prevailing cost of capital, a return $741 million higher than expected from dividends and taxes (the benefit of which the State enjoys under the taxation equivalent regime).

Over the 16 years since that time, annual returns to owners from the energy GOCs (measured on the same basis, but excluding returns of capital from asset sales) have never exceeded the potential annual benefit which was identified at that time, even in nominal terms. This result is despite significant increases in gearing and total capital invested in the sector.

The Commission has estimated the loss in value arising to the Government for not taking up that recommendation is in the order of $7.2 billion (in 2011-12 dollars).[17]

With implementation of the NEM and subsequent retail and regulatory reforms, the energy sector has further evolved into a more dynamic, sophisticated and competitive marketplace. Mechanisms for economic regulation are maturing and there is increasing leadership by the private sector in new investment and efficiency in supply.

A 2006 review of the Queensland energy sector by the Boston Consulting Group ('Boston') identified that the Government's retail activities were at a competitive disadvantage to potential private sector competitors and would present Government with a substantial commercial risk under full competition. The review recommended the sale of Energex's retail interests, a recommendation which was implemented in 2007.

The 2006 Boston review also recommended that the government sell its generator assets. This recommendation was made on the basis of commercial risks imposed by declining wholesale electricity prices, and the risk of failing to attract future private sector investment in new generation while generator GOCs continued to invest capital ahead of efficient market signals. The Boston report noted that:[18]

- *"returns from Queensland's GOC generation portfolio have deteriorated markedly over the past five years, with the decline in wholesale prices a key driver of the downturn. Long-term average returns now compare unfavourably with those of peer generators in the NEM"*

- *"the objectives of competitive markets and maximising both shareholder value and private investment in new capacity will be best served if the Government announces a gradual sell-down of generation assets".*

The intervening period has shown that new private sector investment has been forthcoming. However, the commercial risks identified at that time have been magnified by continued price weakness and the emergence of new private sector commercial structures, especially the vertically integrated retailing structure.

Over the period since the Boston recommendation was made, the carrying value of generating assets held by the generator GOCs has fallen by around 30% in nominal terms, as identified commercial risks have manifested themselves and additional risks have emerged.

In its recent draft report on energy network regulatory frameworks, the Productivity Commission found that operational efficiency and capital rationing by state-owned network service providers represented less efficient outcomes than their private sector peers and identified that:

- The effectiveness of incentive based regulation was dependent upon a strong profit motive in the corporations subject to regulation.

- State ownership of regulated businesses is not conducive to strengthening this motive.

The Productivity Commission also found that:

> *"… government constraints and poor governance arrangements in state-owned corporations (SOCs)* [are] *antithetical to desirable commercial practices, and to the delivery of the National Electricity Objective – efficient operation of, and investment by network businesses for the long term benefit of consumers."*

On this basis, the Productivity Commission advocated divestment of state-owned network businesses, noting:

- *"The rationale for state ownership of network businesses no longer holds. State-owned status is ill-suited to the current incentive regulatory regime. State-owned network businesses appear to be less efficient than their private sector peers. This is not surprising given their multiple objectives, political intervention and the imposition of non-commercial restrictions."*

- *"There are compelling grounds for privatisation of all electricity network businesses in the National Electricity Market."*

The recent 2012 interim report of the Government's Independent Review Panel (IRP) into the efficiency of network service provision concluded that:

- The privately owned distribution network service providers (DNSPs) in Victoria and South Australia have been consistently more efficient than the government-owned distribution network service providers in Queensland, after allowance for the density of customers.

- The performance of the privately owned DNSPs in terms of reliability and service standards is either superior to, or comparable with, their government-owned counterparts.

The IRP's interim findings also corroborate the concerns of the Productivity Commission as to the efficiency of capital rationing and commercial incentives within these organisations, and conclude that there is a compelling case for privatisation of the distribution network service providers.

Other investigations into the efficiency of the energy sector have raised similar concerns as to the appropriateness of public ownership of electricity sector assets:

- The Senate Select Committee on Electricity Prices[19] cited concerns about governance arrangements for government-owned enterprises, and the level of emphasis on consumer outcomes. The Australian Government Department of Resources, Energy and Tourism, in a submission to the Senate Committee, advocated the privatisation of government-owned energy assets, on the basis that:

  "continued government ownership of energy businesses is impeding greater competition and efficiency".[20]

- The Australian Government's 2012 Energy White Paper on energy noted the need for governments to promote efficiency and competition and emphasised the need for state governments to make decisions as to ownership and governance arrangements for energy sector assets.

The Energy White Paper also drew attention to the costs that government ownership can impose on consumers:

- *"The behaviour of energy businesses can have significant implications for consumers, particularly for their energy bills. Government or private ownership of these businesses can be an important determinant of their business costs. In particular, different cultural practices or approaches to managing risk may result in an overemphasis on engineering objectives at the expense of business efficiency or optimal commercial outcomes."*

- *"Government ownership has the potential for conflicts of interest in operational or investment decisions, dividends and equity margins. Capital markets can provide an important discipline for private businesses, but are not always able to do so for state-owned business."*

It is sometimes argued that the disposal of assets denies governments the benefits of the future income stream that the assets would otherwise generate. If the assets are properly valued, the net present value of the future income stream will be reflected in the disposal price. In any event, holding an asset is also subject to a risk that commercial market factors may erode the value of that future income stream.

There is also an opportunity cost to be considered in locking up scarce capital to the detriment of higher priority uses to meet core government service delivery priorities. Section B2.7 addresses the value of the capital which the Government has invested in these assets.

B2.6.2 Generators

In the Commission's view, continued government ownership of generator assets carries substantial commercial risks which the Government is not well placed to manage and which represent an ongoing threat to the State's fiscal position.

The generator GOCs provide commercially traded goods in a national competitive market governed by a tightly specified set of operating rules determined by a national regulatory framework. Through their increasing presence in the market, private sector corporations have demonstrated clearly that these goods can be provided more efficiently and effectively outside of government ownership.

Once the sale of the residual government-owned generator assets in New South Wales is completed this year, 70% of total generation capacity in the national electricity market will be privately owned. The Queensland Government will be the sole remaining owner of any substantial generation fleet outside of the Tasmanian and Snowy hydro-electric schemes.

There appears to be little justification for the State maintaining its investment in generation assets, particularly in an environment where investment capital may become increasingly scarce.

The current outlook for the sector indicates that an upswing in demand, coincident with a potential increase in input costs for competing gas generation, may present a suitable opportunity for the divestment of these assets. By that time, financial impacts of the carbon tax and other carbon abatement measures also should be clearer.

However, to defer divestment of assets until this time would require the State to continue to accept commercial risks in this sector for another two to three years. Such a delay could be justified if the Government is prepared to make commercial and structural adjustments to the generator GOCs over this period to enhance value which could be realised in a future sales process. The detail and timeframes for such adjustments would be a matter for further investigation.

Prior to any sale of generator assets, the Government also would need to consider the most suitable way to structure the generator GOC businesses and their assets to maximise the value recovered from its investments and to minimise residual risks.

Recommendation

7 When market conditions are favourable, the Government divest its electricity generation assets. Factors which will impact the timing of divestment include the carbon tax, other carbon abatement measures and generation capacity in the National Electricity Market.

B2.6.3 Transmission and distribution

Experience in other jurisdictions clearly demonstrates that transmission and distribution network services can be successfully delivered by the private sector, within a maturing national regime of economic regulation. In these circumstances, there remains no compelling economic case to retain these entities in government ownership.

While these businesses face some commercial risks, the current regulatory environment is geared to ensure that the owner receives a return which is commensurate with the risk faced. The converse of this is also true: that the regulated income stream prevents the owner from receiving a return which exceeds that expected. The key question in the case of the transmission and distribution entities is not the quality of the investment, but whether the State has funds available to invest, and to continue to invest into the future.

The State's ownership of transmission and distribution assets represents a large and growing commitment of capital. Long-term debt held by these entities is expected to grow by $6 billion over the current forecast period (to 2016-17). This will be required, along with other capital investment and reinvestment by shareholders, to support a $13 billion capital program identified in the corporate plans for distribution and transmission entities to 2016-17.

This substantial ongoing requirement for capital to support network investments must be met from scarce government funds in competition with other government priorities, such as social and other infrastructure projects. As these investments can be readily made by the private sector, as has occurred in other jurisdictions, there is no need for the Government to maintain an investment of its scarce capital in these assets.

The Productivity Commission's draft report on Electricity Network Regulatory Frameworks indicated that there needs to be an increasing emphasis on commercial incentives for network efficiency built into the regulatory system, rather than the present heavy reliance upon achieving benchmark costs. For these incentives to be effective, the affected network service customers need to be responsive to commercial signals and equity constraints.

Given the mixed objectives of these corporations while in public ownership, and the different drivers of capital funding, it is highly likely that these commercial sensitivities are not optimised while these entities remain in government ownership.

The Queensland Government has committed to ensuring sectoral competition and efficiency within a uniform national market setting. This is to deliver long-term reductions in the cost of electricity to consumers. The Queensland Government should complete its commitment to the National Energy Objective by divesting its network and transmission assets.

The provision of local electrical distribution services (and associated small-scale generation) to areas not connected to the NEM is less likely to be delivered without public sector support. These services are currently delivered by Ergon, and reimbursed via CSO payments made to EEQ. The delivery of these services could be specified as a separately funded non-commercial activity and procured directly in the short term. The issue of whether these services should be delivered by the Government, or procured by the Government from the private sector, should be made prior to divestment of NEM distribution services.

A key consideration in planning a divestment of the transmission and distribution assets is maximisation of value recovery. For potential purchasers, a major driver of value will be the level of revenue certainty provided by regulatory determinations. It is likely to be preferable for a sales process to be aligned with a regulatory re-set period, as this will provide the greatest level of revenue certainty. This issue is addressed further in Section B2.8.

Recommendation

8 Electricity distribution and transmission assets be divested at a time set to align with regulatory re-set periods and favourable market conditions.

B2.6.4 Retail

Private providers now deliver the vast majority of retail electricity services in the NEM, including the majority of the Queensland population. The retail activities of EEQ represent the last substantial retail portfolio in government ownership in the NEM, aside from those currently planned for sale in Tasmania.

The sale of EEQ's retail portfolio in an environment supportive of effective competition in the Ergon distribution area would provide a return of capital to the State. There are alternative options for delivery of the uniform tariff policy (for example, through payment of a network CSO), which would increase the scope for retail competition and the delivery of retail services by the private sector in remote areas.

The sale of EEQ as a competitive retail business, rather than in the current form, may also provide a means of increasing the competitiveness in the retail sector by establishing a third major retailer. This would depend on the level of competition in the Queensland market at that time and the capacity of EEQ to compete effectively.

Recommendation

9 Either separately or in conjunction with other electricity assets, residual retail electricity functions be divested in order to maximise the value of the business for taxpayers.

B2.7 POTENTIAL VALUE OF ENERGY SECTOR ASSETS

Infrastructure Australia has recently published its view that sale of energy sector assets is a necessary part of rebalancing government balance sheets and enabling future infrastructure programs to be funded.[21] For Queensland, the value of the State's investment in the energy sector represents one of the most substantial opportunities to reduce current levels of debt to a more sustainable level while avoiding future capital requirements.

The ultimate value of energy sector assets held by the State can only be known at a point in time in which a fair market transaction takes place. The potential value will be impacted over time by factors such as:

- uncertainty in major input costs, such as fuel and carbon permits
- industry views of future wholesale and contract prices for electricity
- indirect impacts from a change in regulatory policy, other state or Australian Government policy impositions and other factors which may affect a potential buyer's view of sovereign risk
- the direct financial impacts of revenue determinations by the regulator for transmission and distribution entities
- availability of capital to potential purchasers and competition for capital with other potential investments in the market at that time.

The current book value of major capital assets held by the energy sector GOCs offers some indicative guidance as to the minimum value which could be attributed to the core assets of these businesses, noting that:

- The recognised value of non-current property, plant and equipment is dominated by the generator and power supply assets operated by the energy sector companies.

- The clear majority of these assets are held at an estimated 'fair value' and reflect the current value of future earning capacity, which should approximate their minimum market value when continued in their current usage.

- The values given ignore the potential value of Ergon retail customers, and the potential value inherent in the business structured around generator and power supply assets, including land, buildings and other tangible assets.

As at 30 June 2012, the current book value of the five energy GOCs' core assets is around $25 billion, as shown in Table B2.8.

Table B2.8 Carrying value of electricity supply and generator assets						
	Powerlink	Ergon	Energex	CS Energy	Stanwell	Total
30 June 2012 value ($ million)	5,312	7,705	9,195	917	1,730	24,860

Source: Corporation annual reports

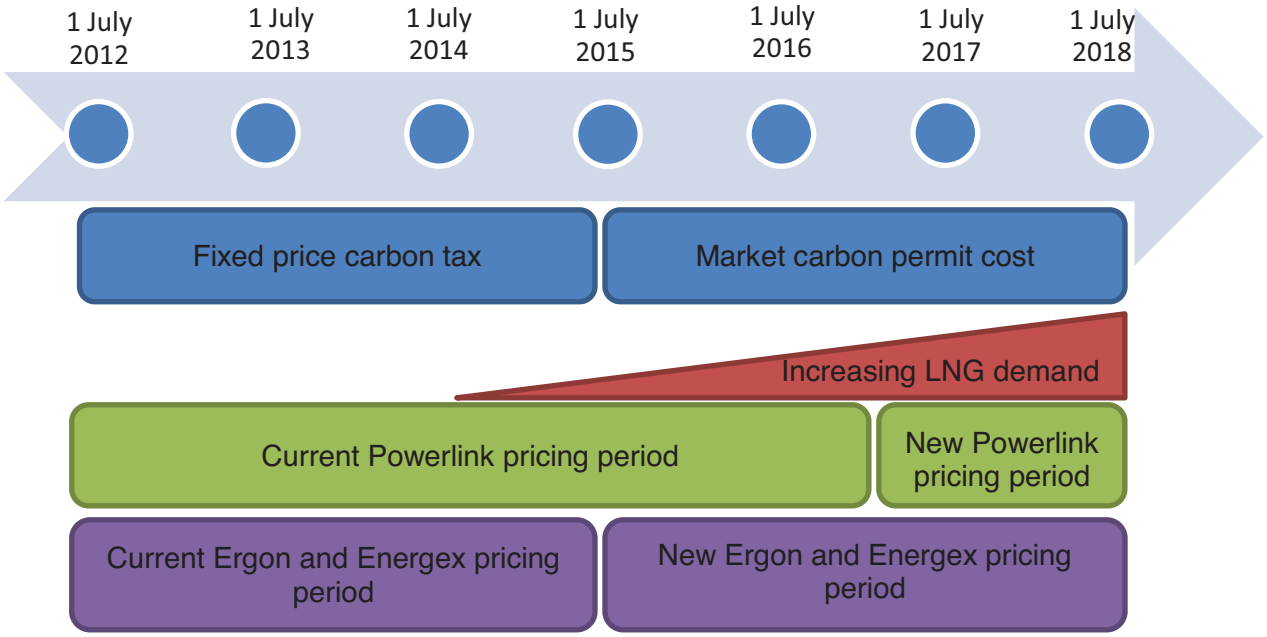
B2.8 TIMING ISSUES

There are a large number of issues that need to be carefully planned and managed in any divestment of the energy GOCs. The potential value of assets will be sensitive to a number of key regulatory and market events summarised in Figure B2.3, which will emerge over time.

The outcomes of these events may affect the timing and quantity of returns from energy sector investments, or value realised from any asset sale, through their impact on:

- market appetites and available capital
- prevailing market demand and supply conditions, especially the extent of generation over-capacity
- revenue outcomes from regulatory resets
- external regulation, such as carbon pricing.

Figure B2.3
Key events for energy sector GOCs



Source: Commission of Audit

It is anticipated that the potential value of generating assets may be particularly sensitive to wholesale electricity market conditions and the status of key input cost determinants such as fuel pricing and the transition to market priced carbon permits. Current forecasts for these factors suggest that value may be more favourable in the period 2015 to 2018, as important factors in the business environment such as carbon taxation and the increase in demand associated with LNG exports emerge.

Awaiting the outcomes of these events imposes the risk that predicted market conditions do not occur, or that other commercial risks emerge in the intervening period. Whether the State wishes to continue to bear these commercial risks for the medium term in anticipation of the forecast market benefits is an important matter for the Government to consider.

This consideration should be influenced by the Government's willingness to remove non-commercial impositions on the GOCs with a view to an increase in the value of the GOCs over that period. An unwillingness of the Government to improve the value of the GOCs by undertaking reforms within its control should weigh the decision towards an earlier sale.

For network GOCs, the key issue affecting revenue levels and potential returns is the revenue allowed by the regulator. For potential purchasers, the level of revenue security provided by a recent revenue determination has value, and it is preferable therefore that a sales process be aligned with the reset periods:

- For Powerlink, this principle suggests that revenue certainty is at its maximum either immediately, or soon after the next reset on 1 July 2017.

- For Ergon and Energex, the reset period will maximise revenue certainty soon after 1 July 2015.

There are arguments for and against earlier and deferred divestment options. However, alleviating the State's debt burden is a key priority, and opportunities for better value recovery may arise quickly. The Government should commence initial scoping and planning work for an orderly and staged withdrawal from direct ownership of energy sector assets, with sufficient flexibility to balance the desirability of reducing debt in the near term with the aim of maximising the value realised.

B2.9 Other Options for Realising Value

The opportunity to recover value and pay down the State's significant debt is maximised by a relatively unconstrained and direct sale of either the energy businesses or their assets. This is the course the Commission recommends; however, there are other options available which may allow some value to be brought forward and applied to debt reduction while maintaining some measure of government involvement in the energy sector.

These options are summarised below, noting that detailed analysis and structuring of potential transactions could only be undertaken once Government objectives for the sector are settled. It should be noted also that options which overly constrain or preclude the sale of these assets could significantly diminish funds available to reduce debt, and improve the State's financial position. That is, ultimately there will be a cost to maintain a desired level of ownership or control by the Government.

B2.9.1 Securitisation of future revenue streams

Securitisation of State energy assets would involve the creation and issuance of tradable securities that are backed by the revenue generated by the assets.

Securitisation involves receipt of an upfront payment for the issued securities (usually through a special purpose vehicle (SPV), tax-exempt company or trust formed for the specific purpose of funding the assets) in consideration for the transfer of a set portion of revenue derived from the relevant pool of assets to the SPV. The SPV typically pays a set coupon on the securities issued. The transaction essentially brings forward the revenue derived from the assets.

Depending on how a transaction is structured, there may be a requirement for the State to guarantee the revenue stream. Such a requirement would diminish the aim of reducing the Government's exposure to commercial risks in the sector.

Any proposed securitisation of State energy assets would need to take into consideration the regulated nature of the revenue derived from some of the assets. In order to ensure regulatory risk is not passed on to the investor (a likely investor and ratings agency requirement to ensure the securities achieve an appropriate credit rating), the transaction would likely need to be structured such that the securities mature before a regulatory pricing reset. This requirement would affect the timing at which securities may be issued.

Upon maturity, ownership of the future revenue stream would revert back to the State and a repayment of principal would be required.

In the context of the regulated infrastructure investments, such an approach could be applied by securitising revenue flows allowed by the regulator for returns on capital in the regulated asset base.

B2.9.2 Project finance

Project finance is the long-term financing of infrastructure and other projects based upon the projected cash flows of the project rather than the balance sheets of the project sponsors.

Usually, a project financing structure involves a number of equity investors, known as sponsors, as well as a syndicate of banks or other lending institutions that provide loans to the operation. The loans are most commonly non-recourse loans, which are secured by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors.

The financing is typically secured by all of the project assets, including the revenue-producing contracts. Project lenders are given a lien over all of these assets, and are able to assume control of a project if the project company has difficulties complying with the loan terms.

Generally, a special purpose entity is created for each project, thereby shielding other assets owned by a project sponsor from the adverse effects of a project failure. As a special purpose entity, the project company has no assets other than the project assets.

Capital contribution commitments by the owners of the project company are sometimes necessary to ensure that the project is financially sound, or to assure the lenders of the sponsors' commitment.

However, there is limited appetite in the current market for non-recourse project financing. At present, limited recourse project financing is more common. In a limited recourse financing, debt providers to the project SPV have limited claims on the general assets of the project sponsors over and above any claim to the project assets in the first instance.

In the context of the network GOCs, this approach could be applied to future capital projects so as to avoid some call on Government capital funds. Where these investments are discrete new projects they could be project financed on a stand-alone basis. Where these new projects are indivisible from discrete parts of the existing network, the value of existing affected assets could be taken as a capital contribution and rolled into a project financing framework.

Any project financing of assets would limit future options for restructuring or otherwise dealing with these assets.

B2.9.3 Unit trust

A unit trust is a trust in which the trust assets are divided into a number of defined shares called units. The beneficiaries subscribe for the units in much the same way as shareholders in a company subscribe for shares. In an ordinary unit trust, a beneficiary is entitled to the income and capital of the trust in proportion to the number of units held.

The unit trust structure is a well-established vehicle for investing in infrastructure assets that preserves the tax effect of direct ownership and investment in infrastructure assets, and allows for investors to be dealt with individually through a standard special purpose vehicle and framework with largely the same features. The unit trust structure also offers a high degree of flexibility around how funding and investment can be channelled into the assets.

Unit trusts are typically perpetual instruments which reference the underlying assets. In this respect, the regulated nature of the State's energy assets would be reflected in the demand for, and pricing of, the units.

B2.9.4 Partial sale

The option of a partial sale of shares in energy sector GOCs could allow the Government to recover a portion of the value held in these assets, while maintaining a majority interest in the company. This option could be considered in parallel with the unit trust or other options for realising value.

Such an option would compromise the achievement of debt reduction objectives. However, it would limit the extent of non-commercial intervention by government owners, due to the need to consider the commercial interests of other shareholders.

B2.9.5 Stapled securities

Stapled securities are created when two or more different securities are contractually bound together so that they cannot be sold separately but are instead treated as a single security.

A stapled security could be established to raise equity to fund capital expenditure for existing and new energy assets. The energy entity would issue income units as a stapled security to investors, which should rank in priority to any payments to the State as equity holder, but after payment of any debt obligations of the GOC.

This security could also work under a unit trust structure whereby the State could transfer energy assets to a unit trust, with the State retaining an equity interest through capital unit issues by the trust. For regulated assets, the trust could issue income units to external investors for a return that would equate to a regulated return earned on these assets.

B2.9.6 Contracting generation sector operations

Two elements of the operation of generating assets could be contracted to the private sector in order to move the Government away from the commercial and market risks faced by the sector:

- contracting out (sale) of trading rights to electricity production
- contracting out operation of the power stations.

Depending on the nature of the contract, it is likely that a sale of trading rights for electricity could also bring forward some future revenues which could be applied to debt reduction.

The sale of trading rights is a similar option to that pursued by the New South Wales Government in its 2010 'gentrader' sales. The option was acknowledged to be sub-optimal in comparison to an outright asset sale.[22] Such an arrangement would allow a part of the value inherent in the generator assets to be bought forward, and for certain market risks to be transferred from government to the purchaser of the trading rights. However, such an arrangement would not recover the full value of these assets, would be limiting to future management options, and may exacerbate operational risks for each power station (depending on the structure of the arrangement).

Sale of trading rights might be packaged with a sale of the residual retail portfolio, to create a ready-made vertically integrated entity. However, this model could only be applied to a portion of the generator fleet given the size of the Government's generation interests relative to the projected Ergon energy requirements.

The contracting out of power station operations is a routine practice in Australian private sector generators. In instances where power stations are owned in joint venture, it is common for power station operations to be undertaken by a company affiliated with or owned by one or more of the joint venture partners. It is likely that such an option would be available, and could be considered as a means of increasing the operating efficiency and risk management of energy sector GOCs. However, such a move will not generate significant funds for debt reduction.

B2.9.7 Long-term lease of assets

Many of the Government's energy assets could be made available for operation by another party under a long-term lease arrangement. Under this option, and depending upon how lease payments were scheduled, it might be possible to access a substantial proportion of the asset value upfront for use in debt reduction.

While the majority of rights and responsibilities associated with these assets would likely be assigned to another party for the period of the lease agreement, ultimate ownership would remain with the Government. Consideration would need to be given to the structure of any lease (that is, operating or finance lease), given each brings different advantages and disadvantages. Any consideration of long-term leases for energy assets should also consider any impact of the mooted change to international lease accounting standards requiring all types of leases to be on balance sheet.

B2.10 Operating Performance

Irrespective of longer-term ownership considerations, in the shorter term, reforms are required to enhance the ability of the energy GOCs to operate on a commercial basis. These are necessary to protect and enhance the value and efficiency of these GOCs.

As already noted, energy sector GOCs have been subject to a range of unfunded policy impositions which have not been applied to private sector counterparts, and which have adversely affected their competitive position and operating performance. These have ranged from the application of non-commercial government policies through to directions which impose a large financial impact upon certain GOCs.

In Section B1 of this Report, the Commission recommended that the shareholding Minister should report to Cabinet on the impact of non-commercial policy objectives imposed on GOCs. This would include the energy GOCs, and should identify the impact on their operating performance, dividends and tax equivalent payments.

Where public policy objectives are to be delivered by the energy GOCs, these impositions should be rigorously costed, assessed for efficiency in comparison with other modes of delivery and transparently funded if the GOC remains the best vehicle for delivery. Where GOCs continue to be contracted to supply public goods or services on behalf of the Government, then these arrangements should be structured in a manner which does not limit options for possible future divestment.

Energy sector GOCs also conduct some activities, and hold assets, which are not required for performance of their core functions. Divestment or capitalisation of these activities and non-core assets in the short term would reduce the State's exposure to the sector, and present opportunities for rationalisation and refocussing of the core businesses.

B2.10.1 Generators

Generator GOCs are exposed to a number of commercial risks which have impacted, and will continue to impact, business performance:

- decreasing pool and contract prices
- increasing fuel and input costs, most significantly through the imposition of the carbon tax
- regulatory impacts, especially those aimed at displacing conventional generation in favour of gas-fired or renewable generation
- limitations on the capacity to manage costs and significant commercial risks, including limitations imposed by directions by owners (such as the requirement to retain staff following the recent 2011 restructuring of the generator GOCs from three to two businesses).

Recent trading by both corporations evidences the impact of these commercial risks, requiring large write downs to the value of generating assets, significant equity injections and low returns from dividends and tax equivalent payments.

The underlying poor performance of core generation assets within Stanwell is masked by significant coal export rebates. However, low returns from its generating business have recently led Stanwell to withdraw 700 megawatts of generation capacity from the market.

As noted in Section B2.5, CS Energy does not meet benchmark financial criteria, and may require significant equity injections from the Government to sustain its business.

In regard to operational efficiency, the Commission notes that:

- Declines in electricity output and revenue of the generator GOCs have not been matched by reductions in costs, resulting in decreasing profitability.

- The 2011 generator GOC restructuring was intended to decrease overhead costs and increase efficiency, but the achievement of efficiencies has been limited. Total operating expenses of the two generator GOCs in 2011-12 were higher in real terms than the expenses of the three generator GOCs in 2009-10.

This provides a clear imperative for the generator GOCs to reduce costs to improve their financial performance and value to the Government. Options include:

- an enhanced focus on productivity and efficiency through operational cost savings
- greater workforce flexibility through the removal of restrictive industrial relations provisions
- an increased emphasis on security of fuel supply and security of revenue
- better capital management
- removal of non-commercial policy impositions on GOCs.

There are also opportunities to free up capital in the generator GOCs by bringing forward returns, or reducing the State's exposure to unsatisfactory returns on equity, through divestment of non-core assets. These options should be pursued where they do not prejudice the ultimate value of core generating assets, and where there are significant benefits from doing so. Options include:

- Bringing forward the value of Stanwell's interests in sales and rebates from existing developed coal reserves (in excess of future fuel requirements).

- Sale of rights to development of generation sites and undeveloped or unutilised coal and gas resources not necessary for existing power stations.

Recommendations

10 For the period that they remain in government ownership, the generation businesses be required to achieve higher rates of return through increased efficiencies, better capital management and operational cost savings.

11 The generation businesses divest themselves of non-core business (such as the coal export revenues of Stanwell), where there are significant bring-forward benefits for the State from doing so.

B2.10.2 Transmission and distribution

The efficiency of the transmission and distribution sector entities has recently been examined by the IRP established under the auspices of the Interdepartmental Committee on energy sector reform.

In its interim report, the IRP identified some $3.6 billion in potential savings in the transmission and distribution GOCs when compared with current regulatory investment allowances. These savings can be achieved mainly by modifications to reliability standards and resultant reductions in capital outlays. The IRP also found that implementation of operational efficiency programs could save a further $1.4 billion in operating costs for distribution GOCs over the next regulatory period, observing that:

- Overhead expenses for distribution network service providers (DNSPs) had grown rapidly, and are among the least efficient in the NEM.

- Comparative data indicates that the Queensland DNSPs are less efficient than their peers on a range of operational metrics, even after allowance for characteristics of the Queensland market such as low customer densities.

The IRP highlighted the need for material improvements in operational efficiency, a focus on cost-effective outcomes for customers, and cultural change to drive operational improvement. In its analysis, the IRP indicated that significant savings could be obtained by increased workforce efficiency, decreased reliance on contractors for non-operational functions and better control of overtime requirements.

The expenditure reductions recommended by the IRP confirm the findings of the 2011 Electricity Network Capital Program (ENCAP) review which also identified significant capital savings could be made in the transmission and distribution businesses.

As demonstrated by the outcomes of the 2011 ENCAP review and the interim findings of the IRP, there is an ongoing requirement for scrutiny to ensure that operating and investment costs remain at minimum efficient levels. This is to maximise returns within regulatory periods, to limit the investment of scarce capital and ultimately to ensure that network charges passed through to retail prices represent an efficient minimum cost.

The AER has ultimate responsibility for allowing prudent levels of network expenditure in each regulatory reset period. However, this responsibility must be exercised within the uncertainty of a five-year future demand horizon and changing views of the optimal balance between system cost and reliability. There is potential for a changing view of prudent investment thresholds over each regulatory period.

The draft report by the Productivity Commission on energy network regulatory frameworks also found that operational efficiency and capital rationing by state-owned network service providers represented less efficient outcomes than their private sector peers.

The IRP found that delivery of remote and isolated area generation by Ergon was also in excess of expected costs, and in particular suffered from an excessive allocation of overhead expenditure from Ergon. On this basis, the IRP recommended that the private sector be tested for alternative provision of this service.

As with the generator GOCs, the transmission and distribution businesses also should divest themselves of non-core businesses, where there are significant cash benefits for the State from doing so. An example is the recent disposal of Electranet by Powerlink.

There are a number of other small non-core commercial business ventures historically developed to meet supplier gaps, but which can now be met by the private sector. Examples of businesses which could be divested from the main distribution businesses include Ergon's ownership of forests for the harvest of power poles, and various workshop and training businesses.

Recommendations

12 For the period that they remain in government ownership, electricity distribution and transmission businesses be required to achieve higher rates of return through increased efficiencies, better capital management and operational cost savings.

13 The electricity transmission and distribution businesses divest themselves of non-core business (as with Powerlink's recent disposal of Electranet), where there are significant bring-forward benefits for the State from doing so.

B2.10.3 Retail

The State's remaining retail interests are held in the non-competing retailer EEQ, with the support of a CSO payment to match the difference between cost of supply and recovery of benchmark tariffs in support of the uniform tariff policy.

The manner in which the CSO is currently structured has certain adverse economic consequences:

- Price and cost signals to EEQ are diminished because the CSO is structured to meet the difference between costs and capped revenues. In particular, EEQ is not provided with a direct incentive to reduce costs.
- There is no incentive for greater commerciality in EEQ, due to the requirement that it operates as a non-competitive retailer.
- The expansion of retail competition in Queensland is not encouraged.
- The bundling of the CSO for NEM connected and non-NEM connected areas blurs accountability for these two distinct activities. For NEM connected areas, the CSO essentially is a top-up of sub-commercial activities within a market context. For non-NEM connected areas, the CSO reflects the subsidisation of EEQ for the provision of services for which it is permitted to make only partial cost recovery.
- Non-market consumers in the EEQ tariff area are shielded from market signals as to the full cost of electricity supply.

These factors drive perverse economic outcomes, such as investment in high cost electricity infrastructure which consumers may not demand to the same extent should they face the full cost of provision. Inefficient network investment must either drive up electricity prices for other users (who collectively face the cost of network provision) or increase the requirement for taxpayer subsidisation of non-market electricity prices.

The Interdepartmental Committee on Energy Market Reform currently is considering issues relating to the uniform tariff policy and associated CSO.

Options for reform of the CSO structure include the payment of an input CSO to EEQ which represents the real difference in cost drivers (that is, network costs and losses of energy in long distance transmission) rather than the gap between costs and revenues. This could reduce CSO volatility and improve the transparency of its application.

In addition, it would provide better price signals to encourage a greater commercial focus in EEQ, thereby enabling it to compete more effectively with other retailers should it be allowed to do so. In turn, this would expand the extent of retail competition in the Queensland NEM region.

However, it would be undesirable for the Government's exposure to retail electricity activities to expand. Any restructuring of the uniform tariff CSO should form part of the final step in the exit of the Government from commercial retail activities.

It is likely that the Government will want to retain a policy objective to shield non-market EEQ customers from the full market cost of electricity supply. Nevertheless, there would be merit in investigating options for increasing the proportion of actual costs to be passed through to these customers, for example by:

- establishing a 'band' of allowable tariffs around the notified price, or specification of pricing zones, to allow limited differentiation on supply costs to different service areas without requiring customers in those zones to face the full cost of supply
- adopting a different reference for the setting of notified prices, for example, the cost of provision in large regional centres, rather than South East Queensland
- excluding very large/commercial users from the uniform tariff policy
- applying mechanisms for better targeting of subsidies to consumers and areas of greatest need.

Recommendation

14 The uniform tariff policy and supporting Community Service Obligations arrangements be refined over time to target the most needy consumers, reduce costs and volatility, and support wider retail competition in Queensland, for example, by the introduction of a tariff band.

ENDNOTES

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2 Ministerial Council on Energy, *Report to Council of Australian Governments: Reform of Energy Markets*, 2003, accessed from www.mce.gov.au

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8 AER, *State of the Energy Market*, 2012, accessed from www.aer.gov.au

9 Market Share of CS Energy and Stanwell Corporation in electricity generation in 2012, AER '*State of the Energy Market*' 2012 report.

10 The AEMO 2012 'Electricity Statement of Opportunities' does not identify the need for new generation investment in Queensland until 2020-21.

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12 Maximum demand is a measure of the highest instantaneous flow of energy for the region (informing requirements for delivery infrastructure and generation capacity). Total energy is the sum of all energy delivered during a financial year (informing the likely utilisation of delivery infrastructure and installed generation capacity).

13 AER, *State of the Energy Market*, 2012

14 With the exception of 2006-07 and 2007-08, when severe drought affected the availability of cooling water to some large generators, and hence supply and price.

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20 Australian Government Department of Resources, Energy and Tourism, *Submission to Senate Select Committee on Electricity Prices*, 2012, accessed from www.aph.gov.au

21 Infrastructure Australia, *Australia's Public Infrastructure, Part of the answer to removing the infrastructure deficit*, October 2012, accessed from www.infrastructureaustralia.gov.au

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B3 PUBLIC TRANSPORT

KEY ISSUES

- Translink is now a division of the Department of Transport and Main Roads, with responsibility for state-wide passenger transport procurement, short-term planning and regulation. It purchases state-wide rail services from Queensland Rail, as well as South East Queensland commuter bus and ferry services from the Brisbane City Council and private providers. Regional commuter bus services are purchased by local government authorities from private providers.

- Queensland Rail is the sole Government Owned Corporation in Queensland responsible for rail transport. In 2011-12, Queensland Rail comprised over 7,800 staff, $6.8 billion in assets and 7,000 kilometres of track. More than 280,000 scheduled services are run annually in three distinct segments:

  - public transport passenger rail services in South East Queensland
  - long distance and tourist passenger services in regional Queensland
  - regional rail freight network.

- Queensland Rail has a high dependence on the General Government sector for operating revenue, a capital structure that is not self-supporting in the absence of government subsidies and a limited capacity to operate on a commercial basis.

- As a monopoly provider of passenger rail services, Queensland Rail currently is not subject to any competitive pressure to reduce costs. Indeed, its costs are effectively underwritten by the Community Service Obligation payments it receives from the Department of Transport and Main Roads under Transport Services Contracts.

- Independent benchmarking against comparable efficient public and private rail operators has assessed Queensland Rail's performance as having low overall passenger productivity, meaning it delivers considerably less value per dollar of government subsidy than benchmark operators.

- To reduce the financial burden for the State, the rail services of Queensland Rail need to be provided on a more efficient and effective basis, especially by introducing contestability to the provision of these services. Contestability also would improve the efficiency of commuter bus services throughout the State.

B3.1 INSTITUTIONAL STRUCTURE

B3.1.1 Translink

Translink was established in 2008 as a statutory authority, responsible for procuring an integrated and coordinated public transport system for South East Queensland (SEQ). The Government has recently shifted this function directly into a new division of the Department of Transport and Main Roads (DTMR), which retains the name Translink. Translink Division now has responsibility for state-wide passenger transport procurement, short-term planning and regulation.

The Translink SEQ service area covers greater Brisbane, the Sunshine Coast, the Gold Coast, Ipswich, Logan, Moreton Bay and Redland areas. Each of Translink's contracted service providers has a contract with the State Government to provide nominated services. All fare revenues on contracted services are paid to Translink and each operator is paid a negotiated contract fee to cover their cost of operation. This fee is their main source of revenue.

Translink's funding source for these contracts is derived from a combination of passenger farebox revenues, which are collected directly by Translink, and government subsidies. Services are heavily subsidised to encourage commuter trips on public transport rather than by private vehicle. Passenger revenues account for approximately 24% of Translink's contract costs across all its contracted services.

B3.1.2 Queensland Rail

Queensland Rail is the sole Government Owned Corporation (GOC) in Queensland responsible for rail transport. In 2011-12, Queensland Rail comprised over 7,800 staff (including external consultants and contractors), $6.8 billion in assets and 7,000 kilometres of track. Altogether, more than 280,000 scheduled services are run annually in three distinct segments:

- The provision of public transport passenger rail services in SEQ, which are delivered as part of an integrated public transport system encompassing rail, bus and ferry services.
- The provision of long distance and tourist passenger services in regional Queensland.
- Provision of a regional rail network for the purpose of operating freight services by rail. In the freight market, Queensland Rail only provides the rail network, with the operation of freight rail services on this network provided by private companies.

B3.2 CURRENT PUBLIC TRANSPORT SERVICES

Public transport services in SEQ are provided through an integrated system including rail, bus and ferry services, coordinated by Translink.

Queensland Rail provides all rail public transport services within this integrated system, with bus and ferry services provided by a range of other service providers, including Brisbane Transport (BT), a business unit of the Brisbane City Council (BCC). Given the integrated nature of the SEQ public transport system, this section considers the key issues for the Government in relation to the purchasing of all public transport services across Queensland, not just the rail component.

B3.2.1 Passenger rail – city network commuter services

Translink has a service contract with Queensland Rail (through its City Network Division) to provide commuter train services in an area from Gympie in the north to Coolangatta in the south and west to Helidon. In 2011-12, City Network provided 50.8 million customer journeys.

In addition to the Translink contract, DTMR (through its Planning and Investment Division) holds a separate service contract with Queensland Rail to support the ongoing provision of the rail network throughout Queensland, including the SEQ rail network.

Queensland Rail owns all of the rollingstock, stations and track assets required to provide these services.

B3.2.2 Passenger rail – long distance and tourist trains

The Queensland Rail Travel Network operates long distance passenger services on the main line between Brisbane and Cairns and to three western inland destinations (Charleville, Longreach and Mount Isa). Queensland Rail also operates a tourist service from Cairns to Kuranda, as well as a small tourist railway between Normanton and Croydon. In 2011-12, there were 449,000 customer journeys on the long distance and tourist services over the Travel Network. The cost of providing all of these services is substantially higher than the fare revenue, and most services are funded through a Transport Service Contract with DTMR.

In addition to the services provided by Queensland Rail, the State Government funds other long distance and tourist passenger services. DTMR contracts with Cairns Kuranda Steam to provide a weekly service between Cairns and Forsayth. This contract was let following a tender process, at a cost of $1.5 million per year.

Long distance passenger fares are not regulated. Intermodal competition (that is, road travel) is strong in long distance passenger services.

B3.2.3 Commuter bus network

Translink also contracts for the delivery of suburban and inter-urban bus services in SEQ to 17 bus operators, 16 of whom are private operators. Each operator has an exclusive right over the routes specified in their contract with Translink. In 2011-12, these operators comprised 2,457 buses on 637 urban commuter routes and over 1,100 school routes.

Each contracted bus operator owns the assets used to deliver the services. Assets include buses, depots and maintenance facilities. Operators are required to meet specified service standards.

In 2011-12, Translink provided 78.2 million bus passenger trips within the greater Brisbane region (Brisbane City Council and small parts of Moreton Bay Regional Council). The largest operator is Brisbane Transport (BT), a business unit of BCC, which operates around 1,200 buses on 245 routes within greater Brisbane. BT, the only publicly owned operator in the passenger bus sector in SEQ, undertook 63,859 urban services per week during 2011-12 and 1,465 school services per week.

Rockhampton, Townsville, Magnetic Island and Cairns are also serviced by a private bus operator.

B3.2.4 Commuter ferry transport

Ferry services in Brisbane are coordinated by Translink and in 2011-12 undertook 5.2 million ferry trips each year and over 3,600 services per week. The ferry services are provided through a contestable contract managed by the Brisbane City Council (BCC). The BCC owns a ferry fleet of 19 CityCats and nine CityFerries and a network of 24 terminals stretching from the University of Queensland at St Lucia to Hamilton. Since 2003, TransdevTSL Brisbane Ferries (a joint venture between Transdev and Transfield Services) has been contracted to operate and maintain CityCat and Cityferry services in Brisbane.[1] This contract was recently renewed.

B3.2.5 Outlook for commuter services

Continued population growth in SEQ is driving a strong demand for increases in the number and scope of commuter services across all three modes.

For commuter rail services, Queensland Rail has a major capital program underway to expand the network, improve stations and increase or replace rollingstock. As identified in the Commission's Interim Report, further major capital projects have been identified to increase capacity of the commuter rail network, including the Moreton Bay Rail Link project (indicative cost $1.2 billion) and automatic train protection (indicative cost $1.6 billion). In addition, Government is considering the Cross River Rail Project which will provide an additional river crossing in Brisbane to alleviate critical capacity constraints in the central Brisbane area.

The Government is similarly considering further significant investment in Brisbane's network of dedicated busways, to increase the capacity and standard of service able to be provided by buses within Brisbane.

A critical issue for the Government will be to ensure that the required investment in infrastructure to support expansions of the commuter passenger services is planned and delivered in the most cost effective way.

B3.3 PUBLIC TRANSPORT SERVICES – OTHER JURISDICTIONS

Within Australia, state governments have increasingly moved towards creating and operating integrated, multi-modal commuter transport systems. The establishment of Translink, with a central coordinating and purchasing role, is consistent with this approach. Pricing, service quality, planning and investment in network assets required for commuter transport are functions that have been retained by government. However, there are differences in how governments have delivered the commuter services, as discussed below.

B3.3.1 Passenger rail – city network commuter services

There are two models used in Australia to deliver commuter passenger rail services. In Queensland, New South Wales, Western Australia and South Australia, a government-owned vertically integrated operator provides rail services. In Victoria, services are contracted through a franchise arrangement to a private sector operator who has responsibility for operating and maintaining above and below-rail assets. In Victoria, a state government corporation, VicTrack, is the custodial owner of Victoria's railway land, infrastructure and much of its rolling stock.

B3.3.2 Passenger rail – long distance and tourist trains

In Australia, all long distance passenger railway services are provided by state government-owned corporations, with the exception of the Great Southern Railway, a privately owned corporation, which operates the Indian Pacific and the Ghan.

It is increasingly difficult for long distance passenger railways to compete with other modes, particularly airlines. In countries such as Japan and some European countries, passenger railways have successfully competed on high traffic routes with high speed trains. To date, attempts to develop a high speed rail in Australia have been unsuccessful and no models have been proposed for Queensland.[2]

The US and Canada have similar geographic characteristics to Australia. In the US, Amtrak (National Railroad Passenger Corporation) is the only provider of intercity passenger rail services. Amtrak is operated and structured as a for-profit corporation, subsidised heavily by the Government. In Canada, VIA Rail Canada is an independent Crown corporation and the only corporation that operates a national network of passenger trains on behalf of the Canadian Government. It is also heavily subsidised.[3]

Table B3.1 provides an overview of service delivery models for long distance passenger rail in other jurisdictions.

Table B3.1
Long distance passenger rail – service delivery model in other jurisdictions

	Model	Structure	Track ownership
NSW	Statutory authority	Vertically integrated	Statutory authority
Vic	Franchise	Vertically integrated	Statutory authority
Great Southern Rail (SA, Vic)	Private company	Vertically separated	Freight companies
US	GOC	Vertically separated	Various freight companies
Canada	GOC	Vertically separated	Two freight companies

Source: Commission of Audit

B3.3.3 Commuter bus transport

Within Australia, the vast majority of commuter bus services are contracted from the private sector:

- Sydney – 38 private sector operators in the 15 Public Transport Regions
- Melbourne – 16 private sector operators under 35 separate contracts with Public Transport Victoria
- Perth – 3 private sector operators in 10 contract areas
- Adelaide – 3 private sector operators in 9 contract areas.

Contract durations in Sydney and Melbourne have been set at seven years. From available information, it appears contracts are or will be awarded through competitive tenders. Victoria has already used competitive processes to award contracts. New South Wales has recently introduced tendering for private bus operator contract regions – the tenders will be staged over two tender rounds across two years from 2012.

B3.3.4 Commuter ferry transport

Brisbane and Sydney provide the most extensive passenger ferry services in Australia. New South Wales has recently outsourced the operation of Sydney Ferries. It has adopted the same model as applies in Brisbane, with a public owner of the fleet and terminals and a private sector firm operating the services.

B3.4 CURRENT RAIL FREIGHT SERVICES

B3.4.1 Rail freight services in Queensland

Queensland Rail provides the regional freight rail network, with the exclusion of the central Queensland coal network which is provided by Aurizon (formerly QR National).[4] Since the split of QR Limited into QR National and Queensland Rail, and the subsequent privatisation of QR National in 2010, Queensland Rail does not operate any above-rail freight services.

While there are no GOCs involved in the provision of any above-rail freight services, the Government does provide some transitional funding to Aurizon for the provision of general freight and livestock transportation services in Queensland. The transitional funding is provided through Transport Services Contracts between Aurizon and DTMR. The contracts commenced on 1 July 2010 and expire on 30 June 2015 and 31 December 2015 respectively.

Under the contracts, for the initial two and a half years, Aurizon will receive monthly base payments and quarterly payments in aggregate totalling $150.0 million for the year ended 30 June 2011, $148.1 million for the year ended 30 June 2012 and $75.1 million for the six months ended 31 December 2012. After 31 December 2012, and until expiry of the contract, there is a process to calculate payment amounts for the services then required by the State as detailed in the contract. In addition, the contracts provide for additional payments of $90.0 million (general freight) and $13.0 million (livestock) between 31 December 2012 and the expiry of the contracts relating to services provided over the life of the contracts.[5]

Queensland Rail's below-rail network consists of seven interrelated freight systems plus the SEQ network, all of which are used for freight traffic. The above-rail operators negotiate access to train paths with Queensland Rail, with users paying access charges for train path allocations. Queensland Rail's responsibilities in relation to the regional network include providing access to network infrastructure and maintaining and expanding track infrastructure as required to meet customer service levels.

Table B3.2 provides an overview of the freight systems, including a description of the track infrastructure and the details in relation to the transportation of freight on each system.

Table B3.2
Overview of Queensland Rail's freight systems

System	Description	Details
North Coast Line	1,680 km system (electrified south of Rockhampton)	Principal freight and passenger rail line in QR's regional network
	Runs from Brisbane to Cairns	Traffic includes containerised freight, cattle trains and heavy haul single commodity trains of sugar, grain and minerals
		High speed tilt services and commuter trains also operate on the network
		Transports over 11 Mt of freight per annum
		Primary capacity constraint is access to paths through Brisbane metropolitan network, although there are localised areas of network congestion
		Supported by Transport Services Contract
Mount Isa	1,000 km non-electrified network Runs from Port of Townsville to Mount Isa	Critical link from North West Minerals Province (NWMP) to Port of Townsville Services large deposits of copper, lead, zinc, silver and phosphate rock Region surrounding rail line produces 75% of Queensland's non-coal mineral output Exploration in the NWMP has increased significantly in recent years – significant growth potential 5.8 Mt per annum transported on Mount Isa corridor Queensland Rail's 2012 *Mt Isa System Rail Infrastructure Master Plan* outlines possible options to expand tonnage on the rail line including necessary enhancements to transport coal from the northern Galilee Basin and other resources from around Cloncurry/Mount Isa Primary capacity constraint is access through Townsville to the port – Eastern Access Rail Corridor is proposed solution
Western	1,240 km non-electrified system Runs from Quilpie in the west to Rosewood in the east	Wide range of freight transported on the system, with coal from the lower Surat Basin and West Moreton basins being the predominant traffic. Grain is also a significant component of freight east of Toowoomba (from the South Western system) Significant demand for additional coal services to Port of Brisbane Primary capacity constraints are access to paths through Brisbane metropolitan network, and traversing the Toowoomba range Supported by Transport Services Contract
Maryborough Area	550 km non-electrified system Runs from Kingaroy in the south to Graham in the north and from Monto in the west to Hervey Bay in the east	General freight traffic transported on the system Contains several branch lines that have a junction with North Coast Line and Moura system There is limited commercial demand for train services on this system Supported by Transport Services Contract
South Western	610 km non-electrified system Runs from Toowoomba to Dirranbandi via Warwick	Primarily used for transport of grain and containerised freight Supported by Transport Services Contract
Central West	780 km non-electrified system Runs from Emerald to Winton via Longreach and adjoins Blackwater coal system at Emerald	Primarily used for transport of grain, livestock and containerised freight Also used for passenger service to Longreach ('Spirit of the Outback') There is limited commercial demand for train services on this system Supported by Transport Services Contract
Tablelands	450 km non-electrified system System consists of two railways – one running from Cairns to Forsayth, the other from Croydon to Normanton	Primarily used for transport of sugar and molasses Also used for passenger services – Kuranda Scenic Railway and Savannahlander services There is limited commercial demand for train services on this system Supported by Transport Services Contract

Source: www.queenslandrail.com.au

In addition, Queensland Rail provides the SEQ rail network, which is a 740 kilometre electrified network. Brisbane is the key hub for freight services from the North Coast Line and the Western and South Western systems. Freight services typically operate over the SEQ system in off-peak periods. However, planned increases to rail passenger services will place pressure on the freight paths.

Total freight transported on the regional network in 2011-12 was 22.07 billion gross tonne kilometres (gtks), an increase of 18% over the previous year.

Within each of its freight rail systems, the functions provided by Queensland Rail are summarised in Table B3.3.

Table B3.3
Functional overview – Queensland Rail's freight systems

Function	Description	Delivery
Rail network planning and development	This includes identifying opportunities for future development of the rail network, identifying and aggregating potential demand, progressing feasibility studies and approvals, and financing developments.	Queensland Rail undertakes the planning and project assessment function for its network. Some developments are funded by Queensland Rail. However, the majority of future developments are expected to be financed by users.
Rail network management	This is the railway manager function (as provided for under the *Transport Infrastructure Act*), including responsibility for the maintenance of the assets, the operation of the railway including train control, and the customer (operator) interface.	This is Queensland Rail's primary function for the rail network.
Maintenance and construction activities	Performance of maintenance and construction activities.	Queensland Rail performs the vast majority of maintenance activities on its network. Significant portions of construction activities are outsourced (primarily civil works). However, some construction activities continue to be performed by Queensland Rail.

Source: Commission of Audit

Queensland Rail is subject to economic regulation of its below-rail services through the declaration of its network for third party access under the *Queensland Competition Authority Act 1997*. Queensland Rail offers access to its rail network to all railway operators on a non-discriminatory basis in accordance with its approved access undertaking. Queensland Rail has recently submitted a new draft access undertaking to the QCA.[6] The QCA has received submissions on the draft undertaking which it is now considering.

B3.4.2 Rail freight networks in other jurisdictions

New South Wales

The country regional network in New South Wales is owned by the New South Wales Government entity 'Transport for NSW'. Since January 2012, the New South Wales Government has contracted with John Holland for the management of the regional network. Under this contract, John Holland is responsible for the operation, management, maintenance and upgrading of the network through to the end of 2021. The total value of the contract is $1.5 billion, and includes lines operated for both freight and passenger services.

Track infrastructure on the interstate and Hunter Valley networks are managed by Australian Rail and Track Corporation (ARTC) under a long-term lease agreement with the New South Wales Government. Although ownership of the network infrastructure remains with the State, ARTC has full responsibility for the track under the lease agreement, including investment decisions and train control functions.

The Sydney metropolitan area rail network is owned and managed by RailCorp, a New South Wales GOC responsible for the provision of commuter passenger services in Sydney as well as long distance passenger services in New South Wales.

Victoria

The Victorian intrastate network is under the legal ownership of the government-owned entity VicTrack, which leases rail infrastructure to the Director of Public Transport (DPT). The DPT then subleases the assets to various track access providers, who are responsible for maintaining network infrastructure. V/Line, another state-owned entity, is responsible for the operation and management of the 3,770 kilometre intrastate rail network through to 2017 under the Regional Infrastructure Lease with the DPT.

The Victorian intrastate network has previously been privately owned and operated. In 1999, the Victorian Government sold V/Line Freight, the vertically integrated state rail freight business, to RailAmerica (which subsequently renamed the business Freight Victoria) under a 45-year lease agreement at a cost of $163 million.

After an initial period of strong commercial performance, ownership of the vertically integrated freight business was transferred to Pacific National (PN) in 2004 for $285 million. However, following the sale of the freight business to PN, commercial performance deteriorated, predominantly due to a lack of major maintenance or significant capital investment on the freight-only components of the network.

This resulted in some lines becoming inoperable and other lines requiring the imposition of speed restrictions. This fall in service quality resulted in a reduction in freight volumes transported on the network. The Victorian Government subsequently resumed ownership of the intrastate network through a buy-back from PN in May 2007. The Victorian Government has subsequently made significant changes to its contracting arrangements with private rail operators.

The Victorian standard gauge interstate railway is managed by ARTC under a long-term lease agreement.

Western Australia

The 5,300 kilometre intrastate freight network in southern Western Australia has been managed by a private entity since the $585 million privatisation of Westrail's freight business in 2000. This included a 49-year agreement for the lease of track infrastructure to the Australian Railroad Group (ARG). Since privatisation, the commercial performance of the network owner has been strong and the condition of the track infrastructure has improved.

ARTC manages the interstate freight network to Kalgoorlie under a long-term lease agreement.

The major bulk iron ore railways in the Pilbara are owned and operated by the iron ore companies (Rio Tinto, BHP Billiton and FMG) as part of their vertically integrated mine to port supply chains.

South Australia

The South Australian intrastate rail freight network is owned by Genesee and Wyoming. The network was privatised as part of the sale of the South Australian Government's vertically integrated rail freight business (SA Rail) in 1997 for $57.4 million. The rail business was purchased by a Genesee and Wyoming-led consortium. In 2010, Genesee and Wyoming expanded its presence with the purchase of the 2,200 kilometre Tarcoola to Darwin railway.

The east-west interstate freight network in South Australia is owned and managed by ARTC.

B3.5 FINANCIAL PERFORMANCE

B3.5.1 Queensland Rail

Queensland Rail's overall financial performance in 2010-11 and 2011-12 is summarised in Table B3.4. Comparability of data for Queensland Rail prior to 2010-11 is affected by the divestment of freight haulage activities in 2010 through the public float of QR National (Aurizon). The table shows a 3% increase in revenue in 2011-12 and a decline in net profit after tax.

Table B3.4
Queensland Rail financial performance

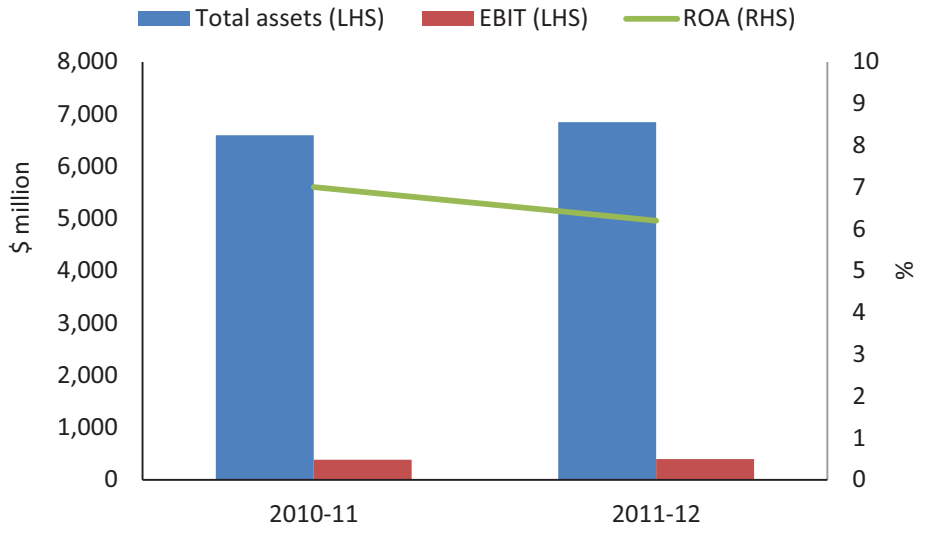
	2010-11 $m	2011-12 $m
EBIT	382.5	394.8
NPAT	149.3	128.3

EBIT = Earnings before interest and tax, NPAT = Net profit after tax

Source: Queensland Rail Annual Report, 2011-12

Chart B3.1 shows earnings and return on assets compared with the value of assets for 2010-11 and 2011-12. Return on assets fell in 2011-12 compared with 2010-11.

Chart B3.1
Assets, earnings and return on assets for Queensland Rail



Source: Queensland Rail annual reports, various

This financial performance can be broken into Queensland Rail's three key product groupings as shown in Table B3.5.

Table B3.5
Financial performance of Queensland Rail, by key product, 2011-12

Product	Revenue $m	Expenses $m	EBIT $m
SEQ passenger	841.5	725.8	115.7
- above rail	413.9	256.3	157.6
- below rail			
Regional network (below rail only)	464.0	351.6	112.5
Long distance and tourist passenger (above rail only)	241.4	224.8	16.6

Source: Queensland Rail

Queensland Rail had a gearing ratio (net debt to total capital) of 52.3% in 2011-12. Comparison with earlier years is complicated by the divestment of the QR National freight business in 2010. Comparable data in other jurisdictions is not available.

Transport Service Contracts (TSC) are in place for most of the products provided by Queensland Rail. Table B3.6 outlines the amounts payable under the three main TSCs.

Table B3.6
Queensland Rail's Transport Service Contract revenue: 2010-11 and 2011-12

TSC	Period of agreement	2010-11 Actual $m	2011-12 Actual $m
City Network	2010 to 2013	743.2	835.9
Rail Infrastructure	2006 to 2013	558.8	520.2
Travel Network	2011-12 and 2012-13	134.5	174.1

Source: Queensland Rail Statement of Corporate Intent 2012-13

The funding provided under these TSCs reflects a large proportion of Queensland Rail's overall revenue. In 2011-12, Queensland Rail's TSC revenue was $1.5 billion compared with less than $320 million received from external sources. Table B3.7 identifies the extent to which Queensland Rail depends on government TSC funding for each of its key products.

Table B3.7
Revenue sources for Queensland Rail, by key product, 2011-12

Region	TSC payment $m	TSC % of revenue
SEQ commuter services		
Above rail (City Network TSC) [1]	835.9	98
City network (Rail Infrastructure TSC) [2, 3]	282.2	89
Rail Infrastructure		
Central West (Rail Infrastructure TSC)	24.7	88
Maryborough (Rail Infrastructure TSC)	15.9	97
South West (Rail Infrastructure TSC)	22.0	87
North Coast (Rail Infrastructure TSC)	114.9	63
Tablelands (Rail Infrastructure TSC)	16.7	79
West Moreton	0	0
Western[4] (Rail Infrastructure TSC)	43.6	39
Mount Isa	0	0
Long distance and tourist passenger (Travel Network TSC)	174.2	76

1 Go Card revenue is collected by Translink, with the TSC payment reflecting the total cost of the contracted services.
2 $144.1 million of this relates to depreciation and return on major rail projects delivered since 2006.
3 The percentage shown is of total revenue only, to exclude the internal trading impact of SEQ commuter access charges.
4 The West Moreton component of this region operates on a fully commercial basis.

Source: Queensland Rail

Around 19% of the above-rail City Network TSC was recovered by fares attributable to Queensland Rail in 2011-12.

As noted in the Commission's Interim Report, Queensland Rail has a high dependence on the General Government sector for operating revenue, a capital structure that is not self-supporting in the absence of government subsidies and a limited capacity to operate on a commercial basis.

Independent analysis of Queensland Rail by L.E.K. consultants in 2010 found that Queensland Rail is a higher cost urban rail operator than other comparable urban rail operators in Australia and that significant saving opportunities are available. Independent benchmarking against comparable efficient public and private rail operators has assessed Queensland Rail's performance as having low overall passenger productivity, meaning it delivers considerably less value per dollar of government subsidy than benchmark operators. Over the past decade, the cost per passenger journey has increased by 97% from $8.50 to $16.75.

B3.5.2 Other transport providers

Commuter bus transport

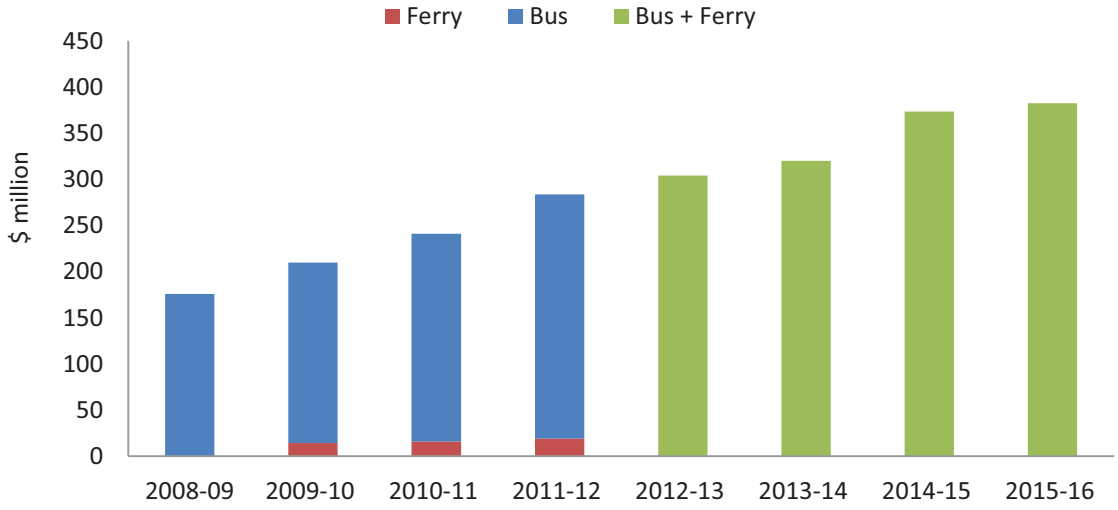
In 2011-12, the 17 contracted bus operators in SEQ were paid $518.2 million to provide contracted services. Around half of this amount, $264.6 million, was paid to BT

BT's bus assets are currently valued in their 2011-12 financial statements at $281 million in replacement cost terms and $59 million in written down terms.

Chart B3.2 shows the cost of past and forecast service payments made to Brisbane City Council for provision of bus and ferry services. The chart shows an escalation in these payments since 2008-09, primarily driven by increases in respect of bus services. Payments increased by 61% between 2008-09 and 2011-12, and are expected to increase by a further 35% between 2011-12 and 2015-16.

On average, Translink recovers only around one-third of the cost of service provision from fare revenues. The difference between the cost of service provision and fare recovery is met by an annual CSO payment to Translink from the consolidated fund.

Chart B3.2
Translink service payments for Brisbane City Council buses and ferries



Source: Queensland Treasury and Trade

Commuter ferry transport

The annual service funding agreement for Brisbane City Council ferries in 2011-12 was $19.1 million.

The written down value of ferries in the Council's 2011 financial statements was $4.7 million ($31.8 million at cost).

B3.6 FUTURE PUBLIC TRANSPORT SERVICES

The foregoing analysis highlights the significant government support paid to provide commuter and freight transport in both metropolitan and regional areas. In a constrained revenue environment, the priority for the Government should be to ensure that this support is directed to those services that would otherwise not be supplied by an alternative provider. Government should focus on financial support on the non-commercial services that continue to provide an identifiable public or social benefit.

In assessing which services fall into this category, Government needs to consider:

- whether any components of the services are operable on a fully commercial basis, taking into account financial performance, extent of interdependence with other parts of the rail business, level of demand and future growth potential

- whether there is any public policy rationale requiring commercial components of the services to remain under government control

- whether value for money is achieved by government funding of non-commercial services.

Where it is not viable for services to be provided on a commercial basis, the key issue to consider is the appropriate service delivery model to maximise Government's value for money. Available evidence from the L.E.K. analysis suggests there are significant inefficiencies in Queensland Rail's operations.

Options for improving the cost effectiveness of these services effectively fall into two categories:

- adjustments to the scope and/or quality of services
- increases in the efficiency and productivity of service delivery.

Any adjustments to the scope and quality of services need to be considered by Government in the context of the economic benefits provided by the services and how best to meet its social and economic policy objectives.

However, for any given level of required service, there are opportunities to increase efficiency by introducing contestability, as this will create competitive pressure in service delivery. As a monopoly provider of passenger rail services, Queensland Rail currently is not subject to any competitive pressures to reduce costs. Indeed, its costs are effectively underwritten by the CSO it receives under the Transport Services Contract from Translink.

B3.6.1 Passenger rail – city network commuter services

One of the major challenges facing commuter services in SEQ is how to most effectively cater for increases in public transport passenger journeys. Strategies for increasing the cost effectiveness of commuter rail services will need to focus on creating incentives for increased efficiency, rather than adjustments in service scope or quality.
In assessing the benefits of introducing contestability in commuter passenger service delivery, key factors that need to be considered are:

- ensuring effective coordination of service delivery, the key elements being effective coordination of network management and the operation of train services (vertical coordination) and the effective coordination of different train services across the network (horizontal coordination)

- ensuring effective investment and network planning

- ensuring network condition is maintained

- creating incentives for improved operational efficiency.

Options for introducing contestability into the delivery of commuter rail services include:

- Competitive tendering of one or more above-rail franchises – this option creates the maximum competitive tension by breaking the rail system up into separate franchise areas and creating competition for each franchise, as well as allowing competitive benchmarking between franchises. However, it also creates the greatest coordination risks, both in terms of vertical coordination between above and below rail, and horizontal coordination between rail services.

- Competitive tendering of a vertically integrated rail franchise – this model reflects the Victorian model of a single operator which would operate and maintain all commuter passenger assets including below-rail assets. It reduces the extent of competitive tension compared with the first option, but comes with a much lower risk of coordination failures, as vertical and horizontal coordination is managed within the franchisee.

- Queensland Rail can introduce competitive outsourcing of key inputs into the delivery of the services, for example, rollingstock cleaning, maintenance, etc. Competitive pressures can create increased efficiency incentives in relation to those key inputs.

The greatest risks to a successful franchise model are:

- Any legacy from under-investment in network maintenance and rollingstock. This was a significant issue in Victoria. There would need to be a thorough assessment of the condition of the network and the maintenance and investment required over the duration of a franchise. Consequential risks for the State also would need to be considered.

- Vertical and horizontal coordination failures associated with introducing multiple service providers with differing commercial incentives. This is particularly the case for a commuter system with high service frequencies and required coordination. This was again a major issue in Victoria, and has led over time to significant changes in the scope and size of the franchise areas. International experience shows that the best approach for metropolitan rail systems is a single vertically integrated franchise, in order to minimise these coordination failures. This is likely to be the most effective approach in SEQ.

Integrated ticketing means that prices would continue to be set by Translink, with the franchisee removed from fare revenue risk. However, it is important that effective incentives to grow patronage and improve yield are built into any franchise agreement.

The key issue affecting long-term performance will be timely investment in rollingstock and the network. It would be desirable for the franchisee to be incentivised to invest in these assets to achieve optimum trade-offs between operating and capital costs. However, major decisions in investments to increase capacity of the SEQ network or rollingstock would necessarily be the responsibility of Government. It is critical that effective institutional arrangements are in place for franchising to continue to deliver the service quality and network expansion as required at least cost.

In Victoria, latter franchise agreements have been more effective in allowing for network expansion than existed in the earlier agreements. This is because the parties better understood the model and developed a constructive relationship between the network operators (the franchisee) and the state government, who remains the network owner and responsible for decisions on expansion of the network.

A final issue that would need to be explicitly addressed in any franchise arrangement is the obligations on the franchisee for the provision of access to the SEQ network for freight services.

Recommendation

15 City passenger rail services and network infrastructure be opened up to contestability, like bus services, to allow different providers, including private providers, to bid to operate services and maintain below-rail assets in a particular franchised area under franchise and lease arrangements.

B3.6.2 Passenger rail – long distance and tourist trains

In the case of long distance passenger services, there is scope for the Government to consider withdrawal from services, given that there is strong intermodal competition for many of the services and it is likely that the transport demand can be absorbed by other transport modes at a lower overall cost.

To implement this option would require:

- supporting alternate service through less costly transport services, for example, buses
- community consultation and adjustment programs
- timing the withdrawal of services in an optimal way.

Rollingstock acquisitions, to be delivered in 2014, for the Brisbane–Cairns services complicate service withdrawals for that line.

Efforts should also be made to locate a private sector party interested in franchising those services which have tourism potential.

Other options available to Government to increase efficiency are:

- Introduce competitive outsourcing of key inputs into the delivery of Queensland Rail services, for example, rollingstock cleaning, maintenance, etc. Competitive pressures can create increased efficiency incentives in relation to those key inputs.

- Seek competitive tenders for the delivery of the services on a least cost basis. The ability to reduce the cost of service provision would depend on the ability of private operators to improve revenue yield or reduce operating costs compared with Queensland Rail.

Competitive tendering for the operation of long distance and tourist passenger services is likely to be the model that will maximise the value for money that the Government achieves in funding these services, assuming there is a compelling case for these services to continue to be provided.

In order for a competitive tendering process to work effectively for long distance and tourist rail services, it would be necessary to consider the most efficient package of routes to be franchised, in order to maximise the potential efficiency gains to be achieved through the franchising arrangement.

As is the case with commuter rail services, the assets required for the provision of long distance and tourist passenger services are long lived, have limited alternative use and have a high acquisition cost. It is likely to be most effective for these assets to continue to be owned by the State, and leased to the franchisee for the term of the contract.

Recommendation

16 Competitive tendering be introduced for long distance and tourist passenger rail service contracts, including:

- ***evaluating the number of routes serviced and frequencies, franchisees and franchise areas before initiating the tender***

- ***owning the rollingstock required to provide the services in a State Government entity, and leasing this to the franchisee for the term of the contract***.

B3.6.3 Bus services

Increases in the payment required to be made to operators (especially to BT) for the provision of bus services are a significant financial risk for the State. As with rail services, the increased efficiency of bus services is most effectively achieved by introducing competitive pressure into service delivery.

To date, contracts for bus services have not been subjected to full competitive tendering. This reflects both the tendering process itself and other barriers to entry, such as the sunk investment made by existing contractors in fixed infrastructure, such as depots and maintenance facilities. This tends to perpetuate the rollover of existing contracts rather than the entry of new operators, leading to a lack of innovation and inefficiency.

The opportunity to set efficiency incentives occurs when the contracts are negotiated. Tender processes for the Brisbane bus network should ensure there is competitive tension for alternative bidders on price and quality of service offered.

The current contract term is seven years, the maximum allowed by the *Transport Operations (Passenger Transport) Act 1994.* There is a strong economic rationale for long-term contracts given the stranding risk faced by contract holders.

Options for seeking greater efficiency in the provision of bus services include:

- Achieving greater efficiency through existing operator contracts – for example, by contracting to an optimal number of operators, designing contracts with incentives for continuous improvement and minimising constraints on contract holders to adapt to market changes and innovate.

- Creating competition in the market by placing all existing routes out to tender. The key issue that would need to be considered in this option is dealing with the benefits of incumbency of the existing bus operators in order to ensure that the tendering process creates strong competitive tension.

- Competitive tendering for reformed franchises. This means that the number of routes and franchises are investigated first and reformed to achieve one-off savings in route operations (through a reduction in dead running) and economies of scale in garaging and maintenance. This will also ensure that each franchise offered is of a sufficient size and scale to allow for efficient service delivery.

A critical issue will be the treatment of BT as a potential service provider in a competitive tendering situation. As BT is the major incumbent with substantial sunk investment, as well as being a business unit of BCC, there is likely to be significant concern from potential tenderers about whether they will be bidding on even terms. Concerns about competitive neutrality could fundamentally undermine the success of a tender.

The extent of savings under a competitive tendering model will depend on how well Translink is able to negotiate contracts based on best practice. The experience in other jurisdictions shows that prescriptive arrangements without incentives for operators to innovate do not yield significant benefit.

Recommendation

17 Competitive tendering be introduced for bus service contracts throughout Queensland, including evaluating the number of routes serviced and frequencies, franchisees and franchise areas before initiating the tender.

B3.6.4 Ferry transport

The operation of the ferry services is already subject to a competitive tender process, and there are strong incentives for a competitive price to be achieved through this process. Heightening incentives for efficiency should be the focus within the context of the contractual obligations to the ferry service provider as well as the impact on the Government's social and economic policy objectives.

B3.7 FUTURE RAIL FREIGHT SERVICES

B3.7.1 Commercial freight services

The provision and operation of commercial rail freight systems is undertaken by the private sector in most Australian states. The only GOC that continues to provide commercial rail infrastructure is ARTC.

The primary public policy concerns with commercial freight corridors being managed by a private company are:

- the risk that access to the infrastructure by rail operators will not be provided on a reasonable and non-discriminatory basis
- the concern that a private operator will not be prepared to invest to expand the infrastructure as required by users.

As with other privately owned network infrastructure, an economic regulatory framework is in place to ensure access to regulated infrastructure is provided on a basis that recognises the interests of both the network owner and network users. In principle, there is no reason why all commercial freight corridors could not be privately managed under the existing regulatory regime. The separation and divestment of QR National in 2010 was a reflection of this policy and regulatory principle.

The split of the Queensland rail network between Queensland Rail and QR National Ltd in 2010 essentially reflected an assessment of commercial and non-commercial components of the freight network. As a result, the highly commercial central Queensland coal network was transferred to QR National and privatised. Those parts of the freight network remaining with Queensland Rail have limited commercial characteristics.

Based on an assessment of access revenue compared with total cost, two of the remaining systems in Queensland Rail's regional network may also be commercial – the Mount Isa rail line and the element of the Western system used for the transport of coal.

The commerciality of the Western system, which transports approximately 7 Mt of coal per annum, is subject to the ability to secure access to train paths through the SEQ metropolitan area. The *Transport Infrastructure Act 1994* does provide for the preservation of non-coal freight paths across the network, including through the metropolitan area. However, securing appropriate freight paths on this section of the network is becoming increasingly problematic due to the competing demands from passenger services, and community disquiet about the transport of coal through densely populated areas. The uncertainty of future access through the SEQ metropolitan area means that the track infrastructure on this system is likely to be of limited value to the private sector.

The Mount Isa to Townsville rail line is the rail corridor in the QR regional network that may be a commercial proposition on a sustainable basis. The commerciality of this rail line is reliant on:

- The rail line operating reasonably independently from the rest of the Queensland rail network, with the majority of traffic connecting to Port of Townsville, and only limited services that also use the adjoining North Coast Line.

- The rail line combines with the Port of Townsville to form a supply chain servicing the North West Minerals Province and the surrounding region.

- High value commodities are transported on the network, in particular minerals such as copper and lead.

- While current freight tonnages on the system are relatively low (5.8 Mtpa), there is significant potential for future growth in freight traffic. This is reflected in expansion plans for the Port of Townsville.

Consideration would need to be given to any potential adverse impact of divesting individual lines within an integrated rail freight network. Scheduling the operation of freight and passenger services across Queensland Rail's regional network is a complex task which could be further complicated by divestment of a single component of the network. Interface and coordination problems caused by fragmenting the ownership structure of the regional network potentially include:

- gaining reliable access to continuous train paths
- coordination of maintenance planning to minimise impact on service levels
- coordination of scheduling
- train control handovers
- identifying liability for service delays
- ongoing consistency of network standard and rollingstock requirements.

As the Mount Isa Line operates reasonably independently of the rest of the Queensland Rail network, any interface and coordination problems should be manageable.

Recommendation

18 Mount Isa rail freight line be transferred to Port of Townsville to be managed as an integrated supply chain, with a view to divestment of the integrated business.

B3.7.2 Non-commercial freight services

Based on an assessment of the operations of Queensland Rail, the six regional rail systems other than the Mount Isa rail line (the North Coast Line, Western, Maryborough Area, South Western, Central West, and Tablelands) appear unable to be undertaken on a separate, commercially sustainable basis, and are likely to remain loss making.

The freight haulage services funded by Government typically are operated in competition with other transport modes. In particular, locations serviced by rail freight usually have alternative options available via road transport on commercial terms.

The Transport Services Contract is used to ensure that the rail network is maintained across a broad geographical area. While the contract clearly specifies the scope of the service to be provided, the policy rationale for providing this broad geographic scope of the rail freight network is not clear.

An alternative view is that there is a broader public policy case for retaining the core rail freight network notwithstanding that it does not currently operate on a commercial basis – in particular the North Coast line and the Western system.

The Commission is sympathetic to the view that their remains a legitimate public policy role for Government to retain existing rail corridors, as an alternative to road transport and as part of future planning for possible resource developments and population growth.

Under continued government ownership, there are options available to increase efficiency in the future management of the sub-commercial components of the regional freight network. An assessment of these options is provided in Table B3.8.

Table B3.8
Options for the future management of the regional rail network

Options	Advantages	Disadvantages
Provide the rail management function under a franchise agreement (similar to the John Holland contract for management of the NSW regional network)	Provision of strong commercial incentive for efficient management and operation of the freight network, and maximisation of commercial opportunities for providing access	Would prevent the State from deriving maximum value from future network expansion opportunities relating to the development of coal resources in the south-west region – any value would be captured by the private contractor
Continuation of current structure with introduction of competitive pressure where possible through contracting of specific services (for example, maintenance)	Provides efficiency incentives through the introduction of competitive pressures in the main operating cost component. However, the efficiency incentives are significantly weaker than the franchising option	Ensures that any value from expanding the network to accommodate increased coal traffic will flow to the State

Source: Commission of Audit

Outsourcing of major operational activities (such as maintenance) should be promoted in order to introduce competitive pressure and incentives for efficiency improvements into the performance of the maintenance task. Moreover, this structure should remain under review – it is entirely possible that the best outcome for the State could be delivered through a properly structured franchising arrangement in the future.

Recommendation

19 Queensland Rail remain the owner and operator of the regional rail network, but with the maintenance task to be outsourced through a competitive tendering process.

ENDNOTES

1 The Queensland Treasury Corporation is also an owner of ferries and buses, which are operated by the Brisbane City Council under lease agreements.

2 The Queensland Rail 'Tilt Train' service enables the operation of higher speed trains on a conventional rail network but is not a high speed rail offering in the sense meant here.

3 Information accessed from www.parl.gc.ca

4 The Australian Rail and Track Corporation also operates a 95 km section of standard gauge freight rail between Acacia Ridge and the New South Wales border.

5 QR National Annual Report, 2012, p.86, accessed from www.aurizon.com

6 Submitted to QCA on 30 March 2012

B4 PORTS

KEY ISSUES

- There are four Government Owned Corporations (GOCs) in Queensland responsible for functions at port facilities: Gladstone Ports Corporation Limited, the Port of Townsville Limited, North Queensland Bulk Ports Corporation Limited and Far North Queensland Ports Corporation Limited (trading as Ports North).
- The GOCs manage a total of 19 port facilities, although three of these are non-trading ports. The ports range from major bulk ports in central Queensland, to key regional multi-cargo ports and through to small community port facilities.
- The GOCs perform a mixed range of functions – from cargo handling, to infrastructure provision and strategic port development, as well as pilotage and maritime safety services.
- The GOCs have been structured to provide an aggregation of assets on a geographic basis, which groups together assets with distinctly different functions or purposes.
- Most of the port facilities operate on a commercial basis, although a number of the facilities have only low throughput volumes, and have limited opportunities for commercial returns. However, there is potential for greater commercial management focus to result in improved performance at various ports.
- In most states, there is a mix of government and private management of port facilities, while cargo handling facilities are predominantly managed by private enterprise.
- There is a significant fragmentation of ownership of key infrastructure for export supply chains in Queensland, especially ports and rail. This has imposed coordination costs as the various participants in the supply chains have different commercial incentives and drivers.

B4.1 SECTOR PROFILE

There are four Government Owned Corporations (GOCs) in Queensland responsible for functions at port facilities:

- Gladstone Ports Corporation Ltd (GPC)
- Port of Townsville Ltd (POTL)
- North Queensland Bulk Ports Corporation Ltd (NQBP)
- Far North Queensland Ports Corporation Ltd (trading as Ports North).

The Port of Brisbane is privately operated under a long-term lease from the State Government. The GOCs have been structured to provide an aggregation of assets on a geographic basis.

The GOCs manage a total of 19 port facilities, although three of these are non-trading ports. These ports range from major bulk ports in central Queensland, to key regional multi-cargo ports and through to small community port facilities.

Table B4.1 provides an overview of the operations of the four Queensland port GOCs.

Table B4.1
Queensland ports – functions and operations

GOC	Port facilities	Functions	Operations
Gladstone Ports Corporation Ltd	Gladstone	Provision of coal handling services at RG Tanna and Barney Point coal terminals	84.5 Mt of cargo handled at Gladstone in 2011-12 (71% coal)
		Management and operation of Port of Gladstone, which caters for major bulk commodity exports as well as regional multi-cargo trade	
	Alma Bundaberg	Management and operation of Port Alma Shipping Terminal and Port of Bundaberg	421,000 tonnes handled at Port Alma and 260,000 tonnes at Port of Bundaberg (privately operated dedicated sugar export terminal)
Port of Townsville Ltd	Townsville Lucinda	Management and operation of multi-cargo port at Townsville	12.9 Mt handled at Port of Townsville in 2011-12
		Management of Port of Lucinda	Port of Lucinda is a dedicated sugar export facility – low tonnages and privately operated
			Operations at Lucinda were significantly affected by Cyclone Yasi in 2011
North Queensland Bulk Ports Corporation Ltd	Hay Point Abbot Point Weipa Mackay Maryborough	Landlord functions (strategic development and maintaining navigable port depths) for bulk ports at Hay Point, Abbot Point and Weipa	124 Mt of cargo handled at NQBP port facilities in 2011-12
		Management and operation of Port of Mackay	Major cargoes handled are coal (Hay Point and Abbot Point) and bauxite (Weipa)
		(Maryborough is a non-trading port)	Terminal infrastructure at bulk ports operated by private entities
Far North Queensland Ports Corporation Ltd (Ports North)	Cairns Mourilyan Cape Flattery Karumba Skardon River Thursday Island Quintell Beach Cooktown Burketown	Management and operation of key regional port at Cairns	Total throughput across port facilities approx. 4.6 Mtpa
		Management of four additional trading ports (Mourilyan, Cape Flattery, Karumba and Skardon River), and two community ports (Thursday Island and Quintell Beach).	Several trading port facilities are dedicated to export of a single product (for example, sugar, zinc, silica sand) and are privately operated
		Cooktown and Burketown are non-trading ports	

Source: Queensland Treasury and Trade

Most of the port facilities operate on a commercial basis, although a number of the facilities have only low throughput volumes, and have limited opportunities for commercial returns. However, there is potential for greater commercial management focus to result in improved performance at various ports.

Most of the major cargo handling terminals located within Queensland ports are owned and operated by various private sector participants. At some ports, GOCs still retain ownership of cargo handling facilities and GPC directly provides coal handling services to port users.

There are no Community Service Obligation payments made to any of the port GOCs. However, a number of the port facilities are subject to long-term legacy contracts that constrain their ability to recover commercial returns from the port facilities. Examples of these legacy contracts include:

- A 75-year agreement negotiated between the Queensland Government and a mineral resource project in the 1960s that limits port charges for the handling of company's mineral commodity exports. In 2011-12, the average port charge that GPC could recover under the agreement was a discount to the prevailing market rate of around 88%.

- A 103-year agreement negotiated between the Queensland Government and an exporting company in the early 2000s. Under the agreement the private company pays no rent on port-owned land and the average port charge recovered by GPC on the company's bulk exports in 2011-12 was a 94% discount on the prevailing market rate.

- GPC's port charges in 2011-12 are estimated to have been around $24 million lower under the agreements, compared with the amount that would have been charged under prevailing market rates.

In addition, a number of the ports experience very low throughput levels, which means that they cannot be viably operated on a commercial basis, for example, the Port of Bundaberg.

B4.2 CURRENT SERVICES

Tables B4.2 shows the range of services provided at Queensland ports.

Table B4.2
Queensland ports – services overview

Function	Description
Cargo handling services	The provision, operation and maintenance of cargo handling terminals located at the port, including the interface with individual customers and the scheduling of berthing of vessels at that terminal for loading/unloading
Infrastructure provision	Provision and maintenance of general port infrastructure facilities. In multi-cargo ports, this may include the provision of berths and significant supporting infrastructure, whereas in bulk cargo ports, general port infrastructure may be quite limited (for example, channels)
Strategic port development	Planning for future port development, including identifying opportunities for future development of cargo handling facilities and general port infrastructure, identifying and aggregating potential demand, progressing feasibility studies and approvals
Pilotage and maritime safety	Responsible for the safe movement of vessels into berthing facilities at each terminal, including provision of navigational aids and pilotage services

Source: Queensland Treasury and Trade

The port GOCs are responsible for the provision of only some of the services directly to port users. Other services within the port precincts are provided directly to port users by either private facilities operating on port land, in the case of bulk cargo handling, or by other government agencies, such as pilotage services. This is shown in Table B4.3.

Table B4.3
Services provided by port GOCs

Port	Cargo handling services	Infrastructure provision	Strategic port development	Pilotage and maritime safety[1]
Gladstone Ports Corporation Ltd				
Port of Gladstone	✓	✓	✓	×
Port of Bundaberg [2]	×	×[3]	✓	×
Port Alma Shipping Terminal	✓	✓	✓	×
Port of Townsville Ltd				
Port of Townsville	×	✓	✓	×
Port of Lucinda	×	×[3]	✓	×
North Queensland Bulk Ports Ltd				
Port of Mackay	×	✓	✓	×
Port of Hay Point	×	×[3]	✓	×
Port of Abbot Point	×	×[3]	✓	×
Port of Weipa	×	×[3]	✓	×
Port of Maryborough[4]				
Ports North				
Port of Cairns	×	✓	✓	×
Port of Mourilyan	×	×[3]	✓	×
Cape Flattery	×	×[3]	✓	×
Karumba Port	×	×[3]	✓	×
Skardon River Port	×	×[3]	✓	×
Quintell Beach	×	✓	✓	×
Thursday Island	×	✓	✓	×
Port of Cooktown[4]				
Port of Burketown[4]				

1 These services are provided by Maritime Safety Queensland across all Queensland ports.
2 GPC owns the John T Fisher wharf that handles bulk molasses.
3 Most port facilities at these ports are provided by private terminal owners, but the port GOCs own the land and limited facilities, and are responsible for maintaining navigable port depths at these ports.
4 While this is a declared port facility, no commercial trade takes place at this port.

Source: Queensland Treasury and Trade

B4.2.1 Cargo handling services

GPC is the only port GOC that provides significant cargo handling services:

- owner and operator of the RG Tanna Coal Terminal
- owner and operator of the Barney Point Coal Terminal
- designated operator for the Wiggins Island Coal Export Terminal (WICET) when it commences operations.

These cargo handling terminals operate on a fully commercial basis.

GPC is unique among government-owned port authorities in that it operates a major cargo handling facility itself. While cargo handling facilities are sometimes owned by port authorities, the operation of these is usually undertaken by private companies. In many cases, the cargo handling facilities themselves are privately owned.

The Government has been progressively divesting itself of involvement in managing and/or operating cargo handling facilities for bulk commodities, with the long-term leasing of Dalrymple Bay Cargo Terminal in 2001 and of Abbot Point Coal Terminal in 2011.

The provision and operation of cargo handling services, in particular bulk coal handling terminals, is typically provided by the private sector, and there is no public policy rationale for requiring this service to continue to be provided by a government-owned business.

B4.2.2 Port infrastructure

Port infrastructure (for example, channels, berths and terminal facilities) is provided on a commercial basis by GOCs where the volume and value of trade at the port is sufficient to enable the recovery of the costs.

The assets of the GOC ports can be grouped into three categories:

- Fully commercial – these facilities are of sufficient scale that they can be commercially operated on a stand-alone basis.

- Low volume commercial – these facilities are operated on commercial principles and have sufficient volume that they are expected to return positive earnings before interest and tax (EBIT) on an ongoing basis, but they are not of sufficient scale to operate sensibly on a stand-alone basis. However, they may be commercially viable as part of a portfolio of facilities, which provides opportunity for economies of scale.

- Non-commercial – these facilities are either non-trading ports, community ports or trading ports that do not have sufficiently high trading volume to return a positive EBIT.

The commerciality of the infrastructure provision and maintenance function of the port facilities is summarised in Table B4.4. The grouping of these port facilities is indicative only and intended to represent a relative, rather than absolute, scale of volume and commerciality.

Table B4.4
Commerciality of port facilities

Fully commercial	Low volume commercial	Non-commercial
Port of Gladstone	Port of Cairns	Port of Bundaberg
Port of Townsville	Port of Mackay	Thursday Island
Port of Hay Point	Port of Lucinda	Quintell Beach
Port of Abbot Point	Port Alma	Port of Maryborough
Port of Weipa	Mourilyan	Port of Cooktown
	Cape Flattery	Port of Burketown
	Karumba Port	
	Skardon River Port	

Source: Queensland Treasury and Trade

B4.2.3 Strategic port development

Strategic port development relates to expansion of port facilities to accommodate expected increases in demand. It will usually be in the commercial interests of the port to maximise its commercial opportunities by expanding port facilities to meet increases in demand, provided that the commercial benefits of the expansion exceed the costs.

The significance of this function varies according to location and characteristics of the particular port facility. In some instances, the manner in which the port facilities are developed may have substantial state development implications. This is particularly the case for the major bulk ports in central Queensland, where there is potential demand for port developments to meet projected resource demand. Particular examples include potential increases in coal production and the development of a major export LNG industry in Gladstone.

In some limited instances, it may be the case that the immediate commercial priorities of a private port operator for development of their port precinct do not coincide with the state-wide interest for strategic port development. This may be an issue of public policy interest where:

- There are only limited available locations for port developments on the scale required to meet future demand, and the particular private operator does not place a priority on developing additional capacity.

- The existence of multiple owners within a port precinct inhibits timely development of strategic infrastructure.

In some limited cases, there may be a public policy justification in Government retaining an ownership or regulatory role in these facilities.

B4.2.4 Pilotage and maritime safety

Maritime Safety Queensland (MSQ) is responsible for the safe operation of vessels within the GOC port facilities. MSQ provides a Harbour Master for each port, who sets the rules for the safe operation of that particular port. Another function provided by MSQ is the pilotage service, which provides pilots to shipping companies to bring vessels safely through the shipping channels into the berths.

In other states, the Harbour Master is often employed by the port authority itself (including in privatised ports), although the Harbour Master has statutory obligations that must be fulfilled in relation to the safe operation of the port in addition to their responsibilities to the employer. The provision of the Harbour Master role by MSQ is now well established and appears to be working satisfactorily.

However, the provision of the pilotage function by MSQ is less clear. While the rules in accordance with which the pilots operate are appropriately the function of the Harbour Master, the provision of the pilots themselves is often a commercial service that is offered by port authorities, either through providing the services in-house, or by outsourcing to a commercial provider of pilots.

B4.3 OTHER JURISDICTIONS

Table B4.5 provides an overview of the ownership and operating arrangements that apply to port infrastructure across Australia. The table shows that, in most states, there is a mix of government and private management of port facilities, while cargo handling facilities are predominantly managed by private enterprise. In Queensland and Tasmania, government retains an interest in the ownership and management of cargo handling.

Table B4.5
Port ownership and management in Australia

Jurisdiction	Cargo handling	Port management	Details
Queensland	Government and private	Government and private	Provision and operation of coal handling terminals at Gladstone is provided by Gladstone Ports Corporation Ltd At other ports, cargo handling services are provided by private companies. This includes coal handling terminals at other bulk cargo ports (for example, Abbot Point and Hay Point) which are managed and operated by private companies under long-term lease agreements Port of Brisbane privatised in 2010 under a 99-year lease agreement Queensland's dedicated bulk cargo ports (Hay Point, Abbot Point and Weipa), major multi-user ports (Gladstone and Townsville) and regional ports are all owned by GOCs
New South Wales	Private	Government and private	Cargo handling services are provided by private companies. This includes bulk coal handling terminals at the Port of Newcastle which are privately owned and operated NSW Government recently approved plans for auction of 99-year lease agreements for Port Botany and Port Kembla (currently government-owned facilities) Other port terminals, including the Port of Newcastle, remain government owned
Victoria	Private	Government and private	Port of Portland and Geelong Port privatised in 1996 Port of Hastings retained under government ownership but operated under Port Management Agreement with Patrick Ports Hastings Port of Melbourne under government ownership
Western Australia	Private	Government	Private companies own cargo handling infrastructure at major bulk cargo ports (for example, Port Hedland and Dampier Port) Government entities retain ownership of regional ports (for example, Geraldton, Fremantle, Esperance, Albany, Bunbury, Broome). Government entities also provide port authority function at major bulk ports (for example, Port Hedland and Dampier)
South Australia	Private	Private	All seven commercial port facilities privatised in 2001 (Flinders Ports) Seaside facilities and Kangaroo Island community port excluded from privatisation
Tasmania	Government and private	Government	All port facilities under government ownership (Tasports)

Source: Queensland Treasury and Trade

New South Wales

All significant port facilities in New South Wales are under government ownership. The major cargo handling facilities are generally privately owned and operated. The port GOCs are responsible for the operation of relatively minor cargo handling facilities and, even in these cases, GOCs do not actually perform the cargo handling functions. The New South Wales Government has recently approved plans to auction 99-year lease agreements for the government-owned facilities at Port Botany and Port Kembla.

Victoria

Two ports in Victoria are operated under private ownership: Port of Portland and Geelong Port. Both of these ports were privatised in 1996. Management and operation of shipping channels at these ports were maintained under government control through the Victorian Regional Channels Authority (formerly the Victorian Channels Authority).

The Victorian Government also had intended to privatise the Port of Hastings. However, the nature of statutory agreements between the Victorian Government and the two major users of the port prevented the sale from occurring. Subsequently, the management of the port facilities was contracted to a private entity – Toll WesternPort (now Patrick Ports Hastings) – under a Port Management Agreement in 1997. Patrick Ports Hastings also manages port waters, including navigation channels and berths, under a channel operating agreement with the Victorian Regional Channels Authority (which retains ownership of the shipping channels under the management agreement).

The Port of Melbourne remains under government control, with the Port of Melbourne Corporation responsible for the management of the port. Within the port, private companies operate cargo handling facilities and provide other services under lease agreements with the Port of Melbourne Corporation.

Western Australia

All significant ports in Western Australia are managed by government-owned entities. However, private companies do own and operate cargo handling infrastructure, particularly those that are used for the export of iron ore (for example, Port Hedland and the Dampier Port) and other ports where bulk cargoes are handled (for example, Bunbury and Fremantle). At these ports, the role of the government entity is limited to that of a landlord port authority.

It is important to note that this ownership and management structure differs to that which applies in relation to major container terminal infrastructure at ports in Western Australia and other jurisdictions. In relation to these facilities, the government-owned entity typically retains ownership of the terminal infrastructure and leases the right to operate the facility to a private company on a relatively long-term basis (for example, 20 years).

South Australia

Seven commercial port facilities in South Australia are under private ownership and operation. Six of these ports are owned by Flinders Ports, with the South Australian Government transferring ownership of these ports to Flinders Ports in 2001 under a 99-year lease agreement. The Port of Ardrossan, which is used for the export of grain, is privately owned and operated, as are the grain handling facilities located at those ports under the ownership of Flinders Ports. One commercial port (Port Bonython) is owned by the state and managed by Santos.

Navigational aids, channels and breakwaters were excluded from the privatisation process, as were the community port facilities at Kangaroo Island (which was not considered to be a commercial facility). These facilities and services remain under government control.

Tasmania

All port facilities in Tasmania are owned and operated by Tasports, a government-owned entity. Tasports was created following the amalgamation of Tasmania's four port companies in January 2006: Hobart Ports Corporation, Port of Launceston, Port of Devonport Corporation and Burnie Port Corporation.

B4.4 FINANCIAL INFORMATION

B4.4.1 GOC financial performance

The financial performance of the port GOCs is shown in Table B4.6 and the following charts (B4.1 to B4.4). The financial results over the past four years reflect the diversity in the scale and functionality of port assets, both within and between the GOCs, as well as a wide variation in different stages of port development.

GPC's earnings have been steadily increasing over the last four years, supported by growth in revenues from cargo handling charges, principally the export of coal. This is shown as an increasing return on assets in Chart B4.1. Additional port facilities are currently being developed in the port precincts. The Wiggins Island Coal Export Terminal is being privately developed and will be operated by GPC once constructed. LNG processing facilities are being developed on Curtis Island.

POTL has reported positive underlying earnings and increasing return on assets over the last four years (Chart B4.2) from growing commodity export volumes through the Port of Townsville. The financial result for POTL in 2009-10 was affected by grant revenue from Government for the Townsville Marine Precinct and Berth 10 extension, leading to a one-off spike in EBIT in that year.

Financial results for NQBP are significantly affected by the long-term lease granted over Abbot Point Terminal 1 during 2010-11, resulting in a one-off substantial increase in EBIT in that year (Chart B4.3). Following the lease of Abbott Point Terminal 1, NQBP, revenue from operations fell from $159 million in 2010-11 to $68 million in 2011-12. A small negative EBIT in 2011-12 reflects impairment charges following the withdrawal of government and customer support for proposed expansion of port facilities.

Table B4.6
Queensland ports, 2008-09 to 2011-12 financial performance

	2008-09 $m	2009-10 $m	2010-11 $m	2011-12 $m
Gladstone Ports Corporation Ltd				
EBIT	110.9	95.1	113.5	135.0
NPAT	55.6	46.5	55.3	69.8
Port of Townsville Ltd				
EBIT	5.0	51.0	20.2	42.9
NPAT	3.2	35.9	13.5	28.6
North Qld Bulk Ports Corporation Ltd[1]				
EBIT	na	34.4	434.4	0.7
NPAT	na	18.1	454.9	(1.9)
Ports North[2]				
EBIT	6.8	7.9	(1.5)	(9.7)
NPAT	(2.2)	5.6	(1.1)	(17.7)

EBIT = Earnings before interest and tax, NPAT = Net profit after tax

1 EBIT and NPAT significantly affected by long-term lease of Abbot Point Terminal 1 in 2010-11. In 2011-12, a write down of $22.7 million of works associated was booked against development of Abbot Point T4-T9 projects. This is due to uncertainty with regard to the economic viability and willingness of Government and customers to fund the projects. In the NQBP 2011-12 Annual Report, the published result for 2011-12 is a loss of $3.6 million. The difference between the positive EBIT of $0.7 million and the loss of $3.6 million reported in the annual report is interest expenses of $4.3 million.

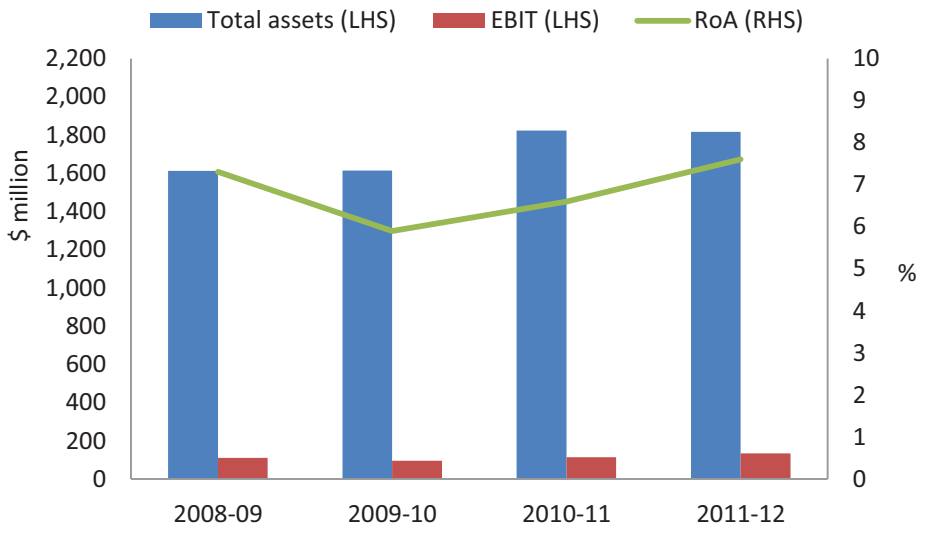
2 The result for 2011-12 reflects a total impairment charge of $17.87 million. This charge is a result of three major items: a write down of a number of property, plant and equipment assets; a reduction in value of investment properties; and an impairment charge predominantly associated with the Foreshore Development Project in Cairns.

Source: GOC annual reports 2011-12

The small positive and negative EBIT for Ports North reflects the lower trading volumes and community facilities that characterise its operations (Chart B4.4). The increase in the negative EBIT reflects impairment charges across a number of port facilities, but predominantly related to development at the Port of Cairns. This has resulted in a sharp fall in the return on assets in 2011-12.

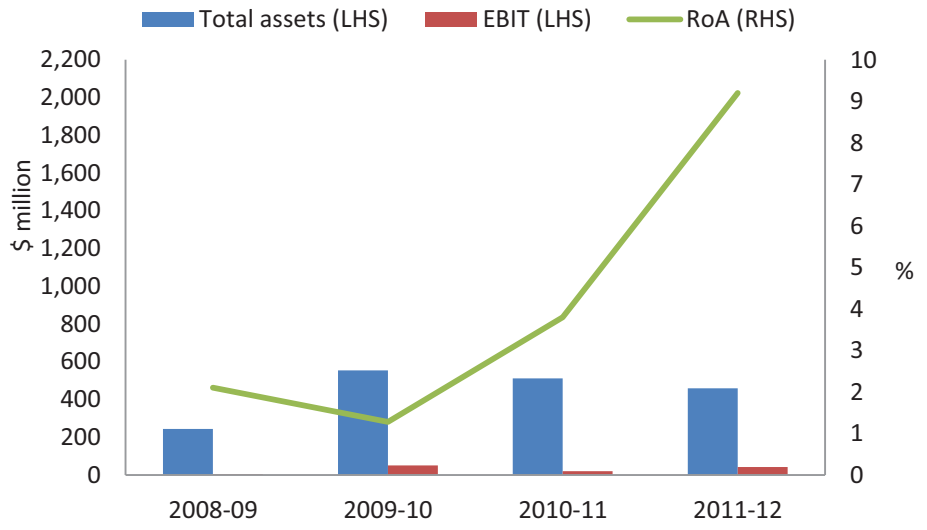
The performance of individual port facilities within each GOC is outlined in the following sections.

Chart B4.1
Gladstone Port Corporation Ltd – assets, earnings and return on assets



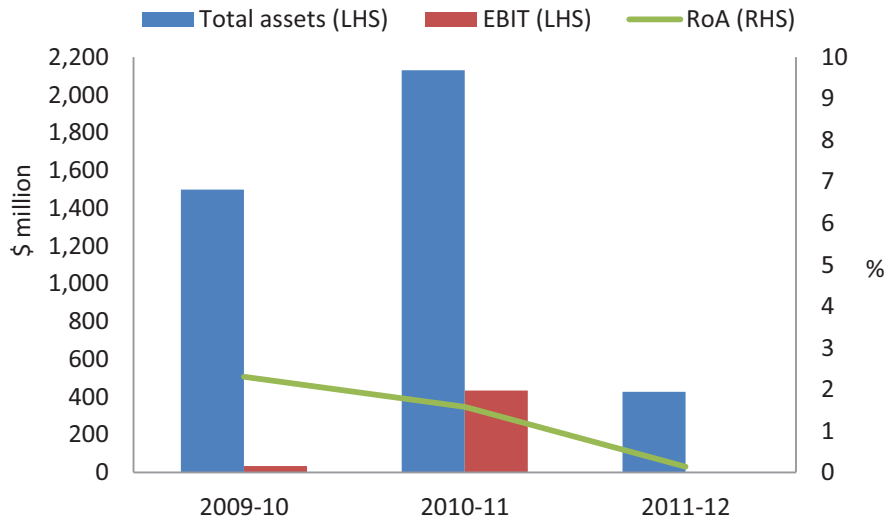
Source: Gladstone Ports Corporation Ltd annual reports

Chart B4.2
Port of Townsville Ltd – assets, earnings and return on assets



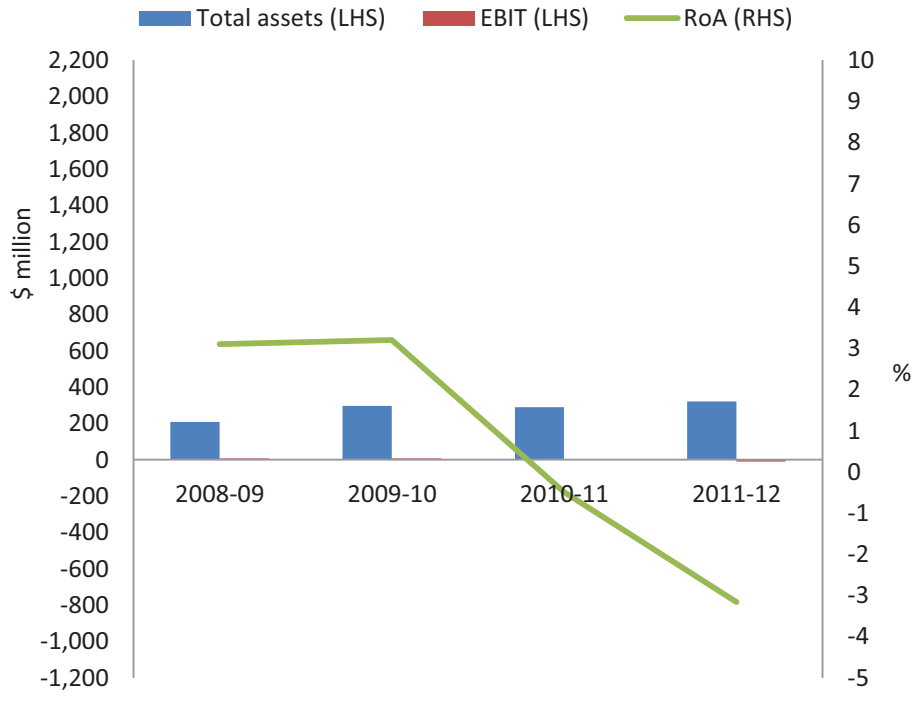
Source: Port of Townsville Ltd annual reports

Chart B4.3
NQBP Corporation Ltd – assets, earnings and return on assets



Source: NQBP Corporation Ltd annual reports

Chart B4.4
Ports North – assets, earnings and return on assets



Source: Ports North annual reports

Table B4.7 shows the gearing ratio – debt/(debt plus equity) – for the Queensland port GOCs and other government owned ports in Australia. The table shows the relatively lower levels of gearing in the Queensland ports compared with facilities with similar operations. The Dampier Port Authority, which manages a major trading port similar to Gladstone, has a gearing ratio around 50% higher than that of GPC.

The Sydney Ports Corporation, covering the non-trading facilities of Port Jackson and the container terminal at Port Botany, had the same gearing ratio as GPC in 2011-12.

The lower gearing ratios for Ports North and North Queensland Bulk Ports reflect the nature of their facilities provided and their current stage of development:

- Ports North has had nil debt over the past two years, reflecting the low volume and community aspects of their ports.
- Port of Townsville has had a gearing ratio of close to zero over the last two years, reflecting constant income and capital development funded from government grants.
- The gearing ratio for NQBP has been significantly affected over the last two years by the $1.8 billion long-term lease of Abbot Point Terminal 1. Between 2009-10 and 2010-11, NQBP borrowings fell from $787.5 million to $67 million, while total equity rose from $532.9 million to $1.8 billion. As a consequence, NQBP's gearing ratio fell to almost zero in 2010-11 before increasing to 0.28 in 2011-12.

Table B4.7
Government port corporations – debt/(debt plus equity) ratio

	2010-11	2011-12
Gladstone Ports Corporation Ltd	0.41	0.35
Port of Townsville Ltd	0.02	0.03
North Qld Bulk Ports Ltd	0.04	0.28
Ports North[1]	0	0
Dampier Port Authority	0.65	0.60
Sydney Ports Corporation	0.36	0.35
Newcastle Port Corporation	0.25	0.24

1 Ports North held nil debt as at 30 June 2011 and 30 June 2012.

Source: Annual reports, various

B4.4.2 Port specific financial performance

Gladstone Ports Corporation Ltd

Table B4.8 presents revenue, expense and EBIT information for GPC in 2011-12 by port.

The financial results for GPC are dominated by the Port of Gladstone itself, principally the coal export facilities at the RG Tanner and Barney Port Terminals.

The Port of Bundaberg has two cargo handling facilities, one of which is privately owned and operated and the other, for the handling of molasses, is owned by GPC. The GPC 2011-12 Annual Report notes that total impairment charges of $15.8 million have been made against GPC assets at Bundaberg over the last three years. In 2011-12, the Port of Bundaberg incurred a loss of $4.4 million excluding the impairment charge and $7.5 million with the impairment charge. In 2011-12, GPC's Bundaberg facilities had 11 full-time employees and serviced 14 vessels.

Port Alma at Rockhampton is owned and operated by GPC and handles general cargo, fuel and other mining-related products and some agricultural commodities. Strong growth in port throughput in the last two years, largely supporting mining and LNG related developments, has contributed positively to GPC's overall results in 2011-12.

Table B4.8
Financial performance of ports owned by Gladstone Ports Corporation Ltd, 2011-12[1]

Port	Revenue $m	Expenses $m	EBIT $m
Port of Gladstone	845.7	705.5	140.2
Port of Bundaberg [2]	(1.3)	6.2	(7.5)
Port Alma	3.7	1.4	2.3

1 For the ports of Bundaberg and Alma, the figures show the contribution of port activities to the consolidated result for GPC.
2 This result reflects a $3.1 million write down (impairment) at the Port of Bundaberg, bringing the total Bundaberg impairment over three years to $15.8 million, as outlined in the Gladstone Ports Corporation Ltd Annual Report, 2011-12.

Source: Gladstone Ports Corporation Ltd.

Port of Townsville Ltd

Table B4.9 presents revenue, expense and EBIT information for POTL in 2011-12 by port.

POTL operations comprise the Port of Townsville itself and the Port of Lucinda. Revenue from the Port of Townsville dominates the POTL results, with both revenues and expenses at Port of Lucinda less than $1 million in 2011-12. The Port of Lucinda jetty was significantly damaged during Cyclone Yasi in February 2011, with repairs completed in the middle of 2012.

Table B4.9
Financial performance of ports owned by Port of Townsville Ltd, 2011-12

Port	Revenue $m	Expenses $m	Operating result from continuing operations before income tax expense $m
Port of Townsville	90.3	48.0	42.2
Port of Lucinda[1]	-	-	-

- Denotes less than $1 million.
1 Port of Lucinda was significantly affected by Cyclone Yasi in 2011-12, with the jetty being closed for reconstruction during the year, resulting in no trading revenue during this period.

Source: Port of Townsville Ltd

North Queensland Bulk Ports Corporation Ltd

Table B4.10 presents revenue, expense and EBIT information for NQBP in 2011-12 by port.

NQBP comprises a diverse mix of assets:

- landlord functions and strategic port development at Abbot Point, Hay Point and Weipa; bulk handling of coal and bauxite at these ports is undertaken by private operators

- management and operation of the Port of Mackay, which experienced an increase in volumes of imports in 2011-12, including for petroleum products supporting development of the Bowen Basin, fertilisers and other bulk commodities.

The result for Abbot Point reflects a $22.7 million write-off of costs associated with the proposed Multi Cargo Facility (MCF) and Terminals 4 to 9 at Abbot Point, following withdrawal of government and customer support for these projects.

Table B4.10
Financial performance of ports owned by North Queensland Bulk Ports, 2011-12

Port	Revenue $m	Expenses $m	EBIT $m
Port of Abbot Point	8.6	37.0	(28.4)
Port of Hay Point	20.3	16.0	4.3
Port of Mackay	25.9	9.8	16.1
Port of Weipa	11.7	4.2	7.5

Source: North Queensland Bulk Ports Corporation Ltd

Ports North

Table B4.11 presents revenue, expense and EBIT information for Ports North in 2011-12 by port.

Table B4.11
Financial performance of key ports owned by Ports North, 2011-12

Port	Revenue $m	Expenses[1] $m	EBIT $m
Port of Cairns	26.0	31.3	(5.3)
Port of Mourilyan	1.6	2.2	(0.5)
Cape Flattery	1.2	0.4	0.8
Karumba Port	5.1	7.4	(2.3)
Thursday Island	2.4	4.7	(2.2)

1 The expense estimates for Cairns, Mourilyan, Karumba and Thursday Island include the one-off expense of impairment and asset write downs.

Source: Far North Queensland Ports Corporation Ltd

The Port of Cairns, being a major regional port as well as the largest trading port, dominates the results for Ports North.

Ports North facilities comprise:

- the trading ports of Cairns, Mourilyan, Cape Flattery and Karumba, which handle specific commodities, including sugar, molasses, petroleum products, livestock and minerals
- major regional port for tourism and recreational activities at the Port of Cairns
- the port of Thursday Island that services the community, including the handling of general cargo.

The negative EBIT for the Port of Cairns in 2011-12 reflects a one-off expense item (impairment) from a reduction in the value of investment properties ($5.04 million) and several individual write downs and impairments linked to the asset revaluation process. Overall, while Ports North's overall EBIT for 2011-12 was a $9.7 million loss, its EBIT excluding these one-off events was $8.2 million.

B4.5 Future Arrangements

The State has a significant investment in port facilities and assets that needs to be managed efficiently to achieve value for money.

The existing ownership structure of these assets and the policy environment supporting them can be improved to maximise benefits.

The four port GOCs are responsible for the operation of a diverse range of assets:

- the ownership and provision of fully developed commercial port services, such as cargo handling, berths and other terminal facilities
- management, as landlords, of privately developed cargo handling facilities on GOC-owned sites
- ownership of underdeveloped land with port access that could have future strategic importance to the State
- a number of low-volume ports and ports with marginal commercial operations.

Moreover, there is no consistent ownership structure of similar port assets. GPC both owns and operates bulk cargo facilities, while NQBP allows private operators to provide these facilities under long-term lease of GOC land.

In the Commission's view, the ownership and management structure of these existing GOC port assets should have as its goals:

- maximising the commercial return to the State from large volume cargo handling facilities and strategic assets, such as Gladstone and Townsville
- providing local communities greater control and management of smaller, non-commercial regional ports.

The present ownership structure of the port facilities is not geared to these objectives, as it groups together assets with distinctly different functions or purposes.

Specifically, the allocation of port assets between the four GOCs is based largely around the geographic location, rather than purpose and value to the Queensland public.

Where non-commercial and public policy functions continue to be performed by some of the assets, some element of government ownership and control will continue to be necessary. However, commercial port assets of the GOCs are more appropriately held in other ownership structures.

The Commission considers that the allocation of port GOC assets going forward should be more aligned with their specific use and purpose, rather than their geographic location. This would suggest that the ownership arrangements for existing assets of the port GOCs be restructured on the following basis:

- private operators under long-term leases – for assets that generate a commercial return
- a GOC – for assets that are not commercial or where there is a public policy role for government in the development of strategic port access and supply chain coordination
- local communities – where there is little wider commercial interest.

B4.5.1 Commercial port activities

Some fully commercial port operations in Queensland – both bulk cargo and port infrastructure – are already operated by private interests under long-term leases. In the absence of an overwhelming strategic or public policy interest, there is no rationale for continued government ownership and control of remaining commercial facilities.

Based on the current and expected movement of cargo and potential for development, the port facilities that fall into this category are Port of Gladstone and Port of Townsville. Benefits that could be expected from private operation and control would include:

- the immediate value returned to taxpayers to repay debt or invest in social or other economic infrastructure
- potential efficiency gains to be driven by private ownership
- the provision of a stronger commercial incentive to increase freight tonnages, thereby boosting Queensland's trade and economic performance.

Leasing of the Port of Townsville and the Port of Gladstone could be expected to improve operational efficiency and potentially increase freight tonnages handled at these ports.

Recommendation

20 The commercial operations of Gladstone Ports Corporation and Port of Townsville Limited be offered for long-term lease to private operators.

Some port GOCs facilities represent one component of important integrated supply chains, particularly for export commodities. The offering of port GOCs for long-term lease should also consider aggregation of port assets with other supply chain components. Aggregation of supply chain assets may benefit both supply chain coordination as well as the return to the taxpayer from the leased assets.

One such example is the Mount Isa to Townsville rail corridor, as discussed in Section B3 of this Report. There is potential to derive significant value from the integration of the Mount Isa rail line and the Port of Townsville. The aggregation and leasing of these assets is likely to increase their overall value to the private sector (relative to the separate divestment of these assets) as these facilities connect to form a continuous supply chain servicing the North West Minerals Province and surrounding regions. There is considered to be significant potential for growth in freight volumes both on the rail line and at the port in the medium to long term.

A further issue to consider is the treatment of the low volume commercial port facilities. Where they are unattractive to divest on a stand-alone basis, there is the potential to aggregate these ports into the Townsville or Gladstone businesses. Provided that the low volume facilities are EBIT positive, a private operator will have an incentive to continue to operate these facilities in a way that maximises their ongoing value. The alternative approach of retaining the low volume port facilities within Government is likely to dull the commercial focus for these facilities, and hence is unlikely to maximise their value.

Options for aggregation of commercial port assets and functions are presented in Table B4.12. As outlined in this table, pilotage services should be transferred to privatised port operators, as is the case with other Australian ports.

Table B4.12
Options for aggregation of GOC port assets

Asset/function	Opportunity	Rationale
Mount Isa rail line and Port of Townsville	Aggregate the Port of Townsville and the Mount Isa rail line into a single supply chain infrastructure business	There is a high level of interdependence between these two businesses, and if divested separately, there is the risk that the value of each business would be discounted to reflect the risk of strategic behaviour by the other. There is significant commonality of issues being faced by the two businesses and a significant degree of coordination is required in order to maximise commercial opportunities.
Low volume ports may be aggregated with larger port facilities at Townsville or Gladstone	Aggregate commercially sustainable low volume ports with the major ports for privatisation	The smaller facilities may not be viable divestment prospects on their own. Provided they can continue to operate on a commercially sustainable basis, they may be attractive as part of a package of ports, similar to the approach taken in SA.
Pilotage services	Transferring control of pilotage services to privatised ports (noting that the services are likely to be contracted to a pilotage service provider)	This would increase the functions over which the port business has control, and should have a positive impact on the valuation of the business. The majority of Australian ports exercise effective control of the pilotage function.

Source: Commission of Audit

Determining whether it is appropriate to aggregate the assets and functions as proposed will require an assessment of the value that is derived for the State from an aggregated sale compared with alternative options.

Recommendation

21 As part of long-term leases, the Government pursue opportunities to increase value through aggregation of assets as follows:

- ***aggregation of the Mount Isa rail freight line with the Port of Townsville, as per Recommendation 18***
- ***aggregation of pilotage services with port facilities, to increase the scope of services that the leased ports are able to manage.***

A key consideration in the leasing of freight infrastructure is whether any obligations should be imposed on the private lessee as part of the lease process. These obligations can range from commitments to maintain specified services or minimum levels of service quality to an obligation to invest in infrastructure improvements or expansions. It has been common practice in other jurisdictions for government to impose such obligations on private operators as part of the leasing of freight infrastructure to the private sector.

In assessing the appropriateness of including obligations in the lease agreement for port infrastructure, a detailed scoping study would be necessary to evaluate the positive impact of imposing the obligation (that is, value that would be derived for the State) against the potential negative impact on the lease price of the asset. Where there is potential for future growth in the value of an asset, the value to the State added by including such an obligation in the lease agreement may outweigh any potential negative impact on the sale price.

As noted earlier, there is also a risk that the commercial development of a leased port facility may not align with broader government state development goals. There is the possibility for this to be addressed through the imposition of lease conditions, as occurred in the lease of Dalrymple Bay Coal Terminal.

Recommendation

22 The Government reserve the right to take action to prevent delays in port development, to enable increased capacity to be developed by Government or other users in the event that a leased port does not wish to invest to meet such capacity.

B4.5.2 Strategic port activities

The possible long-term lease over commercial activities at Gladstone and Townsville does not obviate the need for a continued role for Government in strategic port development in Queensland. Both these port facilities and others have undeveloped port access that may be of future strategic state-wide interest.

This is a legitimate public policy responsibility for Government. Maintaining control over this function ensures that the Government is able to prioritise the State's strategic development objectives when making decisions on developments undertaken on government-owned port land.

Facilitating future strategic port developments is a key role undertaken by NQBP with respect to its ports at Abbot Point, Hay Point and Weipa. It is proposed that NQBP continue as a GOC to operate these strategic port facilities.

There is significant fragmentation of ownership of key infrastructure for export supply chains in Queensland, as a result of government policy decisions over the last 15 years, such as the introduction of third party access to essential facilities and privatisation of commercial businesses. While there have been efficiency improvements as a result of these policy decisions, they have imposed coordination costs as the various participants in the supply chains have different commercial incentives and drivers.

In these circumstances, there is a strategic role for the Government in implementing arrangements to facilitate improved coordination of planning, operation and investment in both the supply chains potentially affected by multiple ownership structures.

Implementation of effective measures for supply chain coordination will require that the coordination frameworks are:

- tailored to the requirements of the specific supply chain and are reflective of an industry-driven approach which is most likely to result in an efficient market based approach to resolving coordination issues

- independent of infrastructure ownership and regulatory arrangements, with the coordination framework able to be applied regardless of the ownership model of infrastructure providers and regardless of whether any supply chain participants are subject to economic regulation.

The Commission considers that the role of NQBP should be expanded to include supply chain coordination.

As outlined earlier in this section, the financial performance information for Ports North suggests that the functions of its ports are either semi-commercial or possibly non-commercial in nature, with the exception of the Port of Cairns. Some of the Ports North facilities provide essential economic infrastructure, but are akin to a community service obligation in some respects given their remoteness. In view of the importance of these facilities to regional communities, the Commission considers that Ports North should remain as a GOC in its current form for economic development purposes.

Recommendations

23 The Government retain North Queensland Bulk Ports as a Government Owned Corporation responsible for the management and future development of strategic port facilities and expand its role to include supply chain coordination.

24 Ports North be retained as a Government Owned Corporation in its current form in view of its limited commercial freight operations and important regional economic role.

B4.5.3 Low volume ports

The port GOCs typically have a mix of high volume, commercial assets and low volume, less commercial assets. This reflects a historical geographic aggregation of port GOC assets, rather than an aggregation based on asset class or efficient business practice.

It is likely that low volume or non-commercial assets of the GOCs will remain in government ownership following the divestment of commercial operations.

In these circumstances, the Government should offer to transfer ownership and control of these ports to local government authorities. Given the small size of these facilities, and their sub-commercial nature, a GOC structure would be inappropriate and not consistent with the objective of maximising the value of port facilities to the State.

The operation of these low volume ports is most significant to local economies, and as such it is appropriate for decisions regarding the continued management and direction of these port facilities to reflect local priorities. The State may be required to commit to certain expenditure to ensure they are in a suitable condition on transfer. Similarly, non-trading ports could be offered to local government either for future use as a port, or to be redeveloped in a way that best meets community needs.

This position is consistent with the approach taken to the management of airports, where smaller local airports were devolved from the Australian Government to local authorities. This has proven to be a successful way of managing these facilities.

Recommendation

25 The ownership and control of remaining government-owned, low volume regional ports be offered to local authorities, in view of the significant role they play in their local communities.

B5 REGIONAL BULK WATER

KEY ISSUES

- Regional bulk water services are provided mostly by state and local government owned water businesses, but the private sector also owns dams, weirs, pipelines and water allocations.
- Application in Queensland of national reforms to the water sector under the National Water Initiative in the 1990s resulted in the creation of SunWater as a separate commercial entity, the creation of tradeable water allocations, and the introduction of pricing regulations. There has also been clear institutional separation of commercial, policy and regulatory functions.
- SunWater performs a range of commercial functions via its ownership of water infrastructure, including bulk water assets (dams, weirs) and distribution assets (irrigation channels, industrial pipelines).
- The financial performance for most of SunWater's assets is constrained by long-standing policy to subsidise infrastructure charges to irrigation users supplied from State government-owned infrastructure. The Government has invited local operators to take over these assets. This should allow it to withdraw from the area and the ongoing non-commercial costs.
- While SunWater should remain as a GOC, there are important aspects of its historical activity that can be taken up by the private sector such as pipeline construction and new bulk water storage.

B5.1 SECTOR PROFILE

B5.1.1 Regional bulk water services – supply and use

Regional bulk water services are defined as the provision of bulk, untreated water outside of South East Queensland (SEQ). Table B5.1 provides an overview of the water supply chain and highlights the elements relevant to bulk water services.

Table B5.1
Supply chain overview

Elements	Description
Water allocations	Represent the rights to access water or a share in the available resource. Water allocations can be held by any individual and can be traded. Values are determined by market factors. Allocations are generally held by end users.
Bulk water	Involves the management of dams and weirs relating to water allocations, and supply of water to users directly from the dam or stream.
Bulk distribution	Involves the diversion and distribution of water from streams/dams into pipelines or channels, to user off-takes.
Treatment	Entails treatment of water to the standard required by end users. This is typically potable standard for drinking supplies.
Reticulation	Involves the distribution of water within urban areas to households, commercial and industrial users.

Source: Commission of Audit

In general, bulk water in regional Queensland is accessed as follows:

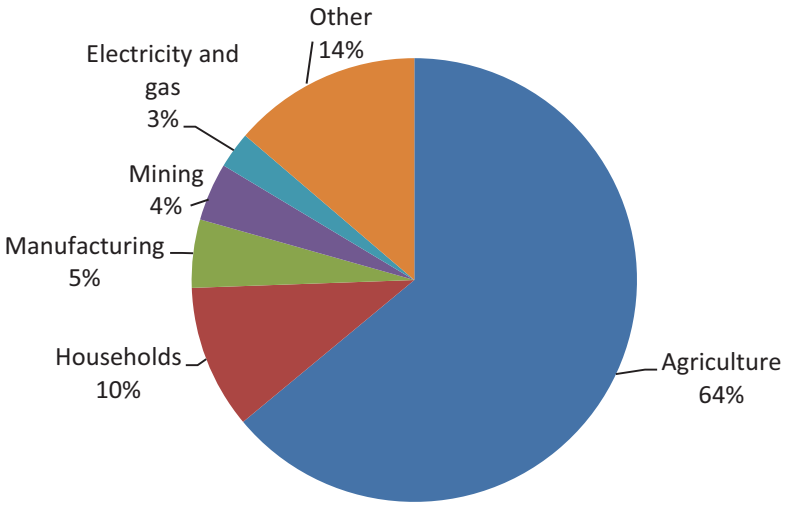
- Large water users such as irrigators, mines, power generators and industrial businesses are responsible for their own water supply. These users hold their own water allocations.
- Local governments are responsible for supply to towns in their area and are accountable for water supply security. Local governments typically hold water allocations for this purpose.
- The Queensland Government undertakes regional water supply planning, although these plans do not assign responsibility for implementation. The Government previously also funded investigations of projects identified under the State Water Policy.

This framework is different in SEQ, where the Government has a very clear responsibility for water security and supply planning, as well as identifying source augmentations and facilitating their development.

Agriculture is the largest user of water in Queensland, and accounts for around 64% of all water use. Almost all of this water is for irrigation. The other major uses are urban water use (households), accounting for 10% of usage at a state-wide level and manufacturing and mining uses, which together account for around 9% of usage.

Chart B5.1 provides an overview of water use at a state-wide level.

Chart B5.1
Water use in Queensland, 2010-11



Source: Australian Bureau of Statistics, Water Account Australia 2010-11, cat. no. 4610.1

B5.1.2 Regional bulk water service providers

Bulk water services are provided mostly by state and local government-owned water businesses, including:

- SunWater, which is a GOC.

- Government-owned statutory water authorities established under the *Water Act 2000,* notably:
  - Gladstone Area Water Board (GAWB), which supplies bulk raw and treated water in the Gladstone region to local governments and industry. GAWB owns storage, bulk distribution and treatment assets.
  - Mount Isa Water Board (MIWB), which supplies bulk treated water in Mount Isa to the Mount Isa City Council, mines (Xstrata) and industry. MIWB owns bulk distribution and treatment assets only.
- Other, smaller statutory water boards, which operate under the governance framework for boards in the *Water Act 2000.*
- The Border Rivers Commission (BRC), which is a joint Queensland–New South Wales authority.
- Local governments and their internal water businesses who supply water to towns in the council area. Councils either source water from storages owned by others (including SunWater), or own and manage their own water storages.
- A local government-owned corporation – Wide Bay Water.

Local governments which own regional bulk water assets include Cairns Regional Council, Townsville City Council, Rockhampton Regional Council, Fraser Coast Regional Council and Toowoomba Regional Council. In some cases, council and SunWater assets are located in the same catchment or stream.

The Fraser Coast Regional Council owns Wide Bay Water, which was established under the *Local Government Owned Corporations Act 1993*. The Fraser Coast Regional Council is reviewing whether Wide Bay Water should continue as a separate entity, and has released a consultant report that recommends that the entity be brought into council as a commercialised business unit.

Table B5.2 shows state and local government-owned businesses in the regional bulk water sector. SunWater has 19 bulk water storage facilities, substantially more than any other business.

Table B5.2
State and local government owned businesses in regional bulk water sector

Business	Bulk water (dams, major storages)	Other assets
SunWater	19	Distribution
GAWB	1	Distribution, treatment
MIWB	0	Distribution, treatment
Border Rivers Commission	1	-
Wide Bay Water	2	Distribution, treatment, reticulation
Cairns Regional Council	1	Distribution, treatment, reticulation
Townsville City Council	2	Distribution, treatment, reticulation
Rockhampton Regional Council	1	Distribution, treatment, reticulation
Toowoomba Regional Council	3	Distribution, treatment, reticulation

Source: Commission of Audit

Box B5.1 describes the other major regional bulk water businesses owned by the State Government, namely GAWB and MIWB. While this Report does not examine these businesses in detail, there do not appear to be any major differences between the assets owned by these entities and SunWater in terms of their commerciality.

Box B5.1
Regional bulk water suppliers

Gladstone Area Water Board (GAWB)

The Gladstone Area Water Board is a statutory authority under the *Water Act 2000*. It supplies bulk treated and raw water to the Gladstone region, and its major assets are Awoonga Dam, pipelines and a treatment plant. GAWB's customers include power generators, the Gladstone Regional Council and major industrial users. GAWB has recently investigated construction of a pipeline from the Fitzroy River to its main storage, Awoonga Dam. SunWater owns Eden Bann Weir on the Fitzroy River, and also owns a pipeline from Awoonga Dam to the Callide Power Station.

GAWB's 2011-12 revenue was $59 million, and EBIT was $27 million.

GAWB's prices are regulated by the Queensland Competition Authority (QCA).

Mount Isa Water Board (MIWB)

The Mount Isa Water Board is a category 1 statutory authority under the *Water Act 2000*. MIWB supplies bulk treated water to the Mount Isa City Council, Xstrata and other industrial users. Its major assets include pipelines and a treatment plant. The pipelines take water from Julius Dam (owned by SunWater) and Moondarra Dam (owned by Xstrata). SunWater also owns the North West Queensland Water Pipeline from Julius Dam to the Ernest Henry Mine and Cloncurry.

MIWB's 2011-12 revenue totalled $20 million, and EBIT for the year was $7 million.

Source: Various Annual Reports 2011-12

The private sector also owns dams, weirs, pipelines and water allocations. These private entities typically own these assets to supply their own operations, although some privately owned assets also supply third parties, including local governments. These private sector suppliers include:

- BMA and Xstrata who supply water from their pipelines to landholders as well as to local governments for use in towns near their coal mines
- Xstrata, which owns Moondarra Dam
  - the Mount Isa City Council and Xstrata own water allocations from this dam
  - MIWB is responsible for bulk distribution of the water allocations from this dam as well as Julius Dam (SunWater).

Some GOCs also own bulk water infrastructure for power generation, including Stanwell Corporation (a pipeline from Wivenhoe Dam to the Tarong Power Station, Kuranda Weir and Koombooloomba Dam) and CS Energy (Splityard Creek Dam).

Major reform to the water sector in Australia was first contemplated under a 1994 Council of Australian Governments (COAG) agreement, and was later updated in the 2004 National Water Initiative (NWI). The key elements relating to regional bulk water were:

- Institutional reform – including separation of regulatory and commercial functions, implementing independent price regulation, and benchmarking efficient performance of water suppliers.

- Water trading – establishing clearly defined water rights (water allocations) and removing barriers to the trading of those rights.

- Pricing reform – achieving, as a minimum, recovery of operations, maintenance, administration and asset renewal costs (the lower bound cost of supply) in rural and regional areas. The NWI also required movement towards full commercial pricing, including a rate of return on existing assets to the extent it is practicable to do so.

In Queensland, the application of these reforms has resulted in:

- the creation of separate commercial entities, such as SunWater, from the water resource manager (Department of Natural Resources and Mines)

- implementation of price regulation through the QCA

- establishment of tradable water allocations

- movement towards lower bound cost recovery for irrigation supplies.

B5.1.3 Other states

A range of models exist in other states for supply to regional towns and industry. In general, water supply is more commonly provided through regional or state-wide water businesses, rather than local government (New South Wales is the only other state where local governments have widespread water supply responsibilities). In Western Australia and South Australia, responsibility for bulk water supply lies predominantly with a vertically integrated State Government provider rather than through local government, whereas in Queensland there is a shared responsibility between both levels of government. In Victoria there are 16 State Government owned regional bulk water supply corporations mostly operating on a vertically integrated basis with local government.

Government ownership of regional bulk water assets is common across all states, as shown in Table B5.3.

Table B5.3
Provision of regional water services in Australian jurisdictions

Jurisdiction	Basis of regional water supply	Details
New South Wales	State and local government water businesses	Vertical separation of bulk water from storages, and distribution and reticulation, by local governments. The state government-owned State Water provides the bulk services to local governments.
Victoria	Regional water businesses	There are 16 regional water and sewerage corporations, which are generally vertically integrated. Businesses are state-owned.
Western Australia	State-wide water business (predominantly)	Water Corporation is a state-owned water business that is vertically integrated and supplies water across most of Western Australia. There are some other smaller vertically integrated water businesses operating in particular areas.
South Australia	State-wide water business (predominantly)	SA Water is a vertically integrated supplier that operates across most of the state. Local governments supply other, smaller areas.

Source: Commission of Audit

As shown in Table B5.4, irrigation services in Australia are provided through a diverse range of structures, from state-owned corporations in Victoria to privately owned irrigation trusts in South Australia. In general, user ownership and/or management of irrigation distribution assets is more prevalent in other states than in Queensland. Bulk water assets (dams, weirs) generally remain in state government ownership.

Table B5.4
Provision of irrigation services in Australian jurisdictions

Jurisdiction	Bulk water – storage	Bulk water – distribution	Details
New South Wales	State	Private	Privately owned irrigation corporations own irrigation distribution systems. State Water is the government owner of water storages.
Victoria	State	State	Irrigation services in Victoria are predominantly supplied by state owned corporations, including irrigation distribution systems and bulk water.
Western Australia	State	Private	Privately owned irrigation corporations own irrigation distribution systems. Water Corporation is the government owner of water storages.
South Australia	State	Private	Privately owned irrigation trusts own irrigation distribution systems. SA Water provides bulk storage services.

Source: Commission of Audit

B5.2 Regulatory Framework

B5.2.1 Regulation of bulk water assets

Implementation of water reforms in Queensland has resulted in water users holding clearly specified rights to water (water allocations), and Government regulating the access to water under those entitlements. There has also been clear institutional separation of commercial, policy and regulatory functions.

The regulatory arrangements in Queensland structurally separate the ownership rights to water (water allocations) from the dam structure.

The State Government defines the available resource and determines how water from a dam is to be managed to meet supply outcomes for water allocation holders. These rules are set for the dam owner and regulated under the *Water Act 2000*. The rights of water users are codified in legislation, including rules governing access to water during drought, and the trading of those rights.

Accordingly, the Government's role is to set the rules under legislation and manage compliance against those rules by the dam owner. Government does not need to own the dam infrastructure to protect water users' rights.

For example, Mount Isa City Council holds a water allocation from Moondarra Dam, which is owned by Xstrata. Xstrata also holds a water allocation, which it uses for its mining operations. The State Government determines Mount Isa City Council's access to water from this dam, and also sets or approves rules about how Xstrata manages the dam, including rules for sharing water in times of drought. Box B5.2 provides further information on the management of water allocations of the Mount Isa City Council.

Box B5.2
Mount Isa City Council water allocations

Xstrata owns Moondarra Dam, near Mount Isa. The Government has made a Resource Operations Plan (ROP) that specifies the water allocations at this dam, and how they are to be managed. This ROP is made under the *Water Act 2000*. The ROP sets out a range of obligations on Xstrata, and also regulates how water is to be shared in times of drought.

Mount Isa City Council owns a water allocation of 12,500 ML from Moondarra Dam. Xstrata also owns a water allocation of 12,500 ML. Xstrata, as the dam owner and holder of a Resource Operations Licence, must manage all water allocations, including the Council's allocation, in accordance with the ROP. For example, the ROP sets out a formula and parameter values to be applied to determine the shares of water in storage between Council and Xstrata. The ROP also sets out rules for the Council and Xstrata to trade or deal with their water allocations.

This means that Xstrata has very little discretion in how water allocations are managed, as these are codified in the ROP.

Mount Isa City Council also holds a water allocation from Julius Dam, which is owned by SunWater. The regulatory regime for SunWater and Xstrata are the same, which means there are no differences for Mount Isa City Council's access to water from either dam due to the ownership of the respective dams.

B5.2.2 Pricing regulation

SunWater is subject to regulation under the *Queensland Competition Authority Act 1997* (QCA Act) and potentially the *Competition and Consumer Act 2010*. Part 3 of the QCA Act provides for the QCA Ministers to refer a pricing matter to the QCA. The QCA only has recommendatory powers, with the QCA Ministers making any determinations. Part 5 of the QCA Act provides for a third party access regime for declared assets. Part 5A of the *QCA Act* also deals with price regulation of water assets, but this only relates to assets in private ownership.

Part IIIA of the Australian Government *Competition and Consumer Act 2010* sets out an access regime for natural monopoly infrastructure, although it is generally limited to assets that hold a strategic position in an industry and are of national significance. This Act has not been applied to SunWater's assets.

To date, only irrigation prices have been referred to the QCA, and the QCA has determined lower bound costs for the 2012-13 to 2016-17 period, and recommended tariffs to meet the Government's pricing policy.

Price regulation for the urban and industrial sectors operates under a quasi negotiate–arbirtrate model. No matters or disputes have been referred to the QCA for industrial or urban prices.

B5.3 SUNWATER – FINANCIAL INFORMATION

SunWater has achieved significant growth in earnings over recent years, reflecting around 60% growth in revenue since 2005-06. There was a near threefold increase in earnings before interest and tax between 2006-07 and 2010-11. Table B5.5 provides a summary for recent years, and shows a one-year decline in EBIT and net profit after tax for 2011-12. The 2011-12 financial results were affected by an impairment expense of $95.9 million for plant and equipment, including $28.7 million in pre-construction costs for the Connors River Dam and pipeline projects. The SunWater Board resolved in July 2012 to cease all project activities associated with the Connors River projects.

Table B5.5
SunWater financial indicators

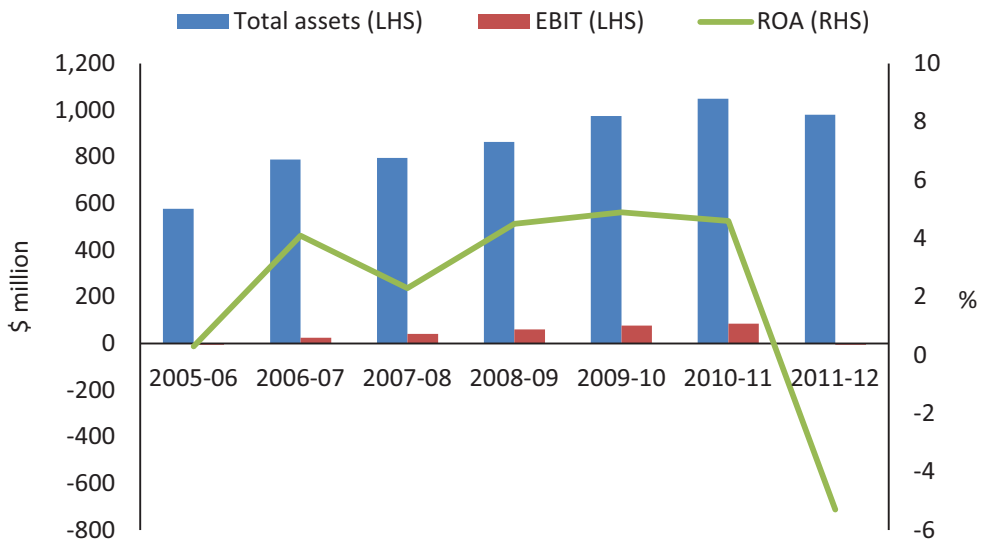
	2005-06 $m	2006-07 $m	2007-08 $m	2008-09 $m	2009-10 $m	2010-11 $m	2011-12 $m
Revenue	122.0	142.8	190.6	198.6	196.4	204.0	206.8
EBIT	(5.4)	24.9	40.7	60.4	76.1	85.0	(5.9)
NPAT	1.3	28.2	17.8	37.1	44.8	46.0	(17.1)

EBIT = Earnings before interest and tax, NPAT = Net profit after tax

Source: SunWater

Chart B5.2 shows earnings compared with total assets and return on assets. The chart shows the impact of the significant impairment of assets reported in 2011-12.

Chart B5.2
Assets, earnings and return on assets, SunWater



Source: SunWater annual reports

Table B5.6 shows that SunWater had diverse sources of revenue over the last two years:

- While industrial and irrigation charges were the two highest revenue sources in recent years, revenues from each of consulting services and interest generated around the same amount of revenue as from urban revenue deliveries (including CSO payments from government).

- CSO payments from Government for irrigation water deliveries varied considerably over the two years, from around $1 million in 2010-11 to over $6 million in 2011-12.

The increase in the CSO payment for irrigation channels in 2011-12, compared with 2010-11, reflects the latest QCA review of the cost of irrigation services – *Irrigation Price Review: 2012-17*. The 2012-17 review impacts on the calculation of the 2011-12 CSO in two ways:

- The more up-to-date information in the 2012-17 review is used to calculate the CSO payment in 2011-12.

- The gap between the QCA determined efficient lower bound cost of irrigation schemes and allowable prices for irrigation services (the CSO) increased over the regulatory period 1 July 2006 to 30 June 2012.

This increasing gap, along with the updated information in the 2012-17 review, is reflected in the increased cost of the CSO in the last year of that regulatory period (2011-12).

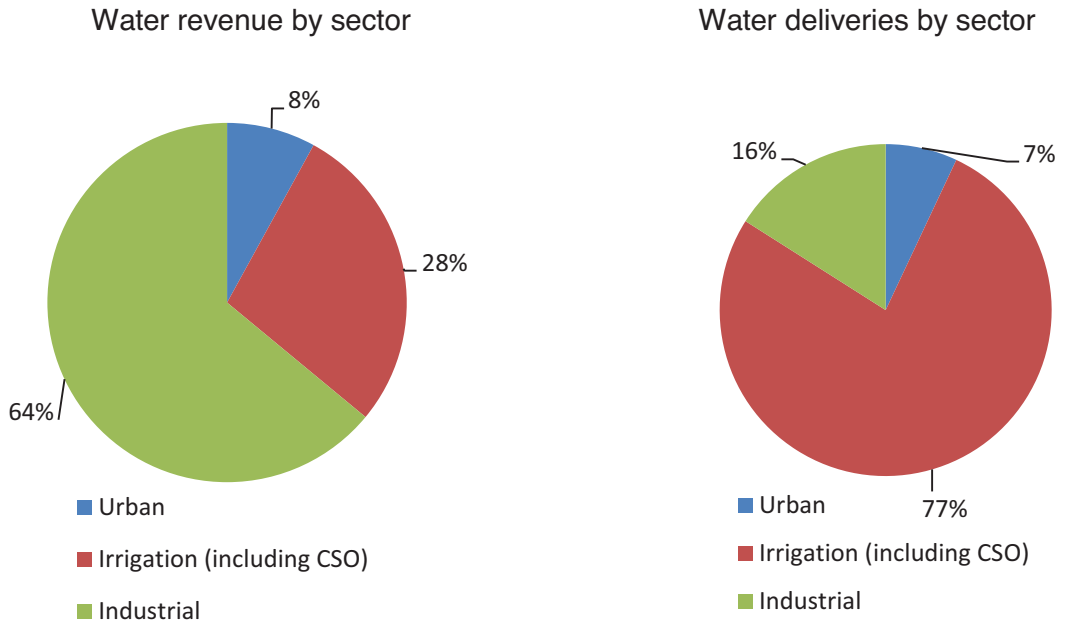
Table B5.6 SunWater revenue by sector/continuing operations		
Service	**2010-11 $m**	**2011-12 $m**
Industrial water charges	104	110
Irrigation water charges	42	49
Consulting and facilities services revenue	15	13
Water allocation revenue (trading)	11	13
Interest	14	13
Urban water charges	8	9
Community Service Obligations – Irrigation	1	6
Community Service Obligations – Urban	5	5
Other revenue	3	4
Total	203	221

Source: SunWater Annual Report 2011-12

The financial performance for most of SunWater's assets is constrained by long-standing policy to subsidise infrastructure charges to irrigation users supplied from state government-owned infrastructure.

Chart B5.3 shows that in 2010-11, while industrial users were the largest revenue source, at 64%, they comprised only 16% of the total water supplied. Irrigation accounted for around 77% of water supplied, but represented only 28% of revenue.

Chart B5.3
SunWater's water deliveries and revenues by customer sector, 2010-11



Source: Queensland Competition Authority, SunWater Irrigation Price Review 2012-17, Volume 1, May 2012

As a result, SunWater's industrial pipelines account for around 88% of operating profit in 2011-12, while operating profit among water supply schemes (dams, weirs) and distribution systems (channels, pipelines) is negligible where the irrigation sector is the major user.

The disproportionately low contribution of the irrigation sector to total revenue (and profit) is explained by the Queensland Government's long-standing policy that irrigation prices do not need to recover a commercial rate of return on the existing asset base. For many water supply schemes and irrigation channels, prices have been capped by Government and do not recover the lower bound cost of supply, let alone provide any return on assets. Where this occurs, Government provides a cash CSO to SunWater to fund the shortfall. This CSO is forecast by Sunwater to be around $9 million in 2012-13 reducing to $4 million at the end of the current price path in 2016-17.

The Government does not provide a CSO to SunWater for the shortfall based on what could be charged, which is a commercial rate of return, up to irrigators' capacity to pay. The Government instead accepts lower profits and dividends from SunWater – effectively an unfunded CSO.

The Queensland Government does not apply this policy to new bulk water assets, such as Paradise Dam and Kirar Weir that were constructed by SunWater's subsidiary Burnett Water. Rather, such investments were expected to be made on a commercial basis, incorporating a commercial rate of return. Also, the Government does not require private or local government water asset owners to forgo a commercial rate of return when charging irrigators to take water from their assets. Hence, the policy is a legacy arrangement, applying only through the State's ownership of SunWater.

The Government also provides a CSO to SunWater to subsidise prices to the town of Cloncurry, from the North West Queensland Water Pipeline. This CSO is around $5 million per annum.

The gearing in SunWater, measured as the ratio of debt to debt plus equity is marginally lower than similar regional bulk water suppliers in other states. Table B5.7 shows little variation in the gearing ratio across each of the states and that the ratio has been stable over the last two years.

Table B5.7
Government regional water corporations – debt/(debt plus equity) ratio

	2010-11	2011-12
SunWater	0.27	0.27
State Water Corporation NSW	0.29	0.30
SA Water	0.30	0.31
Water Corporation WA	0.33	0.31

Source: 2011-12 annual reports for SunWater, and state water corporations in NSW, South Australia and Western Australia

Regional bulk water in Victoria is supplied by a number of smaller suppliers that generally have lower gearing than the state-wide suppliers in other states.

B5.4 IRRIGATION CHANNELS AND SYSTEMS

SunWater owns eight channel systems that provide a commercial service to irrigation customers, who use water as an input to their farming businesses.

The Government's irrigation pricing policy applies to these systems, which means SunWater forgoes a rate of return on the channel assets. Irrigation prices in these channel systems do not always recover the minimum lower bound costs. In these systems, Government provides a CSO to SunWater for the shortfall to allow it to recover efficient lower bound costs. These pricing arrangements and CSO are in place until June 2017.

These assets are uncommercial for so long as this policy continues.

The public policy rationale for continued public subsidisation of irrigation channel systems is not well defined. The benefit from the continued provision of these services is largely captured by well-established private operators rather than the public at large.

The opportunity cost of the subsidies, to the public, is not transparent. Moreover, there has been no formal assessment of the practicable limits of irrigation prices to determine whether further price increases can be achieved, as is contemplated in the NWI.

Similarly, there needs to be a clear policy rationale for dealing with new cost imposts related to providing services to the irrigation sector. For example, SunWater faces significant compliance costs to upgrade spillway capacity and other works to meet dam safety requirements, affecting 15 of SunWater's 19 major dams. Work has been completed (or largely completed) at five dams, and further upgrades are required over the next 10 to 15 years.

It is normal commercial and regulatory practice for compliance costs to be included in user prices. For example, the QCA previously included the safety upgrade cost at Awoonga Dam into GAWB's prices to its customers.

However, upgrade costs at SunWater dams have been excluded from irrigation prices under the Government's pricing policy. SunWater has forecast future requirements for government grant funding to 2016-17, totalling $182 million, to fund the shortfall caused by this policy.

Further cost imposts will emerge under the NWI, which requires that bulk water meters comply with accuracy standards by 2020. SunWater has previously estimated the cost of implementing this upgrade at $130 million.[1] The State Government is yet to decide how the costs of meter upgrades are to be recovered, and in particular if irrigators (who will comprise the vast majority of this cost) will pay for the costs.

As the benefits from irrigation channels are captured largely by private businesses, responsibility for provision of maintenance and upgrading of the channels should rest with private irrigators.

Following a recent review, the Government has announced that Queensland's eight channel irrigation schemes will be invited to develop business proposals to transition from SunWater to local management. Local management already exists in some parts of Queensland (for example, water boards), and extensively in New South Wales, Western Australia and South Australia.

The Commission therefore considers that SunWater's irrigation channels should be transferred to private irrigators under user-management or similar arrangements, and that SunWater should withdraw fully from this activity.

Recommendation

26 SunWater finalise the transfer of its irrigation channels to private irrigators and withdraw fully from this activity.

B5.5 COMMERCIAL AND INDUSTRIAL PIPELINES

SunWater owns nine industrial pipelines that mostly service the mining and electricity generation sectors. These are set out in Table B5.8.

Table B5.8
SunWater commercial and industrial pipelines

Distribution system	Source dam	Main user(s)
North West Queensland Pipeline	Julius	Mining
Burdekin–Moranbah Pipeline	Burdekin	Mining
Eungella Pipeline(s)	Eungella	Mining
Collinsville Pipeline	Eungella	Power generation, mining, urban
Awoonga Callide Pipeline	Awoonga Dam (GAWB)	Power generation (Tarong Power Station)
Blackwater Pipeline	Fairbairn	Mining
Tarong Pipeline	Boondooma	Power generation (Tarong Power Station)
Stanwell Pipeline	Eden Bann Weir	Power generation (Stanwell Power Station)
Kenya – Cunnamulla Weir Pipeline	Coal Seam Gas Water supply from Queensland Gas Corporation	Irrigation

Source: SunWater

The pipelines transport water from source (for example, a dam) to the user, according to conditions specified under individual contracts. This service is fundamentally a commercial one and there are already many private sector owners of water pipelines in Queensland.

SunWater's industrial pipelines are commercial assets, and services could equally be provided under private sector ownership. In fact, these assets are similar in nature to gas pipelines, which are owned privately and largely service industrial users in Queensland.

These assets do not service irrigators and are not subject to the irrigation pricing policy. There is clearly scope to increase private sector investment in the regional pipelines, including expansions of existing pipeline networks or development of new pipelines to meet growth in regional water demands.

As discrete assets earning commercial rates of return, there is no strong case for continued government ownership of these assets, especially where private sector alternatives are available. The Commission considers that these assets should be divested to either private owners or private operators, depending on which offers better value for money for the state taxpayer.

Any decision to divest assets would need to take account of the financial returns from those assets and their likely value. While these pipelines generate most of SunWater's profit, the value of individual pipelines would need to be assessed. Some assets may be of little commercial value, for example, due to legacy contracts, and the costs of divestment may outweigh the benefits.

Decisions also would need to be made about how best to package or structure assets to maximise their value, allow new owners to take advantage of scale and scope economies, and reduce transaction costs of sale.

Timing issues also would need to be considered. In some cases, value might be maximised by deferring a sale. In other cases, the opportunities to maximise value may be more short term – before a major expenditure was required that would place further pressure on the State's fiscal position.

The regulatory arrangements for privatised monopoly assets, particularly governing access and pricing, will also need to be considered to ensure they are appropriate. Further analysis of these issues will be required once policy decisions have been made.

Recommendation

27 SunWater's dedicated water supply infrastructure servicing commercial and industrial clients be offered for private ownership and/or private operation, depending on which solution provides better value for money outcome for the Government.

B5.6 FUTURE ROLE OF SUNWATER

Government's ownership of assets held by SunWater is largely due to decisions made several decades ago (mostly in the 1970s and 1980s), amid a policy environment where the Government invested heavily in, and developed, utility infrastructure. Private provision of water infrastructure at this time was uncommon due to:

- the non-commercial, community nature of infrastructure investment in regional areas
- the owners of bulk water assets and water allocations typically being one and the same monopoly operator
- a lack of private investment funds for such activities.

The relevance of these arguments for continued government ownership of bulk water assets has diminished considerably over time:

- national water reforms have separated property rights over water allocations from bulk water storage and distribution assets. Current owners of the bulk water assets are less likely to control water allocations.

- greater sophistication in the regulation of privately owned monopoly assets
- a switch in focus from bulk water assets being non-commercial community assets to public assets that should earn a commercial rate of return.

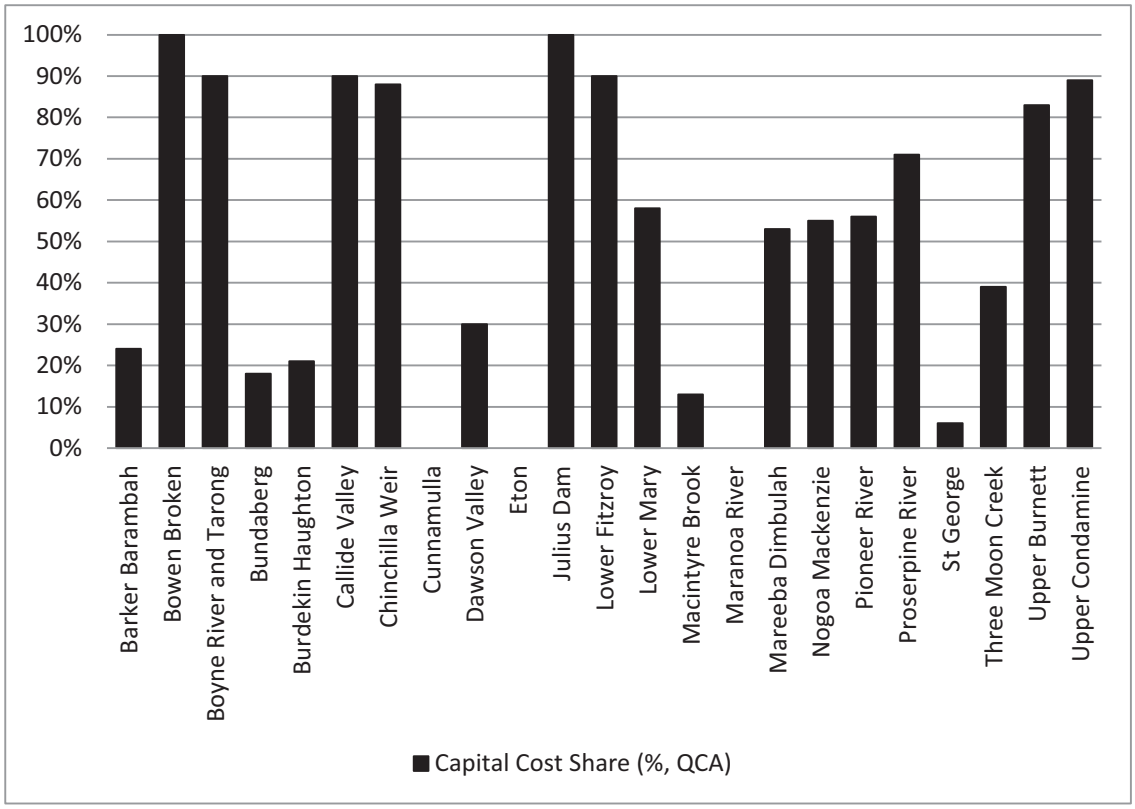
As indicated above, many of SunWater's assets are commercial in nature, although some are not held for commercial purposes in respect of the irrigation sector.

Most of SunWater's bulk water assets (organised into water supply schemes) are affected by the Government's irrigation pricing policy. However, some water supply schemes are not affected, or only affected to a slight degree.

Chart B5.4 shows the percentage of capital costs that were allocated to the non-irrigation sector by the QCA in its recent review of irrigation prices.[2] These percentages are an indication of the proportion of asset value that could be subject to a rate of return for the non-irrigation sector.

Chart B5.4

Percentage of bulk water schemes capital cost not attributed to irrigation pricing



Note: High priority water allocations are taken as a proxy for the non-irrigation sector. These percentages are called Headworks Utilisation Factor (HUF) percentages. A differential exists between the proportion of water allocations and the costs allocated to schemes by the QCA because of the difference in supply reliability between irrigators and non-irrigation water allocations (or more precisely, medium and high priority allocations). Accordingly, in some schemes, non-irrigators comprise a small portion of total water allocations; however, a large part of the capital cost of the scheme is notionally assigned to them for pricing purposes. In these schemes, the portion of asset value that is not subject to a rate of return for irrigators is small, even though irrigators may account for most of the allocations and water use in the scheme.

Source: QCA Final Report, SunWater Irrigation Charges (2012)

Chart B5.4 suggests that the following water supply schemes are, on face value, least affected by the irrigation pricing policy:

- Julius Dam, where there are no irrigators. Rather, the dam is used by Mount Isa City Council, industrial and mining customers and also supplies Cloncurry via the North West Queensland Water Pipeline.

- Bowen Broken River which comprises Eungella Dam and related storages that form the Bowen Broken Water Supply Scheme. Irrigators are a very small proportion of the scheme, and the QCA did not allocate any capital costs to the irrigation sector when recommending prices (though some operating costs were allocated to irrigators). The main users are mines, the Collinsville Power Station and local governments.

- Boyne Tarong Water Supply Scheme, which comprises the Boondooma Dam. The main user is the Tarong Power Station (Stanwell Corporation).

- Lower Fitzroy Water Supply Scheme – a single weir, Eden Bann Weir, forms this scheme although it operates alongside the Fitzroy Barrage and is owned by the Rockhampton Regional Council (as a separate water supply scheme). The main user of the Eden Bann Weir is the Stanwell Power Station (Stanwell Corporation).

- Bulk water assets owned by SunWater's subsidiary Burnett Water (Paradise Dam and Kirar Weir) are not subject to the Government's irrigation pricing policy.

This analysis suggests that at least some bulk water assets, particularly those not affected by the Government's irrigation pricing policy, may operate as stand-alone commercial enterprises in their own right. In these circumstances, there is a case for reconsidering both continued government ownership of bulk water assets and the acquisition of new assets.

On balance, the Commission considers that existing bulk water assets should continue to be retained under government ownership and management, consistent with the practice in other states, as there is presently a limited market for these assets. This should be subject to ongoing review, taking into account market developments and future interest from private sector investors.

However, the increased scope for commercial returns from new bulk water assets suggests these assets should be developed by the private sector unless there is a compelling public policy reason for government provision.

Recommendation

28 SunWater remain as a Government Owned Corporation with a residual function to retain ownership and management of existing bulk water assets in regional Queensland.

B5.7 FUTURE BULK WATER SUPPLY

The supply planning function involves forecasting demand and supply, and planning for measures to achieve a long-term demand–supply balance. This planning has also evolved to incorporate target levels of service in the urban sector, which are usually expressed in terms of the likelihood/frequency, severity and duration of water restrictions.

In SEQ, the planning framework is highly formalised, and responsibilities for bulk water planning and supply security clearly vest with the State Government.

Supply planning in regional Queensland is less formalised and more fragmented.

The State Government produces regional water supply strategies in partnership with its agencies, local government and other stakeholders. However, the strategies do not assign responsibilities for implementation, despite responsibility for supply security in regional towns vesting with local governments.

Other large water users (for example, mines, irrigators, power stations) hold individual water allocations, and are responsible for water supply planning on their own behalf.
The Government has initiated the preparation of a whole-of-government discussion paper on the challenges and opportunities facing Queensland's water supplies, including a 30-year water supply plan for the State.

Supply plans include preferred sources and triggers for augmentation. Hence there is an additional function of investigating these sources and ultimately developing them. Similar to other states, supply planning, sourcing and augmentation should be the responsibility of the water service provider or individual water user (outside of SEQ). However, the State Government has undertaken specific investigations for individual projects in addition to its planning activities outlined above. These projects, which service local government, mining and other demands, were identified under the State Water Policy. This policy required investigations to occur for nominated projects by nominated proponents.

Table B5.9 shows that the State Government also has provided funding for project investigations. The total commitment made by Government amounts to almost $350 million.

Table B5.9
Project investigations mandated under the State Water Policy

Project	Proponent	State Government commitment $m	Project cost estimate $m	Users
Kinchant Dam raising	SunWater	3	na	Residential, agricultural and tourism
Nathan Dam and pipelines	SunWater	120	630 (dam only)	Mining, industry, local government, irrigation
Connors River Dam and pipelines	SunWater	116	1,300	Mining, local government
Fitzroy to Gladstone Pipeline	GAWB	48	345	Local government, industry
Fitzroy River infrastructure	GAWB, SunWater	36	171-238	Local government, industry
Nullinga Dam	SunWater	6	na	Cairns City Council
Water for Bowen	SunWater	2	415	Local government, industry and irrigation
Water for Proserpine	SunWater	18	na	Local governments

na – not available

Source: www.derm.qld.gov.au as at 7 December 2012

These projects are at various stages of completion. Some projects have ceased or have been suspended, and only some of the original cost to complete business cases has been incurred. Some of these projects relate solely or mostly to a single local government, while others relate to growth demands from major users in the industrial and mining sectors.

While water users and local governments are responsible for sourcing water, they can engage third parties to aggregate demands and develop projects that jointly serve a number of user needs. This will generally provide benefits where scale economies exist. Indeed, SunWater has provided this service in developing various pipelines in recent years servicing the mining sector, such as the Burdekin-Moranbah Pipeline. SunWater continues to investigate similar projects, under commercial arrangements with potential users. Supply sourcing and augmentation can be performed by a range of government and non-government entities. Indeed, regulatory arrangements governing project approvals and land acquisition are generally neutral in terms of their applicability to private or public sector entities.

Nonetheless, this function should be the responsibility of the water service provider or individual water user. These entities should also be accountable for ensuring the required sources are identified and developed to meet demand. This is not to say that one or more of these entities should not engage the services of a third party to undertake project investigations, or for entities to work jointly to develop shared infrastructure where it is to their mutual benefit to do so. These decisions are best made by service providers, users and investors. Government's role should be to ensure approval and regulatory processes exist that allow for multi-user infrastructure to emerge and provide certainty to proponents. Processes currently exist through state development legislation.

At the same time, it is worth noting that no private sector entity has yet successfully performed this function and developed large-scale regional water infrastructure for multiple users. Notwithstanding this lack of private involvement to date, there is no reason why this aggregation and sourcing function could not be performed by the private sector in the future, particularly as the private sector involvement in regional bulk water increases.

In the meantime, Government may have a role in bringing willing parties with similar needs together if requested to do so by users, provided users fund the costs and there is a foreseeable pathway for private sector development of the asset. This role could be performed through SunWater in the short term, given its experience and success in doing so to date.

Any investment by SunWater in major water infrastructure would require significant government funding that would divert scarce capital that could be employed elsewhere for core government services. It would be preferable that water users and service providers, or a private sector investor (who might aggregate demands into a multi-user project), fund future investments in regional water infrastructure.

Local governments, as water service providers, are already responsible for financing their water infrastructure investments, and should be encouraged to consider private sector options for development of any new facilities. Local governments also should be responsible for conducting and financing project investigations and planning studies, either by themselves or jointly with other water users with similar needs.

Recommendation

29 Any future bulk water storage facilities be developed by the private sector, unless there are compelling public good or market failure reasons not to do so.

ENDNOTES

1 Sunwater Limited, Submission to QCA, 8 March 2010, accessed from www.qca.org.au

2 Queensland Competition Authority, *Sunwater Irrigation Charges Final Report*, 2012, accessed from www.qca.org.au

B6 FINANCIAL SERVICES

KEY ISSUES

- The provision of financial services by the Queensland Government is dominated by two entities: the Queensland Treasury Corporation (QTC), which undertakes debt and liability management functions; and the Queensland Investment Corporation (QIC), which undertakes investment funds management activities.
- In addition, there are a range of statutory bodies which have powers to invest in financial assets. A small number of these accrue assets as a consequence of their principal responsibility for managing significant long-tail financial liabilities.
- Nearly all of these financial assets are placed with QIC for management.
- QIC was established as a Government Owned Corporation in 1991 to provide a range of independent financial services to the Government and its public sector entities. Over time, QIC's role has expanded to include funds management on behalf of private sector clients, both domestic and international, as well as ongoing provision of funds management services to Government.
- Where alternative providers can deliver services to the same or better standard than government – as is the case with financial services – there is no rationale for the Government to continue to provide these services.
- Just as the Government exited from banking and insurance services, so too it should exit funds management by selling the Queensland Investment Corporation.

B6.1 QUEENSLAND GOVERNMENT FINANCIAL SERVICES PROVIDERS

At one time, the provision of financial services by state and federal governments was commonplace. Compared with the situation that existed 20 years ago, the range of financial services provided by state governments today is considerably diminished.

Whereas state governments provided banking, general insurance and other mainstream financial services, service provision by government is now mostly limited to centralised debt management functions, as well as management of long-tail financial liabilities and the investment funds required to meet these liabilities.

The provision of financial services by the Queensland Government is dominated by the Queensland Treasury Corporation (QTC), which undertakes debt and liability management functions; and the Queensland Investment Corporation (QIC), which undertakes investment funds management activities. In addition, there are a range of statutory bodies which have powers to invest in financial assets. A small number of these accrue assets as a consequence of their principal responsibility for managing significant long-tail financial liabilities.

B6.1.1 Queensland Treasury Corporation (QTC)

QTC was established on 1 July 1988 to provide a range of independent financial services to the Government and its public sector entities. It brought together the financial operations of its predecessor, the Queensland Government Development Authority, the Investment Branch of the Queensland Treasury department, and the debt of the Brisbane City Council and the Queensland Electricity Commission.

QTC was formed as a separate entity (a 'corporation sole'), constituted by the Under Treasurer. In practice, the Under Treasurer's functions have been delegated to a Capital Markets Board. In 1991, responsibility for the State's wholesale and medium to long-term investments was transferred from the Investments Division of QTC to the newly established entity, the Queensland Investment Corporation (QIC). As a result, QTC's role was modified to focus primarily on central borrowing activities, including debt and liability management, although it retained a limited funds management role.

QTC's primarily role is to implement the operational functions of a corporate treasury on a cost-recovery basis for the benefit of the State and its public sector organisations. This involves sourcing the State's long-term debt funding requirements in the most cost effective manner, and investing the State's short to medium-term cash surpluses with the aim of maximising returns to Queensland's public sector bodies within a conservative risk management framework. The debt and investment offering is provided to public sector bodies on a cost-recovery basis covered by administration fees of approximately 10 basis points per annum.

QTC's role as the State's corporate treasury services provider is limited to an operational capacity, while Queensland Treasury retains strategic oversight of, and ultimate responsibility for, the entities under its control.

In 1994, QTC broadened its capabilities and established an independent corporate advisory service. Introducing these complementary services allowed QTC to broaden its service to the State to include the provision of independent financial and risk management advice. While contestable, corporate advisory services are provided by QTC to public sector clients at rates below comparable services offered by the private sector.

QTC's investment funds manager role is relatively limited. It is responsible for only a small proportion of total funds under management in the Queensland Government.

QTC's treasury function serves to facilitate cash management for those public sector entities utilising QTC's investment services, and the State more broadly. However, statutory bodies are able to invest monies external to QTC per the investment powers granted them under the *Statutory Bodies Financial Arrangements Act 1982* (SBFA Act 1982).

B6.1.2 Queensland Investment Corporation (QIC)

At the time QIC was established, governments across Australia still maintained a significant presence in the ownership and provision of financial services:

- The Commonwealth Bank was still fully owned by the Australian Government.
- The Australian Government still owned the Australian Institute of Company Directors.

- State governments still owned banking and insurance services, although some had been forced to divest.

The financial services sector has changed profoundly since QIC was established. Both state and federal governments have long departed as owners of financial service providers, although the federal government remains a provider of private health insurance.

The financial sector is now more mature and competitive than it was 20 years ago and the regulatory environment is more sophisticated.

The rationale for statutory bodies to source their investment funds management from government rather than a competitive market of private investment managers has diminished.

For QIC, it is not only their original government funds management role that requires review. Over time, QIC's role has expanded to include funds management on behalf of private sector clients, both domestic and international, as well as ongoing provision of funds management services to Government:

- In 2002, QIC secured its first international client, a Dutch pension fund, signalling the start of an increasingly global organisation.

- Up until July 2004, QIC's private client fund growth was limited by approval from shareholding Ministers. Between July 2004 and November 2010, a cap on private client funds under management (FUM) was permitted (increasing from 10% to 15% over the period), subject to various conditions.

- In 2006, QIC made its first direct real estate investment outside of Australia, as well as QIC's first global direct infrastructure investment, Thames Water in the UK.

- In 2007, QIC expanded into London, with its first European Office.

QIC is unique among the federal and state governments in providing funds management on behalf of private sector clients.

After QIC introduced the House of Boutiques Model (nine specialist boutiques) in 2009, all restrictions relating to QIC sourcing external FUM were revoked in November 2010. This further shifted QIC from its original role as investment funds manager for the statutory bodies with long-tail liabilities.

QIC public client FUM as a percentage of total FUM for 2011-12 was 85.9%, while public client investment management and performance fees for the same period totalled 79.6% of total investment management and performance fees.

QIC's current growth plans are centred on growth in new private client FUM, including aspirations to attract business from large sovereign wealth funds. In order to deliver the growth targeted in their forecasts, suitable sources of seed capital are required.

QIC's boutique model provides a range of fund offerings with mixed returns. Table B6.1 shows the actual return on QIC investment funds since their inception compared with benchmark returns.

Table B6.1 QIC investment performance as at 31 October 2012			
QIC General investment funds	Actual return since inception %	Benchmark return since inception %	Return relative to benchmark %
Cash Enhanced Fund	5.88	5.43	0.45
Growth Fund	7.12	6.42	0.70
International Equities Fund	3.22	3.81	-0.59
Diversified Australian Equities Fund	8.66	10.52	-1.86
Australia Fixed Interest Fund	8.07	7.74	0.33
Diversified Fixed Interest Fund	8.06	7.59	0.47
Global Fixed Interest Alpha Fund	8.75	5.41	3.34
Global Fixed Interest Inflation Plus Fund	6.84	6.75	0.09
Property Fund	8.55	6.16	2.39
Active small companies	4.14	1.69	2.45

Source: Queensland Treasury and Trade

Fees paid to QIC by statutory bodies with long-tail liabilities and administering investment mandates range between 16 and 40 basis points per annum.

There is no compelling public policy rationale for an agency of Government to provide these financial services. They can be accessed on a competitive basis from private investment managers.

Furthermore, it is highly questionable as to whether Government should bear the risk of managing investment funds for the private sector.

The continued participation of QIC in this activity creates a distortion in financial markets. By means of its status as a crown entity, QIC has a competitive advantage that is not available to its private sector competitors. This includes benefits that accrue to QIC clients from certain land tax and stamp duty exemptions that have been applied to QIC's investments (where QIC invests in its capacity as trustee). The tax advantages arise as a result of QIC's crown status.

This advantage is inconsistent with long-standing principles of competitive neutrality.

The same arguments that apply to QIC also apply to QTC. In an era of open, competitive and dynamic financial markets, there is no strong rationale for government provision of investment funds management services.

B6.1.3 Long-tail liability management

State governments, for a range of public policy reasons, administer a number of long-tail liabilities. The nature of these long-tail liabilities is broadly consistent across state governments, with the bulk of liabilities by value being accounted for by:

- government employee superannuation schemes
- workers' compensation entitlements
- compulsory third party motor vehicle accident insurance
- builders' home warranty insurance

- trustee services, such as for deceased estates and rental bonds.

The funding of these liabilities relies on investment of accumulated financial contributions from actual or potential beneficiaries of the liability schemes. These are capital contributions in the case of superannuation, and rental bonds and premiums in the case of insurance activities. The statutory bodies administering the liabilities must also put in place an investment strategy for the accumulated financial assets.

A description of Queensland entities which manage the funding of long-tail liabilities is presented in Table B6.2.

Table B6.2
Entities administering investment funds

Entity	Public policy purpose
Long Term Assets Advisory Board	Established in 2008 to oversight the asset and liability management of QTC's long-term assets and the associated fixed rate note liability, and QSuper's public sector defined benefits assets.
WorkCover	Established in 1997 to provide accident insurance for work-related injuries in Queensland on an exclusive basis, with the exception of self-insurers.
Residential Tenancies Authority	Established in 1989 to offer a rental bond custodial service. The RTA provides tenancy information, bond management, dispute resolution, investigation, policy and education services.
Building Services Authority	Established in 1991 to regulate the building industry in Queensland. The BSA provides licensing services, dispute prevention and resolution services, home warranty insurance and information and education to consumers and contractors.
QLEAVE (Building & Construction)	Established in 1992 to administer a paid long service leave scheme for eligible workers in the building and construction industry regardless of whether they work on different projects for one or more employers.
QLEAVE (Contract Cleaning)	Established in 2005 to administer the portable long service leave scheme for workers and employers in the contract cleaning industry in Queensland.
Motor Accident Insurance Commission	Established in 1994 to license and supervise compulsory third party (CTP) insurers, monitor the operation of the CTP scheme, and administer the Nominal Defendant Fund. Various revenue sources are used to fund the Commission's research initiatives.
Nominal Defendant	Established in 1961 for the purpose of compensating people who are injured as a result of the negligent driving of unidentified and/or uninsured (no CTP insurance) motor vehicles.
Public Trustee	Established in 1916 to deliver a full range of professional, accessible and reliable trustee, financial and related services in a supportive, compassionate and ethical manner.

Source: Queensland Treasury and Trade

Special arrangements are in place for the management of the Government's liability for public sector superannuation. This is outlined in Box B6.1.

Box B6.1
Long Term Assets Advisory Board

The LTAAB is responsible for the oversight of asset and liability management for the State's defined benefit superannuation obligations. This represents the largest pool of investable assets within the Queensland Government's financial services sector. The assets under the LTAAB's administration are QTC's long term assets which do not form part of QTC's day-to-day capital markets operations.

The long term assets were transferred to QTC by the State Government on 1 July 2008 as part of a strategy to remove the associated volatility of the assets from the State's balance sheet. The long term assets are held in unit trusts managed by QIC. LTAAB also maintains responsibility for a liability hedge portfolio made up of derivative instruments which are managed with the long term assets by QIC. The liability hedge portfolio is designed to hedge movements in the Government's defined benefit liability resulting from changes in interest rates and inflation.

In return for the long term assets, QTC provides the Government a fixed rate note (currently 7.5% per annum) which sits as a liability on its balance sheet providing full funding for 98% of Queensland's public sector defined benefits, and other monies used to fund general insurance and long service leave liabilities. The remaining 2% of the State's fully funded defined benefits liability is covered by a pool of assets (employee contributions) managed by external providers on behalf of QSuper.

QTC's long term assets managed by QIC (employer fund) were valued at $29.2 billion as at 30 June 2012. The associated fixed rate note liability was valued at $31.9 billion as at 30 June 2012. QTC carries the net liability on its balance sheet, despite benefitting from the positive contribution provided by way of the liability hedging.

The assets managed by a range of external investment managers on behalf of QSuper were valued at $4.1 billion as at 30 June 2012 and are also used to fund defined benefit members associated insurance and tax liabilities.

Source: Queensland Treasury and Trade

Legal responsibility for these liabilities continues to rest with Government.

For superannuation entitlements, as an employer the Government will always retain the legal liability for payment of these entitlements.

For the various insurance schemes, Government has chosen to provide these services and assume the responsibility for the liabilities, for policy reasons including:

- There would be no private market for insurances of this type without the Government mandating the compulsory payment of premiums. If this is required, it is best done through the Government's compulsory revenue-raising powers.

- Even in the event that the Government mandated the payment of premiums to a private liability manager, the basic intention of these insurance schemes is not a commercial return. It is to maintain a social safety net.

- Management of these liabilities also can have effects on overall state economic efficiency and competitiveness, through the levels of insurance premiums. It is likely that the Government will have an objective of keeping premiums at a level which is competitive with other states. Any surpluses on these schemes should be returned through lower premiums, rather than retained and distributed as dividends.

For these reasons the Government retains legal responsibility for these long-tail liabilities and the governance structure to ensure that the liabilities continue to be met – such as an independent board (and trustees) that is closely supervised by the Government.

However, it does not follow that all aspects of the liability management function necessarily must be retained within Government.

The management of liability claims itself is a transaction or registry based service that can be contracted to private providers with specialist expertise in performing these services. In New South Wales, the claims management function of the state's workers' compensation scheme is contracted to private insurance firms with expertise in claims management. In Victoria, the processing of the deposit and return of rental tenancy bonds is contracted to a private registry service.

The Commission acknowledges there are justifiable public policy arguments for the Government retaining the legal responsibility for long-tail liabilities. However, where feasible, it should outsource private provision of transaction and registry services to manage claim liabilities.

Recommendation

30 Whilst the Government retain responsibility for long-tail liabilities, it outsource provision of transactional, registry and claim management services relating to its liabilities.

B6.2 INVESTMENT FUNDS MANAGEMENT – QUEENSLAND

Table B6.3 shows those Queensland entities responsible for significant long-tail liabilities and the value of financial assets that support the funding of the liabilities, as at 30 June 2012.

Table B6.3
Financial assets of entities administering investment funds
(as at 30 June 2012)

	Value and location of investment funds ($b)			
	QIC	QTC	Other	Total
Long Term Assets Advisory Board	29.2	-	-	29.2
WorkCover	2.7	-	**	2.7
Rental Tenancies Authority	0.7	-	**	0.7
Motor Accident Insurance Commission – Nominal Defendant	0.6	*	-	0.6
QLeave – Building and Construction Industry	0.5	*	*	0.5
Public Trustee[1]	0.5	**	*	0.6
Motor Accident Insurance Commission	0.1	*	-	0.2
Building Services Authority	0.1	*	-	0.2
QLeave – Contract Cleaning Industry	*	-	*	*
Total	34.3	0.1	0.1	34.6
% of total	99.4	0.3	0.3	100.0

* less than $50 million
** $50 million to $100 million

1 The Public Trustee also administers other assets on behalf of clients outside of its Common Fund. These assets are not required to be included in the Public Trustee's balance sheet. In some cases, the Trustee has a discretion over how these assets are invested, whereas in other cases the Trustee is required to manage the assets on behalf of the client, but with little or no discretion over the assets themselves.

Source: Annual Reports 2011-12, Public Trustee of Queensland

These entities accrue financial assets from either capital contributions or insurance premiums that are mandated by the liability schemes and which are invested to meet liabilities as they fall due. A description of the main entities and their liabilities is provided in Appendix A.

Table B6.3 also shows the investment funds manager selected by the entity to invest on their behalf. Key points are:

- All but a minor fraction of the financial assets held to fund long-tail liabilities are placed with QIC, with smaller amounts in QTC – primarily in short-term investments or cash.
- Entities invest only a minor amount directly with private sector financial institutions, primarily cash on hand at a bank for day-to-day operational expenses.

B6.2.1 Investment powers of Queensland statutory bodies

The decision to appoint an investment funds manager by one of the entities is a responsibility of the respective entity's board. Each board is comprised of independent directors with a fiduciary responsibility to the entity.

The power for these entities to undertake investments is provided in the SBFA Act. The Act and its accompanying regulations define three categories of investment powers and the statutory bodies to which each investment power applies. Table B6.4 shows that the entities in Table B6.3 covered by the SBFA Act are covered by Category 2 investment powers.

Table B6.4
Statutory body investment powers under the SBFA Act

Investment powers under the SBFA Act[1]	Applicable statutory bodies[2]
Category 2 investment power - Category 1 investment powers[3] – for at call investments or for a fixed time of not more than three years - if the investment is at call or for a fixed time of not more than one year – an investment arrangement with a rating prescribed by regulation - if the investment is for a fixed time of more than one year and not more than three years – an investment arrangement with a rating prescribed by regulation	WorkCover QLeave Building Services Authority Motor Accident Insurance Commission – Nominal Defendant Motor Accident Insurance Commission Residential Tenancies Authority

1 Summary only. Full powers described in Part 6, Division 1, SBFA Act.
2 Summary only. Full list described in the SBFA Regulation 2007.
3 Category 1 investment powers allow for at call investments or fixed for a period of not more than one year in an approved deposit taking institution, Commonwealth guaranteed investment or prescribed investments in QIC or QTC.

Source: Queensland Treasury and Trade

The Public Trustee and the LTAAB are not governed by the SBFA Act, but instead have specific investment powers vested in their Boards:

- The Public Trustee maintains independent investment powers granted and overseen by the Public Trust Office Investment Board.

- LTAAB maintains independent oversight of asset and liability management of the long-term assets on QTC's balance sheet.

Generally, the Category 2 powers allow statutory bodies to invest in three types of low risk investments for a period of no less than three years:

- those issued or guaranteed by the Australian or State Government
- a deposit with a financial institution
- investment arrangements offered by QIC or QTC that are prescribed by regulation.

Under Part 7 of the SBFA Act, prescribed statutory bodies may also enter into derivative transactions under certain conditions. These statutory bodies currently include:

- Building and Construction Industry (Portable Long Service Leave) Authority
- Residential Tenancies Authority
- WorkCover Queensland.

With the exception of the investment products that can be offered by QTC or QIC, the range of investments available to statutory bodies with long-tail liabilities is largely limited to government guaranteed risk free securities offered by the State or Australian Government.

The prescribed QIC and QTC investment arrangements permitted under Category 2 investment powers are outlined in Table B6.5.

Table B6.5 QIC and QTC investment arrangements under Category 2 investment power	
QIC	**QTC**
QIC Australian Fixed Interest Fund	QTC Capital Guaranteed Cash Fund
QIC Cash Fund	QTC Debt Offset Facility
QIC Growth Fund	QTC Fixed Rate Deposit (up to three years)
QIC Stable Fund	QTC Working Capital Facility

The ability to invest through QIC and QTC offers a wider range of investment alternatives to statutory bodies. QIC is able to offer access to investment funds backed either by cash, equity or real property assets. This will partly explain the choice of QIC as the preferred funds manager in Table B6.3. QTC is limited in its offering to different types of at call or fixed interest products.

There is a highly competitive and mature private sector market of investment managers. It is not clear what additional value is contributed by funds management services provided by QIC and QTC that cannot be sourced by direct investment with private investment managers.

A key question regarding the choice of QIC, and to a lesser extent QTC, is whether the funds management decision is driven by the product offering as such (which is widely available elsewhere) or whether it is driven primarily by competitive advantages conferred by government ownership – primarily the implicit government guarantee. These advantages are not available to their competitors.

B6.3 INVESTMENT FUNDS MANAGEMENT – OTHER STATES

Box B6.2 describes the investment funds management framework in other states. The main points to note are that:

- Only Queensland and Victoria have dedicated government investment funds managers separate to their central borrowing authorities.
- Only Queensland allows its funds manager to accept investment funds from private investors.
- Only Victoria and South Australia mandate the use of government funds managers for all government funds management activities.
- In other states, government departments and agencies are given the autonomy to choose their funds manager and may use the government borrowing authority as a default if no dedicated government funds manager exists.

Box B6.2
State government funds management

Investment funds management across states					
	Queensland	NSW	Vic	WA	SA
Dedicated government funds manager [1]	Yes	No	Yes	No	No
Private funds management by government	Yes	No	No	No	No
Mandated use of government funds manager [2]	No	No	Yes	No	Yes

1 In the states that do not have dedicated government funds managers, the state's central borrowing authority provides a default funds management service.

2 In Victoria, five government liability managers are required to use the Victoria Funds Management Corporation as their funds manager. These are liability managers for the government superannuation scheme, workers' compensation (two managers), motor accident, and building industry insurance. For South Australia, this is South Australian Financial Authority, the central borrowing authority.

New South Wales

The New South Wales Government established a decentralised, contestable system for the investing activities of government entities, subject to the operation of *The Public Authorities (Financial Arrangements) Act 1987* (PAFA). The Act sets out levels of investment powers depending on the nature of the government entity and details the nature of investments allowed. There is no government-owned investment or stand-alone government funds management entity in the state. However, New South Wales Treasury Corporation (T-Corp) offers a funds management service to government entities within this contestable framework.

Victoria

The Victorian Government operates a centralised investment and funds management business through Victoria Funds Management Corporation (VFMC). VFMC is established under the *Victorian Funds Management Act 1994* as a public authority with a role to provide commercial and competitive investment and funds management services to Victorian public authorities. Five public authorities in Victoria are mandated to invest with the government-owned financial services businesses, Treasury Corporation of Victoria or VFMC.

Western Australia

Management of investable funds of government entities is decentralised and highly contestable. Similar to the structure in New South Wales, there is no government-owned funds management business. However, government entities can choose to invest cash with the state's central borrowing authority, Western Australia Treasury Corporation.

South Australia

South Australia has a centralised model for the investing activities of government entities. Unlike the central borrowing authorities mentioned above, the central borrowing authority of South Australia, South Australia Financing Authority (SAFA), is not a corporation and the General Manager, SAFA reports directly to the Under Treasurer. As such, SAFA is limited in the investment products it can offer. However, all government entities are mandated to place surplus and investable funds with SAFA.

Source: Commission of Audit

The different approaches across the states reflect different views as to the relative costs and benefits of:

- centralisation of all government funds management with other cash management and debt management functions

- decentralisation of all government funds management, which allows for greater diversification of risk.

These issues were explored in the NSW Financial Audit 2011 by the New South Wales Government. The Financial Audit noted that:

- Compared with Queensland and Victoria, New South Wales has a decentralised approach to funds management.

- The decentralised approach had the advantage of diversifying risk, but the disadvantage of overlapping functions and associated cost inefficiencies.

- The decentralised approach made it more difficult for the state to have a consolidated view of its investment position.

With respect to the inefficiencies apparent in a decentralised approach to funds management, the NSW Financial Audit pointed to:

- the duplication and costs incurred by the various boards of different liability managers, who each engage their own investment consultants, advisers, custodians and funds managers to administer what is essentially the same government asset – the government's accumulated holding of investment funds

- the underutilisation of New South Wales Treasury Corporation, which has existing expertise in funds management.

The Financial Audit recommended that New South Wales not follow the QIC model of undertaking funds management for private clients.

After weighing up the costs and benefits of the different approaches, the Financial Audit recommended a centralised approach to funds management in New South Wales. Recommendation 18.22 of the report proposed that:

> *"A Treasurer's direction be issued under Section 9 of the Public Finance and Audit Act 1987 requiring all general government agencies to undertake new investments through Treasury Corporation."*

This recommendation was not adopted by the New South Wales Government.

Consistent with this position, the NSW Trustee and Guardian announced on 14 September 2012 that it had appointed a private sector custodian and trustee of investments in its Common Fund as well as a private sector funds manager. Previously, New South Wales Treasury Corporation acted as investment funds manager for the Public Trustee NSW.

The approach adopted in Victoria is an intermediate model that attempts to capture the positive features of both the decentralised and centralised models. The Victorian Government mandates that five significant long-tail insurance managers place their investment funds with VFMC, with other agencies having the discretion to choose their own funds manager. Under this model, the Victorian Government obtains the advantages of centralised funds management over the bulk of their financial assets, while gaining diversification of risk in the remainder of public sector agencies.

B6.4 Future Approach to Funds Management

The Commission notes that there is no consistent approach among the states on the most appropriate model of government funds management.

There are plausible public policy justifications for both a decentralised and centralised model of funds management. It is difficult to quantify the relative costs and benefits, because of the data limitations and complexities involved. In some respects, the choice of model will be a matter of judgement, based on a balanced view.

Throughout this Final Report, the Commission has articulated a consistent view that, in a fiscally constrained environment, the Queensland Government should focus on providing those services that only government can provide. Where alternative providers can deliver services to the same or better standard than Government, there is no rationale for Government to continue to provide those services.

On balance, the Commission considers that this principle should also apply to the provision of financial services. Specifically, the Commission considers that both the private and public client book of QIC should be divested, for the following reasons:

- The private funds management sector is mature, competitive and appropriately regulated. There is no justification for government provision of these services when they can be provided more than adequately by the private sector.

- In substance, there is no difference between the funds management services currently provided by QIC to Government and private clients, and other financial services that the Government has divested over the last 20 years.

- On balance, the Commission prefers an approach to government funds management that supports a diversification of investment risk for Government, based on underlying rates of return, not on the basis of competitive advantages conferred on a government provider. This approach offers scope for superior returns to be achieved, net of fees.

In Queensland's case, there is also the particular issue of QIC standing alone as a government funds manager that manages investment funds not only on behalf of Government, but also on behalf of private clients. Such an expansion into private sector activity only makes sense as a precursor to divestment of the business.

The 1996 Queensland Commission of Audit concluded that there was little justification for government involvement in the funds management industry through QIC. Given the evolution of QIC's role and increasing sophistication of the private funds management sector since that time, it is even more difficult to justify the continuation of QIC in government ownership.

Accordingly, the Commission considers that QIC's business should be divested as a going concern. This would require revision to the SBFA Act.

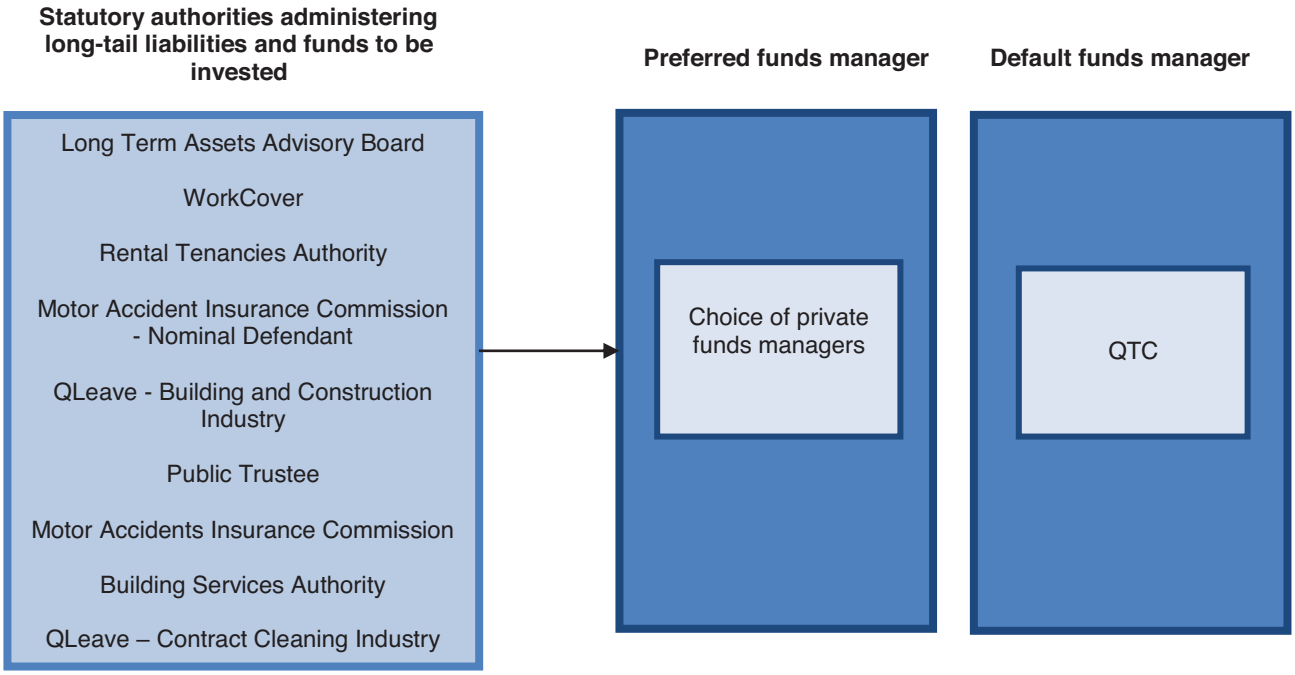
The structure of Part 6 of the Act that defines investment powers would remain largely unchanged. The core of the investment arrangements outlined in Part 6 could be readily accessed by a private investment funds manager.

The investment arrangements managed or offered by QIC under Schedule 7 of the regulations issued under the Act would need to be removed. However, as the Government has determined that these are an appropriate class of investment for statutory bodies with Category 2 investment powers, the SBFA Act and regulations should be amended to allow for those statutory bodies to undertake similar investment arrangements through a private investment funds manager.

For those liability managers who consider that a government funds manager is most appropriate for them, QTC could remain as the default investment manager. This should be on the basis that this component of QTC's activities would be subject to a full competitive neutrality model, encompassing taxation and other charges and a competitive neutrality fee reflecting the benefits conferred from an implicit government guarantee.

The recommended approach is outlined in Figure B6.1.

Figure B6.1
Proposed approach for Queensland funds management



Source: Commission of Audit

Recommendations

31 The Government divest Queensland Investment Corporation with both its private and public sector client book.

32 The Government amend the* Statutory Bodies Financial Arrangements Act 1982 *and regulations to allow statutory bodies to invest with a private sector funds manager on the same basis as is currently permitted under the Act and its regulations for Queensland Investment Corporation.

B7 COMMERCIAL BUSINESS UNITS

KEY ISSUES

- The Government's Commercial Business Units (CBU) model was developed in the early 1990s in response to reforms aimed at improving the efficiency and effectiveness of the Queensland public sector. It was designed to transition certain business activities to a more commercial environment. However, progress has been limited.
- The CBUs generally are monopoly suppliers of services to other government agencies. Mostly, they do not provide services to the general public and government departments and agencies are prohibited from using alternative suppliers to access services delivered by CBUs. This means that CBUs had captive clients, and face little or no competitive pressure, either in terms of costs, prices or quality of service.
- In the absence of such competitive pressures, there is limited, if any, effective scrutiny of costs and hence prices charged to internal clients. As a result, taxpayers are funding unnecessarily high costs for Government to transact business with itself.
- Following recent reviews by the Government, some activities of CBUs have been ceased, while others will have more limited roles in the delivery of services in regional and remote areas.
- The Commission is not convinced that there is a role for CBUs, even in regional and remote areas. It is possible that the existence of government providers in these areas may have created a barrier to entry, which discouraged a market for private providers. If this is the case, private providers could emerge in many regional locations, if there is a market opportunity.

B7.1 BACKGROUND

In its June 2012 Interim Report, the Commission identified that there were questions as to the viability of some Commercial Business Units (CBUs) that operate within the General Government sector, the value for money which they provide to clients, and the implications for the State's financial position. The Commission proposed to address these issues in further detail in its subsequent report.

Since then, the Government has reviewed the functions of CBUs, and has made decisions on future government involvement in various commercial and quasi-commercial activities.

In the light of these decisions, this section addresses the residual role of Government in undertaking activity of a commercial or quasi-commercial nature in the General Government sector through CBUs.

The Government's CBU model was developed in the early 1990s in response to reforms aimed at improving the efficiency and effectiveness of the Queensland public sector. At the time, the commercialisation reforms were applied to suitable government businesses where there was an opportunity for more commercial delivery, but were not large enough for corporatisation.

The CBUs are intended to operate within a departmental framework that applies the concept of commercialisation to the provision of its services (including adoption of full cost pricing principles), with clear and non-conflicting objectives, management responsibility, authority and autonomy, and accountability for performance. They operate within the administrative structure of a department, are responsible to the Minister through the chief executive, and are subject to Ministerial direction.

Table B7.1 shows the eight CBUs that existed prior to the Government's recent review.

Table B7.1
Commercial Business Units

Business unit	Services	Department/Location
GoPrint	Printing services	Department of Housing and Public Works
Sales and Distribution Services (SDS)	Centralised stationery supplies and distribution	Department of Housing and Public Works
QFleet	Government vehicle fleet services	Department of Housing and Public Works
QBuild	Government building maintenance	Department of Housing and Public Works
Project Services	Government project management services	Department of Housing and Public Works
RoadTek	Road construction and maintenance	Department of Transport and Main Roads
Property Services Group	Industrial land development	Department of State Development, Infrastructure and Planning
CITEC	IT services	Department of Science, Information Technology, Innovation and the Arts

Source: Queensland Treasury and Trade

The commercialisation framework was an appropriate tool 20 years ago to transition commercial activities undertaken by government from departments and statutory authorities to a more commercial business setting.

In reality, however, progress towards a more commercial environment has been limited. Despite a commercial façade, the operating environment of CBUs continues to be non-competitive:

- Government agencies largely are required to use the services of the CBUs, and therefore a number of the CBUs experienced little threat of competition from private providers. There is no incentive to keep costs low, to ensure prices are competitive, or to improve service delivery to major customers.

- In many instances, government agencies have been prohibited from accessing alternative service providers. As such, CBUs have had a guaranteed source of revenue, irrespective of the efficiency of their service delivery.

- For a number of the CBUs, much of the fee income was sourced from the mandated services provided to government customers, through an internal flow of funds within government.

In summary, the CBUs generally are monopoly suppliers of services to other government agencies. Mostly, they do not provide services to the general public, and government departments and agencies are prohibited from using alternative suppliers to access services delivered by CBUs. This means that CBUs have captive clients, and face little or no competitive pressure, either in terms of costs, prices or quality of service.

In the absence of such competitive pressures, there is limited, if any, effective scrutiny of costs and hence prices charged to internal clients. As a result, taxpayers are funding unnecessarily high costs for Government to transact business with itself.

Table B7.2 shows the eight CBUs' financial performance and staffing numbers for 2011-12, noting that any profit or loss for a CBU is a transfer between one government entity to another. The table shows that despite CBUs having guaranteed sources of income, only three of the eight CBUs earned sufficient business income to cover their tax liabilities, after excluding grants and subsidies from Government.

Table B7.2
Commercial Business Units, financial information, 2011-12

Business unit	Gross turnover $'000	Net operating profit/(loss) after tax, excluding grants & subsidies $'000	Staff (full-time equivalent)
GoPrint	12,980	(3,132)	55
Sales and Distribution Services	56,465	(3,256)	99
QFleet	245,348	16,713	118
QBuild	976,479	(927)	2,515
Project Services	157,293	422	654
RoadTek	1,025,549	46,518	1,776
Property Services Group	137,553	(6,812)	21
CITEC	182,426	(38,003)	611

Source: State Budget 2012-13, Service Delivery Statement 11 September 2012

A review of other Australian jurisdictions confirmed they adopted similar commercial policies and principles for government commercial operations. For example, the New South Wales Government's Commercial Policy Framework aims to replicate within government businesses the appropriate disciplines and incentives that lead private sector businesses towards efficient commercial practices.

As in Queensland, and as required under the Competition Principles Agreement signed by all jurisdictions, those government agencies supplying goods and services in competition with the private sector are required to price the goods and services on a competitively neutral basis.

Table B7.3 compares the status of equivalent commercial business activities of government agencies in the other jurisdictions.

Table B7.3
Equivalent activities in other Australian jurisdictions

Service	Australian Government [1]	NSW	Vic	WA	SA
IT services	No	No	Yes (CenlTex)	No	Yes (Shared Services SA)
Printing services	Reserved printing only	Reserved printing only	Reserved printing only	Reserved printing only	Reserved printing only
Stationery and distribution	No	No	No	No	No
Government fleet	No	Yes	Yes	Yes	Yes
Government building maintenance	No	Yes (NSW Public Works)	No	No	Yes (Department of Transport, Planning & Infrastructure - Facility Services)
Project management	No	Yes (NSW Public Works)	No	Yes – (Building Management & Works)	Yes (Department of Transport, Planning & Infrastructure - Project Services)
Road construction and maintenance	No	Yes (Road & Fleet Services)	Yes (VicRoads)	No	No
Industrial land development	No	Yes LandCom (residential, commercial & industrial)	Yes Urban Renewal Authority (residential)	Yes LandCorp (residential commercial & industrial)	Yes Urban Renewal Authority (residential & industrial)

1 The Australian Government sold its eight commercial business units in 1997.

Source: Commission of Audit

The review of the jurisdictions for similar businesses to Queensland's CBUs reveals:

- The recent decisions of the Queensland Government bring the scope of CBU activities more into line with that of other jurisdictions.
- Where there is no similar service, the jurisdiction has contracted the service to the private sector.
- Queensland is the only jurisdiction to have separate commercial business units that have both sat within a government department structure and have been registered under the National Tax Equivalent Regime.

- Other than the Australian Government, all jurisdictions operated similar businesses to Queensland's Property Services Group, although they are currently operating in separate entities to the departmental structure.

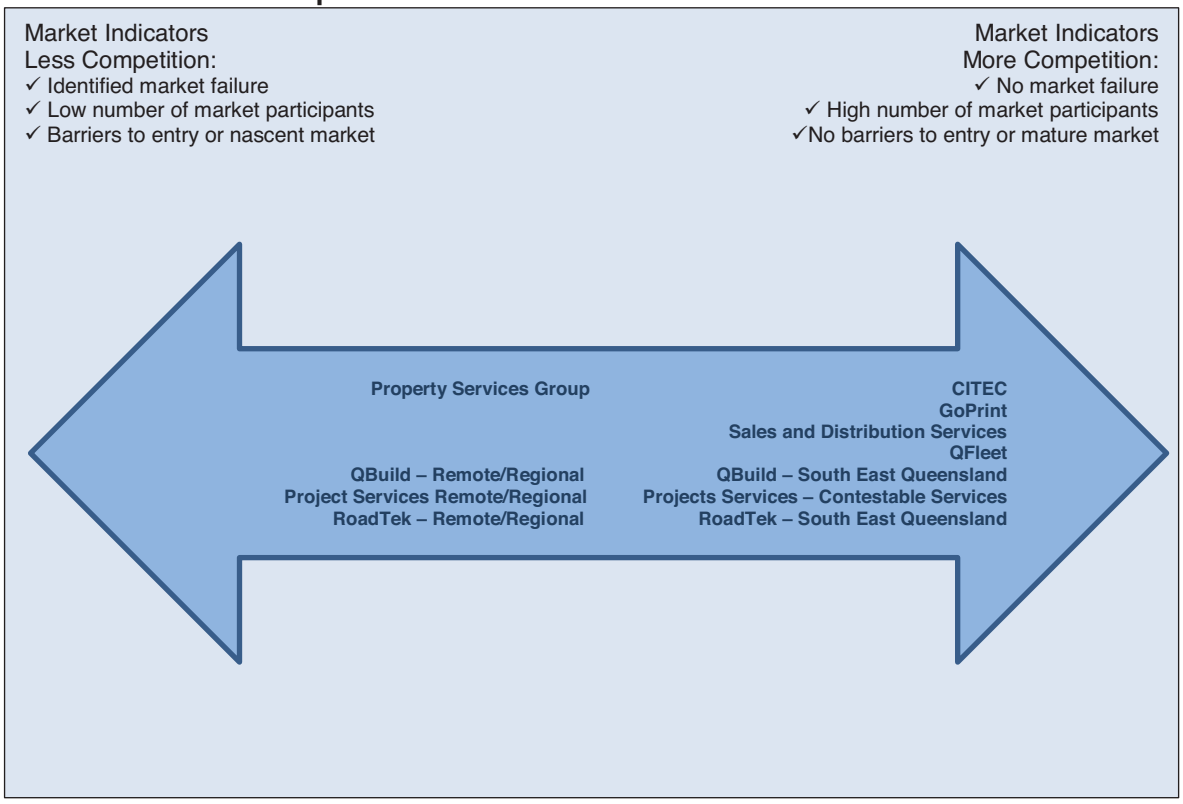
B7.2 STRATEGIC FRAMEWORK

Government does not need to deliver those services which can be delivered at equal or lower cost by the private sector. This means it will usually step in where there is some level of market failure. Usually government will be required to deliver those goods and services that have a value to the community as a whole, but not to an individual provider.

The CBUs deliver services in areas that are generally supplied by the private sector as full commercial services. If the Government were to exit its CBUs, there would be private suppliers available to step up and supply goods and services.

There may be some geographic areas where competitive supply of services would be harder to source than South East Queensland. This assessment is depicted in Figure B7.1.

Figure B7.1
Market penetration of Commercial Business Units



Source: Commission of Audit

Following recent decisions of the Government, the commercial operations of GoPrint have been discontinued, and these functions are now being sourced on a competitive basis from the private sector.

Sales and Distribution Services (SDS) ceased the bulk of its operations in December 2012. Residual SDS responsibilities relating to disaster management and recovery are to be transitioned to individual agencies during 2013.

The functions of CITEC are addressed in Section E7 of this Report. The residual functions of the remaining CBUs are considered below.

B7.3 QBUILD AND PROJECT SERVICES

QBuild and Project Services operate within the Department of Housing and Public Works.

QBuild previously provided construction and building maintenance services throughout Queensland to government agencies. It also provided whole-of-government responses to protect and maintain government infrastructure assets in the event of natural disasters and major incidents and provided other services in the areas of building security, cleaning and horticulture.

QBuild relied on an annual government subsidy to fund a policy directive to employ and train building trade apprentices over and above typical industry numbers.

Project Services provided building design and consulting services to government agencies.

In its recent review of these functions, the Government found that the current market in South East Queensland for building design, construction, cleaning and maintenance services is highly competitive with a large number of private sector providers. However, advice from government agencies is that they find it difficult or more costly to source services locally in regional and remote areas of the State.

On this basis, the Government has decided that QBuild and Project Services will amalgamate to provide a centrally focussed building, maintenance and disaster response service, particularly focussing on the remote and regional areas of Queensland. Services currently provided to government agencies in South East Queensland will be outsourced to the private sector.

An implementation plan for the amalgamation of the two CBUs has been prepared for consideration by Government.

The Commission is not convinced of the necessity for continued government provision of construction and building maintenance services, even in regional and remote areas of the State. In the Commission's view, the Government should test the market, by seeking expressions of interest from private contractors for provision of these services in regional Queensland.

It is possible that the existence of government providers in QBuild and Project Services may have created a barrier to entry, which discouraged a market for private providers. If this is the case, private providers could emerge in many regional locations, if there is a market opportunity. Government provision of these services should only be continued in those more remote areas where suitable private providers are unable to be found.

Where these services continue to be provided by Government, they should be closely targeted to identified gaps in private provision of the services.

B7.4 ROADTEK

RoadTek was established in 2002, having previously operated as part of the commercial operations group of Main Roads since 1996. RoadTek operates within the Department of Transport and Main Roads, and is responsible for the construction and maintenance of Queensland's roads and bridges. Its services are provided state-wide across three areas: asset services, network services and plant hire services.

In its recent review of RoadTek, the Government found the current market in South East Queensland is a highly competitive and contested market, unlike the markets in remote and regional Queensland. Given the current market conditions, it was concluded that it would be more efficient for Government to outsource work to the private sector in South East Queensland.

Road network maintenance in South East Queensland is in the process of being transitioned from RoadTek to the private sector, as private sector capacity becomes available. RoadTek will instead maintain a downsized internal day labour workforce to focus on delivering services to regional and remote communities, albeit no longer as the preferred supplier to Government. In regional and remote areas, RoadTek will now be required to compete with private sector providers.

Reasons that have been suggested as to why there is a continued role for Government to provide these services include:

- There may be a lack of established pre-qualified civil infrastructure organisations located within the regional and remote areas. Companies must be pre-qualified to deliver civil works for the Department of Transport and Main Roads. The low volume of projects at a suitable dollar value may not be sufficient to attract their interest and to provide a level of return they consider justifiable. As a result, they have not established a presence in these areas and there is no immediate incentive to attract these organisations.

- Local government authorities (cities, regional councils, and shires) find it difficult to maintain skilled workforces due to the competing industry requirements for delivery of the LNG, rail and mining projects currently happening across Queensland.

In relation to RoadTek's other service delivery areas, the following suggestions have been made for continuation of government services:

- The Department of Transport and Main Roads requires certified inspectors for certain structures including, bridges, culverts, gantries, tunnels and sound barriers.

- Local governments hire plant and equipment from RoadTek due to a lack of capacity to fund their own asset purchases and the lack of private sector providers for construction equipment hires.

The Commission is not convinced of the necessity for continued government provision of road maintenance services in regional areas, particularly as the continued presence of RoadTek in these areas potentially may be creating barriers to entry for private sector providers.

The Commission notes that the New South Wales Government has recently announced it will seek expressions of interest for private contractors to undertake road maintenance in regional NSW. As noted earlier, the prospective withdrawal of a government-owned monopoly provider from a market may well provide new opportunities for private providers, especially local contractors, to establish operations which previously may not have been viable, for example, due to barriers to entry.

As with the services provided by QBuild and Project Services, the Commission considers that the Government should test the market, by seeking expressions of interest from private contractors for provision of the remaining services of RoadTek in regional Queensland.

Where these services continue to be provided by Government, they should be closely targeted to identify gaps in private provision of the services.

Recommendation

33 The Government seek expressions of interest for remaining Commercial Business Unit services for QBuild, Project Services and RoadTek provided in regional areas. Following market testing, government provision of services in these areas should continue only where there is an identified gap in private provision.

B7.5 PROPERTY SERVICES GROUP

The Property Services Group (PSG) was established in 1998 and operates within the Department of State Development, Infrastructure and Planning. It is responsible for the planning, securing and managing of land supply for industrial development where market gaps occur or planning failures arise.

PSG's role is to ensure that land is available for industrial purposes and to identify and monitor industrial land use priorities across the State. It also promotes the orderly establishment and expansion of industry and responds to opportunities for industrial development in Queensland.

As at 30 June 2012, PSG industrial land inventory (both freehold and leasehold) was valued at $296 million. This is a substantial holding of land, spread across most regions of the State.

Historically, the justification for Government to continue to provide this service included:

- A need to complement the role of the private sector in developing sites which private sector market participants were unable or unwilling to supply to the market. In established industrial areas, this typically involved targeting the less profitable large footprint sites or sites where there are limited industry users.

- Provision of industrial land in areas where demand had yet to reach levels that would ordinarily attract private sector land developers.

- A need to supply industrial land to support strategic industrial development opportunities for the State. This could require the supply of land with particular infrastructure or buffer areas to support development. For example, the PSG developed Curtis Island Industrial Precinct to support the establishment of three LNG export processing facilities in Gladstone.

The recent government review of PSG found evidence to suggest that market failures continue to exist in parts of Queensland in relation to industrial land planning and development. However, there were also opportunities to reduce its industrial land holdings over the next three years by some $200 million.

Further, the Commission notes that Government is amending the *Industrial Development Act 1963* with a view to expanding the PSG's mandate to deal commercially in land, property and supporting infrastructure to further economic development in Queensland.

To ensure Government receives value for money, PSG will need to continue developing appropriate governance arrangements for its commercial activities, ensuring it is consistent with Queensland Treasury and Trade's policy framework for Commercialisation of Government Business Activities in Queensland.

The Commission supports the rationalisation of the PSG portfolio of land as a way of unlocking the substantial value of these land holdings. However, the Commission is not convinced of the necessity for continued government provision of industrial property development services, beyond the development of major sites of strategic state significance, such as Curtis Island.

Recommendation

34 The functions of the Property Services Group be limited to the development of major industrial sites of State significance where there are strategic considerations for government, and that surplus land holdings be rationalised.

B7.6 QFLEET

QFleet was established in 1991 and operates within the Department of Housing and Public Works, providing vehicle leasing and fleet management services to the government sector. During 2011-12, it operated a fleet of approximately 13,000 vehicles, covering vehicles required for normal departmental service delivery functions as well as vehicles provided to CEO/SES officers under remuneration packages.

Table B7.4 shows the profile of QFleet vehicles as at April 2012.

Table B7.4
Profile of government vehicle fleet, April 2012

Profile	Number
Ministers, Legislative Assembly	31
CEOs, SES (including section 17 and 122 contracts), Judiciary and Marine Pilots	833
Senior Medical Officers and Directors of Nursing	280
Emergency response passenger vehicles	386
Health Action Plan	50
Regular Queensland Government plated vehicles	10,714
Special build vehicles	323
Untied clients	469
Total vehicles	**13,086**

Source: Department of Housing and Public Works

Table B7.5 shows the provision of vehicle fleet services in the Australian Government and the five mainland states. The table shows that:

- New South Wales, Queensland and Western Australia have significantly larger vehicle fleets than Victoria and South Australia, primarily reflecting the use of vehicles to deliver services over a wide geographic area.

- All of the states have a similar structure for fleet services, with procurement and leasing primarily undertaken within government, while fleet maintenance, disposal and increasingly fleet management are undertaken by private providers.

Table B7.5
Government vehicle fleet services

	Qld	Australian Government	NSW	Vic	WA	SA
Size of fleet	13,100	14,115	25,155	8,783	11,094	8,400
Fleet service provider	Govt	Private	Govt	Govt	Govt	Govt
Core agencies tied to provider	Yes	Yes	Yes	Yes	Yes	Yes
Provision of fleet services:						
- Procurement of vehicles	Govt	na	Govt	Govt	na	Govt
- Leasing of vehicles	Govt	Private	Govt	Govt	Govt	Govt
- Vehicle maintenance	Private	Private	Private	Private	Private	Private
- Fleet management	Govt	Private	Govt	Govt	Private	Govt
- Disposal of vehicles	Private	Private	Private	Private	Private	Private

na – not applicable

Source: Commission of Audit

The recent internal government review of QFleet found that, although individual government agencies could source their vehicles directly from private suppliers, it is more efficient and better value for money for Government to use its centralised purchasing power through a single government entity such as QFleet. The review found that retaining QFleet would avoid duplication of services across agencies and take advantage of economies of scale for the procurement, management and disposal of government fleet.

Similar conclusions have been drawn by other reviews of vehicle fleet procurement in other states.

For those jurisdictions with significant car fleets (above 10,000), there is an ongoing assessment to be made between:

- the financial benefits from centralised bulk purchasing through a single government agency

- providing the opportunity for government agencies, including in remote and regional areas, to access vehicles from local suppliers where it is cost efficient to do so and does not pose financial risks for the State.

The Commission is not convinced that vehicle fleet procurement needs to be an 'all or nothing' approach, such that the benefits of bulk purchasing can only be realised through all procurement being undertaken by a single government-owned agency.

Bulk purchasing undertaken by a single government agency or a private fleet manager acting on the Government's behalf should not affect access to fleet discounts from vehicle manufacturers and suppliers. These discounts are still available to Australian government agencies even though vehicle procurement and management is entirely outsourced.

The Commission considers that the Queensland Government should adopt a vehicle fleet procurement policy that:

- outsources all fleet management functions, except for policy development and contract management, to a private fleet manager

- preserves its bulk purchasing/fleet discounts with vehicle manufacturers and suppliers, on the basis of both past and projected vehicle acquisitions

- within the bulk purchasing agreements with manufacturers and suppliers, provides flexibility for departments and agencies to source vehicles locally, where it is efficient to do so.

This would broadly follow the model adopted by the Australian Government and which has been in place for some time.

As part of the outsourced arrangements, the Commission considers that the Queensland Government should cease the acquisition of vehicles that are provided as part of a government employee's remuneration.

Vehicles provided as part of remuneration arrangements are private in nature and should not be acquired by the Government. Public servants are already offered an equivalent amount of cash salary to arrange their own vehicle as an alternative to a QFleet vehicle.

This should become the standard practice in the Queensland Government, with no further access to vehicles acquired by QFleet.

This being said, as is the practice in the private sector with employees receiving corporate discounts, arrangements could be made enabling public servants to benefit from Government's bulk purchasing discounts.

Recommendation

35 The Government contract out all of the services of QFleet to the private sector.

B7.7 FUTURE ROLE OF COMMERCIAL BUSINESS UNITS

The Commission acknowledges that the Government has only recently reviewed and made strategic decisions in relation to its CBUs, and that these changes will need to be bedded down.

However, private sector provision of services exists to a greater or lesser degree in all of the CBU activities that the Government has decided to retain.

The Commission is not convinced that these services should continue to be provided by Government. Where it has not done so, the Government should seek expressions of interest for the private provision of services in regional areas. Government provision of CBU services should only continue where there is an identified gap in private provision or where there is an overwhelming state interest in the provision of such services.

Prior to any further testing of the capacity of the market to provide such services, the Government should implement full cost pricing on a transparent basis across all remaining CBUs and allow government agencies to seek alternative quotes from the private sector for the provision of services provided by the CBUs.

For example, QBuild should adopt full cost pricing and client agencies should be encouraged to obtain competitive tenders for jobs which could be undertaken by local providers in a contestable market. This would allow QBuild to focus on delivering specific services that are not commercially viable for private sector providers. It would also expose QBuild to competitive pressures to achieve greater efficiency in its operations.

Work should also be undertaken to improve transparency of QBuild costs of building maintenance services to client agencies, thereby enabling a comparison of costs under an outsourced arrangement in a contestable market.

QBuild should also benchmark itself against other providers and report on differences.

Government should regularly test the contestability of the remote and regional markets to ensure the presence of RoadTek is not creating barriers to entry for private sector providers:

- RoadTek should adopt full cost pricing for its services and full transparency of information on the cost of road maintenance services in remote and regional areas, which will inform potential competitive suppliers in the market.

- RoadTek should benchmark itself against other jurisdictions and report on differences.

A key theme of this Report is a requirement for Government to return to the principle that the public is best served when public sector resources are allocated to those services that government must provide because they cannot be provided by the private sector. This is the core of government service provision. Government resources that duplicate activity elsewhere means less resources are devoted to essential services that only government can provide and also has the potential to discourage the development of a viable private market.

Where CBUs continue to exist, they must deliver optimum value for money for the State, and they should not hinder the development of private providers.

Recommendation

36 Services provided by remaining Commercial Business Units (CBUs) be subject to full cost pricing and government departments and agencies be allowed to source private sector providers as an alternative to CBUs, where these are cost competitive and represent better value for money.

B8 PRICING REGULATION

KEY ISSUES

- Governments established a range of regulatory regimes in their GOC sectors to support the transition from monopoly government providers to more commercial operations, and to ensure efficient pricing of infrastructure. The approach to price regulation takes a number of forms.
- The Queensland Competition Authority (QCA) is the State's independent economic regulator. The QCA can apply different regulatory frameworks depending on the nature of the service, the market, level of competition and the costs of regulation.
- Economic regulation should be independent, objective, stable and certain, thereby giving confidence to service providers to make long-term and efficient investment decisions.
- There has been a tendency for governments to use price regulation as a mechanism to protect consumers from 'price shocks', where prices or price increases are considered to be excessive. This type of government intervention in pricing arrangements may provide some temporary or short-term price relief for consumers.
- However, it creates regulatory uncertainty and inconsistency for existing and potential industry participants, which can discourage investment. Over time, it is unsustainable to have a situation in which prices do not reflect the actual cost to deliver services.
- Queensland's price setting arrangements for regulated industries are fundamentally sound. However, there are no clear and consolidated guiding principles on which the arrangements are based. These should be introduced.

B8.1 FRAMEWORK FOR PRICING REGULATION

In accordance with Paragraph 3 (e) of its Terms of Reference, this section provides a comprehensive review of the efficiency and effectiveness of current pricing arrangements for regulated infrastructure, including electricity, water, rail and ports. This includes a comparison with pricing arrangements adopted for regulated infrastructure in other jurisdictions, to assess relative strengths and weaknesses of these various arrangements.

As noted in previous sections of this Report, the GOC sector in Queensland originated in market sectors dominated by network infrastructure that were initially owned and operated as monopoly assets. This was particularly the case in the provision of electricity and water and, to a lesser extent, in public transport and port facilities.

Governments established a range of regulatory regimes in their GOC sectors to support the transition from monopoly government providers to more commercial operations, and to ensure efficient pricing of infrastructure. The approach to price regulation in Australian generally takes two forms:

- indirect regulation, through price oversight or monitoring, where an agency of government observes and reports on pricing behaviour, but does not usually involve the direct regulation of prices

- direct regulation, where either an independent regulator can regulate prices with legal effect, or make recommendations to ministers to exercise such powers.

B8.2 THE QUEENSLAND COMPETITION AUTHORITY

The QCA is the State's independent economic regulator. It is a statutory body established in 1997 under the *Queensland Competition Authority Act 1997* (QCA Act). In 2011-12, the QCA was funded from a combination of State Government funding ($3.5 million) and fees levied on regulated entities ($9.3 million).

Under the QCA Act, the QCA is required to have at least three members appointed by Governor in Council, with terms no longer than five years. Until recently, the QCA Board comprised five part-time members, including the Chair. The Government recently reviewed the structure of the board in light of the QCA's expanding responsibilities and increased work load. From 29 January 2013, the position of Chair is a full-time role.

The QCA is an independent entity. While it is subject to the written directions of the responsible Ministers in performing functions, it is not subject to government direction in relation to the conduct of investigations, reports or its decisions in regard to third party access.

B8.2.1 Functions

Under its Act, the QCA can:

- conduct price monitoring investigations in relation to monopoly business activities (and report the results of the investigations to the Ministers)

- if issued with a direction by responsible Ministers, investigate, report and make recommendations to Ministers on the regulation of prices as directed by the Minister

- make determinations over the pricing of water by declared private sector water entities

- investigate and report on any matter relating to competition, industry, productivity or best practice regulation

- mediate to resolve access disputes

- conduct arbitration hearings for resolving access disputes

- approve undertakings for services

- monitor compliance with approved access undertakings.

On 1 July 2012, the QCA established the Office of Best Practice Regulation, with responsibility for assessing the regulatory burden of legislation. This role includes reviewing the existing stock of Queensland legislation to prioritise areas for targeted regulatory review with the aim of reducing the regulatory burden imposed by legislation.

B8.2.2 Role in economic regulation

Under the provisions of the QCA Act, the QCA can apply different regulatory frameworks to declared businesses. The form of economic regulation depends on the nature of the service, the market, the level of competition and the costs of regulation. The QCA's economic regulatory role is provided for in part 3 (Prices Oversight) and part 5 (Access to Services) of the QCA Act.

Price oversight and price monitoring

Prices oversight or price monitoring provides transparency for customers and government about cost and pricing structures as well as other performance indicators, such as service and quality standards.

Prices oversight seeks to ensure that certain government and non-government monopolies or near monopolies do not charge excessive prices for their products or services.

Through the prices oversight process, the QCA can either:

- investigate the pricing practices of such monopolies, or
- monitor their pricing practices.

The QCA only performs either of the above at the request of or referrals from its responsible Ministers.

While a regulated entity is not compelled to act on a regulator's recommendations, public and government scrutiny, as well as the threat of further regulation, may influence pricing behaviour.

The advantage of this form of regulation is that the business can operate commercially without intrusive regulatory intervention, except for an ex-post assessment of its pricing.

Pricing recommendations and determinations

A more active or direct regulatory approach is where the independent regulator has powers to either:

- make legally binding determinations on prices to be charged in regulated sectors, or

- make recommendations to Ministers on appropriate prices in regulated sectors – with the discretion of Ministers as to whether they accept or reject the recommendations.

Direct price regulation can be justified where there is a real risk and concern of unreasonable pricing practices for an essential service or utility. Price determinations are typically only appropriate for a limited set of essential markets or industries which have clear natural monopoly characteristics, such as the electricity distribution and transmission networks.

The QCA's only price determination power, provided under part 5A of the QCA Act, is over private sector water entities that have been declared under the legislation. Currently, there are no private sector water entities declared under the legislation. Therefore the QCA is not exercising its price determination powers provided under the QCA Act.

However, a Minister may delegate to the QCA the power to make a pricing determination under specific legislation administered by the Minister. For example, in September 2012 the Minister for Energy and Water Supply delegated to the QCA his powers under the *Electricity Act 1994* to determine prices that a retail entity may charge its non-market customers for the period 1 July 2013 to 30 June 2016. Under this delegation, the QCA makes its pricing determination under the powers of the *Electricity Act 1994*, rather than its own Act.

Under part 3 of the QCA Act, the Government in the past has directed the QCA to examine and make recommendations on pricing practices of monopoly business activity such as Sunwater and the Gladstone Area Water Board (GAWB). For example:

- In 2010, the Government referred the monopoly business activities of GAWB to the QCA for an investigation of its pricing practices to apply for 2010-11 to 2014-15.

- In 2010, the Government also directed the QCA to recommend irrigation prices to apply to 22 SunWater water supply schemes from 1 July 2011 to 30 June 2016. This time period subsequently was amended to 1 July 2012 to 30 June 2017.

Third party access

The third party access regime supports competition by enabling competitors (that is, 'third parties') to access essential infrastructure which cannot be economically duplicated.

In Queensland, the infrastructure which may meet the criterion for a third party access regime includes electricity and gas distribution systems, water storage and distribution systems, rail tracks, and port terminals and channels.

The QCA plays an important role to facilitate the sharing of essential monopoly infrastructure. This role is increasingly important as private entities seek to invest in significant monopoly infrastructure, particularly in the mining industry (for example, in the Surat and Galilee basins).

Although the QCA currently has third party access responsibility, the Government can elect to transfer this responsibility to the Australian Competition and Consumer Commission (ACCC).

The third party access regimes applying to Aurizon, Queensland Rail Limited and the Dalrymple Bay Coal Terminal have been certified as effective by the Australian Treasurer, consistent with the State's obligation under the Competition and Infrastructure Reform Agreement 2006.

B8.3 PRICING REGULATION IN AUSTRALIAN STATES

Table B8.1 provides a comparison of the pricing arrangements for regulated infrastructure and other assets across Australia.

Table B8.1
Price arrangements across Australian states

Jurisdiction	Retail electricity	Ports	Rail	Water	Other
NSW Economic regulator – Independent Pricing and Regulatory Tribunal (IPART)	Retail electricity providers determine pricing for market contracts. IPART determines non-market contract prices under the *Electricity Supply Act 1995.*	Port user charges are determined by the individual port authorities – commercially negotiated charges.	IPART determines the maximum fares City Rail can charge its passengers.	IPART directed (at Minister's discretion) to determine prices for bulk and metropolitan water under IPART Act.	IPART Review of: • taxi fares • bus fares • ferry fares • local government rates • hospital costs and outcomes.
Victoria Economic regulator – Essential Services Commission (ESC)	Retail electricity providers determine pricing for both market and non-market contracts.	Port charges are determined by port authorities – commercially negotiated charges.	Rail providers sets prices for freight and passenger services fares.	ESC determines water prices for metropolitan and regional/rural under the *Water Industry Act 1994.*	ESC review of: • domestic building insurance • taxi fares • accident towing • vocational education and training • caravan park tariffs.
Queensland Economic regulator – Queensland Competition Authority (QCA)	Retail electricity providers determine pricing for market contracts. The QCA determines non-market contract prices (other than Tariff 11 in 2012-13) under the *Electricity Act 1994.*	Port charges are determined by port authorities – commercially negotiated charges.	Government sets prices for freight and passenger service fares.	Government sets prices for South East Queensland bulk water. Distributor retailers set retail water prices. Irrigation water prices set by Government on the recommend-ations of QCA.	One-off reviews as directed by the Ministers in relation to productivity, industry, competition or best practice regulation.

Jurisdiction	Retail electricity	Ports	Rail	Water	Other
Western Australia Economic regulator – Economic Regulation Authority	Government sets retail prices as part of budget process.	Port charges (other than statutory charges, which are set by government) are determined by port authorities – commercially negotiated charges.	Government sets freight prices and metropolitan passenger fares – excludes Pilbara rail.	Government sets urban and rural prices.	
South Australia Economic regulator – the Essential Services Commission of South Australia (ESCOSA)	Retail electricity providers determine pricing for market contracts.	Port charges are determined by port authorities – commercially negotiated charges.	Government sets fares for passenger services.	ESCOSA determines SA Water retail water prices under a Pricing Order from Government.	

B8.4 ELECTRICITY PRICES

In Queensland, retail competition commenced on 1 July 2007. There are currently 27 electricity retailers licensed in Queensland.

The nature of the retail electricity industry in Queensland is largely defined by geography and is generally considered in terms of the higher customer density South East Queensland (SEQ) region and the remaining areas of regional Queensland. Retail electricity provision in SEQ is currently dominated by three retailers, while regional Queensland is largely serviced by Ergon Energy Queensland (EEQ). These four retailers meet more than 90% of small customer retail requirements between them.

In relation to regional Queensland, retail electricity prices are impacted by the Government's uniform tariff policy (UTP). The UTP ensures that Queenslanders have access to the same cost of electricity regardless of where they live. The benchmark is the cost of electricity in SEQ, which is less than that for the rest of the State.

To support the UTP, the Government pays EEQ, a state-owned non-competitive electricity retailer, a community service obligation payment to provide standard retail contracts at notified prices (that is, non-market contracts) to customers in regional Queensland. Notably, once customers using less than 100 MWh a year choose to move to a market contract with an alternative supplier, they cannot return to EEQ.

The regulatory framework for electricity is set out in the *Electricity Act 1994* and the Electricity Regulation 2006. Under this framework, the relevant Minister must, for each tariff year, decide the prices or the methodology for fixing prices (a price determination) that a retail entity may charge its non-market customers (that is, non-market contracts or standard retail contracts at notified prices).

Market contract prices are set by the individual electricity providers.

Across Queensland, 45% of small customers (less than100 MWh annual consumption) and 74% of large customers are supplied under market contracts. Within this average, the proportion of customers on market contracts is significantly higher in SEQ (more than 60%, with a negligible number being on market contracts in regional Queensland). In SEQ, retail electricity for large customers is only offered under market contracts.

In relation to prices for non-market customers, the relevant Minister (currently the Minister for Energy and Water Supply) has delegated this function to the QCA since the commencement of full retail competition. Therefore, following approval of the new retail pricing methodology, the Government delegated to the QCA the responsibility of setting the notified prices to apply from 1 July 2012 to 30 June 2013 to all regulated retail electricity tariffs except for the main residential tariff, Tariff 11.

Government excluded Tariff 11 from the 2012-13 price determination for all Queenslanders, by freezing the price at 2011-12 rates plus the cost of the Australian Government's carbon tax.

In September 2012, the Minister for Energy and Water Supply provided the QCA with a delegation requiring it to determine regulated retail electricity prices for a three year period from 1 July 2013 to 30 June 2016. While the task is delegated for three years (rather than a one year period as in previous years), the QCA is still required to make price determinations annually.

In relation to delegations, the Minister may state the terms of reference for price determination, including:

- the period for which the price determination is to apply
- the timeframe within which the QCA is to make and publish reports on the price determination
- the particular policies or principles the QCA is to consider when making the price determination
- the matters the QCA must consider when working out the notified prices and making the price determination
- the consultation requirements the QCA must comply with before making the price determination.

In making the price determination, the *Electricity Act 1994* requires consideration of the following:

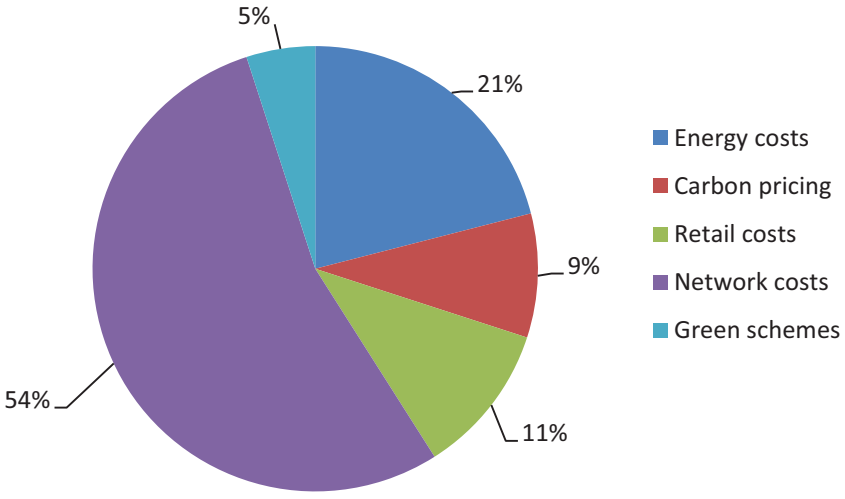
- the actual costs of making, producing or supplying the goods or services
- the effect of the price determination on competition in the Queensland retail electricity market
- any matter the QCA is required by delegation to consider
- any other matter the QCA considers relevant.

Retail prices for electricity comprise four main cost components, as shown in Table B8.2 and Chart B8.1.[1]

Table B8.2
Components of electricity costs

Composition of electricity costs	Description of costs	Proportion of final cost of electricity	Price setting 2012-13
Generation (energy) costs	Costs relating to purchasing energy, environmental and renewable energy costs, energy losses and National Electricity Market fees.	The cost of energy typically makes up around 21% of the final cost of electricity; however, additional costs for Carbon and other 'Green schemes' contribute an additional 14%.	Actual costs are set by forces in markets for wholesale energy markets, markets for financial products and green certificates. The actual allowance which is passed through to consumers is determined by QCA using a building blocks approach.
Transmission and distribution (network) costs	Costs associated with transporting electricity through the transmission and distribution networks.	Typically makes up around 54% of the final cost of electricity.	Set by the Australian Energy Regulator and is fully passed through to consumers
Retail (operating and margin) costs	Costs relating to services provided by the retailer to its customers including customer administration, corporate overheads, meter reading, billing, IT systems, revenue collection, regulatory compliance, marketing costs, etc.	Typically makes up around 11% of the final cost of electricity.	The allowance to be passed through to the consumer is set by the Queensland Competition Authority using the building blocks approach.

Chart B8.1
Regulation of electricity price components



Source: Department of Energy and Water Supply; Commission of Audit;

As shown in the above chart and table, around 21% of the retail price of electricity relates to generation costs while a further 54% relates to network costs (both transmission and distribution). Additional costs due to the carbon tax and other green schemes make up around 14%, as shown in Chart B8.1.[2]

Non-market contracts are intended to be a transitionary tool to move to a fully contestable retail market (that is, where the market sets the retail electricity prices). Non-market contract prices are set at levels slightly above efficient costs to encourage competitors to enter the market and acquire customers by 'beating' the notified price.

In recent times, there have been two policy decisions that have resulted in electricity prices not reflecting the full cost of services. These are:

- In 2011-12, the then shareholding Ministers of Energex and Ergon directed these GOCs not to recover an amount of $93.2 million in additional revenue that had been approved by the Australian Competition Tribunal for the 2010-11 to 2014-15 regulatory period.

- In 2012-13, the Government amended the *Electricity Act 1994* to allow the Minister for Electricity and Water Supply to set the standard residential electricity tariff (Tariff 11) by regulation. Responsibility for setting Tariff 11 was removed from the QCA, although the QCA provided advice to the Minister on the estimated cost of the carbon tax for 2012-13.

The Government set Tariff 11 for 2012-13 based on the frozen 2011-12 tariff, plus the cost of the carbon tax. Recognising the impact of the decision on retailers, the shareholding Ministers for Energex issued a direction to reduce the cost of the domestic network charge by an amount to take account of the estimated cost of the freeze.

Table B8.3 shows a comparison of the pricing arrangements for retail electricity across the Australian jurisdictions.

Table B8.3
Pricing arrangements for electricity – state comparison

Jurisdiction	Pricing
New South Wales	• Independent Pricing and Regulatory Tribunal (IPART) delegated price determination role under the *Electricity Supply Act 1995.* New South Wales price determinations have been made for a three year period with 're-openers' where cost changes fall outside a set boundary. • Prices are set based on 'building blocks approach' to network and retail cost components for the three 'standard retailers' operating in the three distribution areas of the state. • Network costs are passed through to customers while retail cost components (energy purchase costs, retail operating costs and retail margin) are based on estimates by IPART. • A Weighted Average Price Cap has been adopted for the retail component, which regulates the average change in regulated prices, rather than the actual change in individual prices. This gives retailers the flexibility to determine the level and structure of their tariffs, as long as they meet the constraint on the change in their weighted average prices.
Victoria	• The Victorian Government removed all price caps on retail electricity prices from 1 January 2009. • However, Part 2, Division 2 of the *Electricity Industry Act 2000* includes reserve powers for the Governor in Council to regulate tariffs for the sale of electricity to prescribed customers or a class of prescribed customers, and this power may be conferred on the Essential Services Commission (ESC).
Western Australia	• The Minister sets regulated retail electricity prices under subordinate legislation made under the *Energy Operators (Powers) Act 1979* (for example, Energy Operators (Electricity Retail Corporation) (Charges) By-Laws 2006 or Energy Operators (Regional Power Corporation) (Charges) By-Laws 2006). • Electricity prices are announced as part of the annual budget and are not cost reflective. • The Minister can direct the Economic Regulation Authority (ERA) to conduct an inquiry. • ERA has been directed to recommend pricing for the government-owned electricity retailers.
South Australia	• Retail price regulation was discontinued in South Australia on 1 February 2013. • Network costs are passed through to customers.
Tasmania	• Pursuant to the *Electricity Supply Industry Act 1995*, the Electricity Supply Industry (Price Control) Regulations 2003, and the *Economic Regulator Act 2009*, the Office of Tasmania's Economic Regulator sets the maximum prices that Aurora Energy Pty Ltd (Aurora) may charge for the provision of retail services to non-contestable tariff customers. • The 2010 determination set maximum retail tariff prices for non-contestable retail tariff customers on mainland Tasmania for the period 1 July 2010 to 30 June 2013. • Maximum retail tariff prices were set by reference to separate weighted average tariff baskets for all non-contestable customers, that is, both non-contestable business and residential customers.

Source: Commission of Audit

A form of regulation of retail electricity prices exists in all jurisdictions except Victoria, which deregulated the electricity industry in 2008 and South Australia from 1 February 2013.

The Australian Energy Market Commission (AEMC) is conducting a series of reviews of the effectiveness of competition in retail electricity markets across Australia. It has completed reviews into the electricity retail markets in South Australia, Victoria and the Australian Capital Territory recommending, in all three instances, to deregulate prices.

Victoria and South Australia have since deregulated retail market pricing. The Australian Capital Territory did not accept the AEMC's recommendations. Future reviews are expected as follows: Queensland in 2014, South Australia in 2015, the Australian Capital Territory in 2016, and Tasmania no sooner than 18 months after full retail contestability is implemented which is expected to be from 1 January 2014.

The Interdepartmental Committee on Energy Market Reform is examining electricity prices as part of its review, which is due to be completed in early 2013.

B8.5 WATER PRICES

The regulatory framework for water encompasses the *Water Act 2000* (Qld), Water (Market Rules) Notice 2008, the Water Regulation 2002, the South East Queensland (SEQ) market rules and the QCA Act.

In Queensland, depending on the water entity, either the Government or the relevant water entity is responsible for price setting.

B8.5.1 South East Queensland water pricing – prior to 1 January 2013

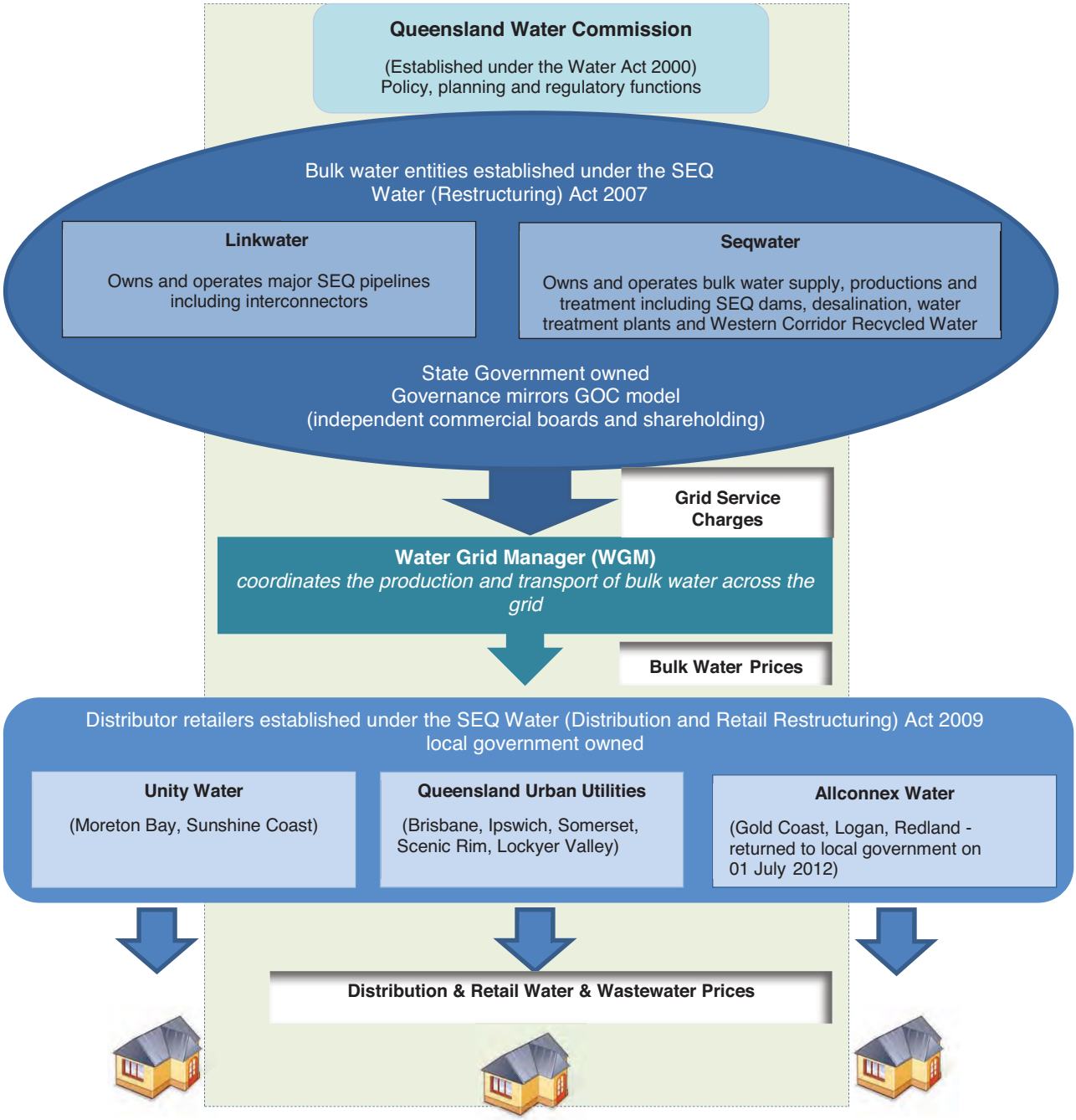
The previous government made a significant capital investment in the development of the SEQ water grid in response to prolonged drought conditions. The total cost of the investment amounted to around $6 billion. A significant reduction in the demand for water, and a return to more normal supplies from existing sources, has meant that a number of these infrastructure assets are either not in use (that is, Wyaralong Dam and Gold Coast desalination plant) or only partly in use (Western Corridor Recycled Water scheme).

The cost of this investment in the SEQ water grid is passed through to consumers through bulk water prices.

Prior to 1 January 2013, the structure of water prices in SEQ had three components as shown in Figure B8.1:

- grid service charges
- bulk water prices
- distribution and retail water and wastewater prices.

Figure B8.1
Previous South East Queensland water sector



Source: Queensland Treasury and Trade

B8.5.2 Grid service charges

Until 2013, the Minister for Energy and Water Supply determined grid service charges (GSCs) which were set annually.[3]

The GSCs paid to Seqwater and LinkWater covered:

- provision for the cost of asset consumption or depreciation (return of assets)

- provision for the cost of capital (return on assets)
- operations, maintenance and administrative costs.

Around 65% of total service charges related to the capital charge component (that is, allowance for capital replacement and interest costs).

The QCA's main role for the bulk water entities was to oversight efficient costs. The QCA did not have the power to determine the GSC. In accordance with section 8.4 of the SEQ market rules, the QCA provided advice on the GSC to be paid to Seqwater and LinkWater by the SEQ Water Grid Manager.

B8.5.3 Bulk water prices

Bulk water prices paid by distributor–retailer to the Water Grid Manager (WGM) were set by Government through the Queensland Water Commission (QWC). These were based on a 10-year price path, with pricing based on transitioning customers to paying 'full cost prices'. The projected full cost price takes into account the cost of servicing the debt raised to undertake the $6 billion investment in the SEQ water grid infrastructure assets.

To mitigate the impact on consumers of this significant investment in new water infrastructure, the previous government made two key decisions in relation to bulk water pricing:

- First, it would accept a rate of return on new assets equivalent to the State's cost of funds rather than a higher 'commercial' return.

- Second, the transition from council-specific historic pricing levels to a common, region-wide destination price would be staged over 10 years, with debt to be repaid over 20 years. Once the full cost price was reached, bulk water increases would be no more than the rate of inflation.

That is, bulk water prices were determined by striking a balance between the achievement of full cost pricing and the need to recognise the cost of living impacts for householders and businesses. Full cost pricing includes the capacity to repay the debt from accumulated losses incurred over the course of the price path.

Under the 10-year price path, the WGM operated at a significant financial loss, as it paid the full cost of bulk water services, but sold water to customers at a lower price. Currently, bulk water prices have only been recovering around half of the costs of supplying bulk water in SEQ, leading to an operating loss for the WGM in 2011-12 of $433.8 million.

These losses will accumulate as debt over the first 10 years (2008-09 to 2017-18), to be repaid as sales revenue increases over the remainder of the 20-year pricing period to 2027-28. The annual losses funded by debt currently are estimated to result in total borrowings of over $3 billion by 2017-18. The significant size of the debt is the result of the decision to phase-in bulk water price increases over 10 years.

While bulk water prices initially were to be reviewed every five years (first review scheduled for 2013), an early review in November 2010 updated prices to reflect changed capital assumptions (including the decision not to proceed with Traveston Crossing Dam) and other key parameter adjustments, such as changes in demand and interest rates.

B8.5.4 Distribution and retail water and wastewater prices

The distributor–retailers (DRs) own and operate SEQ councils' water and wastewater businesses.

From 1 July 2010, the DRs were provided with the authority to determine water prices based on a regulatory asset base (RAB) agreed by Government, with the QCA undertaking a price monitoring role.

On 7 April 2011, in response to community concern about the scale of water and sewerage price increases announced by Allconnex and Unitywater, the Government announced:

- A two-year CPI price cap for residential and small business customers from 1 July 2011. Legislation passed in late June 2011 gave effect to the cap on retail water and wastewater prices.

- SEQ councils would be given an opportunity to opt out of their DRs and re-establish council-owned and operated water businesses. Irrespective of their decision, councils would have the responsibility for water and wastewater prices within their local government areas.

- For the period after the CPI price cap (that is, from 1 July 2013), local governments must have a price mitigation plan which shows how they intend to moderate the impact of price increases, assist vulnerable customers and keep the community informed about price increases.

The QCA has had an annual price monitoring role for the distribution and retail water and wastewater prices charged in SEQ since 1 July 2010. This role is expected to continue until 30 June 2013.

From this date, DR water and sewerage prices will be determined by councils, consistent with the requirements of a price mitigation plan as required by legislation. The continuation of the price mitigation plans is currently under review.

The DRs and council-owned water business have been subjected to a significant level of regulatory uncertainty since their creation in 2010, due to a combination of price monitoring, price capping, and more recently, uncertainty around responsibility for price setting arising from the price mitigation plans.

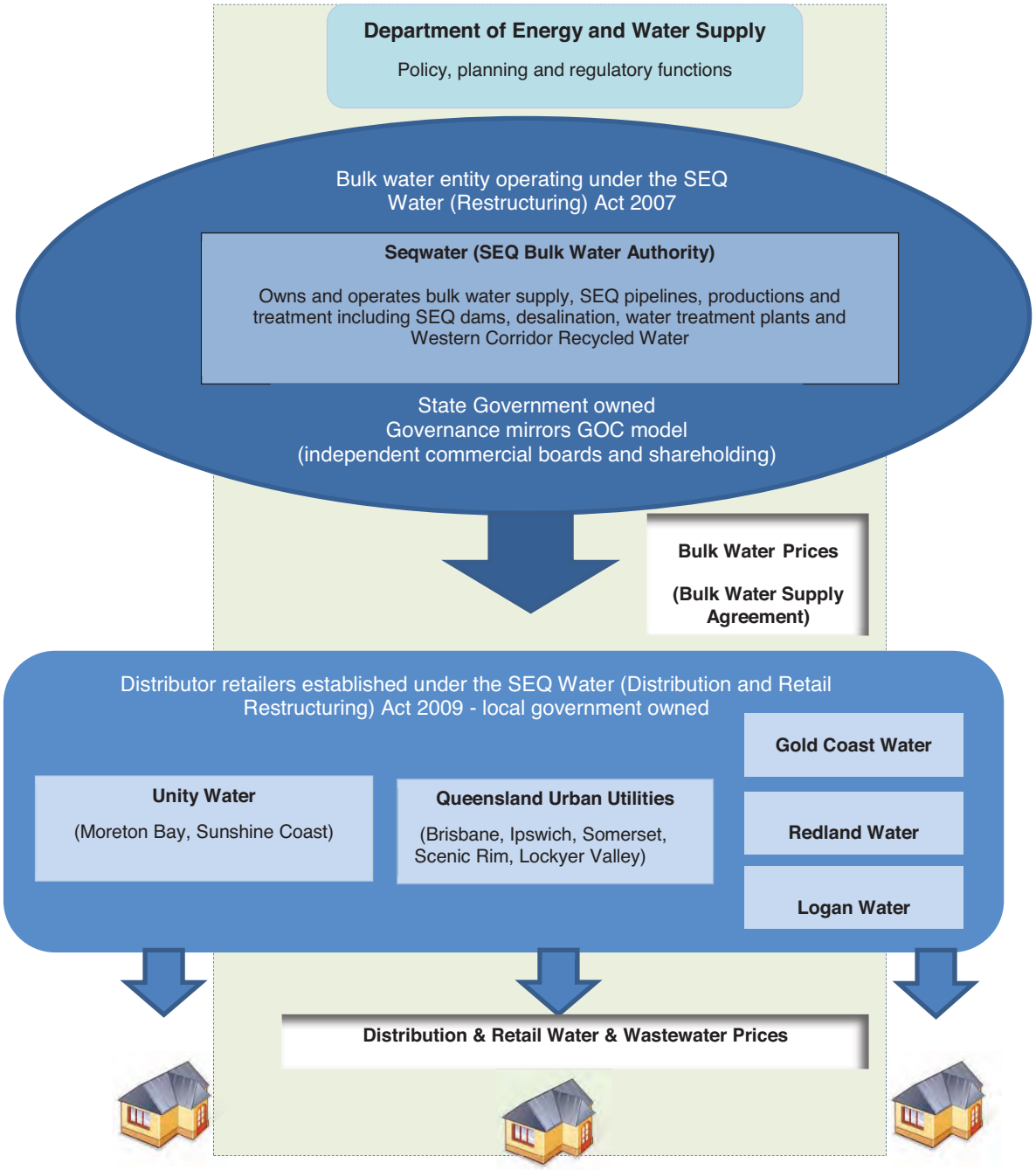
B8.5.5 South East Queensland water pricing – post 1 January 2013

To assist in reducing the cost of bulk water supply in SEQ, the Government has undertaken a rationalisation of the SEQ bulk water industry, effective from 1 January 2013. This has involved consolidating LinkWater and the SEQ Water Grid Manager into Seqwater, to operate as one single statutory body.

The Queensland Water Commission has been abolished and its functions transferred to the Department of Energy and Water Supply.

The restructured SEQ water sector is shown in Figure B8.2.

Figure B8.2
Restructured South East Queensland water sector from 1 January 2013



Source: Queensland Treasury and Trade

The *Water Act 2000* and the *Water Supply (Safety and Reliability) Act 2008* were amended to effect the structural changes, with the aim of putting in place a regulatory framework that will lead to improved accountability between the bulk water business and its customers.

Given the current projected decline in demand for water and updated infrastructure assumptions, the restructured SEQ water sector will continue to accumulate further debt to cover operating losses. In this regard, Seqwater has assumed the debt of the former WGM, and will incur future losses as the bulk water price which it charges DRs will be less than full cost pricing, reflecting the current price path policy.

Seqwater's revenue – and therefore debt levels – is highly sensitive to demand and population growth. These assumptions are being closely examined in the context of the current price review being undertaken by the Department of Energy and Water Supply, due to be finalised by March 2013.

Bulk water prices will continue to reflect a significant component of debt servicing costs arising from the previous government's significant investment in water infrastructure for South East Queensland, much of which is now redundant or under-utilised.

B8.5.6 Irrigation water prices

SunWater provides water supply services to agricultural, industrial, urban and rural users.

SunWater is subject to regulation under the *Queensland Competition Authority Act 1997* (QCA Act) and potentially the *Competition and Consumer Act 2010*. Part 3 of the QCA Act provides for the QCA Ministers to refer a pricing matter to the QCA. Part 5A of the QCA Act also deals with price regulation of water assets, but this only relates to assets in private ownership.

To date, only irrigation prices have been referred to the QCA. Irrigation water prices, unlike urban and industrial water prices, are based primarily on the 'lower bound' cash costs of providing the service, that is, they do not include a provision for return on existing assets.

Price regulation for the urban and industrial sectors operates under a quasi negotiate-arbitrate model. No matters or disputes have been referred to the QCA for industrial or urban prices.

In March 2010, the previous government issued a notice to the QCA directing it to recommend an irrigation price path for the period 2012-13 to 2016-17. This was the first independent review of SunWater's irrigation-related costs and prices. The previous irrigation price path was based on a two-tiered negotiation process jointly developed between SunWater and irrigation stakeholders.

The Ministerial direction required that the QCA recommend bulk water supply and irrigation channel prices/tariff structures be set to provide a revenue stream that allows SunWater to recover:

- efficient operational, maintenance and administrative costs including expenditure on renewing and rehabilitating existing assets

- a rate of return on assets valued at 1 July 2011 (the initial regulated asset base)
- after 1 July 2011, a return of and on prudent capital expenditure on existing assets or for constructing new assets.

For the last category, regard was to be given to the agreed level of service between SunWater and the customers of the water supply scheme.

On 10 May 2012, the QCA released its final report, *SunWater Irrigation Price Review: 2012-17*, including recommended lower bound costs to apply to SunWater irrigation schemes for the 2012-13 to 2016-17 period and recommended tariffs to meet the Government's pricing policy.

On 30 June 2012, the responsible ministers for the QCA (the Treasurer and Attorney-General) wrote to the Chairman of the QCA advising that they had accepted the recommendations of the review.

Table B8.4 compares the pricing arrangements for water across the Australian jurisdictions. The table shows that, with the exception of Western Australia, there is far less direct Ministerial involvement in the setting of water prices in other states compared with Queensland. In the other states, pricing determination powers are more likely to rest with the independent economic regulator, rather than ministers.

Table B8.4 Pricing methodologies for water – state comparison	
Jurisdiction	**Pricing**
New South Wales	• The *IPART Act* provides IPART with a standing reference to conduct investigations and make reports to the Minister on the determination of pricing for government monopoly services (as defined under the Act and corresponding statutory instruments). • The state's major water entities (such as Sydney Water Corporation, Sydney Catchment Authority and several local councils) are regulated under this provision. • In practice, IPART makes price determinations for these entities on a continuing basis without active involvement or the approval of the Minister. • IPART also has the authority to regulate pricing matters of other water entities via Ministerial referrals made under other legislation (for example, Sydney Desalination Plant Pty Ltd).
Victoria	• A regulatory order made under the *Water Industry Act 1994* provides the ESC with an ongoing responsibility to approve or set pricing for regulated water entities (numerous metropolitan, regional and rural water entities). • The regulatory order sets out procedural requirements for the making of a price determination by the ESC. • There is no active Ministerial involvement in the regulatory process.
Western Australia	• The ERA has no ongoing responsibility for determining or monitoring the pricing practices of water entities. • Under the ERA's enabling legislation, the Minister can direct the ERA to conduct an inquiry into a regulated industry. • This has been used by the government to direct the ERA to report on, and recommend pricing for, the state's major water entities (for example, State Water Corporation, Busselton Water Board). • The ERA's role is recommendatory in nature, with actual price increases announced as part of the annual budget process.
South Australia	• ESCOSA has recently been given an ongoing authority to regulate pricing for water entities by the *Water Industry Act 2012*. • ESCOSA's new price determination powers are set out under its enabling legislation. • However, a Pricing Order is to be made by the government under the Water Industry Act which will set policies or principles that ESCOSA must follow when making a determination. • ESCOSA is still to finalise the approach it will take to regulate entities, pending release of the Pricing Order (at the moment it appears that it will adopt a determination role for SA Water and a price monitoring role for other water entities).

Source: Commission of Audit

B8.6 RAIL FARES AND CHARGES

Queensland Rail Limited (Queensland Rail) operates the inner-city and long-distance passenger services and provides below rail access to third party rail operators.

B8.6.1 Passenger rail fares

Queensland Rail operates rail passenger services through the CityTrain (Brisbane and the surrounding centres passenger service) and TravelTrain (regional passenger travel) services.

For both, the CityTrain network and the TravelTrain network, passenger fares are set by Translink. The passenger services operated by Queensland Rail do not operate on a commercial basis. The Department of Transport and Main Roads estimates that passenger rail fare revenue currently covers approximately 30% of the current cost of providing services.

There are no publicly stated principles on which fares are set, and there is no process for independent review of the costs of operating either the CityTrain or TravelTrain network. As per the Commission's recommendations in Section B3, contestability in the provision of these services would encourage greater cost efficiency and more competitive pricing of these services.

B8.6.2 Below rail charges

The QCA does not set network (below rail) access prices for Queensland Rail, nor does it undertake any form of assessment of the prudent and efficient costs.

Queensland Rail provides access to its network infrastructure under a third party access regime (access undertaking) approved by the QCA under the QCA Act. Queensland Rail does not transport any freight over its own network, but provides third party access for freight transport, including for coal and other bulk minerals, agricultural products and general freight.

Queensland Rail is currently subject to a 2008 access undertaking that the QCA approved for the Queensland Rail network, as amended to include new tariffs and tariff-setting rules in June 2010.

Rail operators and other third parties seeking access to the freight system of the rail network are subject to the network access undertaking which defines the regime for open access to rail infrastructure. The undertaking provides the framework for access seekers to negotiate access to Queensland Rail infrastructure. Queensland Rail's undertaking contains reference tariffs for coal train services on the western system.

The negotiation and management of access requests related to the Queensland Rail network and its associated infrastructure are handled directly by Queensland Rail, in accordance with the terms and conditions of the access undertaking. Rail operators and others seeking access to the rail network are required to negotiate most aspects of their proposed operations with Queensland Rail directly.

In March 2012, Queensland Rail submitted a Draft Access Undertaking (DAU) to the QCA for its review. The DAU seeks to replace the current undertaking with a set of regulations more suited to a network operator which is not vertically integrated with an above-rail freight business. The QCA has received submissions on the DAU and is considering those submissions

To date, with few access seekers, the QCA has not seen the need to investigate costs and develop its own reference tariffs separate to those agreed directly between Queensland Rail and third party users.

The privatised QR National (now Aurizon) owns and operates a coal network made up of almost 2,670 kilometre of heavy haul rail infrastructure in central Queensland.

Aurizon has an access undertaking approved by the QCA that came into effect on 1 October 2010 and is due to expire in 2013. The access undertaking sets out the terms and conditions under which Aurizon will provide access to rail infrastructure covered by the undertaking. It also sets out the process required for an access seeker to negotiate access to the infrastructure and how any disputes in relation to access are to be resolved.

B8.6.3 Regional freight charges

All non-coal freight transport (including livestock and mineral commodities, such as zinc, lead and copper) is provided by third party rail freight operators, including Aurizon and Pacific National, who set commercial charges in a competitive market environment. As noted above, while Queensland Rail owns the larger part of the below rail regional freight network (around 6,300 kilometres of track), it does not transport any freight on this network using its own rollingstock.

The Government provides some transitional funding to Aurizon for the provision of general freight and livestock transportation services in Queensland. The transitional funding is provided through a Transport Services Contract between Aurizon and DTMR. The contracts commenced on 1 July 2010 and expire on 30 June 2015 and 31 December 2015 respectively.[4]

Table B8.5 compares pricing regulation of both below and above rail services across Australian jurisdictions.

Table B8.5 Pricing arrangements for below and above rail services – state comparison	
Jurisdiction	**Pricing**
New South Wales	• IPART determines the maximum fares that can be charged for most of the train travel in New South Wales and also regulates the NSW Rail Access Undertaking (that is, regime) which applies to access to rail infrastructure.
Victoria	• Rail providers set fares for passenger travel and charges for freight. • Essential Services Commission regulates the rail access regime for rail services. • Under the *Rail Management Act 1996*, the Commission is responsible for deciding whether to approve or not approve access arrangements submitted to it by access providers.
Western Australia	• The Economic Regulation Authority regulates the WA Rail Access Regime which applies to access to railway lines and on-the-ground facilities, which are commonly referred to as 'below-rail' facilities, and does not apply to the use of rollingstock or any 'above-rail' facilities. • The regime oversees negotiations between rollingstock (above rail) operators and railway (below rail) owners, with negotiations based on regulated policies and practices established under the legislation. • Under the Railways (Access) Code 200 (Code) railway owners are required to submit floor and ceiling cost (not defined in the Code) determinations on the commencement of a railway's operations, and costing models reflecting specifications of relevant route sections of railway owners' networks. This information is made available on the regulator's website.
South Australia	• Government sets fares for passenger services. • The *Railways (Operations and Access) Act 1997* assigns certain functions to Essential Services Commission of South Australia including establishing pricing principles for access to rail services. • The Act establishes a negotiate–arbitrate access regime (the Access Regime) that covers certain railways and associated facilities within South Australia, including the rail lines within Adelaide used mainly for urban public transport service; and the intrastate lines used primarily for freight services. .

Source: Commission of Audit

The Australian Competition and Consumer Commission (ACCC) also regulates access to the Hunter Valley coal network in New South Wales via an undertaking under Australian Government competition laws. The ACCC also regulates most of the interstate rail network via another undertaking. Both networks are operated by the Australian Rail and Track Corporation.

In most jurisdictions, regulators have established floor and ceiling prices (or revenue limits) for access to rail infrastructure. The floor and ceiling are generally based on the costs likely to be incurred within an access period, and the revenue consequently required by the provider to meet those costs.

The floor-ceiling price band is designed to preclude monopoly pricing, while also ensuring access seekers pay at least the incremental cost of their access. The floor price therefore generally is set equal to the marginal or incremental cost of providing a particular service. The ceiling price generally relates to the full economic cost of providing the service, including an adequate return on capital.

The Victorian Rail Access Regime differs from those regimes in other jurisdictions in that it involves use of a revenue cap requiring the reference tariff to be set at such a level that, across all declared transport services, the anticipated revenue is equal to a reasonable forecast of the infrastructure provider's efficient cost of providing the services.

B8.7 PORT USER CHARGES

Queensland has 19 ports that are either owned and/or operated by four government-owned port corporations, operating under the provisions of the:

- *Government Owned Corporations Act 1993* (GOC Act)
- *Transport Infrastructure Act 1994*
- *Financial Accountability Act 2009*
- Australian Government's *Corporations Act 2001*.

Each GOC is responsible for setting its port user charges through commercial negotiations. Port charges have regard to QCA pricing principles to maximise volume throughput for the ports.

The governance framework applying to the port GOCs allows for their commercial activities to be subject to regulation by the QCA should this be deemed necessary. To date it has not been necessary to subject any the four port GOCs to a 'third party access' regime or pricing regulation for the use of port infrastructure.

The only Queensland port facility declared under the State's Third Party Access Regime (part 5) is the Dalrymple Bay Coal Terminal (DBCT), at the Port of Hay Point:

- The Queensland Government owns DBCT through a wholly government-owned entity, DBCT Holdings Pty Ltd.

- In September 2001, a private operator was granted a 50-year lease over the terminal, with the option of a further 49 years.

- In June 2006, the QCA approved an access undertaking for DBCT, which expired on 31 December 2010.

- DBCT sought approval for a DAU in March 2010, which was approved by the QCA in September 2010. The approved access undertaking took effect from 1 January 2011.

Table B8.6 shows a comparison of the pricing arrangements and regulation for ports across the Australian jurisdictions.

Table B8.6 Pricing arrangements and regulation for port services – state comparison	
Jurisdiction	**Pricing**
New South Wales	• Ports are held by government-owned corporations. • The terms and conditions offered for port access are not specified by the regulatory framework, but in practice most key port facilities make their terms and conditions publicly available, so that potential customers are able to assess and potentially negotiate changes. • Port charges are determined by port authorities – commercially negotiated charges.
Victoria	• Ports are a mix of private and government-owned corporations in Victoria. • Prices charged for port services are monitored by the Essential Services Commission, with the option for port users to seek relief under an access regime if commercially negotiated prices cannot be agreed upon.
Western Australia	• Ports are held by government-owned corporations, and there is no formal direct regulation of 'third party access' to port infrastructure in Western Australia or of pricing for the use of port infrastructure. • The government is responsible for approving statutory charges; otherwise, other charges are determined by the port authority.
South Australia	• Ports are a mix of private and government-owned corporations in South Australia. • Prices charged for port services are monitored by the Essential Services Commission of South Australia (ESCOSA), and there is a mechanism available for port users to seek relief under an access regime if commercially negotiated prices cannot be agreed upon.

Source: Commission of Audit

As part of the Competition and Infrastructure Reform Agreement (CIRA), COAG agreed to review the regulation of 'significant' ports, port authorities, and handling and storage facility operations to ensure they are consistent with the following access, planning and competition principles:

- Wherever possible, third party access to port services should be on the basis of agreed terms and conditions.
- Commercial outcomes should be promoted by establishing competitive market frameworks in preference to economic regulation.
- Where regulatory oversight of prices is warranted, this should be undertaken by an independent body which publishes relevant information.
- Where access regimes are required, and to maximise consistency, those regimes should be certified in accordance with the *Trade Practices Act 1974* (now the *Competition and Consumer Act 2010)* and the Competition Principles Agreement.

These reviews have been completed. For Queensland, the Ports Review recommended that the existing regulatory arrangements for the ports (that is, 'threat of regulation') continue, with the exception of DBCT.

For DBCT, the access regime has been certified as effective by the Australian Treasurer.

B8.8 FUTURE REGULATORY FRAMEWORK

Economic regulation should be independent, objective, stable and certain, thereby enabling service providers to make long-term and efficient investment decisions confidently. The OECD has articulated these principles in its *Guiding Principles for Regulatory Quality and Performance*. An extract from these principles is included in Box B8.1.

Box B8.1
OECD Principles of Good Regulation

The OECD's *Guiding Principles for Regulatory Quality and Performance* observes that good regulation should:

- serve clearly identified policy goals, and be effective in achieving those goals
- have a sound legal and empirical basis
- produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account
- minimise costs and market distortions
- promote innovation through market incentives and goal-based approaches
- be clear, simple and practical for users
- be consistent with other regulations and policies
- be compatible as far as possible with competition, trade and investment facilitating principles at domestic and international levels.

Source: OECD, Guiding Principles for Regulatory Quality and Performance, Paris, 2005, p. 3

It is important that economic regulation promotes and strengthens Queensland's long-term economic growth, by keeping infrastructure costs and prices competitive, as they represent a significant input cost for the State's key industries. In this context, the role of the Government should be to encourage the development of contestable markets where prices are based on costs that are subject to competitive market pressures.

However, there has been a tendency for governments to use price regulation as a mechanism to protect consumers from 'price shocks', where prices or price increases are considered to be excessive. This type of government intervention in pricing arrangements may provide some temporary or short-term price relief for consumers.

However, it creates regulatory uncertainty and inconsistency for existing and potential industry participants, which can discourage investment. Over time, it is unsustainable to have a situation in which prices do not reflect the actual cost to deliver services as this will require an ever-increasing call on the Budget which Government will find too costly to sustain.

Over the longer term, the better approach is to ensure there are more effective regulatory arrangements which promote competition to exert downward pressure on costs and hence prices.

As shown in Table B8.7, the economic regulators in other states, especially New South Wales and Victoria, have a greater role in pricing arrangements than the QCA does in Queensland, compared with the direct role of Ministers. The table provides a comparison of Queensland's regulated pricing arrangements with Victoria and New South Wales.

Table B8.7
State comparison of price regulation

	Queensland	NSW	Victoria	Western Australia	South Australia
Electricity					
Generation	Service provider	Service provider	Service provider	Service provider	Service provider
Transmission	AER	AER	AER	AER	AER
Distribution	AER	AER	AER	AER	AER
Retail - market contracts	Service provider	Service provider	Service provider	Service provider	Service provider
Retail - non-market contracts[1]	Minister/Govt QCA	IPART	Service provider	Miniser/Govt ERA	ESCSA
Ports	Service provider	Service provider	Service provider	Service provider	Service provider
Water – Metropolitan					
Bulk water prices[2]	Minister/Govt	IPART	ESC	Minister/Govt	ESCSA
Distribution/retail[3]	Minister/Govt QCA From July 2013				
Water – regional					
Bulk water – non-irrigation	Service provider	IPART	IPART	Minister/Govt	ESCSA
Irrigation	QCA	IPART	IPART		
Transport					
Passenger rail services[4]	Minister/Govt	IPART	Service provider	ERA	Minister/Govt
Freight[5]	Minister/Govt	Service provider	Service provider	ERA	
Third party access regimes	QR	IPART	ESC	ERA	ESCSA

AER = Australian Electricity Regulator; ESC = Essential Services Commission; ESCOSA = Essential Services Commission of South Australia;
IPART = Independent Pricing and Regulatory Tribunal; QCA = Queensland Competition Authority;
QR = Queensland Rail

1 The Queensland Government excluded electricity Tariff 11 from the 2012-13 QCA price determination to fulfil an election commitment to maintain Tariff 11 non-market contract at 2011-12 levels.
2 Urban bulk water prices are set by Ministers in Queensland.
3 In April 2011, the Queensland Government announced a two-year CPI price cap for residential and small business customers from 1 July 2011. The QCA maintains a price monitoring Role.
4 In Queensland, Translink, a division of the Department of Transport and Main Roads, sets rail fares. In NSW, IPART recommends to the government a maximum retail price. The government may set a price below the maximum recommended price.
5 Ministers determine the price paid for the transport of certain regional freight services and livestock transport, and provides a subsidy to Aurizon for the provision of these services at the specified rate. Most bulk commodity freight prices (for example, the transport of bulk coal or minerals) is set by service providers.

Source: Commission of Audit

Queensland's price setting arrangements for regulated industries are fundamentally sound. However, there are no clear and consolidated guiding principles on which the arrangements are based.

The Commission considers that a set of guiding principles should be developed to provide a stable, predictable and consistent pricing framework for regulated infrastructure. These principles, which should be based on the OECD Principles of Good Regulation, will govern the extent of government involvement in price setting.

At the minimum, the following principles should apply to pricing arrangements for regulated industries in Queensland:

- Where possible, prices should be determined by competitive market pressures. Over the long term, this has been demonstrated to be the most effective mechanism to exert downward pressure on prices, as seen in Victoria's deregulated electricity industry.

- Where market competition is limited or in the early stages of development, the independent economic regulator is the most appropriate body to deal with pricing matters, including undertaking a price deterministic role.

- Ministerial involvement in price determinations should be the avenue of last resort, for example, if there was a critical imperative to manage short-term cost pressures in essential services that are not substitutable.

To ensure greater consistency in the pricing framework, the Commission considers that all pricing reviews should be conducted by the QCA under its enabling legislation. At present, pricing reviews can be conducted under different legislative frameworks, including the *Electricity Act 1994* and the *Water Act 2000*.

To assist the QCA in this role, the QCA Act should be amended to provide for a price determination power similar to that which applies with the New South Wales Independent Pricing and Regulatory Tribunal.

Commercial markets and regulatory practices have changed markedly since the QCA Act was first introduced. It is therefore timely to update and modernise the access and price regulation provisions of the Act, especially to reflect the dynamic environment for regulated assets. This will encourage efficient investment in critical infrastructure to support the future economic growth of the State.

Recommendations

37 A stable, predictable and consistent pricing framework be established for regulated infrastructure, by adopting a policy that all pricing reviews are conducted by the Queensland Competition Authority under its enabling legislation, rather than through separate legislative or administrative processes.

38 The Queensland Competition Authority Act 1997 be amended to:

- ***provide for a price determination power similar to that which applies with the New South Wales Independent Pricing and Regulatory Tribunal***
- ***update and modernise access and price regulation provisions to reflect the commercial environment for regulated assets.***

ENDNOTES

1 Queensland Competition Authority, *Final Determination: Regulated Retail Electricity Prices 2012-13*, May 2012, accessed from www.qca.org.au

2 Department of Energy and Water Supply, *The 30-year electricity strategy: directions paper*, 2012, accessed from www.dews.qld.gov.au.

3 The QCA provided final advice on Grid Service Charges for 2012-13 in July 2012.

4 Under the contracts, for the initial two and a half years, Aurizon will receive monthly base payments and quarterly payments in aggregate totalling $150.0 million for the year ended 30 June 2011, $148.1 million for the year ended 30 June 2012 and $75.1 million for the six months ended 31 December 2012. After 31 December 2012, and until expiry of the contract, there is a process to calculate payment amounts for the services then required by the State as detailed in the contract. In addition, the contracts provide for additional payments of $90.0 million (general freight) and $13.0 million (livestock) between 31 December 2012 and the expiry of the contracts relating to services provided over the life of the contracts.

PART C:

FINANCIAL MANAGEMENT

PART C

FINANCIAL MANAGEMENT

PREFACE

There is an urgent need to restore the highest standards of financial management to public administration – with an enhanced long-term financial planning framework, improved budget, cash and asset management, and greater transparency and accountability.

The Commission's June 2012 Interim Report provided a comprehensive review of the State's financial position, and recommended a process of fiscal repair which is being addressed by the Government.

Part C of this Report considers a number of broader issues relating to the financial management of the State, including the lack of a coherent and consistent framework for long-term financial and economic planning.

In view of the State's relatively high asset base, capital and asset management practices need to be strengthened. Enhancements to the appropriation framework and budget management would support the task of fiscal repair. There is also scope to improve the administration of grant programs, to ensure better value for money.

Long-term systemic reforms to strengthen the financial and economic management of the State are also considered, especially the establishment of a Queensland Productivity Commission to provide independent advice to Government on ongoing productivity improvements to boost future economic growth.

C1 FINANCIAL PLANNING FRAMEWORK

KEY ISSUES

- Many of the decisions made by government have long-term consequences or involve the development of long-term assets. Yet decisions are often made with a short-term focus.
- While there have been previous attempts at longer-term government strategic plans and infrastructure plans, their usefulness has been diminished by the lack of any serious assessment of available fiscal capacity.
- Asset planning is being undertaken to varying degrees by agencies, but often on a piecemeal, fragmented and uncoordinated basis both within agencies and at a consolidated whole-of-government level, and with little regard to available financial capacity, especially over the longer term.
- Some of the business cases to support major debt-funded investments have been found by the Commission to be poorly specified or inadequately documented.
- Some projects suffered significant cost escalation during delivery, putting unnecessary additional pressure on the budget.
- The Commission considers that this needs to be redressed through a better long-term financial planning framework to provide a more disciplined, rigorous and informed framework within which the Government makes its decisions.

C1.1 LONG-TERM PERSPECTIVE

The Commission's Terms of Reference refer to trends and long-term projections in state revenues and expenses, as well as strategies to improve the sustainability of the State's capital program beyond the forward estimates period to 2030. Such issues most appropriately should be considered within the context of a rigorous financial and economic planning framework.

The Government has commissioned the development of 30 year plans for the electricity, water and agriculture sectors, and a 20 year tourism strategy. Also, the Schools Planning Commission has been established to streamline and coordinate the planning and future needs of schools in Queensland.

These initiatives demonstrate a commitment to long-term planning, and reinforce the need for a structured planning framework for the State to ensure that long-term plans are built on consistent demographic, economic and financial projections.

Many of the decisions made by Government have long-term consequences or involve the development of long-term assets. Yet decisions are often made with a short-term focus. The Commission considers that this needs to be redressed through a better long-term financial planning framework to provide a more disciplined, rigorous and informed framework within which the Government makes its decisions.

The information needed to undertake decision making in a long-term context currently is not available. In particular, there is no whole-of-government indicative funding envelope to help guide capital or service delivery prioritisation or planning beyond the forward estimates period.

Long-term planning is inherently uncertain, and needs to be considered as a guide or a tool to better inform government decisions that will have long-term consequences. Long-term planning can provide indicative longer term trends based on best estimates for major demographic, social and economic factors.

An important part of the planning process is that it provides a disciplined framework within which future policy decisions can be made on a more informed basis. Plans will change over time, in response to a number of factors, including changing funding capacity and changing priorities (including changes of government). The planning process needs to be sufficiently flexible to accommodate such changes. Nevertheless, the discipline of working within an informed long-term framework enables decisions to be made on the basis of the best available information on likely future circumstances.

A major issue for a state in undertaking long-term financial planning is the uncertain nature of policy initiatives and funding from the Australian Government. It is important that the Council of Australian Governments work toward achieving a more consistent longer policy and funding framework for the states.

Figure C1.1 sets out diagrammatically the structure of the Commission's proposed long-term financial planning framework for Queensland. Key features are an Intergenerational Report, along the same lines as that produced by the Australian Government, as well as a State Infrastructure Plan with a 10 year planning perspective. These build on existing processes for strategic planning, and financial planning through the annual budget and forward estimates.

Within this framework, the Commission supports the development of longer-term strategic plans out to 20 years for key policy areas, to provide a link between the broad longer-term outlook in the Intergenerational Report, and the more detailed and comprehensive shorter-term plans for asset replacement and enhancement.

Figure C1.1
Long-term financial planning framework

40 Year Intergenerational Report
- demographic, economic, fiscal trends - report every five years, core data released annually - report discusses implications for the community and service delivery
10 Year Plans and Projections
- State Infrastructure Plan and Asset Management Plans – reviewed annually - Incorporates an assessment of indicative funding capacity
4 Year Plans and Estimates
- Agency strategic plans - Forward estimates
1 Year Plans
- Service Delivery Statements - Agency operational plans

Source: Commission of Audit

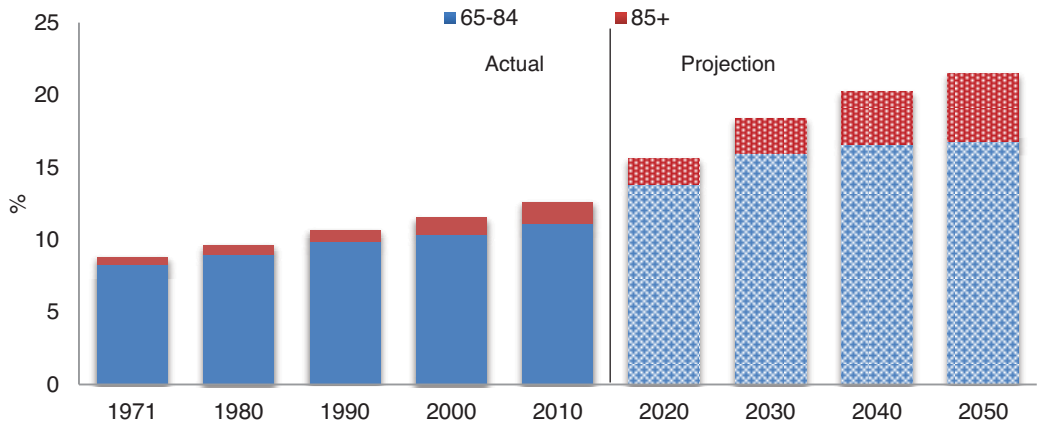
C1.2 INTERGENERATIONAL REPORT

The Australian Government has produced Intergenerational Reports in 2002, 2007 and 2010. They provide an overview of likely demographic, economic and financial trends in Australia over a period of 40 years. A consistent theme of these reports has been the ageing of the Australian population, which will drive increased government expenditure demands.

The Commission considers there is a need for a similar Intergenerational Report for Queensland covering a 40 year time horizon, to be produced every five years to outline long-term demographic, economic and financial trends, and likely implications for the State.

For example, Queensland's population is projected to grow from around 4.5 million persons at June 2011 to between 7.4 and 7.8 million persons by 2050. Queensland's population is projected to age significantly over the next 40 years with the proportion of persons aged 65 and over increasing from 13% in 2010 to 21% in 2050 (see Chart C1.1). Over this period, this population cohort is expected to increase threefold from 560,000 to 1.66 million.

Chart C1.1
Historical and projected proportion of the Queensland population aged 65+



Source: ABS 3105.0.65.001 and Commission of Audit

The changing size and composition of the population undoubtedly will have significant implications for the State's health, education, housing and transport services in particular. It will also pose significant challenges for the State's capacity to fund the required services and infrastructure.

In this regard, an Intergenerational Report for Queensland should incorporate long-term demographic and economic projections. This would enable the Government to model its expected future revenue and expenses (including capital expenses) on a no policy change basis. Taken jointly, these two streams of analysis would establish Queensland's indicative future funding capacity and future funding requirements respectively. Section A1 of this Report presents an initial set of long-term demographic, economic and fiscal projections which could provide a starting point for an initial Intergenerational Report for Queensland.

It is expected that the Government could use scenario analysis to consider how best to meet future service delivery requirements, potentially including the adoption of new service delivery models, such as those canvassed in Part D of this Report. Similarly, scenario analysis could be used to assess the most cost effective combination of recurrent and capital expenditure to meet service delivery demand.

In an iterative process, expenditure and revenue policy settings could be reviewed with a view to achieving an affordable service delivery framework going forward. In such a process, the Government would consider a range of revenue options in conjunction with a range of expenditure options in order to develop a sustainable long-term fiscal trajectory.

If the Government does not engage in long-term planning in an ordered and coherent way, it will be forced by crisis to respond to emerging pressures in an ad hoc and sub-optimal manner. This will lead to harsher adjustments and poorer outcomes for the State of Queensland.

Apart from its role in providing a more informed basis for long-term government decision making, there would be a number of other significant potential benefits of an Intergenerational Report for Queensland, including:

- As a public good, the demographic and economic projections could be used in a range of other planning tasks both inside and outside of Government.
- Common data sets for key demographic and economic series would improve consistency of planning processes across the Government.

- The process of developing agency expense projections to support service delivery objectives would clarify relationships between agency client bases and service requirements, potentially leading to better performance indicators.

- It would educate the public on the challenges to be faced and the options available. It would focus attention on policies to be put in place to achieve desired service outcomes.

Recommendation

39 The Government produce an Intergenerational Report covering a 40 year horizon, to be produced every five years to outline long-term demographic, economic and financial trends, and likely implications for Queensland.

C1.3 STATE INFRASTRUCTURE PLAN

The Intergenerational Report for Queensland should be supported by a 10 year State Infrastructure Plan (SIP), incorporating an assessment of indicative financial capacity. The SIP should be updated annually as an input into the State budget process.

While there have been previous attempts at longer-term government strategic plans and infrastructure plans, their usefulness has been significantly diminished by the lack of any serious assessment of available fiscal capacity. For example, neither the previous Queensland Infrastructure Plan (QIP) nor the earlier South East Queensland Infrastructure Plan and Program (SEQIPP) incorporated any assessment of available fiscal capacity. In the absence of such an assessment, the usefulness of these plans was highly compromised.

Asset planning is being undertaken to varying degrees by agencies, but often on a piecemeal, fragmented and uncoordinated basis both within agencies and at a consolidated whole-of-government level, and with little regard to available financial capacity, especially over the longer term. This is a significant shortcoming, especially where decisions, such as the commitment to stage the Commonwealth Games, have long-term financial implications beyond the formal forward estimates period. In such cases, the funding strategy appears to have been to fund such projects as the obligation crystallises, without proper consideration of other competing priorities or projected funding capacity at the time.

The SIP would provide a whole-of-life assessment of investment in new and/or replacement capital, maintenance programs and asset disposal programs by agency, rolled up to a whole-of-government plan. It would involve a review of policy priorities by the Department of the Premier and Cabinet (DPC), analysis of funding capacity by Queensland Treasury and Trade (QTT), and assessment of priorities and co-ordination issues by these two departments in conjunction with the Department of State Development, Infrastructure and Planning (DSDIP). In this regard, QTT maintains a high-level medium-term Excel financial forecasting tool (budget year plus eight years) which could be used to assess funding capacity.

As well as articulating possible funding options, and options for private sector involvement, the SIP also should closely analyse affordability issues, for example, by reporting on key high-level asset and financial sustainability ratios over the long term. These ratios should include:

- asset consumption ratio
- asset sustainability ratio
- interest coverage ratio
- net financial liabilities ratio
- operating surplus ratio
- working capital ratios.

These financial sustainability and asset sustainability indicators should be regularly updated and monitored and included in the financial planning and forecasting processes across departments to be consolidated into a whole-of-government position.

Total Asset Management Plan (TAMP)

The building block for the SIP would be an entity level total asset management plan (TAMP) which would be required for every public sector agency expecting to incur asset related expenditure over the life of the plan (including departments, statutory authorities, Government Owned Corporations (GOCs) and local government authorities).

Each TAMP should include fully integrated plans for asset acquisition, replacement, maintenance and disposal, based on a rigorous evaluation of future service delivery objectives and needs. These plans should be supported by financial statement forecasts/projections (that is, income statement, balance sheet, cashflow statements) and relevant financial sustainability ratios.

There needs to be a balanced assessment of the long-term sustainability of asset life cycle management, not just investment in new assets This requires consideration of factors such as asset condition, quality, capacity, useful life, maintenance issues (including backlogs), level of service and any service performance deficiencies. The case for investment in new assets should be supported by suitable project evaluation processes such as the Project Assurance Framework (PAF) and Value for Money (VfM) frameworks.

The development of TAMPS should include an assessment of:

- an agency's service delivery objectives and outcomes, and how these would be supported by its asset planning, including the impact of asset recurrent costs on agency resourcing

- any capability gap between the capacity of existing assets and planned outcomes

- options for achieving planned outcomes, including:

  – policies to manage demand and supply issues
  – upgrade/replacement of existing infrastructure
  – investment in new infrastructure
  – other efficiency management processes
  – other service delivery solutions

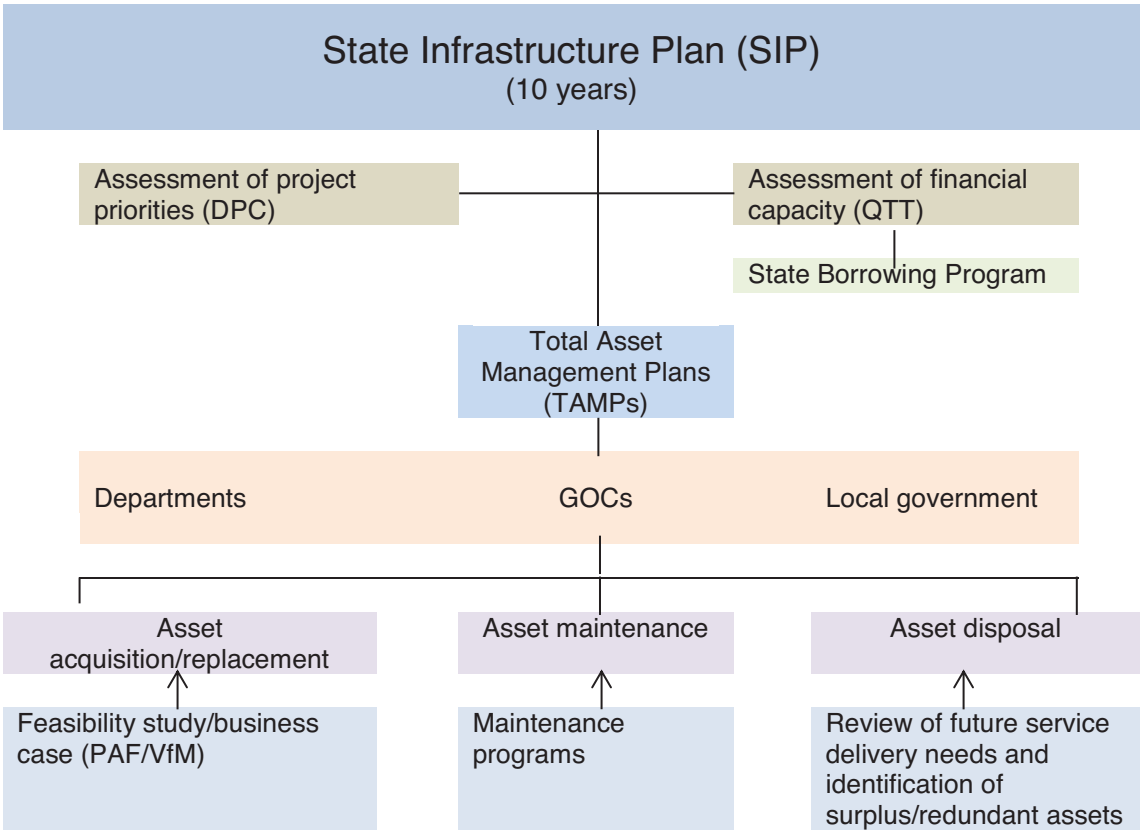
- investment, funding and procurement options, including affordability and the financial impact evaluated through the use of a long-term financial forecasting model.

There is merit in agencies using an internal investment review panel to make capital investment and divestment decisions. The panel should include executives from planning, management and finance areas to agree the outcome, and assess long-term impacts for the agency. New projects need to be integrated into long-term capital plan and asset life cycle management (where appropriate).

Where major infrastructure investments are planned, an integrated project team involving Projects Queensland is likely to be necessary to oversight the development of a full business case, including project evaluation processes and the assessment of whole-of-life asset costs.

Figure C1.2 illustrates the internal review processes for development of TAMPS, and their consolidation into the SIP, which would be subject to final sign-off by Cabinet (or delegated to the Cabinet Budget Review Committee). TAMPS would need to be prepared on a consistent basis by public sector agencies, GOCs and local authorities, as discussed in more detail in Section C1.4. TAMPS for GOCs and local government authorities would be subject to their own internal approval processes, but would need to be consolidated into the SIP, to give a complete picture of future capital funding.

Figure C1.2
State Infrastructure Plan Framework



Source: Commission of Audit

Recommendations

40 The Government strengthen its asset management processes by developing and updating each year a 10 year State Infrastructure Plan which prioritises likely service delivery, capital and maintenance requirements in the context of indicative funding capacity.

41 Public sector agencies be required to produce annual 10 year Total Asset Management Plans, as input to the State Infrastructure Plan, which incorporate:

- ***whole-of-life assessments of investment in new and replacement assets***
- ***asset maintenance plans***
- ***asset rationalisation and disposal plans***

in accordance with the Government's service delivery priorities.

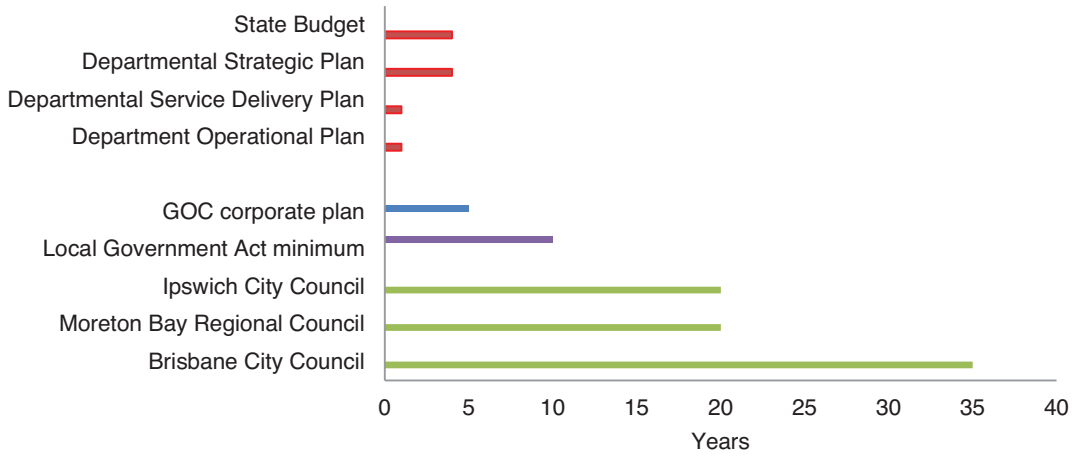
C1.4 Consistency in Financial Planning Framework

C1.4.1 Overview of current arrangements

The current Queensland statutory planning framework is piecemeal and inconsistent, with different planning requirements applying to different entities under different legislation.

Chart C1.2 summarises some of the major financial planning timeframes for the three major groups of public sector agencies: departments, GOCs and local government authorities. The longest planning horizons apply to entities furthest from the centre of government. Typically, departmental planning requirements are for less than five years, whereas the typical planning timeframe required for local government authorities is 10 years. Major local government authorities operate much longer planning timeframes, extending out to 35 years for the Brisbane City Council.

Chart C1.2
Financial planning timeframes



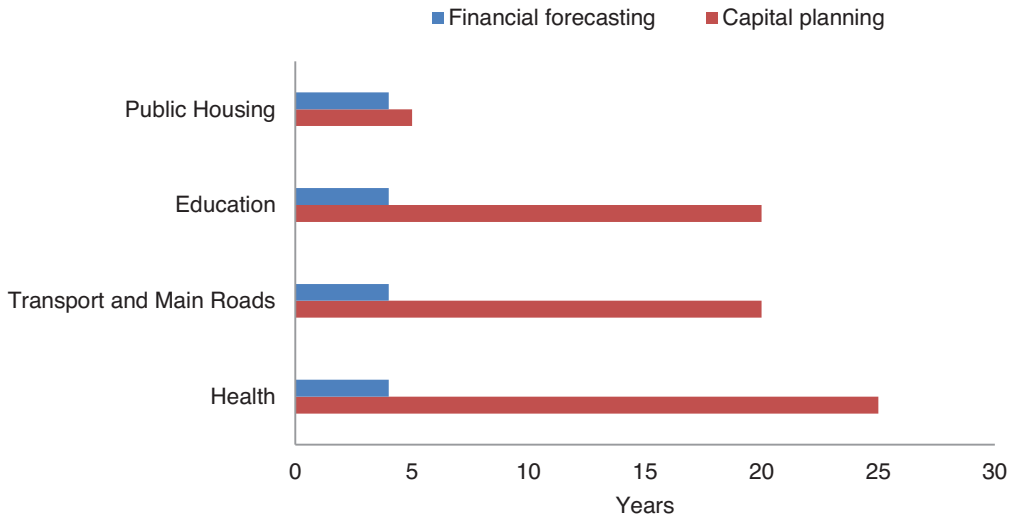
Source: Commission of Audit

C1.4.2 General Government sector financial planning requirements

Financial forecasting requirements for departments generally are limited to the four year strategic planning period prescribed in the Financial and Performance Management Standard 2009. The State Budget recurrent and capital funding estimates also are currently limited to the budget plus three forward estimate years, making a total period of four years. Departments generally do not use, and are not required to prepare, long-term (that is, 10+ years) financial forecasts in their planning processes.

There are no mandated asset planning requirements for departments.[1] Some departments with material asset bases have developed a longer-term approach to capital planning as shown in Chart C1.3. However, there are differences between departments. For example, capital planning timeframes range from five years for Public Housing through to 25 years for Queensland Health. Moreover, capital planning timeframes are not aligned with timeframes for financial forecasts.

Chart C1.3
Department financial forecast and capital planning timeframes



Source: Commission of Audit

As noted earlier, QTT maintains a high-level medium-term Excel financial forecasting tool (budget year plus eight years) to inform the Government of various sensitivity impacts and calculate key credit metrics where required. The assumptions used are generally based on historical averages and QTT forecasts. There are only limited linkages between QTT financial forecasts and department asset management plans.

C1.4.3 Government Owned Corporation (GOC) financial planning requirements

Prior to the commencement of each financial year, GOC boards are required to prepare and submit a Corporate Plan and a Statement of Corporate Intent to shareholding Ministers for their approval[2]. While the *Government Owned Corporations Act 1993* provides guidance on the content of statements of corporate intent, the Act does not specify the content of corporate plans.

The Commission notes that GOC policies and guidelines currently are being reviewed. As part of this process, the previous GOC guidelines for statements of corporate intent and corporate plans have been withdrawn as they were considered to be too prescriptive.

Government guidelines had required that GOC boards plan and consider long-term strategies for their businesses. They had also required the corporate plan to focus on the medium to long-term outlook, primarily dealing with outcomes over the next five year period. The five year forecast period (budget plus four years) is one year longer than the requirements for departments and statutory authorities.

Outside of statutory requirements, many GOCs have implemented longer-term capital and infrastructure management plans. For example, SunWater has a 25 year capital management strategy and the Gladstone Ports Corporation has a 50 year strategic plan.

QTT advises that revised GOC guidelines are likely to maintain a minimum five year timeframe for financial forecasting and planning purposes.

C1.4.4 Queensland local authority financial planning requirements

The State prescribes long-term financial planning requirements for local authorities through the *Local Government Act 2009* and the Local Government (Finance, Plans and Reporting) Regulation 2010. These requirements are more comprehensive than those applying to public sector agencies. Box C1.1 summarises key requirements, which are designed to achieve improved fiscal and economic sustainability of local authorities over the short, medium and longer term.

Box C1.1
Local government financial planning requirements

Under the *Local Government Act 2009*, local authorities are required to prepare:

- a long-term community plan to provide strategic direction for at least 10 financial years
- a long-term financial plan, including forecasts covering a period of at least 10 years (to be reviewed annually). This financial forecast includes a statement of financial position, statement of cash flow, statement of income and expenditure and statement of changes in equity
- a long-term asset management plan
- a five year corporate plan
- an annual budget (plus minimum of two years forward estimates) that considers a number of sustainability ratios (asset consumption ratio, asset sustainability ratio, interest coverage, net financial liabilities ratio, operating surplus ratio, working capital ratio)
- an annual operational plan.

Source: Queensland Local Government Act 2009

Some major local authorities have adopted a longer term approach to financial forecasting which exceed the statutory requirements. For example:

- Ipswich City Council prepares a 20 year financial forecast integrated into its asset management planning process.

- Moreton Bay Regional Council recently developed a 20 year financial forecasting model for use in its planning and forecasting processes.

- Brisbane City Council prepares a 35 year financial forecast, with particular focus on the first 10 years.

In summary, there are marked differences in the reporting timeframes for financial forecasts between public sector agencies, GOCs and local authorities. Moreover, financial forecasts generally are not aligned with other planning instruments, such as strategic or corporate plans and capital plans. In the Commission's view, there is a need for a consistent approach to financial planning requirements, with minimum requirements being aligned with the proposed 10 year timeframe for TAMPS and the SIP.

Recommendation

42 Common financial planning requirements should be applied across the General Government, Government Owned Corporation and local government sectors.

C1.5 STATE BORROWING PROGRAM

The State Borrowing Program (SBP) provides the approval mechanism for public sector agencies to undertake borrowings to fund new capital works. The scope of the SBP covers departments, GOCs, local authorities and some statutory bodies.

Once the Treasurer has approved the borrowing program for a year, the Queensland Treasury Corporation (QTC) arranges debt funding for approved projects on the request of the approved entity.

C1.5.1 Financial risk assessment

There are different financial risk assessment processes involved for entities which require funding under the SBP:

- *General Government borrowings* (principally borrowings by departments)

  Because departmental borrowings are serviced from consolidated fund revenue in the General Government sector, there is no credit risk as such, beyond the overall credit risk of the Government as a whole. The main concern is to review the department's capacity to realise savings or comply with any other conditions imposed as part of the approval processes for undertaking new capital works.

- *Government Owned Corporations*

  QTC performs a credit review of proposed borrowings by GOCs, with a recommendation by QTC's board for SBP approval (or otherwise) provided to the Treasurer through QTT.

- *Local government authorities (LGAs)*

  The Department of Local Government (DLG) is responsible for performing due diligence assessments to determine the capacity of LGAs to service the debt they are seeking.

  QTC also performs a credit assessment to determine repayment capacity, when requested by DLG. The credit assessment processes used by QTC and DLG use different rating scales and approaches to evaluation.

- *Other statutory authorities*

  A credit review process is typically required by QTT before loans to other statutory authorities are approved by the Treasurer. Generally, QTC is engaged to determine repayment capacity of the loan by the statutory authority.

C1.5.2 Multi-year approval

Under current arrangements, SBP approval is granted for debt funding for a project for a single financial year. This is problematic for projects which require debt funding for more than one year. There is no certainty that future debt funding will be available when it is required. The limited time period available under the annual drawdown approval requirement of the SBP encourages a 'use it or lose it' approach by some entities.

Approvals under the SBP should be provided on a multi-year project basis where this is relevant for long-term asset acquisition. Approval should be available for up to the life of a project, subject to annual review as the SBP is prepared each year. This approach would provide greater funding certainty for borrowers and would reduce the incentive to unnecessarily draw down debt funding in advance of its requirement.

C1.5.3 Terms and conditions

Given the significant increase in State debt in recent years, the Commission considers there is a need for closer management of approvals for new borrowings under the SBP. In this regard, there is scope for QTC to play a more active role to assist in minimising the State's contingent exposure to debt-funded entities, by tightening its loan terms, conditions and documentation to enable more effective monitoring of financial risk. This could include requiring entities:

- to demonstrate that the application of the funding is consistent with the original borrowing submission

- to provide standard credit metrics and project reports on a regular basis to enable ongoing risk assessment

- to engage in periodic credit reviews

- to demonstrate compliance with any borrowing conditions imposed in the original loan approval, or imposed at a later time.

QTC should have the ability to refuse to advance funds to an entity which does not comply with its borrowing conditions or is in breach of any agreed financial ratios, covenants or other commitments. In addition, QTC should be able to recommend to the Treasurer that repayment of borrowings be required in cases where it has concerns about the ability of an entity to comply with its borrowing conditions.

C1.5.4 Draw down of funds

Under current processes, there are insufficient checks to validate that SBP funds are being used as intended to fund capital expenditure. There is also no process for requiring that funds are only drawn down when required and there are some indications that some entities have borrowings with the State and at the same time have substantial cash on deposit with other financial institutions.

This practice has undesirable consequences, in that it inflates the quantum of debt funds to be raised by QTC under the SBP, and adversely affects the State's credit metrics. It also complicates the task of managing interest rate risk. This is not an efficient or cost effective form of financing from an overall State perspective, as it can impact the total cost of accessing funds in financial markets, the financial position of the State, and its credit rating.

For these reasons, the Commission considers that it would be advisable for QTT to establish a prudent draw-down process to ensure that loan funds are only advanced to agencies when they are required to pay for assets.

Collectively, these measures to strengthen the management of the SBP would assist in restoring and maintaining the highest standards of financial discipline across government. In particular, they would support the Government's debt reduction strategies, and contribute to more effective management of the State's contingent liabilities.

Recommendation

43 Management of the State Borrowing Program be strengthened to support the Government's debt reduction strategies, with approval of funding to be conditional upon enhanced credit lending assessments and other terms and conditions based on recommendations of Queensland Treasury and Trade.

C1.6 PROJECT PLANNING AND MANAGEMENT

C1.6.1 Recent experience

As part of the financial planning process, careful planning and management of major infrastructure projects is necessary to ensure value for money is achieved. In a review of a number of material infrastructure projects, the Queensland Audit Office (QAO) found that:

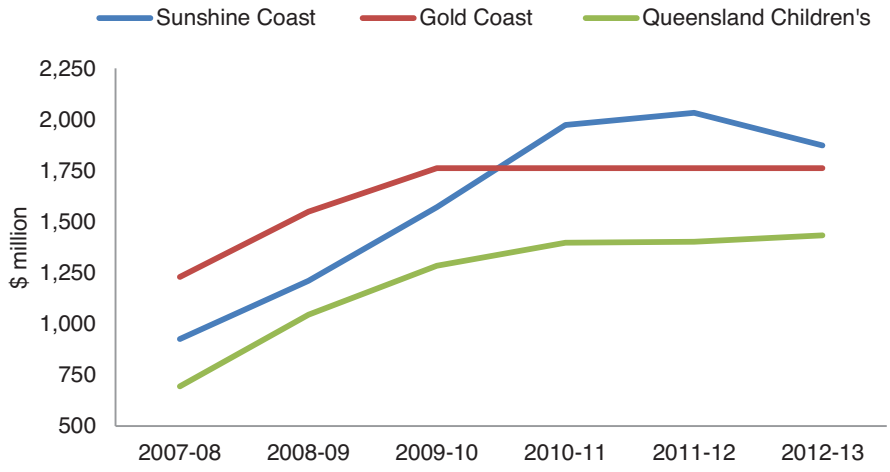
> "…. *there was a lack of clarity over the roles and responsibilities of agencies involved at the business case/investment decision phase. Better documentation for the selection of delivery methods is required through more robust business cases and procurement strategies*".

The review also found that for some projects, insufficient analysis of and comparison of delivery options was provided and that, in some cases, the delivery method appeared to have been decided prior to the business case being prepared.[3]

The Commission's investigations indicate that there has been a failure to apply sufficient rigour and discipline to the evaluation and project management of major infrastructure projects in recent years. As a result, some projects suffered significant cost escalation, putting unnecessary additional pressure on the budget. These included major hospital projects and major water-related infrastructure projects.

For example, Chart C1.4 shows increases which have occurred in the estimated construction costs of three major hospital projects: the Queensland Children's Hospital, the Gold Coast University Hospital and the Sunshine Coast University Hospital. When first included in budget estimates in 2007-08, the combined cost of these three projects was estimated to be $2.9 billion. In the 2012-13 Budget Papers, the combined cost estimate for the three projects had increased to $5.1 billion, an increase of $2.2 billion, or 78% higher than the original estimated project costs. In the cases of both the Queensland Children's Hospital and the Sunshine Coast University Hospital, latest cost estimates are more than double the original published estimates. However, there has been some reduction in estimated costs for the Sunshine Coast University Hospital in 2012-13.

Chart C1.4
Estimated costs for major new Queensland hospitals



Source: Queensland Budget Paper No. 3 Capital Works

For these three projects, the majority of the cost increases occurred between the preliminary costings being announced, and the subsequent completion of a detailed business case that is, the cost increases occurred pre-contract signature, but after a decision to proceed with the projects had been taken. The main reason for the cost increases during the business case phases was excessive optimism bias in the preliminary costs. The scope of the projects and their inherent risks were not adequately costed at the preliminary phase, and only became more apparent after a full detailed analysis and due diligence was conducted at the business case phase. Further, adequate construction cost escalation was not included in preliminary costings. In the case of the Queensland Children's Hospital, there have also been some cost increases post-contract signature.

In relation to investments in ICT assets, a significant proportion of projects fail to deliver the expected benefits or meet expected budgets. The Queensland Government Chief Information Office advises that many projects show poor project outcomes, with cost and scheduling overruns. For example, 10% of significant ICT projects had increases in budgets of greater than 75%.

In the case of major whole-of-government ICT projects such as ICTC and IDES, and the shared services initiative, actual capital and operating costs far exceeded initial projections, and overly optimistic projected benefits failed to be achieved. Further information on these projects is presented in Section E7 of this Report.

Poor outcomes for these projects can be attributed in large measure to problems in the preparation phase (planning and specification), and/or in the build phase (construction and delivery). For example, deficiencies in planning are likely to result in inadequacies in the development of feasibility studies and business cases.

The Commission has outlined the need for a more comprehensive and rigorous approach to asset planning which places primary emphasis on evaluating the best way to meet future service delivery needs. This will better define the need for, and expected benefits from, new infrastructure. It will also minimise the risk that infrastructure is inadequately specified, wrongly located, or underutilised.

C1.6.2 Procurement and financing options

Where new assets are required, balanced consideration needs to be given to procurement and financing options, with the objective of achieving best value for money for each project. There are a wide range of procurement models (and variants thereof), but they can be categorised broadly as:

- 'traditional' procurement models, which entail government financing of the project
- Public-private partnership (PPP) models, which involve private sector financing of the project.

Figure C1.3 illustrates the range of procurement models on the basis of this categorisation.

Figure C1.3
Procurement models for infrastructure

Traditional models	PPP models
• Construct only	• Direct user charge (such as a 'build, own, operate and transfer' (BOOT) arrangement)
• Design and construct	• Shadow user charge
• Design, construct and maintain	• Availability payment
• Construction management	
• Managing contractor	
• Early contractor involvement	
• Alliancing	

Source: Commission of Audit

The selection of an appropriate procurement and financing option involves a wide range of factors, and will vary according to the individual circumstances of each project. However, in broad terms, the selection will be driven by time, cost and risk factors.

Project costs

Traditionally, the Government has preferred to own and finance its assets, although the private sector has played a significant role in the construction phase. One of the major reasons for this traditional approach is that government enjoys access to financial markets on more favourable terms than private sector proponents, and therefore can generally obtain debt finance for projects on a more cost effective basis.

However, funding costs are not the only costs that need to be considered when evaluating an infrastructure project. It is not clear that government necessarily can fund projects more cost effectively when total whole-of-life project costs and risks are taken into account. Consideration also needs to be given to the risk of additional costs arising from poor project management and scope creep, as well as whole-of-life operating costs, including depreciation, repairs and maintenance, cleaning and other facilities management services.

Depending on the project, private sector providers can enjoy cost advantages in some or all of these additional areas. The commercial perspective of private sector providers also may result in more innovative and cost effective solutions across the entire infrastructure planning and delivery process, including the design, construction, financing, ownership and maintenance of assets. There is an active market of private providers for all these functions and greater use should be made of this expertise and experience.

Furthermore, private sector financing of infrastructure provides an additional source of funds in current circumstances where the State's capacity to raise additional debt funds on a cost effective basis is severely constrained.

Project risks

The overall cost of a project depends critically on the management of project risks. There are a large number of risks associated with a project, including construction, financing, legal, regulatory and operating risks. Under traditional procurement options, government carries all these risks. However, government is not necessarily the best party to manage all project risks.

In many cases, private sector parties are better placed to manage certain project risks. As a general principle, risks should be allocated to the party best able to manage them at the lowest cost.

PPPs have evolved as a mechanism for private sector investment in public infrastructure where the private sector bears significant project risks. Figure C1.4 shows some of the key risks applicable to PPP projects.

Figure C1.4
Key risks of PPP projects

- Site risk
- Design, construction and commissioning risk
- Sponsor risk
- Financial risk
- Hard and soft facilities maintenance operations risk and the payment mechanism
- Market risk
- Network and interface risk
- Industrial relations risk
- Legislative and government policy risk
- Force majeure risk
- Asset ownership risk
- Tax risk
- Interest rate risk

Source: National Public Private Partnership Policy and Guidelines, Council of Australian Governments, November 2008

There have been mixed outcomes for PPP projects in Queensland, the rest of Australia and elsewhere. Difficulties have been encountered generally where risks have not been appropriately allocated, quantified (for example, demand risk on toll roads) or priced.

As a result, the risk appetite of the private sector has changed, and new hybrid PPP models are emerging which involve greater sharing of risk between the private and the public sectors, for example, initial underwriting of debt by the public sector, partial underwriting of demand risk by the public sector and government capital contributions to assist in the financing of a project.

Project Assurance Framework and Value for Money Framework

The Project Assurance Framework (PAF) and Value for Money (VfM) Framework currently provide the basis for the development of business cases and selection of appropriate procurement and financing options for major infrastructure projects in Queensland.

The PAF provides for a preliminary evaluation of procurement options, based on a strategic assessment of the service requirement. If the preliminary evaluation indicates scope for private sector involvement through a PPP, business case development then progresses through the VfM framework. Otherwise, the project progresses to a business case assessment of traditional procurement options through the PAF.

The VfM framework provides a basis for the evaluation of potential PPP options on a value for money basis. However, in practice, only a small number of PPP projects have been undertaken in Queensland, notably the Southbank Institute of Technology, Airport Link, South East Queensland Schools and the Clem7 Tunnel, the last of which was a Brisbane City Council project. Currently, the Gold Coast Rapid Transit and Sunshine Coast University Hospital projects are being procured as PPP projects.

It is not clear that the current VfM guidelines provide a balanced assessment of private sector investment options. The focus on the Public Sector Comparator (PSC) is overly simplistic and tends to result in traditional procurement being the default option, as PPP options need to demonstrate better value for money. However, this approach gives insufficient weight to some of the broader benefits of private sector investment, including scope for:

- commercial innovation, especially for large, complex and high risk projects
- better integration of whole-of-life costs
- improved asset management, utilisation and maintenance
- better management of project risks, such as scope creep and cost escalation
- access to a wider knowledge, skills and experience base than otherwise is available within government.

Current procurement processes are cumbersome and time consuming. In addition, they impose onerous and costly bid requirements on bidders which can be a disincentive to participation by private sector proponents, thereby limiting competitive tension between bidders.

Projects Queensland has been established to better coordinate and manage the planning and pre-construction phases for major infrastructure projects, including business case development, procurement, tendering and financing. It is also reviewing the PAF and VfM frameworks, with a view to encouraging greater private sector investment in infrastructure projects.

The revised guidelines should be streamlined to reduce the timeframes for undertaking preliminary evaluations and business cases. In addition, tender processes should be rationalised to incorporate less onerous and less costly bidding requirements.

Recommendation

44 The Project Assurance and Value for Money frameworks be revised and the process streamlined to allow:

- ***reduced timeframes for preliminary evaluation and business cases***
- ***revised tender process with less onerous and less costly bidding requirements***
- ***greater acknowledgement of skills which will add value through innovation, efficiency and more effective management of risks, especially for large and complex projects.***

C1.6.3 Project management

The Government has established a Strategic Project Program Board (SPPB) to oversight the delivery of all major projects (greater than $100 million in value), or which involve a high degree of risk. It comprises the Coordinator General and the heads of DPC, QTT and DSDIP, and will complement the role of Projects Queensland, as it will focus on the management and delivery phase, rather than the planning phase.

A key role for the SPPB will be to ensure that projects have been specified effectively, accurately costed, have appropriate risk and contingency provisions, and are delivered within budget. It will also be responsible for approving any scope change to a major project that could affect the project's cost.

The primary focus of the SPPB will be at a strategic level. In this regard, it will be important for the SPPB to develop processes and structures to ensure that the necessary planning and specification work precedes major project decisions. The SPPB also will need to work closely with agencies to build project management skills and capacity at an operational level to ensure projects are delivered within approved budgets and achieve value for money outcomes.

As part of this process, the Commission considers that the Queensland Government's Gateway Review Process should be applied to all projects that are regarded as 'high value' or 'high risk' (generally, greater than $100 million).

Recommendation

45 The Strategic Project Program Board:

- ***develop processes and structures to ensure that the necessary planning and specification work precedes major project decisions***
- ***work with agencies to build project management skills and capacity at an operational level to ensure projects are delivered within approved budgets and achieve value for money outcomes.***

ENDNOTES

1 Queensland Treasury and Trade, *Financial Accountability Handbook*, *Volume 3 Designing Internal Controls*, 2012, accessed from www.treasury.qld.gov.au

2 *Government Owned Corporations Act 1993*, Parts 7 and 8 accessed from www.legislation.qld.gov.au

3 Queensland Audit Office, *Report to Parliament No. 8 for 2010* accessed from www.parliament.qld.gov.au

C2 ASSET MANAGEMENT

KEY ISSUES

- The Queensland Government's land and fixed assets totalled $222 billion in 2010-11, of which $171 billion is held by the General Government sector. Queensland has a relatively high asset stock compared with other states. The value of land and fixed assets in Queensland is larger than any other state and almost one-third of the Australian total.
- With a higher asset base, Queensland incurs higher maintenance costs and a higher depreciation expense, which affects the State net operating balance, and its ability to fund service provision. There are significant maintenance backlogs in major departments, such as the Department of Health, the Department of Education, Training and Employment and the Department of Transport and Main Roads.
- As a result, it is essential that the State's assets are managed efficiently and effectively to ensure enhanced value for money. This will require better utilisation of existing assets, including the rationalisation of surplus or underutilised assets, and the adoption of alternative models of ownership and/or management of the assets.
- The Government has a substantial stock of office accommodation and employee housing assets which lock up valuable capital resources. This capital would be more appropriately deployed in the provision of infrastructure to support front-line service delivery.
- The Government currently holds over $1 billion in major stadium and convention centre assets, requiring annual budget funding of over $200 million to meet operating costs. Management of these assets needs to be undertaken on the most cost effective basis to minimise the operating costs for government.

C2.1 THE STATE'S ASSET BASE

The Commission's Interim Report noted the consistently high level of capital expenditure in Queensland relative to other states, both as a share of gross state product (GSP) and in per capita terms. It also noted the significant increase in capital expenditure since 2005-06, and the increasing trend to fund this expenditure with debt.

This Section considers some of the implications of this continuing strong capital expenditure, especially in terms of utilisation, management and maintenance of the asset base. Issues relating to the capital management framework are also addressed.

For 2010-11 (the latest year for which information is available), the Queensland Government's land and fixed assets amounted to $222 billion, of which $171 billion was held by the General Government sector. The remaining $51 billion was held by Government Owned Corporations (GOCs) and is classified to the Public Non-Financial Corporations sector.

Assets held by GOCs broadly provide economic infrastructure such as electricity, ports, rail and water. Issues relating to GOCs are addressed in Part B of this Report.

Assets in the General Government sector include land, roads, hospitals, schools, police stations, prisons, court houses, TAFE colleges, social housing, office accommodation, employee housing, sporting venues, and other cultural institutions. Broadly speaking, these assets are held to deliver social benefits to the community.

The focus of this Section of the Report is on assets held within the General Government sector. In this sector, Queensland has a relatively high asset stock compared with other states. The value of land and fixed assets in Queensland is larger than any other state and almost one-third of the Australian total, as shown in Table C2.1.

Table C2.1
Value of land and fixed assets as at 30 June 2011 (General Government)
($ billion)

	NSW	Vic	Qld	WA	SA	Aust
Land and fixed assets						
Land	28.8	36.8	90.7	39.2	5.9	206.2
Fixed assets	100.5	58.0	80.5	34.5	27.8	329.5
Total	**129.3**	**94.8**	**171.2**	**73.7**	**33.7**	**535.7**

Source: Australian Bureau of Statistics, cat. no. 5512.0

Queensland's stock of General Government land holdings is significantly higher than other states, comprising $90.7 billion, or just under half of the land stock of all states. Queensland accounts for around $80.5 billion, or almost a quarter of the total value of fixed assets in Australia.

As shown in Table C2.2, in per capita terms, the differences are even more pronounced. Queensland has higher asset stock values than other major states, even after excluding the value of land. Queensland's per capita fixed asset stock is 29% higher than New South Wales and 71% higher than Victoria.

Table C2.2
Land and fixed assets, $ per capita

	NSW	Vic	Qld	WA	SA	Aust
Land and fixed assets $ per capita						
Land	3,993	6,643	20,266	16,659	3,619	9,235
Fixed assets	13,935	10,487	17,985	14,679	16,925	14,760
Total	**17,928**	**17,130**	**38,251**	**31,339**	**20,544**	**23,996**

Source: Commission of Audit; Australian Bureau of Statistics, cat. no. 5512.0

Asset values across the states also may not be directly comparable because of different accounting practices and valuations. However, even if the data are not directly comparable, they indicate broadly that the Queensland Government has a larger asset base in absolute and relative terms, making the effective management and utilisation of its asset base especially important.

A major consequence of a higher capital base is a higher depreciation expense, which affects the State's net operating balance, and its ability to fund service provision. Over the last six years, the average depreciation expense per capita has been 50% higher in Queensland than in other states, as shown in Table C2.3.

Table C2.3
Relative depreciation expenses, $ per capita

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Queensland	410	450	433	572	565	560
Other states	285	304	319	334	369	382
Differential (%)	44	48	36	71	53	47

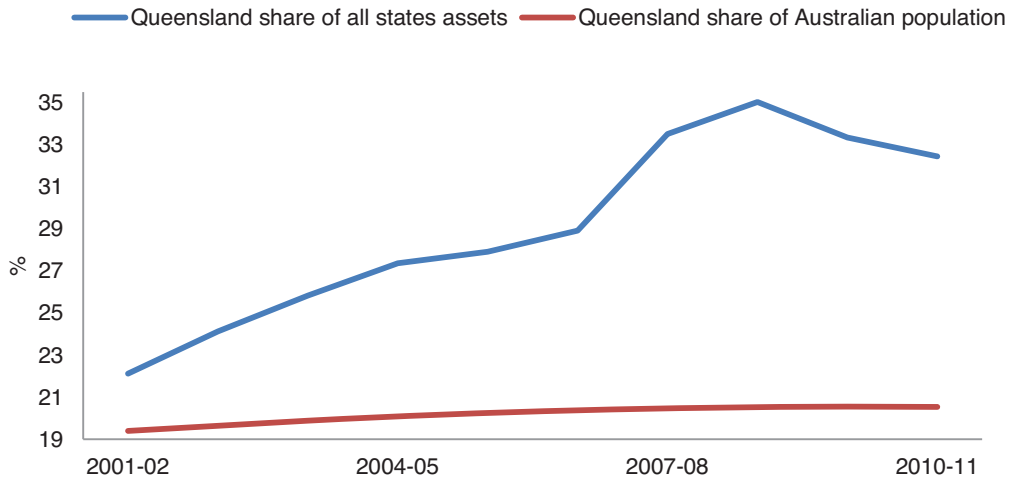
Source: Commission of Audit; Australian Bureau of Statistics, cat. no. 5512.0

There are several factors that partly explain why Queensland has a relatively high level of capital expenditure and a correspondingly higher level of capital stock than other states. These include a relatively more dispersed population requiring greater asset provision in non-urban areas (particularly for roads), and relatively higher population growth. In recent years, there has also been a need to repair or replace assets damaged by natural disasters.

Successive Queensland governments have also used capital works programs as components of regional development strategies and for employment creation.

Chart C2.1 shows trends in Queensland's share of land and fixed assets compared with Queensland's population share since 2001-02.

Chart C2.1
Queensland's share of total states' land and fixed assets and Queensland's population share



Source: Commission of Audit, Australian Bureau of Statistics, cat. no. 5512.0

Regardless of the factors involved, Queensland has a relatively large asset stock, and relatively high operating expenses associated with that stock. This makes it essential that the State's assets are managed efficiently and effectively to ensure value for money in supporting the delivery of front-line services. This will require better utilisation of existing assets, including the rationalisation of surplus or underutilised assets, and the adoption of alternative models of ownership and/or management of the assets.

Rationalising surplus or underutilised assets will provide a funding source for high priority new capital and will also reduce the recurrent operating expenditure requirements for ongoing repairs and maintenance. Depending on the location and type of asset, there may also be opportunities to make assets available for use by third parties, or for alternative community uses outside of government.

Issues relating to specific types of assets such as schools, TAFE colleges, police facilities and social housing, are addressed in the relevant sections of Part D of this Report. The remainder of this Section addresses other assets not previously considered, such as government owned and leased office accommodation, employee housing, convention and entertainment centres and major sports stadiums.

C2.2 MAINTENANCE OF THE ASSET BASE

C2.2.1 Asset maintenance backlogs

The Commission's Interim Report noted asset maintenance backlogs in the departments of Health and Education. On the basis of information provided by the Department of Transport and Main Roads, there is a maintenance backlog for road pavements, surfaces, bridges and major culverts of around $2.5 billion.

The Department of Transport and Main Roads (DTMR) has 20 year vision standards and asset management plans for the State Controlled Road Network (SCRN). DTMR has advised that it is unlikely to meet these standards based on current funding and policy settings. Although the department has had to divert resources recently to more urgent tasks such as new network capacity and the reconstruction effort arising from recent flooding and cyclone Yasi, maintenance spending has been an issue over a longer period.

Box C2.1 presents further information on the maintenance backlog in the State road network.

Box C2.1
Maintenance backlog – State road network

- The State's controlled road network (SCRN) has a gross replacement value of $59.0 billion (Annual Report 2011-12).

- The value of the SCRN has increased by 115% or $31.6 billion since 2005-06, with major road projects over this period including the Ipswich Motorway upgrade, the Centenary Highway upgrade, the Northern, Southern and Eastern Busways, and the Tugun Bypass. Other projects included the Regional Bridge Renewal Program (construction of 17 bridges), and more recently the reconstruction of the SCRN as a result of the 2010-11 natural disasters.

Source: Department of Transport and Main Roads

Asset maintenance backlogs have developed despite the existence of established benchmarks for asset maintenance. These benchmarks include:

- Queensland Health has a policy for Hospital and Health Services to allocate at least 2.15% of asset replacement value to address maintenance issues.
- For buildings, the Department of Housing and Public Works recommends a minimum maintenance funding benchmark of 1% of an asset's written down value.[1]
- DTMR uses a financial sustainability ratio developed by Austroads to assess the relationship between repair and renewal and the depreciation of assets.

C2.2.2 Asset maintenance strategy

The issue of asset maintenance is particularly important for Queensland, partly because of its historically large asset base, but more particularly because of the recent rapid increase in the size of this base. New assets will have relatively small maintenance requirements in their early years, but this will tend to increase with the age of the assets.

The choice between investment in new capital assets and the maintenance of existing assets is a matter of prioritisation. Development of appropriate asset maintenance strategies should form part of total asset management plans for agencies, as discussed in Section C1 of this Report.

In developing asset management plans, departments need to assess the relative merits of investing in new infrastructure compared with upgrading or replacing existing infrastructure. Protection of the value of current assets is usually a better value proposition than having to replace them prematurely. Effective and timely maintenance activity will reduce the lifecycle cost of an asset.

Asset maintenance plans need to articulate where it is appropriate to provide more or less maintenance effort than benchmarks, which are only guidelines and should not be regarded as prescriptive. A prudent asset maintenance strategy also needs to take account of a range of factors, including safety issues, current condition, and the expected life of the asset.

Options for ensuring that sufficient priority is given to maintenance activity include:

- incorporating maintenance requirements into construction and maintenance contracts for new capital works projects, so that maintenance costs are considered in conjunction with upfront capital costs as part of the investment decision-making process
- competitive tendering of maintenance contracts for packages of existing assets, such as groups of schools, employee housing, defined segments of roads or highways.

C2.3 GOVERNMENT OFFICE ACCOMMODATION

The Queensland Government has relied on a combination of government-owned buildings and private sector leased accommodation to meet its accommodation needs. The policy generally was for long-term, stable demand to be met through the owned portfolio and long-term commercial leases, while short-term leases were used to meet periodic fluctuations in demand.

The Department of Housing and Public Works (DHPW) is responsible for policy advice, strategic planning and procurement, and the management of office accommodation across Government. The Government Office Accommodation Unit of DHPW negotiates new lease and lease extensions for office accommodation in accordance with government accommodation guidelines.

Across Queensland, General Government sector agencies currently occupy approximately 1.1 million m² in owned (estimated 435,000 m² in 153 owned buildings) and leased (estimated 682,000 m² in 646 buildings) office space. This includes some 423,000 m² of office space in the Brisbane CBD including:

- 222,000 m² (52%) in government owned buildings
- 201,000 m² (48%) in commercially leased space (74 leases in 35 buildings).

Table C2.4 shows a comparison of office accommodation information across the Australian jurisdictions.

Table C2.4
Office accommodation policies and comparison of office space by jurisdiction

Jurisdictions	Estimated occupied office space	No. of properties (owned and leased)	Ownership
Queensland	1.1 million m²	799	Individual agencies
Australian Government	2.9 million m²	711	Individual agencies
New South Wales	1.4 million m²	1,000	Held centrally
Victoria	650,000 m²	250	Individual agencies
Western Australia	615,500 m²	469 (19 owned 450 leased)	Held centrally
South Australia	na	na	na

na – not available

Source: Commission of Audit

Developments in relation to public ownership and management of government office accommodation across other jurisdictions are summarised below:

- During the late 1990s, the Australian Government's office accommodation was managed centrally by its commercialised business unit, the Australian Property Group (APG), which was sold in 1998 as the commercial arm of the Domestic Property Group. Under the management of the APG, and as a mechanism to encourage departments to better manage their use of office space, the government introduced a user pays system of internal rental charging to occupier departments. The introduction of the user pays system resulted in departments reducing the size of their office accommodation and thereby the cost of accommodation.[2]

  In the late 1990s, the Australian Government outsourced the management of its office estate as part of an effort to outsource activities which were not core functions of government – that is, relying on private sector providers to provide these services at more cost effective rates.

  The outsourcing of the management of office accommodation was immediately followed by a move away from direct ownership, resulting in significant reduction in the size of the Australian Government's owned estate. The decision to divest itself of its real estate holdings was in recognition that property was a valuable asset and the release of the capital tied up in these assets could be used more effectively elsewhere.

  The Australian Government's Property Management Framework was established in 2009, with an aim to improve whole-of-government property management including reducing actual density to a target of 16 m² per employee. The framework also requires the government to produce an Australian Government Office Occupancy Report each year.

- In 2012, the New South Wales Government undertook a review of its property portfolio, which is valued at more than $100 billion. In particular, the review focussed on property utilisation and development of strategies to best achieve value for money from the management of its portfolio including:

  - rationalising and restructuring the number of government property agencies and departments
  - increasing the use of private companies to fund, develop and own public infrastructure
  - increasing consultation with the private sector and undertaking many more major public–private partnerships.

  In October 2012, the NSW Government announced the sale of nine government properties worth more than $300 million in order to raise funds for essential infrastructure.

- In Western Australia, the government undertook a review of its office accommodation portfolio in 2010 to identify and achieve savings in leasing and operating costs.

  A number of strategies have been implemented, including centralising lease management; standardising lease fit-outs; relocating government accommodation out of the central business district to suburban commercial settings; and reducing the amount of leased floor space by some 20%, including reducing leased space per person from 19 m² to 15 m² and sharing facilities across departments.

- In South Australia, the Commission of Audit Report of 2010 recommended that the management of all government accommodation should be put to competitive tender. It also recommended that standards for government accommodation fit-outs should be established, and that a competitive tender for the managing contractor role for all government fit-outs should be undertaken.

  The South Australian Government is currently reviewing its Office Accommodation Management Framework on this basis.

- In the United Kingdom, the government has an objective to reduce the size of the government office estate to achieve savings and transform the way government works. On this basis, the Government Property Unit was established in 2010 to find efficiency savings from the central government office estate (of over 5.4 million m², costing around £1.8 billion annually). In particular, savings are to be achieved from the disposal of property, surrendering of leases and reducing density targets to 10 m².

  A review on progress made in achieving efficiency savings was undertaken by the House of Commons Committee of Public Accounts in July 2012. The Committee release its report, *Improving the efficiency of central government office property*, which found the unit had not delivered savings because:

  - departments operated in financial silos which do not encourage a whole-of-government approach to sharing space, risks and costs
  - there was a lack of centralised property ownership which would enable lease negotiations to be undertaken on a standardised basis
  - decentralised ownership of the estate led to a reluctance to dispose of excess and underutilised property
  - until property is seen as a cost rather than an asset, potential savings will not be realised (that is, departments will continue to be reluctant to dispose of property).

Reflecting these developments in other jurisdictions, the Commission considers that efficiencies could be achieved if ownership and management of government office accommodation is consolidated with the long-term goal to rebalance the Government's office accommodation strategy towards leasing arrangements with the private rental market rather than continuing property ownership.

C2.3.1 Government ownership

As outlined above, there has been a broad trend towards divestment of property assets by governments. Consistent with this trend, the Government should aim to reduce its investment in office accommodation assets, relying on medium-term leases with private sector owners. This will allow it to focus its capital investment on infrastructure which supports front-line service delivery, rather than ownership of buildings to accommodate public servants, as this is a function which can readily be undertaken by the private sector.

Property assets such as buildings are long-term assets of interest to superannuation funds and other institutional investors due to their predictable and stable long-term cash flows, which can be matched to the liability profiles of such investors. Such investors have specialist expertise and experience on owning and managing such assets. These are skills which are not generally available in the public sector, and do not need to be available where there is an active and competitive private market.

Proceeds from the sale of property assets can be redirected to the repayment of state debt or funding new infrastructure. The redevelopment of the Government Administration Precinct in the Brisbane CBD (George and William Streets) will provide the Government with an initial opportunity to divest itself of assets. As part of this project, there will be a rationalisation of government accommodation, including the sale of government office buildings. The project also involves private sector development of 1 William Street to meet government accommodation needs.

Greater reliance on the private sector rental market and the charging of market rent rates will provide departments with a greater incentive to manage the size of their office accommodation on a more cost effective basis.

C2.3.2 Tenancy and building management

The Commission believes there are opportunities to manage office accommodation using a different delivery model at a lower cost. The management of a property portfolio should not be a core activity of government. Again, this is a function better performed by private sector managers who are expert in tenancy and building management. To this end, a competitive tender to manage all government accommodation should be put to the market.

The successful proponent would manage against a set of criteria which would address such factors as space allocation per employee, environmental standards, acceptable locations (CBD, major urban centres, other), standard landlord services such as maintenance and repair, and other quality standards (Occupational Health Safety and Welfare, fire and evacuation).

C2.4 GOVERNMENT-OWNED EMPLOYEE HOUSING

In Queensland, Government provides employee housing to support the transfer and retention of staff with required skills and qualifications to particular locations in order to meet service delivery needs.

Employee housing is located primarily in regional, rural and remote locations throughout Queensland, where generally there is no viable rental market to support employees' accommodation requirements. Government employee housing is largely provided to teachers, health care workers and police. The portfolio comprises houses, barracks, motel style accommodation and semi-detached units.

Currently, individual agencies own and manage their employee housing stock, but this arrangement is complemented with oversight from a whole-of-government Housing Management Committee. The committee is responsible for employee housing policies and reports at a whole-of-government level on procurement, maintenance and use of employee housing. The employee housing policies are:

- Government Employee Housing Management Framework – Policy for the management of Queensland Government employee housing

- Government Employee Housing Scheme – Policy & Conduct.

Until recently, each department managed its own tenancies and determined its own policies in relation to rental rates and employee eligibility criteria. As a consequence, there are inconsistencies between departments on rental rates and the level of government subsidisation.

Across the General Government sector, employee housing generally is either fully or highly subsidised. The Commission understands that most departments charge only nominal rents (average of less than $100/week) to employees, which is sufficient to cover only the basic utility costs such as water usage and electricity. For example, Queensland Health employees in government-owned accommodation are either fully or highly subsidised by the department.

Across the General Government sector, there are some 5,100 residential dwellings, including 300 dwellings leased from the private sector. The current estimated value of the government residential property holding for which values are currently available is $950 million.

Table C2.5 shows the number of dwellings across the portfolios as at April 2012.

Table C2.5
Government-owned employee housing by portfolio, 2012

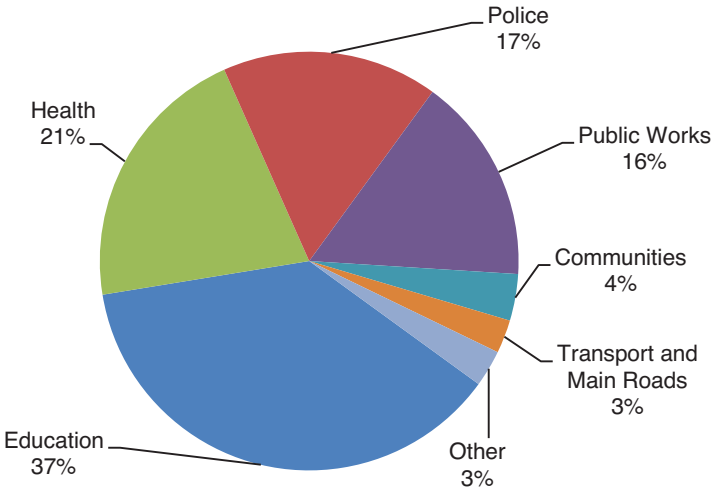
Portfolio	Number of owned dwellings	Estimated value $m
Education	1,932	349.0
Health[1]	1,080	na
Police	861	125.3
Public Works	824	236.6
Communities	186	43.4
Transport and Main Roads	133	39.2
Fire and Ambulance - Community Safety	84	na
Environment and Resources	53	5.9
Other	9	1.4
Total	**5,162**	**950.0**

na – not available
Note: Dwellings may include accommodation for multiple staff for example, nurses quarters. Queensland Health has 1,966 units of accommodation, including 450 non-operational (not co-located with a health facility), 1,021 staff quarters, and 495 other dwellings on operational sites (that is, co-located with a health facility).

Source: Department of Housing and Public Works

Chart C2.2 depicts the proportion of properties across the portfolios.

Chart C2.2
Portfolio – employee dwellings



Source: Department of Housing and Public Works

Government employee housing is primarily located in rural and remote areas of Queensland, with less than 10% of the dwellings located in major communities with functioning rental markets.

An ongoing issue for Government has been the ageing and deteriorating condition of the current housing stock and an associated backlog of maintenance. In 2008, the Auditor-General undertook an audit to assess the effectiveness of management of the employee housing stock by the four departments with the majority of that stock. The audit found that improvements could be made across all four departments in relation to the management of tenancies and backlog maintenance, and that strategic planning for procuring and maintaining employee housing was inadequate. As a result, the standard and condition of dwellings varies across departments.

In 2010, the Auditor-General reviewed progress on recommendations made in the 2008 reports, and found some progress made but further improvements could be made.

The maintenance of government employee housing has been undertaken on a whole-of-government basis by DHPW. The maintenance process is supported by a centralised maintenance management information system.

In April 2012, the Government approved the transfer of all government-owned employee housing to DHPW by 1 July 2013 for ongoing management. The key aim is to bring the Government's employee housing assets up to an appropriate standard and condition to enable the stock to operate on a financially viable basis and attain a level of self-sufficiency. The process to effect this transfer is currently being considered by the Government.

DHPW is currently undertaking an audit of the government employee housing stock to identify the standard and condition of each property and to estimate the cost to bring the current stock up to the minimum standard. The Government has also requested that options be developed for the future ownership and management of the portfolio with recommendations to be reported back to the Government in April 2013.

A preliminary assessment of approximately 25% of the employee housing portfolio suggests that most dwellings are in sub-standard condition and some 60% do not meet the minimum level of amenity. Based on the inspection results, the department estimates the deferred maintenance liability on the portfolio is some $82 million.

Table C2.6 provides a summary of the policies and models of delivery of employee housing across the Australian jurisdictions.

Table C2.6
Policies and models of delivery of employee housing by jurisdiction

	Australian Government	NSW	Vic	WA	SA
Employee housing provided	Yes	Yes	No[1]	Yes	Yes
Employee housing policy framework	Defence Housing	Employee Housing Policy	Not applicable	Government Regional Officers' Housing Program	Government Employee Housing Program
Responsible agency	Defence Housing Australia	Department of Trade and Investment	not applicable	Department of Housing	Department for Transport, Energy and Infrastructure
Ownership	Individual agencies	Individual agencies	Individual agencies[2]	Central agency	Central agency
Investment model	Mix of public and private ownership	Public ownership	not applicable	Mix of public and private ownership	not available
Rental rate setting responsibility	Central agency	Central agency	not applicable	Central agency	Central agency
Rent subsidy provided to employees	Yes	Yes (range of 20% to 70% below market rent)	No	Yes (up to 100% of market rent)	Yes (range of 15% to 50% below market rent)
Tenancy management	Central agency	Individual agencies	not applicable	Central agency	Central agency

Notes:
1 In the early 1990s, the government policy position changed, with departments no longer providing government employee housing. However, teacher housing is provided in limited circumstances on a short-term tenancy basis to new teaching staff.
2 Department of Education holds approximately 280 residential properties in remote communities.

Source: Commission of Audit

The Commission has reviewed employee housing policies in other jurisdictions. Key points are summarised below:

- The Australian Government provides defence employees with subsidised housing by using a private investment model. Defence Housing Australia (DHA), a government-owned commercial entity, has a portfolio of over 17,000 dwellings valued at over $7 billion that are owned by a mix of public, private individual and institutional investors. Over 60% of dwellings are owned by the private sector and leased back to the DHA. It is currently one of the largest housing providers in Australia apart from the state public housing authorities.

  DHA's functions include housing construction and sales and asset and tenancy management.

  The DHA business model provides access to funding to cover its operational costs and for reinvestment into the property portfolio.

  The DHA model was reviewed in October 2010 by Australian Housing and Urban Research Institute[3] which considered it to be a successful model for large scale private investment in provision of rental housing. The report identified a number of key factors that made the DHA model successful including:

  - Private investors were attracted to the rent guarantee and the significant maintenance program at the end of each lease.

  - The tendering of large maintenance contracts drove down maintenance costs of the portfolio.

  - The quality of the portfolio was maintained because of the rigorous design guidelines that enable DHA to acquire and develop appropriate housing.

  - The quality of the portfolio could also be sustained because DHA could undertake a significant amount of trading in its stock.

  - The DHA demonstrated good governance and management practices including high quality and regular reporting about its operations tailored to meet the needs of each of its key stakeholders – that is, investors, tenants and government.

- In New South Wales, each department is responsible for its portfolio of employee housing. For example:

  - The NSW Teacher Housing Authority was established to provide housing to teachers. The authority currently owns or manages some 1,500 houses and villa units throughout the state. The properties are leased to teachers at market rates of rental.

  - In 2006, the management of the NSW Police Property Portfolio containing 1,350 properties (residential dwellings and police stations) was outsourced to United Group Services (UGS). The UGS's responsibilities included:

    - management and administration of the Police Property Portfolio
    - asset and property management (including lease administration)
    - management and administration of the Capital Works Program
    - divestment and acquisition services
    - facilities management.

  - In July 2012, the NSW Ombudsman released a report on *the Management of Asbestos in Police Buildings*. The report recommended a new model for managing the NSW Police Property Portfolio due to the Ombudsman finding of '*serious deficiencies in the way a significant number the State owned properties has been managed over the years, with detrimental consequences for the safety and wellbeing of the occupants*'. The Ombudsman found there was '*evident confusion between the NSW Police Force, UGS and the State Property Authority about their respective roles in relation to Police properties'*.

- In Victoria, although the current policy is not to provide employee housing, the government does provide some short-term employee housing when needed to maintain government services to remote and rural communities.

  For example, the Department of Education and Early Childhood Development owns a portfolio of approximately 280 residential properties in 86 remote rural communities across Victoria. These properties are allocated to teacher tenants by a host school in consultation with the Infrastructure Division to provide short-term tenancies for new teaching staff.

- In Western Australia, the Government has formed partnerships with the private sector to identify property owners to lease to the Department of Housing. Currently, over half of residential dwellings used for employee housing are owned by the private sector.

  The Department of Housing sub-leases these properties to government agencies. The agencies pay full market rent (for housing in locations where there is a viable property market) plus a $30/week administration fee to the Department of Housing, and sub-leases properties to their employees at a reduced rate, but in accordance with the whole-of-government Tenant Rent Setting Framework.

  For properties owned in non-market locations, the rent charged to agencies is based on the cost to procure the property.

- In South Australia, the Government provides limited employee housing to assist employees to take up positions in regional areas. The intent is to supplement local markets when there is insufficient housing to allow employees to make their own accommodation arrangements.

  The Department for Transport, Energy and Infrastructure's Building Management Accommodation and Property Services Unit is responsible for delivering housing services in regional South Australia for eligible employees of government agencies and statutory authorities. It is responsible for the allocation of housing to eligible government employees.

Having regard to experience elsewhere, the Commission considers that efficiencies could be achieved in relation to the Government's employee housing portfolio by:

- consolidating its employee housing property portfolio into the one agency and reviewing the future delivery model for employee housing (which is currently occurring)

- applying a consistent rental rate policy across all government residential properties, with the rent being dependent on an agreed set of criteria

- changing the ownership mix between the public and private sectors.

In relation to the final point, currently only some 6% of the government employee dwellings are leased from the private sector, with the remaining 94% owned by government. Based on models adopted for the delivery of defence employee housing by the Australian Government and in Western Australia, there are clearly proven options for government to pursue to improve value for money by greater reliance on private ownership of employee housing, wherever there is a viable market.

C2.5 CONVENTION AND EXHIBITION CENTRES

The State owns three major convention and exhibition centres, one each in Brisbane, the Gold Coast and Cairns. Table C2.7 provides information on these three centres.

Table C2.7
Queensland's convention and exhibition centres

Stadium	Agency	Operator/ manager	Facility age (years)	Land & building carrying value at 30 June 2012 ($m)
Brisbane Convention and Exhibition Centre	South Bank Corporation	AEG Ogden	17	377
Gold Coast Convention and Exhibition Centre	Department of Housing and Public Works	Jupiters Limited	8	191
Cairns Convention and Exhibition Centre	Department of Housing and Public Works	AEG Ogden	16	118

Source: Commission of Audit

The Brisbane Convention and Exhibition Centre (BCEC), a purpose built venue located in South Brisbane, is currently owned by South Bank Corporation. At the time of this report, the Government was in the process of reviewing the governance arrangements for the BCEC.

The BCEC is managed by AEG Ogden, an international venue management specialist. During 2011-12, gross revenue generated from BCEC operations was $48.1 million, and total payments made to the operator were $1.7 million.

The Gold Coast and Cairns Convention Centres are held by the Department of Housing and Public Works. The two centres are managed by AEG Ogden and Jupiters Limited respectively, both private sector operators. During 2011-12, gross revenues generated and total payments made to the operators were:

- Gold Coast – Revenue $23.9 million; payments to operator $0.6 million
- Cairns – Revenue $5.4 million; payments to operator $0.344 million.

The Commission supports the continued management and operation of these centres by private sector specialists, as this will minimise the costs and risks to Government of ownership of these facilities.

C2.6 MAJOR STADIUMS

Stadiums provide venues for sporting, cultural and community events. Public ownership of major stadiums is common around the world. At the very least, governments play a critical role in the funding of stadium developments.

Historically, there has been little interest in private sector development and management of major stadiums around the world. Private investors rarely find major sports stadiums an attractive investment, because of the difficulty of earning an acceptable rate of return on the investment.

In the absence of private sector interest, public development and ownership of sport and entertainment stadiums has been undertaken to achieve the following outcomes:

- increasing tourism and consequential tourist dollars being spent in Queensland
- major events attracting global and domestic awareness thereby leading to long-term positive impacts for tourism
- growth and development of business activity, investment and employment in local areas
- development of community pride and providing greater choice in leisure activities.

In 2001, the Government consolidated all of Queensland's existing (and future) major stadiums under the management of Stadiums Queensland, to provide greater flexibility and opportunities for the management of the State's major sports facilities, to facilitate better commercial decision making across the venues, and to enable more strategic future use decisions in relation to each facility.

The presence of a single oversight body ensures that government funded and owned venues do not compete with each other 'against the public interest' to secure major national and international events. In addition, such a model provides the opportunities for economies of operation, both from an ownership and management perspective.

Stadiums Queensland's functions are to:

- manage, operate, use and promote major sports facilities
- undertake development of any of the following:
  - major sports facilities
  - sports, recreational or entertainment facilities for declaration as major sports facilities
  - infrastructure associated with major sports facilities or proposed major sports facilities.

Stadiums Queensland owns and operates nine major sports stadiums across Queensland with a combined value of some $1 billion. The nine venues are operated by a mix of in-house and externally sourced venue management services. Five of the stadiums are managed by Stadiums Queensland and four are operated by private sector operators.

Table C2.8 provides information on each of the stadiums.

Table C2.8
Queensland's major stadiums

Stadium	Major purpose	Operator[1]	Location	Seating capacity	Facility age (years)	Carrying value at 30 June 2012 ($m)
Brisbane Entertainment Centre	Entertainment	AEG Ogden	Boondall, Brisbane	13,500	26	59.0
Townsville Stadium	NRL	Stadiums Queensland	Townsville	26,500	27	52.5
Metricon Stadium	AFL	Gold Coast SUNS[2] (also the tenant)	Gold Coast	25,000	1	141.3
Queensland Sport and Athletic Centre	Athletics	Stadiums Queensland	Mount Gravatt, Brisbane	49,000	33	66.9
Queensland Tennis Centre	Tennis	Tennis QueenslandC2 (also the tenant)	Yeronga, Brisbane	5,500	4	115.3
Skilled Park	NRL	Stadiums Queensland	Gold Coast	27,400	5	133.6
Sleeman Sports Centre	Athletics/ Swimming	Stadiums Queensland	Chandler, Brisbane	Various	33	56.6
Suncorp Stadium	NRL/ Rugby/ Soccer	AEG Ogden	Milton, Brisbane	52,500	9	298.3
The Gabba	Cricket/ AFL	Stadiums Queensland	Woolloongabba, Brisbane	42,000	12	176.1

Notes:
1 The stadiums where management has been outsourced are highlighted in green.
2 In relation to the Metricon Stadium and Queensland Tennis Centre, the operator/tenants fund all operating costs under the management arrangements.

Source: Stadiums Queensland

Revenues are generated from corporate boxes, membership fees/club seats, catering facilities and advertising opportunities. In 2011-12, Stadiums Queensland earned some $42.6 million ($41.7 million in 2010-11) from these activities.

It also received annual State government grants totalling $35 million for 2011-12 ($26 million in 2010-11) for the operation, maintenance and continuing development of the nine major sports stadiums. A further $39.6 million is received annually from the Community Investment Fund. In total, Stadiums Queensland received government grants and other contributions of some $77 million in 2011-12 ($110.8 million in 2010-11).

The operating loss before government grants and contributions was $84 million for 2011-12 ($91.5 million for 2010-11). Effectively, the government grants and other contributions cover most of the operating losses for Stadiums Queensland.

In 2012-13, Stadiums Queensland will receive an additional $13 million from Government to fund capital purchases required to maintain Queensland's major sports facilities to a standard appropriate for the conduct of international and national events, and community sports activities.

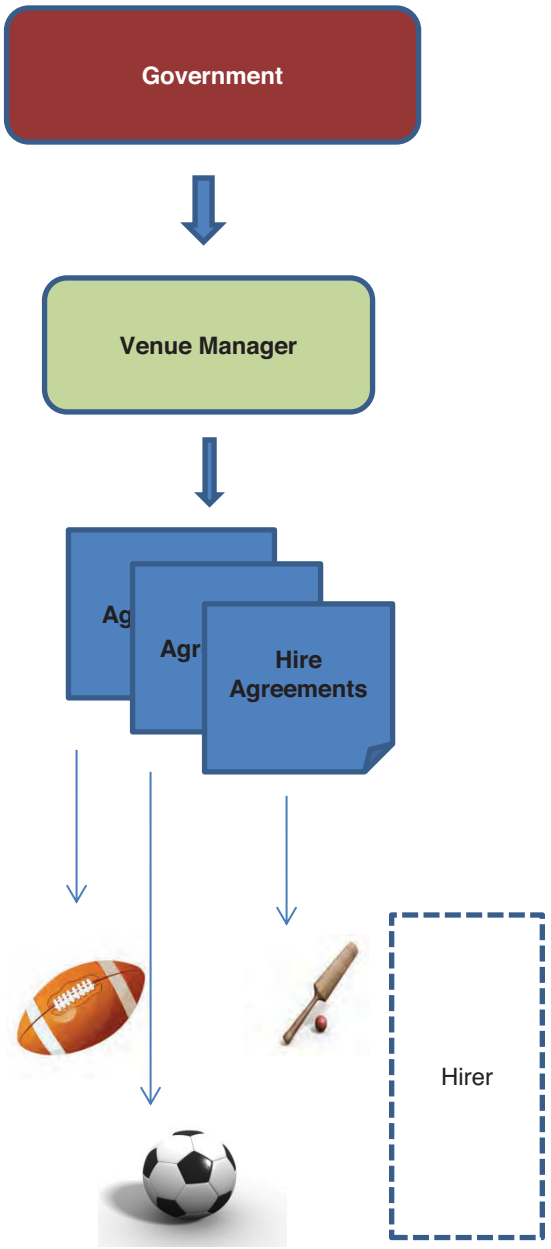
Sports facilities usually have a life of around 30 years before major refurbishment is required.

Responsibility for the management and operation of multi-purpose sport stadiums is complex due to the management of prioritisations (that is, peak periods or conflicting dates of events) and negotiations with multiple commercial sports franchises for access to a single stadium. For this reason, the Commission considers that major stadiums should be operated by private sector venue management specialists.

Accordingly, the five remaining stadiums operated by Stadiums Queensland should be outsourced to private sector venue managers through a competitive tender process to determine the subsidy required to operate the venues. This is likely to minimise the cost to Government of ownership and operations of these stadiums. In such circumstances, a competitive tender could be structured on the basis of the lowest subsidy required to operate the venue.

Figure C2.1 illustrates the outsourced management model for the operations of the multi-use venues.

Figure C2.1
Outsourced management model



Approve and review:

- stadium goals and objectives
- management and operating policies
- operating and capital budgets
- performance targets
- last resort dispute resolution between Venue Manager and Hirer

Managing all aspects of the venue on behalf of Government including (but not limited to):

- promoting and securing events
- negotiating commercial contracts
- operating and maintenance services
- asset management including maintenance and capital replacement
- provision of services to hirers including but not limited security, ticketing, catering, cleaning, etc.

Run event including:

- all activities related to the event in compliance with hire agreement
- access to Government for dispute resolution

Source: Commission of Audit

Recommendations

46 The Government rationalise its asset base with a view to:

- ***achieving better value from existing assets (including better sharing of assets across departments)***
- ***reducing asset costs by disposing of, or consolidating use of, under-utilised assets***
- ***where efficiencies can be achieved, moving public sector office accommodation to private sector benchmarks***
- ***examining and comparing ownership and leasing arrangements with a view to utilising the most cost effective solution for office accommodation***
- ***utilising the private rental market for the provision of employee housing where feasible and cost effective***
- ***achieving more effective maintenance of current and future assets.***

47 The tenancy and property maintenance management functions of Government be outsourced to expert private sector providers to ensure maximum efficiencies are achieved.

48 The Government adopt a consistent rental rate policy with a uniform set of criteria to be applied across all government residential properties.

49 The operation and management of the remaining five major stadiums currently undertaken by Stadiums Queensland be outsourced to the non-government sector where it is cost effective to do so.

ENDNOTES

1 Department of Housing and Public Works, *Maintenance Management Framework,* 2012, accessed from www.hpw.qld.gov.au

2 C M J Warren, *Corporate Property Strategies in the Federal Public Sector*, University of New South Wales, 2003, accessed from www.prres.net

3 P Phibbs and B Hanna, (AHURI), *Lessons of Defence Housing Australia for affordable housing provision*, Australian Housing and Urban Research Institute, Final Report No. 153, 2010, accessed from www.ahuri.edu.au

C3 BUDGET MANAGEMENT FRAMEWORK

KEY ISSUES

- The previous Government's Charter of Fiscal Responsibility lacks substance and clear direction. It failed to prevent an erosion of fiscal discipline in the Queensland Government. A return to fiscal strength for Queensland requires the restoration of the highest standards of financial management in public administration.
- The current appropriation framework is complex and confusing, and does not enable Parliament to exercise effective control of the overall level of expenditure by departments. The framework needs to be simplified, and provide greater control of total expenditure by departments.
- The budget process needs to be strengthened to align with the Government's fiscal objectives, and to ensure that resources are allocated in accordance with government priorities.
- There have been deficiencies in cash management processes, which are now being addressed by Queensland Treasury and Trade.
- Financial reports could be improved, to be more user-friendly and to enhance transparency and accountability.

C3.1 CHARTER OF BUDGET ACCOUNTABILITY

The Commission's Interim Report outlined a revised financial and performance framework based on the guiding values of value for money, financial sustainability, accountability, transparency and fiscal responsibility. A return to fiscal strength for Queensland requires the restoration of the highest standards of financial management in public administration – standards which are transparent, and for which the Government should be held accountable.

Under the *Financial Accountability Act 2009*, the Queensland Treasurer is required to prepare a Charter of Fiscal Responsibility. Other governments have similar requirements, including the Australian Government, which operates under a Charter of Budget Honesty, which outlines information requirements in relation to:

- the principles of sound fiscal management
- the government's fiscal strategy
- the contents of key annual government reports such as the budget, the mid-year review and the final budget outcome report
- requirements for an intergenerational report
- requirements for a pre-election economic and fiscal outlook report
- guidelines around costing of election commitments.

Compared with the Charter of Budget Honesty, the Queensland Charter of Fiscal Responsibility lacks substance and clear direction. The Queensland *Financial Accountability Act 2009* simply requires that the Treasurer must from time to time table a document outlining the Government's fiscal objectives and fiscal principles and must report regularly on the outcomes achieved against the charter.

This means there is limited effective accountability, because the Government can change the fiscal principles and objectives at any time. The gradual decline in fiscal standards outlined in the Interim Report and the gradual erosion of fiscal discipline demonstrate the risks of this approach, and reinforce the need for a mechanism to entrench strong budget management practices and disciplines within a legislative framework.

The Commission considers there is a need for a new Charter of Budget Accountability to formalise and enshrine in law the Government's commitment to strong fiscal management, accountability and transparency. Box C3.1 outlines a sample 'plain English' guide to the issues to be incorporated in the proposed charter. The Commission has not attempted to spell out the contents of a new charter in detail, as this appropriately should be considered in depth by the Government and Parliament.

The new Charter of Budget Accountability should incorporate:

- the Government's fiscal framework
- a requirement for the Treasurer to articulate and report on the effectiveness of fiscal strategies to achieve the Government's fiscal objectives
- minimum reporting requirements for effective accountability
- minimum contents for key financial reports
- a requirement to provide regular updates of long-term fiscal projections
- a requirement to prepare and release an updated pre-election fiscal outlook document.

The draft charter includes a requirement for the Under Treasurer and the Director-General of the Department of the Premier and Cabinet to jointly release a pre-election fiscal update no later than one week before the date of an election. This should include any new measures approved by the Government until the time of the announcement of an election. It should also include a declaration that the updated fiscal outlook includes any other known factors which would materially impact on the State's operating statement and balance sheet position, especially revenue, recurrent and capital expenditure and debt projections.

Recommendation

50 A Charter of Budget Accountability (along similar lines to the Australian Government's Charter of Budget Honesty) be legislated to formalise the Government's commitment to strong fiscal management, accountability and transparency, with the Charter to include:

- ***the Government's fiscal objectives***
- ***a new budget planning and review framework***
- ***minimum content requirements for improved financial reporting in budget and related documents***
- ***a requirement for the publication of a pre-election budget update.***

Box C3.1

PROPOSED OUTLINE FOR CHARTER OF BUDGET ACCOUNTABILITY ACT

(PLAIN ENGLISH VERSION)

Part 1 – Intent of the Charter
Part 2 – Core values of Government
Part 3 – Fiscal principles
Part 4 – The State planning and forecasting framework
Part 5 – Commitment to open and accountable financial reporting
Part 6 – Commitment to a strong budget process
Part 7 – Enhancing the role of Parliament
Part 8 – Minimum content of budget reports
Part 9 – Pre-election fiscal update

INTENT OF THE CHARTER

The intent of this Charter is to formalise the Government's framework for developing, managing and reporting on the Budget and the State's financial position in an effective, transparent and accountable manner.

CORE VALUES OF GOVERNMENT MANAGEMENT

Under this Charter, the Parliament requires the Government to:

- achieve value for money in public outlays
- establish clear mechanisms for promoting and enforcing accountability for delivering results from public outlays
- provide clear and transparent reporting of government activities.

FISCAL PRINCIPLES

Under this Charter, Parliament directs the Treasurer to prepare the Budget consistent with the Government's stated fiscal principles:

- stabilise then significantly reduce debt
- achieve and maintain a General Government sector fiscal balance by 2014-15
- maintain a competitive tax environment for business
- target full funding of long-term liabilities such as superannuation.

THE STATE PLANNING AND FORECASTING FRAMEWORK

The Treasurer will develop the Budget within a planning framework which will involve:

- Every five years the Treasurer will prepare an Intergenerational Report, incorporating 40 year economic and financial forecast.

- The Government will annually update a 10 year State Infrastructure Plan (SIP) which will include:
  - asset acquisition plans
  - asset maintenance plans
  - asset disposal plans.

The SIP will carefully articulate the relationship between asset acquisitions and enhanced service delivery levels.

COMMITMENT TO OPEN AND ACCOUNTABLE FINANCIAL REPORTING

The Treasurer will undertake periodic public consultations on the relevance and usefulness of public financial reporting.

The Treasurer will ensure that all relevant financial reports can be accessed readily in electronic format.

The Treasurer will prepare and table at the end of each quarter a set of General Government Financial Statements for that quarter.

COMMITMENT TO A STRONG BUDGET PROCESS

The Treasurer will prepare a Budget consistent with the fiscal principles outlined in this Charter and with the Government's long-term planning commitments.

The Budget will contain a statement of the Fiscal Strategies to be implemented to comply with the Fiscal Principles.

The Treasurer will maintain guidelines for budget submissions which require that:

- New spending or savings measures have clear implementation milestones and performance trajectories to enable implementation and performance review.
- There is a clear line of sight between the submission and the Government's policy objectives.
- The benefits and costs of different ways of achieving the submission's objective are clearly articulated.
- New capital spending proposals are consistent with the State Infrastructure Plan, and that the full recurrent costs of such proposals are considered in the Budget.

The implementation and effectiveness of new spending and savings measures will be reviewed at least every three years.

Ongoing departmental programs will be reviewed at least once every three years. Reviews of new and ongoing programs will examine whether the activities being undertaken by departments are consistent with government policy objectives, and if the activities are being undertaken efficiently and effectively.

The Treasurer in the Budget shall be granted a Treasurer's Advance for the purpose of funding any urgent and unavoidable expenditure throughout the year. The amount of funding in the Treasurer's Advance will be disclosed in the financial estimates of Queensland Treasury and Trade.

ENHANCING THE ROLE OF PARLIAMENT

The Treasurer will prepare a supplementary Appropriation Bill to seek approval for any additional expenditure in the financial year in which that expenditure occurs.

MINIMUM CONTENT OF BUDGET REPORTS

The Treasurer is to ensure that the following minimum information is provided in the relevant budget documents as set out below.

Annual Budget

At a minimum, the annual Budget will contain:

- an overview of the Budget
- a statement from the Treasurer which outlines:
  - the Government's fiscal objectives, plans to achieve them, and progress towards achieving them
  - the budget themes and key revenue and expenditure measures
- an assessment of economic conditions and trends
- an overview of expected revenues
- an overview of expected expenses
- an outline of the Government's capital expenditure plans
- sensitivity analysis for major revenue and expense items
- historical context for volatile revenue items
- a statement of the new expenditure, savings and revenue measures in the Budget, including a reconciliation with the previous budget
- a discussion of Commonwealth–State financial relations
- an indication of the impact of the budget on regional areas
- data required under the Uniform Presentation Framework Agreement
- a tax expenditure statement
- a concessions statement
- financial statements for departments
- performance milestones and performance indicators for departments
- the amount of funding provided for the Treasurer's Advance
- a statement of the amount of carryover funding included in departmental estimates.

Mid-Year Economic and Fiscal Outlook Report

The Treasurer will table a mid-year economic and fiscal update report in December each year. The timing of the report may be varied with the agreement of the Leader of the Opposition to incorporate any unforeseen material events such as natural disasters.

The Mid-Year Update will contain the baseline information for the following budget round and will include at a minimum:

- an assessment of economic conditions and trends
- updated forward estimates including any approved departmental measures
- an overview of expected revenues
- an overview of expected expenses
- a reconciliation of changes to the Government Finance Statistics aggregates in the budget
- Uniform Presentation Agreement financial statements for the General Government and Non-financial public enterprise sectors.

The Government Financial Outcomes Report

The Treasurer will prepare a Government Financial Outcomes Report which will include a comparison of actuals against original budget to close the reporting cycle for the year.

At a minimum, the report will contain:

- a statement from the Treasurer which discusses progress towards achieving the Government's fiscal targets for the previous year, as well as other major whole-of-government milestones
- a comparison between budget and actual revenue and expenditure, including capital expenditure, and reasons for major variations
- UPF financial statements which compare actual outcomes with original budget estimates for the year, with explanations of major variances in gross terms
- the amount of funding allocated from the Treasurer's Advance
- a year end tax expenditure statement
- a year end concessions statement
- a capital outcomes statement to report on the capital program for the year.

Quarterly Financial Reports

The Treasurer will prepare a quarterly financial report for the General Government sector which will include:

- the full suite of UPF tables for the GG sector
- actual revenue collections for the Budget
- departmental expenses.

The quarterly financial reports will include the corresponding quarter of the previous financial year as a comparator.

PRE-ELECTION FISCAL UPDATE

The Under Treasurer and the Director-General of the Department of the Premier and Cabinet will jointly release a pre-election fiscal update no later than one week before the date of an election.

The pre-election update will include any new measures approved up until the time of announcing the election, and is to include a declaration that the updated fiscal outlook includes any other factors known to these officers which would materially impact on the revenue, expense or capital estimates.

C3.2 APPROPRIATION

C3.2.1 Appropriation framework

The current appropriation framework provides two funding streams for departments, as follows:

- appropriation revenue, which is paid from the Consolidated Fund on the authorisation of Parliament under an Annual Appropriation Act

- controlled or own source revenue, which is not paid into the Consolidated Fund, but rather is retained by departments, and treated as automatic or 'deemed' appropriation under the *Financial Accountability Act 2009.*

Under the *Financial Accountability Act 2009,* Parliament may approve three classes of appropriation funding for departments, namely payments for:

- **departmental services** – which fund the normal services provided by departments

- **administered items** – which allow departments to expend funds on behalf of government for example, to repay debt

- **equity adjustment** – which funds capital expenditure and may also be used to withdraw funding from departments. On this basis an equity adjustment may be either positive or negative.

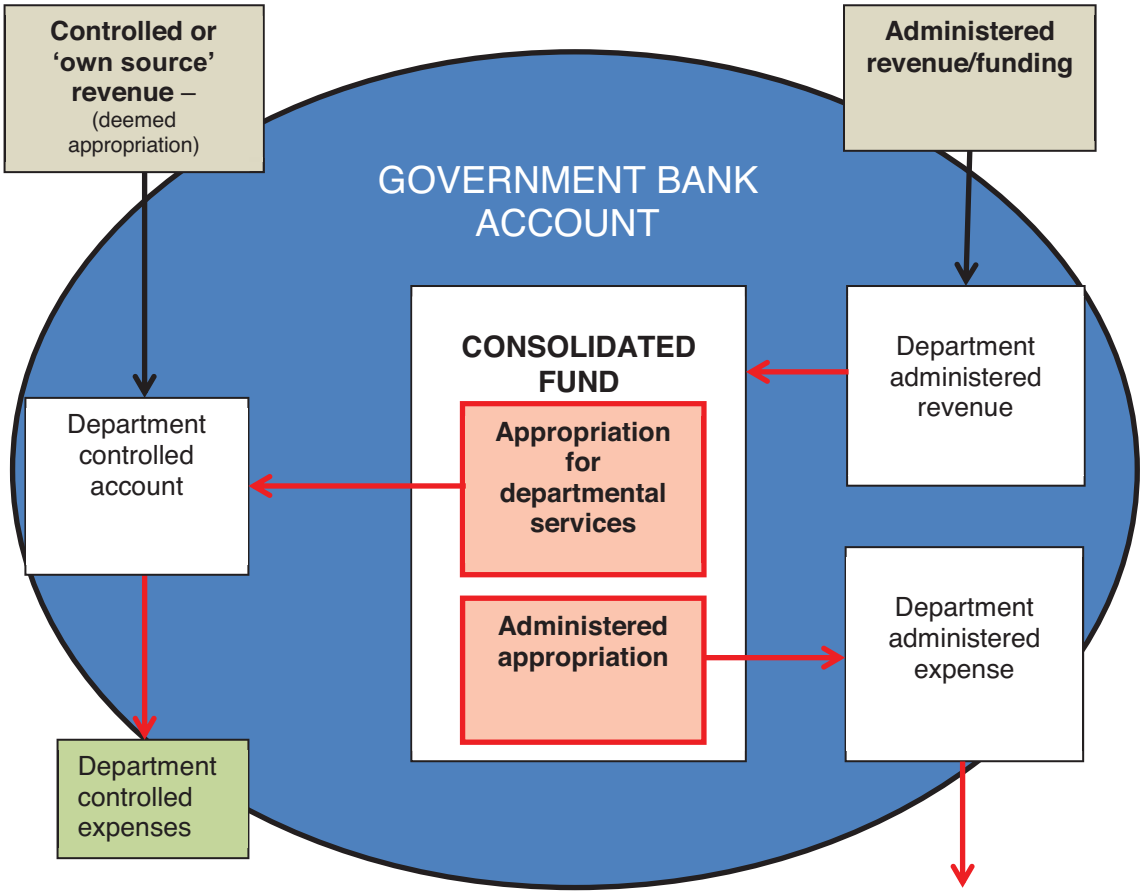
Figure C3.1 illustrates, in simplified form, the appropriation framework for recurrent expenditure. It shows the relationships between key components in the Government's bank account, especially the Consolidated Fund and departmental controlled and administered accounts. Points to note are:

- Administered accounts collect around 76% of departmental revenue collections and controlled accounts collect around 24%.

- About 78% of departmental controlled expenditure is funded by an appropriation for departmental services from the Consolidated Fund, while the remaining 22% is funded from own source revenues.

- Departmental administered expenditure is funded by administered appropriation from the Consolidated Fund.

Figure C3.1
Appropriation framework for recurrent expenditure



Source: Commission of Audit

C3.2.2 Expenditure control

Under the current appropriation model, Parliament is unable to exercise effective control of the overall level of expenditure by departments. This is because departments have discretion to vary expenditure according to their collection of controlled revenue, which is 'deemed' appropriation, and therefore not subject to the discretionary approval of Parliament.

The amount of controlled revenue varies between departments, with some receiving only relatively small amounts, while others receive substantially higher amounts. This means that some departments have greater flexibility than others in terms of their overall level of expenditure.

From a whole-of-government perspective, the practice of deemed appropriation constrains the capacity of the Government to exercise full control of departmental expenditure through the normal process of Parliamentary appropriation. It also constrains the capacity of the Government to redirect controlled revenue as required to meet higher priority needs.

This has the capacity to erode fiscal discipline, especially in circumstances where the Government wishes to exercise close control of departmental spending to achieve fiscal objectives.

For Parliament to exercise effective control over the total level of departmental expenses, the Commission considers that the *Financial Accountability Act 2009* should be amended as follows:

- remove the general provision for deemed appropriation
- require revenue currently treated as controlled revenue to be paid into the Consolidated Fund
- require a department to restrict its expenses to the amount of funding provided through appropriation from the Consolidate Fund.

There may be a need to retain a process of deemed appropriation in special circumstances, for example where, controlled revenue forms a substantial share of an agency's overall funding, for example, the Queensland Audit Office. However, such circumstances are likely to be very limited, and the discretion to deem appropriation should rest with the Parliament.

Departmental operating statements

To complement this revised approach to appropriation, the Commission proposes that the reporting format for the operating statements of departments should be changed to a 'net cost of services' presentation. This presentation separates appropriation revenue from other departmental revenues, and does not explicitly calculate a net operating result.

The main advantage of the net cost of services presentation is that it clarifies the funding process, and places the focus of the statement on departmental expenses, which is consistent with an enhanced emphasis on the efficiency and cost effectiveness of service delivery.

This is an option which is available under the Australian Accounting Standards, and is adopted by the Australian Government, and also by Western Australia and South Australia. Under this approach, the main elements of a department's operating statement would be (in order of presentation):

- operating expenses (by major type)
- revenues collected (by major type)
- revenues returned to government
- funding from government for operating expenses.

C3.2.3 Funding of capital expenditure

Funding of capital expenses also is complicated by the existence of a number of funding sources. At present, capital may be funded from:

- services appropriation for depreciation
- controlled revenues
- operating surpluses
- borrowing
- direct equity capital injection.

Under the simplified appropriation process outlined above, controlled revenue would no longer be available as a direct funding source for departments.

There is also some variability in the treatment of 'services appropriation for depreciation'. In most cases, it is returned to the Consolidated Fund as an 'equity withdrawal' from departments, so that there is no net effect on the Government's cash position. However, in some cases, departments are permitted to retain depreciation funds as a source of funding for capital expenditure. This is undesirable, as it can lead to the accumulation of surplus cash balances in departmental bank accounts, which may not necessarily be utilised to meet the highest priority needs of Government.

To ensure consistency, the Commission proposes that all depreciation funding should be returned to the Consolidated Fund as an equity withdrawal. Capital expenditure should be funded directly as an equity injection as and when required, in accordance with government priorities.

This would ensure funds are used efficiently and that surplus cash balances are not accumulating unnecessarily in departmental bank accounts. It would remove some complexity in the current arrangements, and would establish a consistent basis for the funding of capital expenditure for all departments. It would also ensure greater transparency and accountability in the funding of capital expenditure.

C3.2.4 Appropriation categories

Under the current appropriation framework, Parliament does not formally approve either the funding provided at the service area level (as set out in each department's Service Delivery Statement), or the detail of expenses proposed for each service area.

This means that control of expenditure by a department occurs only at the aggregate level, and not at any level of disaggregation below that, for example, by program, function or service area. The justification for the current arrangements is that it provides departments with flexibility to move resources between service areas. However, this flexibility for departments entails a loss of control of expenditure by the Parliament.

On balance, the Commission considers that there is a need for tighter control over departmental expenses, given the fiscal repair task of the Government. This would enable closer Parliamentary control of the spending priorities and allocation of resources of departments.

There are three main options for improving the level of appropriation control:

- Appropriate funding on the basis of the services provided by departments.

  This would reflect service structures, and would facilitate closer scrutiny of departmental activities.

- Appropriate funding for existing activities and individual new initiatives. This would underscore the role of the Parliament in the formal approval of new programs.

- Appropriate funding for specific classes of expense, for example, employee expenses, other operating expenses, depreciation, etc.

  This would align appropriation with the categories of expenditure recorded in departmental financial statements.

While each of these options has merit, the preferred approach of the Commission would be to adopt appropriation categories based on classes of expenditure, as this aligns closely with the policy objective of the Government to limit employee expenses to a 3% cap. It would enable closer scrutiny of the performance of departments in meeting the Government's objectives.

This preferred approach should include a separate appropriation for non-cash expenses, such as depreciation. In addition, noting the asset maintenance backlogs discussed in Section C2 of this Report, there is also a case for a separate appropriation category for repair and maintenance expenses. This would enable greater transparency and accountability, especially closer Parliamentary scrutiny of trends in repairs and maintenance expenditure by departments.

Based on the above points, the Commission proposes a revised appropriation structure, as follows:

Proposed appropriation categories:

Recurrent appropriation:
- employee expenses
- non-cash expenses
- repairs and maintenance
- other expenses

Capital appropriation:
- payments for capital expenditure
- repayment of non-cash expenses funding
- other equity withdrawals

As a general principle, appropriation categories should be structured to reflect the Government's management position and priorities. Over time, as the fiscal repair task is completed, it may be more appropriate to move to appropriation categories based on departmental structures or activities.

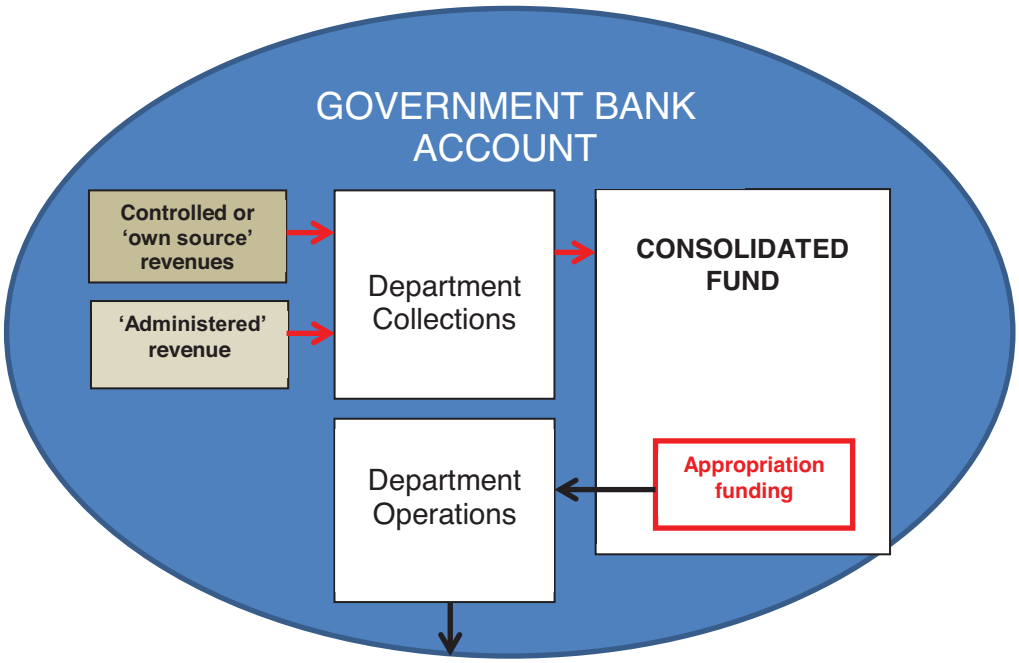
C3.2.5 Simplified appropriation framework

The Commission's proposals outlined would simplify the current complex appropriation and accounting framework. The proposed simplified appropriation framework is illustrated in Figure C3.2. Under this framework:

- All revenues collected by departments would be paid to the Consolidated Fund (including controlled or own-source revenue and administered revenue).

- All expenditure by departments would be funded by appropriation from the Consolidate Fund, on the basis of appropriation categories reflecting specific classes of expenditure.

Figure C3.2
Simplified appropriation framework



Source: Commission of Audit

C3.2.6 Unforeseen expenditure

Each year, payments from the Consolidated Fund are authorised in two separate Appropriation Bills. The Parliamentary Annual Appropriation Bill provides funding for the Legislative Assembly. The Ordinary Annual Appropriation Bill provides funding for all other departments. Each Appropriation Bill may contain funding provisions for four financial years, namely:

- previous year – approval for expenditure incurred in the previous year which has not been appropriated (supplementary appropriation for unforeseen expenditure)
- current year – updated estimates of the appropriation required for the current year
- budget year – appropriation sought for the following (budget) year
- post budget year – interim funding for the first half of the post-budget year (supply).

To illustrate, Table C3.1 shows the components of the Appropriation Bill 2012 and the financial years to which they relate. Apart from prospective funding for the new 2012-13 budget year, and initial supply for the following 2013-14 financial year, the Bill also approved retrospectively unforeseen expenditure for both the 2010-11 and 2011-12 financial years.

Table C3.1
Relationship between the elements of the Appropriation Bill 2012

2010-11 financial year	2011-12 financial year	2012-13 financial year	2013-14 financial year
Supplementary Appropriation for Unforeseen Expenditure (retrospective)	Supplementary Appropriation for Unforeseen Expenditure[1] (retrospective)	Appropriation sought for budget (vote) (prospective appropriation)	Supply (interim appropriation)

1 The presentation of information in the Appropriation Bills for 2012 is different than usual, because the late (September) budget has allowed the inclusion of the actual appropriation requirements for the 2011-12 financial year. In previous years, the unforeseen expenditure for a year has normally been included in the following year's Appropriation Bill.

Source: Commission of Audit

Unforeseen expenditure arises when the original appropriation approved for a department may be inadequate to deliver the services expected in a year, for example due to unexpected cost increases, or if new or expanded services are approved by Government during the year. To allow for these eventualities, section 35 of the *Financial Accountability Act 2009* provides that the Governor-in-Council may authorise the issue of moneys from the Consolidated Fund during the year where the existing appropriation is insufficient. These amounts are charged as unforeseen expenditure.

Pending formal Parliamentary approval, Governor-in-Council approval for unforeseen expenditure can be sought at any time during the financial year, but must be sought within four weeks of the end of the financial year. Information on unforeseen expenditure is tabled in Parliament as part of the Consolidated Fund Financial Report. Section 24(2) of the *Financial Accountability Act* requires the Report to be normally completed within three months of the end of the financial year.

The current process for approval of unforeseen expenditure results in an extended delay between when expenditure is incurred and when it is finally approved by Parliament. This detracts from proper transparency and accountability, especially the need to provide a reasonable and timely explanation to Parliament as to why additional appropriation is required. This is not consistent with the highest standards of financial management.

Box C3.2 outlines the changes which have occurred in recent years in the process for approval of unforeseen expenditure.

Box C3.2
Process for the approval of unforeseen expenditure

- Prior to 2007, the normal practice was for approval for unforeseen expenditure to be sought within six months of the end of the financial year through Appropriation Bills (No. 2), usually introduced in October and passed in October or November each year.

- The Appropriation Bills (No. 2) for the 2006-07 financial year were introduced to the Legislative Assembly on 16 October 2007, but were not passed until 15 April 2008 – more than 9 months after the end of the financial year to which the unforeseen expenditure related. This was less than two months prior to the introduction of the Appropriation Bills (No. 1) for the 2008-09 Budget on 3 June 2008.

- Since 2007, Appropriation Bills (No. 2) have been discontinued, and requests for unforeseen expenditure approval have been deferred until the subsequent Appropriation Bills which introduce the annual budget, for example, the current *Appropriation Act 2012* includes the unforeseen expenditure approvals relating to the 2010-11 financial year. For a June budget, this means that approval for unforeseen expenditure is not sought from Parliament until almost 12 months after the financial year to which that expenditure relates.

Source: Commission of Audit

In the Commission's view, accountability is compromised when Parliamentary approval of unforeseen expenditure is sought after the expenditure has been incurred and after the end of the financial year to which it relates. By this stage, Parliament is providing a retrospective 'rubber stamp' approval of expenditure for which there has been limited, if any, public scrutiny.

As a basic principle of financial management, requests for unforeseen expenditure should be submitted to Parliament for scrutiny and approval before the expenditure is incurred. To this end, the Commission considers that the *Financial Accountability Act 2009* should be amended to provide for a new Supplementary Appropriation Bill to require government to seek Parliamentary approval for additional expenses in the year in which they are to be incurred.

It is envisaged that this supplementary bill could be introduced into Parliament around the time of the Mid Year Fiscal and Economic Review. This would restore a higher level of public accountability, and a higher level of fiscal discipline, consistent with the practice adopted by the Australian Government. This bill could also address any revenue variations (effectively 'unforeseen revenue') arising from the proposed variation to the treatment of controlled revenue.

The reinstatement of the Treasurer's Advance (discussed in Section C3.3.3) would give the Government some flexibility to manage its financial position without needing to seek additional appropriation for small expenditure variations. The Treasurer's Advance should only be used to provide additional emergency funding for previously approved programs. All new programs should be explicitly approved by Parliament via an Appropriation Bill before commencement of the program.

Recommendation

51 The* Financial Accountability Act 2009 *be amended to provide for:

- ***all government revenues to be paid into the Consolidated Fund, to be appropriated by Parliament to fund operational and capital expenses of departments***
- ***a revised appropriation process by which Parliament approves a total expense limit for agencies, including a limit for employee expenses***
- ***a new Supplementary Appropriation Bill to require government to seek Parliamentary approval for additional expenses in the year in which they are to be incurred***
- ***a revised capital funding process under which cash funding for depreciation expense is held centrally and agencies receive an explicit appropriation for capital.***

C3.3 BUDGET PROCESS

C3.3.1 Funding capacity

The budget process is the primary vehicle for decisions by government which have significant funding implications. It provides the opportunity for the Government's strategic objectives to be considered from a holistic perspective. It also enables competing priorities to be ranked and assessed in order of merit, consistent with available funding capacity. In practice, Cabinet normally delegates to the Cabinet Budget Review Committee (CBRC) responsibility for preparation of the budget within the strategic objectives set by the Government.

A key risk to the achievement of a government's strategic objectives is consideration of ad hoc expenditure proposals in an unstructured decision-making framework, which does not allow for effective prioritisation of expenditure proposals. Outside the formal budget process, there will always be circumstances through the year where decisions need to be made by a government which have funding implications. Ideally, these circumstances should be kept to a minimum, as they have the potential to undermine the integrity of the budget process and outcome.

For example, insofar as possible, the purpose of the Mid Year Review should be to update economic parameters, and incorporate the latest advice from the Australian Government on funding allocations. It generally should not be used as a vehicle for a further round of funding submissions from departments.

Through the year, other decisions by Government with significant funding implications need to be managed carefully, again to ensure that projected budget outcomes can be achieved within available funding capacity. Where issues are considered on a one-off basis, there is also the risk that lower priority issues receive funding at the expense of higher priority issues.

As a general principle, a more rigorous and accountable process for the approval of unforeseen expenditure will provide a stronger framework within which to assess funding decisions outside the formal budget process.

In conjunction with the Government's strategic objectives, CBRC should review the forward estimates and determine the amount of funding available in the budget, whether it needs to pursue revenue measures and/or savings targets, and then prioritise its objectives consistent with the available funding capacity.

Ideally, this process should indicate to Ministers what additional resources, if any, the Government is willing to provide to the department, and what objectives the Government wants the department to achieve. The role of the Minister should then be to consider how to best achieve the Government's objectives, and develop a range of options to meet the objectives.

It is important for Ministers to know the indicative funding capacity available to meet the Government's objectives. This will assist departments to plan realistically, and will assist Queensland Treasury and Trade (QTT) in advising whether departmental expenditure proposals are affordable.

C3.3.2 Budget submissions

As part of the annual budget process, departments normally are invited to lodge submissions with CBRC outlining funding issues for the forthcoming budget year, including prospective new expenditure, revenue and/or savings measures. Before the preparation of budget submissions commences, departments should be advised of the Government's agreed objectives and priorities, and the resources available to achieve them. This will result in better quality budget submissions which are targeted towards achieving clear objectives within specified fiscal limits.

Departmental submissions should canvass alternative options for achieving government objectives and service delivery outcomes. This is particularly relevant, for example, if some options involve additional capital expenditure and others involve additional recurrent expenditure. To ensure a balanced evaluation, capital and recurrent funding options need to be considered concurrently.

To ensure CBRC has all the relevant information for effective decision making, there are several key elements that should be incorporated into all budget submissions.

- Firstly, the submission should clearly state the objective of the funding proposal (as previously approved by CBRC), and outline what alternative options have been considered to meet this objective, including the costs and benefits of each option and the reasons why the proposed option is preferred.

- Secondly, each funding submission should include, at a minimum, annual performance milestones which will allow for effective review of progress in implementing the objective.

- Finally, submissions should explain how other initiatives of government and departmental capital plans complement the proposal.

As part of its decision-making process, CBRC needs to be fully apprised of the full financial impact of proposed budget measures. As outlined in Section C1 in this Report, when capital plans are developed, they should include the ongoing recurrent cost impact on the budget. Without this information, it is not possible to properly assess whether projects are cost effective and affordable, or to make an informed choice between alternative proposals which use differing mixes of capital and recurrent spending.

Briefing officers from QTT and the Department of the Premier and Cabinet (DPC) should utilise the information available from departmental program reviews to assist CBRC in its consideration of departmental funding submissions.

C3.3.3 Treasurer's Advance

The Treasurer's Advance was a contingency provision for situations where the final costs of a program may not have been known at the time of a budget, or to provide for unforeseen circumstances throughout the year. The Commission is advised that the use of the Treasurer's Advance was discontinued in 2007-08, because it was considered that it was not being used in the way it was originally intended. In the final year of its existence, the Treasurer's Advance had an appropriation of $50 million.

In the context of a budget process which has a single major financial decision-making round, there is a need for a mechanism to provide emergency funding for unforeseen events. It is preferable that such a provision is transparently approved by Parliament as part of the annual budget. The discontinuation of the Treasurer's Advance provision, and the reliance instead on various contingency provisions within the budget, has led to diminished transparency, especially in relation to unforeseen expenditure.

The Commission considers that the Treasurer's Advance should be reinstated and that the amount of the Treasurer's Advance should initially be in the order of $100 million. Reinstatement of the Treasurer's Advance at a modest level would assist the Treasurer in managing funding pressures which arise during the course of the year, outside the formal budget process.

The Treasurer's Advance should not be treated as a general contingency provision, but should relate solely to unforeseen or emergency needs (urgent and unavoidable expenditure). On this basis, the Treasurer's Advance should not be used generally as a funding mechanism for new measures, but only for genuinely unforeseen cost variations in existing activities.

Procedures would need to be developed to ensure that a disciplined approach is applied to the use of the Treasurer's Advance. This would include development of criteria for access to funding from the Treasurer's Advance, and initial screening of departmental submissions by Treasury to determine whether these criteria have been fulfilled. Where initial criteria have been met, submissions would then need to be cleared by the Treasurer and progressed to CBRC for a decision as to whether funding from the Treasurer's Advance should be provided.

C3.3.4 Budget review processes

Review of ongoing activities

Much of the budget process typically is focussed on consideration of new expenditure, revenue and/or savings measures, and associated funding implications. This involves an 'incremental' approach, where new measures are considered at the margin, but there is often limited, if any, serious consideration of a department's ongoing services and overall funding base. This tends to limit the scope for shifting resources to respond to the changing service delivery priorities of the Government.

The current Government's first budget placed greater emphasis on savings to be achieved through the rationalisation of obsolete and/or lower priority programs, as part of broader reviews of departmental base budgets. This was necessary to address the Government's fiscal repair task.

Beyond this, all departmental activities should be reviewed on a regular basis to ensure that they continue to be aligned with government priorities and to ensure that services are being provided efficiently and effectively on a value for money basis. Key questions which need to be addressed as part of such reviews include:

- Are the services being delivered by a department consistent with the Government's strategic objectives and priorities?
- Are the services achieving their performance targets?
- Do the services provide value for money in achieving their goals?
- Are there more effective ways to achieve the Government's objectives and priorities?
- Are there programs which are obsolete, redundant or no longer accord with the priorities of the Government?

As a general guide, the Commission considers that the base budgets of departments should be reviewed at least once every three years (or broadly once during the term of the Parliament). This is similar to the practice adopted in many universities where major programs or faculties are subject to a regular review process involving external parties every 3-5 years.

In broad terms, the purpose of these reviews would be to:

- review the efficiency and effectiveness of a department's core activities and base budget
- identify the scope for reallocation of resources from low priority activities to high priority activities
- identify options for better achievement of performance targets
- identify innovative forms of service delivery to achieve improved outcomes and greater productivity in government expenditure
- identify the scope for savings measures, including the achievement of savings targets set by the Government in the budget process.

It is often difficult to undertake comprehensive reviews of base budgets of departments within the context of the annual budget process. There would be merit in establishing an independent review body to undertake these reviews, utilising both public sector and external expertise, including relevant subject matter specialists from the private sector, academia or corresponding departments from another jurisdiction (within Australia or overseas). Reports on the outcomes of such reviews should be publicly available, so that there is more effective public scrutiny of the use of taxpayers' funds by departments.

The Commission considers that this function should be performed by the Queensland Productivity Commission recommended in Section C5 of this Report.

Review of new measures

To ensure effective performance in agencies, and to allow early identification of implementation issues, the budget process should include an evaluation of the progress in implementing new revenue, spending and savings measures.

This review process should include a review of effectiveness of new programs, with a view to terminating any programs which are not achieving their objectives, and returning any unspent funding to the Consolidated Fund. Alternatively, there may be a need to consider alternative measures to achieve desired objectives. The findings of these reviews could be a factor considered in the performance agreements of accountable officers.

Recommendation

52 The annual budget process be strengthened by:

- ***improving the quality of budget submissions and supporting information***
- ***managing funding pressures within a rigorous and disciplined assessment of fiscal capacity***
- ***re-establishing a Treasurer's Advance for any urgent and unavoidable cost pressures***
- ***periodic review of progress in the implementation of new spending and savings measures, including review of outcomes achieved***
- ***reviewing base budgets of departments at least once every three years.***

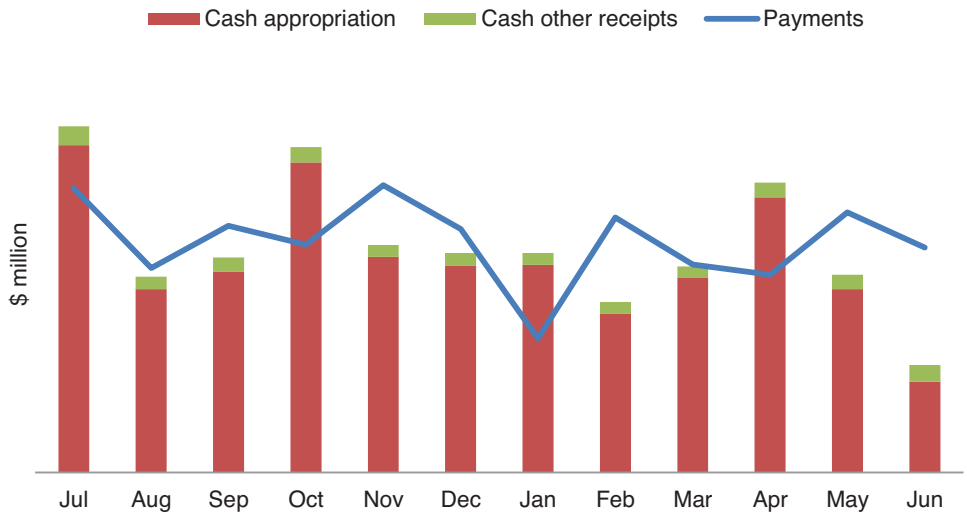
C3.4 CASH MANAGEMENT

Once annual appropriations for departments have been approved, QTT transfers the appropriated funds into departmental bank accounts. It has been standard practice to establish default payment profiles for recurrent appropriation for departments. Under these arrangements, 95% of appropriation funding is paid to departments in equal fortnightly instalments throughout the year. The remaining 5% of their annual appropriation funding is held back, to be paid to them in the last pay period for the year (if required).

There is provision in the QTT payment system to tailor the payment profile to departments, for instance, to provide additional funds to meet quarterly grant payments or for lumpy capital payments. Apart from some adjustments for material seasonal requirements, there has been little attempt by QTT to match payment profiles with the cash flow requirements of departments. This has led to some deficiencies in cash management practices.

To illustrate, Chart C3.1 shows the pattern of payments from and receipts to one department's bank account during 2011-12. This is a typical example of the mismatches in payments and receipts. It shows that, in some months, the department has received more funds than required to meet its payment obligations. In other months, the department has received less funds than required, in which case its cash balances have been used as a temporary source of liquidity.

Chart C3.1
Payments and receipts, departmental example, 2011-12



Source: Queensland Treasury and Trade

At the end of 2011-12, there were departmental cash balances of $1.5 billion, indicating that departments were holding cash well in excess of their immediate expenditure requirements. These funds are swept into an offset account by Queensland Treasury Corporation (QTC) on a regular daily basis to minimise whole-of-government funding costs. Nevertheless, it is unnecessary for departments to hold surplus cash balances, as this can lead to inefficient practices such as unwarranted end-of-year expenditure to avoid loss of funds.

On a daily basis, the cash position of departments should be as close as possible to a zero balance. This would involve a different approach to the payment of cash to departments. Specifically, regular appropriation payments should be made to departments on an 'as needs' basis, in accordance with cash flow projections. This would mean that funds would be advanced to departments only when they were required to meet payment commitments. Departments could use a small overdraft facility to allow for cash flow estimation errors.

This approach to appropriation funding would eliminate some current slack in the cash payment process, and would provide an incentive for departments to improve the quality of data provided for cash management purposes. The Commission is advised that QTT is currently implementing a revised cash management process along these lines.

Recommendation

53 The Government enhance the cash funding process for agencies so that payments are made on an 'as needs' basis, in accordance with cash flow projections.

C3.5 FINANCIAL REPORTING

C3.5.1 Budget reporting

Information reported in the Queensland Budget Papers is broadly comparable with other jurisdictions, reflecting the practice that states tend to benchmark their reporting performance against each other. Also, states are obliged to comply with some standardised reporting requirements such as the Uniform Presentation Framework (UPF), and take into account the standard information requirements of international credit ratings agencies.

Nevertheless, there is some variability between states in the nature and extent of financial information presented in budget documents for example, base years for historical time series and forward estimates. This affects the ability of users to analyse and make informed judgments about a state's underlying financial position

The Commission considers that there is scope to make financial information and analysis more accessible and user friendly. This would enhance transparency and accountability of financial information, which is important, as public scrutiny of such information provides a strong incentive to more responsible financial management.

To facilitate more informed analysis of key budget aggregates by users, the Commission suggests that the Queensland budget reporting should include at least five years of historical data on a consistent basis for all UPF tables, and for all revenue items at the level of disaggregation currently provided in Budget Paper No. 2 (*Budget Strategy and Outlook*). Also, forward estimates should be presented with a similar level of disaggregation. This would provide a consistent basis for the analysis of historical trends and future projections for all major financial aggregates presented in the budget papers.

Similarly, key economic aggregates also should be presented on a basis consistent with the financial aggregates, to facilitate broader analysis by users for example, to enable financial data to be expressed as a proportion of Gross State Product, or on real or per capita terms, to suit their analytical purposes. Other possible reporting initiatives to enhance user analysis include:

- the provision of time series data and economic parameters online in Excel (as occurs in conjunction with the Victorian Budget)

- the provision of key financial metrics along the lines of those included in the New South Wales budget papers, such as:

  - revenue, expenses and capital expense as a proportion of GSP
  - revenue, expenses and capital in real terms
  - debt as a proportion of GSP and of revenue
  - key ratings agency metrics.

Much of this material already is available internally within QTT, and could readily be made available for public use at minimum additional cost.

C3.5.2 Consultation with interested parties

As a provider of financial information, Government is not always in the best position to readily determine the information requirements of users, especially what is useful and meaningful to users. Transparency and accountability would be enhanced if QTT was to periodically seek feedback from relevant stakeholder groups on the merits of the current reporting regime and the scope for making relevant and cost effective improvements.

The Parliamentary Finance and Administration Committee would be an appropriate body to oversight the ongoing development of a state financial reporting framework.

C3.5.3 Reporting portal

To ensure greater transparency and accountability, and to promote greater public understanding, of the financial position of the State, the Commission considers that a dedicated website should be created as a special purpose financial reporting portal for the Queensland Government. This would enable ready access to a wide suite of information by state, national and international audiences.

The website should contain (at a minimum) links to financial reports for QTT, Queensland Treasury Corporation, Queensland Investment Corporation, and all Queensland departments and Government Owned Corporations. Also, it could potentially include reports from ratings agencies, QTC investor reports, and other relevant information.

Apart from these reports, the website should include documentation of all key financial processes, including the financial planning processes recommended in Section C1 of this Report.

C3.5.4 Reporting of administered activities

Consistent with the current appropriation framework, departments separately account for controlled activities and administered activities. For example, a number of agencies maintain separate administered accounts to manage revenues which they collect on behalf of Government as a whole, and in some cases for the administration of some of their own expenditure programs.

The main classes of transactions included in administered accounts are:

- the collection of taxes, fees and fines, and royalties which constitute general taxpayer revenue
- the recording of payments from the Australian Government
- grant payments
- whole-of-government superannuation transactions and balances
- whole-of-government borrowing and debt servicing costs.

The rationale for separate controlled and administered accounts is that it allows departments to distinguish between transactions and balances for which they are directly responsible, and those which they manage on behalf of the whole of government. This is a significant distinction for a department such as QTT, which is a small department in terms of controlled activities, but which manages large administered transactions on behalf of Government.

The separate reporting of controlled and administered activities can result in some anomalies, as illustrated in Box C3.3.

Box C3.3
Anomalies in reporting of administered grants

Accounting for Australian Government general financial assistance grants for local government

The Australian Government pays the Queensland Government a grant for on-passing to local government authorities for general financial assistance. This money is recorded as administered revenue because it is not available to the State for discretionary purposes. It is then recorded as an administered expense when it is transferred from the department's administered account to the Consolidated Fund.

To enable payments to be made to local government authorities, the Government is required to appropriate the payment to a department, where it is recorded as a controlled revenue. It is then paid to the local government authorities as a controlled expense.

This transaction involves two sets of revenue records and two sets on expense records to record a relatively straightforward on-passing payment.

Accounting for Australian Government payments to non-government schools

The Australian Government makes payments to the Queensland Government for on-passing to non-government schools. This funding is recorded as a grant received by the department. It is then returned to the Consolidated Fund. It is then appropriated to the department as an administered item, and the department then pays it to non-government schools as an administered expense. The same funding appears twice in the revenue and expense sections of the department's administered account.

Source: Queensland Treasury and Trade

Given the relatively small number of administered activities, the distinction between controlled and administered activities is not significant for most departments. The Commission considers that the separate recording and reporting of administered activities should be discontinued, unless warranted on the grounds of materiality. In most cases, administered items could easily be reported in the notes to a department's accounts, rather than by maintaining separate bank accounts and financial reporting structures.

Recommendation

54 The Queensland financial and performance reporting regime be strengthened to promote transparency and accountability, including by:

- ***extending the range and accessibility of analytical information on budget aggregates***
- ***creating a single dedicated electronic access point for government financial information***
- ***consulting with interested parties with a view to improving the relevance and usefulness of published information***
- ***providing for departments to report separately on administered items only where warranted on the grounds of materiality.***

C4 GRANT ADMINISTRATION

KEY ISSUES

- In aggregate, grants are the second largest contributor to General Government sector expenses. In 2011-12, grants amounted to $11 billion, representing 24% of government expenses. Discretionary grants to individuals and not-for-profit entities amounted to $5.1 billion.
- The definition of grants is very broad, as there is a wide range of arrangements for governments to fund external organisations and individuals. Grants include payments which are a substitute for direct government service provision, and which should be treated as service delivery contracts.
- Across Government, there are in excess of 400 individual grant programs, with nearly 90,000 recipients (individuals and organisations) receiving payments under these programs each year. Grants for Health, Education and Community Services account for 76.5% of the value of grants and almost half of the number of grant programs.
- Of the total number of grant programs, 10% had a value of $25,000 or less, while approximately 25% had a value of $100,000 or less. These grants average less than $8,500 per recipient.
- There is a high degree of variability between departments in the cost of administering grant programs.
- There is potential to rationalise and consolidate the number of grant programs, and to improve the administration of grant systems to increase efficiency and free up resources for service delivery.

C4.1 BACKGROUND

Based on information in the Report on State Finances,[1] grants in 2011-12 amounted to $11 billion, or 24% of total government expenses. In aggregate, grants are the second largest contributor to General Government sector expenses, after employee expenses.

Governments use grant expenses to help support policy objectives in a number of areas where either they are not directly responsible for service provision or they choose to support alternative service providers rather than directly provide services. Grant expenses (which also include subsidy payments to some enterprises) may also be used as an income transfer mechanism. Grants may be for either current or capital purposes.

Current grants include grants and subsidies to the community for schools, hospitals and community services. These grants support non-government healthcare providers and organisations servicing the community in areas such as health, disability and childcare services. Community Service Obligation payments (CSOs) are provided to Public Non-Financial Corporations (PNFCs) which are required to provide non-commercial services or services at non-commercial prices. Current grants amounted to $9,026 million in 2011-12.

Capital grants include payments to PNFCs, not-for-profit entities and other non-government entities, such as businesses and households, for capital purposes, including the First Home Owner Grant and capital expense programs. Capital grants amounted to $1,978 million in 2011-12.

The breakdown of grants for 2011-12 is summarised in Table C4.1.

Table C4.1
Government grants, 2011-12 ($ million)

Grants to individuals and not-for-profit entities	5,075
Grants to other sectors of government	2,157
Grants to local government	2,028
Grants for on-passing to not-for-profit entities[1]	1,744
Total grants	**11,004**
- **Capital grants**	**1,978**
- **Current grants**	**9,026**

1 In certain cases, the Queensland Government directly on-passes Australian Government grant payments. The major payment is for non-government schools. On-passing grants for Local Government are included in the Grants to local government line.

Source: Queensland Treasury and Trade

For the purposes of the following analysis, the Commission has focused on the administration of discretionary grants to individuals and not-for-profit organisations. These payments amounted to $5,075 million in 2011-12. Grants to other sectors of government, to local government and for on-passing to not-for-profit entities are subject to separate decision-making processes, which are beyond the scope of this Section.

Chart C4.1 shows grant payments to individuals and not-for-profit entities from 2007-08 to 2011-12. Over this period, these grants have increased substantially, by 25%.

Chart C4.1
Grant payments to individuals and not-for-profit organisations

Note: Published data is not available before 2007-08

Source: Queensland Treasury and Trade

C4.2 SCOPE OF GRANT PAYMENTS

Grants reported in the budget and Queensland departmental annual reports comply with the definition of grants provided by Queensland Treasury and Trade (QTT).[2] Under these guidelines, grants are defined generically as funding or other incentives which exhibit some or all of the following characteristics:

- a transfer to a recipient which may be in return for compliance with certain terms and conditions
- a transfer which may not directly give approximately equal value in return to the government (that is, there is a non-exchange transaction or subsidisation)
- a recipient may have been selected on merit against a set of program-specific criteria.

The definition of grants is very broad, as there is a wide range of arrangements for Government to fund external organisations and individuals. There is a spectrum of grant designs which ranges from full flexibility for the recipient to use the payment in any way, providing that they have met the relevant grant criteria (for example, scholarships), to arrangements which involve a high degree of oversight and supervision from Government and a high degree of accountability for the expenditure of funds provided under the grant.

The latter group of grants typically involves payments which are closely related to government service provision, and may be regarded as a substitute for direct government service delivery. These often can be regarded as 'service level agreements', because there is a contractual arrangement through which the grant is provided in return for the provision of a certain service to a certain level or standard.

One of the key themes of the Commission's report is to increase opportunities for the contestable provision of services by the non-government sector on behalf of government. This is likely to increase the scope and importance of so-called grant payments which are very closely related to a service delivery arrangement, or the purchase of services.

The financial administration of such programs needs to be consistent with the normal oversight of government purchasing, rather than with the traditional arrangements for grant administration. It would be useful for the QTT financial guidance material to be revised to provide guidance for determining when grants should be treated as service level agreements for reporting and monitoring purposes.

The criteria should provide that, if a payment to a third-party entity is made to provide services for which the government is legally or legislatively responsible, then by default the payment should be treated as the provision of a service. In effect, this would mean that service level agreements would be removed from the category of grant payments and transferred to the category of 'supplies and services'.

The treatment of service level agreements as purchase arrangements rather than grant funding arrangements may create some issues of consistency with the relevant external reporting standards. QTT should consult with the relevant organisations to establish what scope there is to improve the reporting of grant arrangements under current reporting standards.

If there is not sufficient flexibility under external reporting standards, QTT should consider what measures could be implemented in its internal financial guidance to distinguish clearly between service level agreements and other grant payments. This would ensure that service level agreements are subject to an appropriate monitoring and reporting regime, including relevant governance and performance standards. It would also ensure a separate focus on 'genuine' grant payments.

C4.3 Commission Review of Grants

To assist in its review, the Commission sought information on grant payments and systems from all government departments. The scope of the review focussed on grant payments to individuals and non-government organisations (excluding on-passing payments to the non-government schools sector). As such, the review was based on a slightly different scope than the total payments of $5.1 billion for individuals and non-profit organisations shown in Table C4.1.

In particular, some $200 million of grants paid by statutory authorities were not included in the scope of the Commission's review. Additionally, the review was undertaken prior to the finalisation of the annual financial statements and was based on indicative data, including some classification differences.

In total, the Commission's review covered $4.6 billion of grant payments by departments, equivalent to around 91% of the grant payments to individuals and non-profit organisations included in Table C4.1. This provides a high coverage of relevant grants, and a high degree of reliability of the results derived from the review. These results are discussed below.

C4.3.1 Grant definitions in departments

To assist with the Commission's analysis of grant programs across Government, each department was asked how it defines a grant. Varied responses were provided, albeit with some unifying themes.

Notably, a number of departments stated there was no central, comprehensive definition of a grant. Individual program areas decide whether a payment should be described as a 'grant', with some departments having no specific definition of 'grant' within their policies.

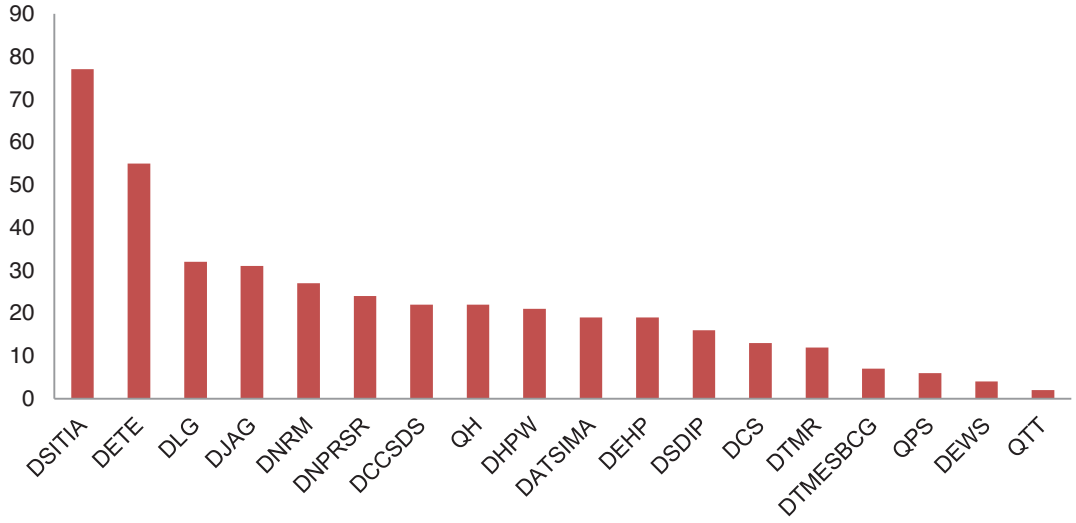
Departments use the term 'grant' to describe a range of payments made to various entities including, for example, internal business units and schools.

For such a large expense item, there needs to be a more consistent definition as to what constitutes a grant.

C4.3.2 Number of programs

Across Government, there are in excess of 400 individual grant programs. Nearly 90,000 recipients (individuals and organisations) receive payments under these grant programs each year. The Department of Science, Information Technology, Industry and the Arts (DSITIA) and the Department of Education, Training and Employment (DETE) combined are responsible for almost one-third of all grant programs and the top four agencies are responsible for 48% of all programs. Chart C4.2 shows the number of programs by agency.

Chart C4.2
Number of grant programs by agency



Note: Space considerations prevent including the full name of departments in this chart. Full names may be found in the Glossary.

Source: Commission of Audit

Over half of the grants administered by DSITIA have one recipient. Over one-third of all grant programs across Government have only one recipient, while approximately half have five or less recipients.

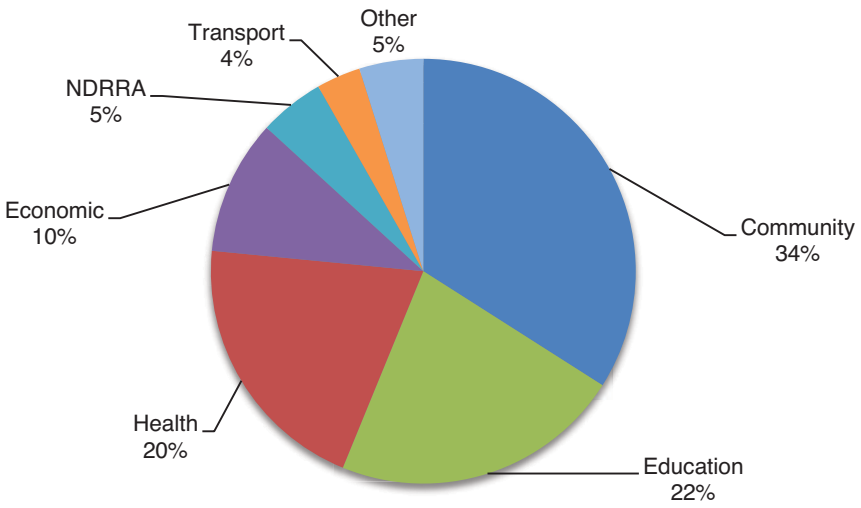
C4.3.3 Breakdown by category

Each agency was asked to categorise their grant programs into one of the following functional categories:

- Education (includes grants to schools and other organisations for the purposes of skill development)
- Health (includes payments by the Department of Health)
- Community Services (includes grants for community safety and programs that benefit the whole community)
- Economic (includes grants targeted at developing businesses, industry and sectors of the Queensland economy)
- Environment (includes grants for research and conservation, and disaster prevention and preparation. excludes NDRRA)
- Transport (includes grants for developing transport infrastructure and pathways)
- Sport and recreation (includes grants for sporting clubs and associations for infrastructure and programs)
- Cultural (includes grants for arts and other cultural activities)
- Research (includes grants for scientific and industry research)
- Natural Disaster Relief and Recovery Arrangements (NDRRA).

Chart C4.3 shows the proportion of grants by value for the above categories. Grants for Community Services accounted for 34% of total grants, followed by Education (22%) and Health (20%). In total, these three categories accounted for 76% of total grant expenses.

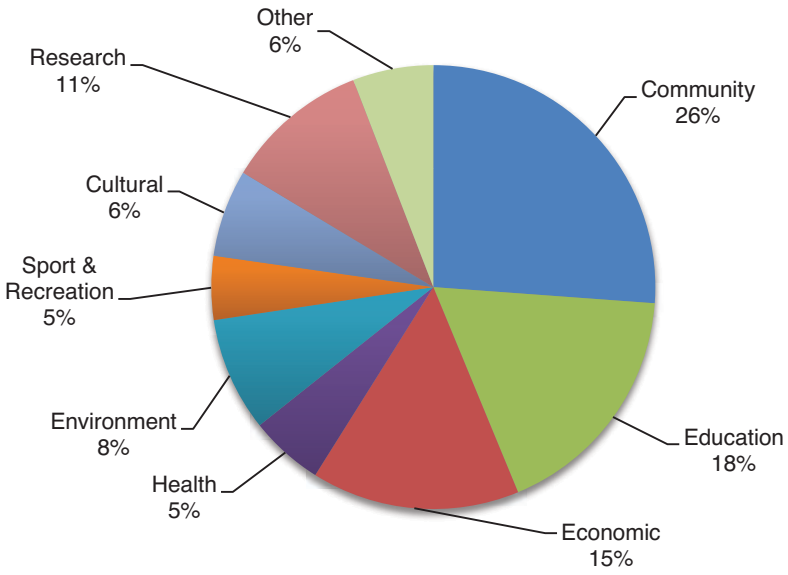
Chart C4.3
Grants ($) by category



Source: Commission of Audit

Chart C4.4 shows the proportion of grants by number by category. The Community Services category accounted for 26% of grants by number, while Education accounted for a further 18% by number.

Chart C4.4
Grants (number of programs) by category



Source: Commission of Audit

C4.3.4 Cost of administration

It was difficult to determine a total cost of administration for grant programs. While some departments were able to provide a total dollar value, others were unable to do so for a number of reasons. The Department of Education, Training and Employment stated:

> *"Deriving a total cost for DETE grant delivery is problematic given that grant processes are diverse and aligned with business and policy owners throughout the department. The difficulty is amplified because grant payments are integrated with other payments comprising State and Commonwealth funds provided to State Schools, Non-State Schools, Central Governing Bodies, Long Day Care Centres, non-department organisations, parents, students and hostels."* [3]

Some agencies were able to provide information on the total cost of grants administration in 2011-12:

- The Department of Communities, Child Safety and Disability Services (DCCSDS) reported the total cost of grants administration as $41.4 million. This equates to a cost of $3.11 per $100 of grants funding administered.

- The Department of Natural Resources and Mines (DNR) reported a total cost of $2.4 million. This equates to a cost of $2.12 per $100 of grants funding administered.

- The Department of National Parks, Recreation, Sport and Racing (DNPRSR) reported a total cost of $499,500. This equates to a cost of approximately $0.58 per $100 of grants funding administered.

This indicates a high degree of variability in the cost of administering grant programs. In comparison, the Office of State Revenue reports a cost of $0.53 to administer $100 of revenue in 2011-12.[4] This shows that there are potential efficiency gains to be made in the administration of grants funding, although it should be noted that different accountability arrangements for different grant programs may impact on some of the cost differentials noted above.

C4.3.5 Range of programs

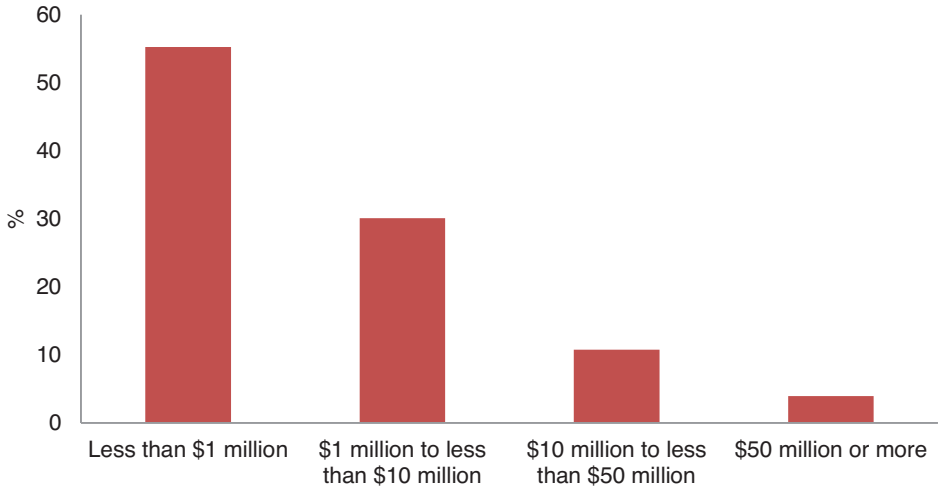
The Commission's review identified a wide range of programs. Of the total number of grant programs:

- 10% had a total program value of $25,000 or less
- approximately 25% had a total program value of $100,000 or less.

The programs with a total value of $100,000 or less had an average payment of less than $8,500 per recipient. Over half of these programs were for community purposes (including grants for community safety and programs that benefit the whole community) and research purposes (includes grants for scientific and industry research), and one-third of these grants are administered by a single agency. This indicates the potential for consolidation of programs.

Chart C4.5 shows that over half of all grant programs had a value of less than $1 million and 85% had a value of less than $10 million. Less than 5% of programs had a value of more than $50 million.

Chart C4.5
Grant programs by value range



Source: Commission of Audit

The above analysis suggests that there is scope to rationalise and consolidate the number of grant programs. Combined with greater accountability for the recipients to report against desired outcomes, this could yield administrative savings, and improve transparency, especially in relation to coherence and clarity of the programs.

A case study which shows the potential for rationalisation of grant programs is presented in Box C4.1 below.

Box C4.1
Case study – Grant complexity

UnitingCare Community (UCC) is the largest grant funding recipient of DCCSDS. Excluding related grants to individuals, in 2012-13, UnitingCare Community will receive about $88 million under 232 grants ('services') delivered at 123 locations across Queensland. These 232 grants are supported by 99 service agreements, managed by more than 30 staff in the department's seven regions.

The funding includes:

- $9.1 million for 34 social inclusion services
- $38.7 million for 63 child safety services
- $40.3 million for 135 disability and community care services

Source: Department of Communities, Child Safety and Disability Services

In 2008, the Australian government released a review of grant programs commissioned with the aim of improving the efficiency, effectiveness, accountability and transparency in the administration of grant programs across the government. The report recommended that:

> "… *grant-administering agencies be encouraged to review the structure of their grant programs with a view to reducing the overall number of programs, achieving greater coherence and clarity of objectives, improving transparency, reducing but sharpening the range of performance indicators, and achieving administrative savings*." [5]

In 2009, the Western Australia Economic Audit Committee conducted a wide ranging review into the best way for the government to engage with the community and deliver necessary services in the most efficient and effective manner. Among other issues, the review recommended:

- streamlining payment processes to reduce administrative costs
- streamlining administration of grants through reducing the number of programs
- streamlining administration of grants by developing centralised systems and support for grants administration to facilitate online applications, monitoring and reporting.[6]

In the Commission's view, the Government should rationalise and consolidate grant programs, consistent with reviews undertaken elsewhere which advocate consolidation of programs into broad categories covering wide priority areas in line with government policy objectives.

Recommendations

55 The Government publish a list of all grant programs on an annual basis.

56 Grant programs across Government be rationalised and consolidated, with a view to:

- ***reducing the piecemeal and fragmented nature of current programs***
- ***adopting a consistent definition and treatment of grants across Government, separate from subsidies, service level agreements and other forms of payment for services rendered***
- ***ensuring the efficiency and effectiveness of grant programs in achieving stated objectives***
- ***providing a more informed basis for future decisions on the nature, range and scope of grants proposed to be made, and the organisations receiving these grants***
- ***achieving better value for money for the large expenditure made on grants.***

C4.4 EFFECTIVENESS OF PROGRAMS

There is insufficient reliable information regarding grant programs in Queensland to enable a proper evaluation of their effectiveness.

As an example of the difficulties in obtaining relevant information, the Minister for Health reported in the Queensland Parliament on 10 July 2012 that it had taken:

> *"… the best part of three months to get a substantive consolidated list of the organisations that were receiving grants through Queensland Health."* [7]

The 2007 Auditor-General report found there were inconsistencies in the degree of historical and proposed funding-related information available through departmental websites and annual reports.[8]

In order to engage more fully with the community and business in securing the best outcome for government grant monies, it is essential that Government and the community have access to relevant, up to date and consistent grant information. Without such information, there can be considerable confusion in the community about government grant programs, for example, as to the type of grants available, the purpose of the grants and the process to apply for grants.

In this regard, the Queensland Auditor-General (2007) reported that:

> *"Open and transparent reporting, which appropriately balances the right to privacy for individuals and right of the public to be informed, enhances government and NGO accountability Publication of existing funding availability and information of upcoming government programs can also aid NGOs in their long term planning for community service delivery."* [9]

Without a structured and reliable reporting framework for grants, the Government is not in a position to properly evaluate the effectiveness of grant programs, or to make informed decisions about the establishment of new grant programs, and/or the discontinuation of existing programs.

The publication of detailed grants data would have the additional benefit of increasing public scrutiny of grants and result in a higher level of accountability for government expenditure on grant programs.

C4.5 GRANT SYSTEMS

A number of different grant systems are used across the Government to manage and track grant programs. These vary from fully electronic systems that allow for online lodgement to manual entry Excel spreadsheets. This disparity of systems and the lack of controls around reporting have hindered a whole-of-government analysis of grant programs.

In total, agencies reported 28 broad categories of systems used to track grant funding and manage grant programs across the Government. The most commonly used tool is an SAP payments system. However, these systems are predominantly used for payment of grants only, with the general administration of the programs occurring through manual entry spreadsheets or custom built databases.

There is some crossover of systems among agencies, but only to the extent they were previously part of the same agency. For example, the departments created out of the former Department of Employment, Economic Development and Industry (DEEDI) still use the DEEDI Grants Management System with some shared resources for system maintenance and administration.

The current Queensland grant portal[10] provides organisations and members of the public with the opportunity to search for grant programs through a number of different channels. The portal provides information on the grants available, including the value, the eligibility criteria and some information on the purpose of the grant program. However, there is no facility to lodge an application online or even download an application form. Additionally, the information available in the portal is incomplete and outdated, for example, not all government grants are covered.

The incorporation of facilities for online lodgement, or the ability to access all relevant information, including the ability to download application forms, could provide an improved portal that would allow greater ease of access to programs for applicants and reduce the administrative burden for both Government and applicant.

Only a very small number of grant programs reviewed allow for online lodgement of applications and no programs allow the applicant to track the status of their application electronically. Providing applicants with the capacity to track their application through all stages of the process would provide administrative efficiencies and free up resources to focus on service delivery.

The online grant system used by the United States Government (www.grants.gov) provides a single source of information on federal grant funding opportunities. The portal, managed by the US Department of Health and Human Services, allows applicants to find grant opportunities, register and apply for grants and track the status of their application through all stages of the process. Grants.gov is a central storehouse for information on over 1,000 grant programs and provides access to approximately $500 billion in annual awards.[11]

Specifically, a whole-of-government online portal would provide information about the grants available, the ability to lodge and track the status of the application online and the ability to report against milestones under the funding agreement.[12] These facilities are already available in a number of Australian Government agencies. Ideally, such a system would reduce the administrative burden on both the applicant and the agency assessing the grant application, freeing up resources from administration and assessment to service delivery.

The *Review of the Australian Government's Use of Information and Communication Technology* (2008) also noted an overwhelming majority of grant management systems were paper-based, Excel or custom-developed and used for discrete, stand-alone programs.[13] Improvements in grant administration systems are desirable to reduce costs and achieve greater efficiency for both grant recipients as well as for government.

There are several specialist grants administration systems available in the Queensland Government, as follows:

- The Office of State Revenue Grantor Management System was developed initially to administer the former fuel subsidy scheme, and is now used for a wide range of grants using the best practice grant system. The OSR Grantor Management System administers community grants through the Office of Liquor and Gaming and has developed a grants solution, QGrants, for DNPRSR and DETE.

  QGrants allows for the online lodgement of applications and the ability for applicants to view their application status online. As OSR will only pay recipients electronically, applicants are able to manage their bank account and other personal details through a single portal.

- The Queensland Reconstruction Authority uses its own system to administer grant programs for individuals and organisations as part of its reconstruction task.

- The Queensland Rural Adjustment Authority is in the process of sourcing a new loan and grant system.

Arising out of the recommendations of the Western Australian Economic Audit Committee, a Funding and Contracting Services unit (FaCS) has been established in the Western Australian Department of Finance. It is a specialist unit whose role is to provide support for line agencies dealing with the not-for-profit and community sectors in implementing the *Delivering Community Services in Partnership* policy.

FaCS is not a central agency for grant funding and delivery. Rather, its role is to provide support to agencies in their procurement and contracting functions, and to consolidate compliance reporting by grant recipients to reduce their reporting burden. There would be merit in considering the establishment of a specialist unit similar to FaCS within QTT.

Given the high variability between agencies in the cost of administering programs, this function should be managed by specialist grant administration systems based on best practice, to minimise the administrative and overhead costs involved.

Recommendation

57 The administration of grant programs be managed by specialist grant administration systems based on best practice, to minimise the administrative and overhead costs involved.

ENDNOTES

1 Queensland Treasury and Trade, *2011-12 Report on State Finances of the Queensland Government*, 2012, accessed from www.treasury.qld.gov.au

2 Queensland Treasury and Trade, *Financial Accountability Handbook*, *Volume 6: Grant Management*, 2012, accessed from www.treasury.qld.gov.au

3 Information provided by the Department of Education, Training and Employment

4 Queensland Treasury and Trade, unpublished

5 P Grant, *Strategic Review of the Administration of Australian Government Grant Programs*, Department of Finance and Deregulation, 2008, accessed from www.finance.gov.au

6 Economic Audit Committee, *Putting the Public First: Partnering with the Community and Business to Deliver Outcomes, Final Report*, 2009, accessed from www.dpc.wa.gov.au

7 *Parliamentary Record of Proceedings*, 10 July 2012, accessed from www.parliament.qld.gov.au

8 Queensland Audit Office, *Report to Parliament No. 2 for 2007; Results of Performance Management Systems Audit of Management of Funding to Non-Government Organisations*, 2007, accessed from www.parliament.qld.gov.au

9 Queensland Audit Office, *Report to Parliament No. 2 for 2007; Results of Performance Management Systems Audit of Management of Funding to Non-Government Organisations*

10 See www.qld.gov.au/services/grants

11 See www.grants.gov

12 P Grant, *Strategic Review of the Administration of Australian Government Grant Programs*

13 P Gershon, *Review of the Australian Government's Use of Information and Communication Technology*, Department of Finance and Deregulation, 2008, accessed from www.finance.gov.au

C5 LONG-TERM SYSTEMIC REFORM

KEY ISSUES

- In this Report, the Commission makes a large number of recommendations for long-term systemic reform in areas including public utilities, the delivery of government services, the public sector and the operation of Government.
- A whole-of-government framework focussed on promoting efficiency and productivity is required to drive long-term reforms to benefit the economy. Key elements of such a framework include: service delivery evaluation, monopoly prices oversight; access regulation, competitive neutrality, regulation review, business case evaluation, financial and performance audit and policy review.
- Queensland has most of these key elements. However, there is scope to strengthen the State's economic performance with independent advice on measures to improve service delivery, evaluate policy options and enhance productivity.
- The Government is undertaking a range of measures to address regulatory reform. There is scope for further action to reduce the regulatory burden on industry by streamlining major government approval processes.
- Direct and indirect government assistance to industry has a significant effect on the structure of the economy and the incentives to invest. The role of the Government in assisting industry and facilitating industrial development needs to be clearly stated, consistently applied and directed towards productivity improvements which benefit the whole economy.
- Queensland's future economic growth and fiscal sustainability are likely to be constrained unless there are longer term changes to federal financial relations. In the meantime, the Queensland Government should work for greater clarity and accountability in the respective roles of the states and the Australian Government, to avoid additional costs to the community in terms of overlap, duplication, cost-shifting and confusion over responsibility for outcomes.

The Commission's Terms of Reference refers to "*long term systemic reform to grow and strengthen the Queensland economy".* In this Report, the Commission makes a number of recommendations directed to long-term systemic reform in areas including public utilities, the delivery of government services, the public sector and the operation of Government.

This Section addresses further broader reform issues to strengthen the economic and financial management of the State. Apart from the general service delivery functions of government, there is a need for the Government to adopt policies which minimise the regulatory burden on industry and promote economic development of the State.

There must be an effective institutional framework to prevent poor productivity practices inhibiting the efficient delivery of services and constraining future economic growth. This includes informed and independent scrutiny of the uses to which public resources are being put, to ensure value for money is achieved.

C5.1 AN EFFICIENCY AND PRODUCTIVITY FRAMEWORK

C5.1.1 Principles

There are a number of fundamental principles which underpin a robust and effective framework to promote efficiency and productivity.

First, the organisations or institutions charged with responsibility to scrutinise conduct with a view to promoting productivity must be independent of the day-to-day administrative operations of government. This allows them, if need be, to highlight government policy failings. This independence in turn improves the effectiveness of the organisation's work.

Second, the work of these organisations should be made public. Transparency underlines the independence of these organisations. Exposing their work to public scrutiny improves the quality of the work by allowing interested parties, particularly those with specialist knowledge, to critically assess the work. This encourages the organisations to put rigour into their analysis.

Third, it is important that these organisations have clarity as to their specific roles, functions and responsibilities.

Finally, the staff of the organisations should have the appropriate resources and mix of specialist skills and expertise to enable them to carry out their responsibilities.

In its analysis below, the Commission applies these principles in considering the appropriate range and functions of organisations for the productivity and efficiency framework in Queensland.

C5.1.2 Elements of a framework

A comprehensive framework to promote competition, productivity and efficiency has a number of interdependent elements. While individual elements of the framework may be effective in the absence of other elements, all are important in contributing to improved economic performance. The major elements are as follows:

- **service delivery evaluation** – As discussed in Section C3 of this Report, there is a need for regular reviews of departmental activities to ensure that services are being provided efficiently and effectively on a value for money basis. This should encompass broad-based investigation of opportunities to streamline service delivery or alternative service delivery models.

- **monopoly prices oversight** – Monopolies in both the public and private sectors have market power. Without oversight, they have the capacity to increase prices and reduce services compared with those available under competitive market conditions. Monopoly prices oversight is intended to ensure monopolies do not abuse their market power in this way.

- **access regulation** – Essential infrastructure often has the characteristics of a natural monopoly, in that it is too expensive or not feasible to duplicate existing infrastructure. Regulation is required to ensure assets with these characteristics are accessible to all potential users.

- **competitive neutrality** – Significant government business activities which compete with the private sector can have an advantage because the owner can provide selective assistance through underpricing some inputs or by policy actions or regulatory decisions. Competitive neutrality regulation is required to ensure this does not occur.

- **regulation review** – Governments regulate to achieve better social or economic outcomes. Regulation has costs as well as benefits and these costs and benefits require:

  "*analyses that consider the welfare impacts of regulation taking into account economic, social and environmental impacts including the distributional effects over time, identifying who is likely to benefit and who is likely to bear costs".*[1]

- **business case evaluation** – The principles of sound business case evaluation are well understood and all jurisdictions have relevant guidelines and standards for this purpose. Business cases for significant projects are complex and require assessment of options across a large number of interrelated financial, economic, social, environmental and engineering factors. Given this complexity and the significant investments of capital involved for large projects, it is important that there is a capacity for independent scrutiny of business cases for major projects to ensure they comply with the principles of sound business case preparation.

- **financial audit** – These are required to check account keeping methods to ensure they meet prescribed requirements to properly inform the owners and the public, and to prevent fraud or misappropriation of funds.

- **performance audit** – The purpose of performance audits is to assess the performance of public sector entities, and how effectively, efficiently and economically their objectives are being met, within the policy parameters of the government.

- **policy review** – Policy review has a wider perspective than performance audits, as it entails research, analysis and advice on economic, social, environmental and other issues affecting the welfare of citizens. The objective is to assist governments to make better policies in the long-term interest of the community – by focussing on ways of achieving a more productive economy, and hence improving living standards.

C5.1.3 The present framework in Queensland

The present framework of economic regulation in Queensland comprises different organisations which carry out many of the functions described above.

The Public Service Commission (PSC)

The Public Service Commission provides advice to the Premier and Government on the administration of the Queensland Public Service and the management and employment of public service employees.

It also ensures that the public service has the human resource and organisational capacity to deliver on government outcomes. By working collaboratively with all agencies, the PSC aims to ensure that the Government's workforce is effective in supporting government priorities.

The PSC has had the legislative power to conduct reviews of the effectiveness and efficiency of public service agencies since the amalgamation of the Service Delivery and Performance Commission (SDPC) with the Office of the Public Service Commission (OPSC) in 2008. However, no reviews under these legislative provisions have been undertaken in this time.

Public Sector Renewal Board

The Public Sector Renewal Board (PSBR) comprises board members both from within and external to the public service. It is supported by the Office of Public Sector Renewal (OPSR), which forms part of the PSC. The PSBR will operate until 2014, and provides strategic advice and direction on the functions of departments, and their efficiency and effectiveness in undertaking those functions.

Steering Committee for the Review of Government Service Provision

The Steering Committee for the Review of Government Service Provision (the Steering Committee) was established by the Council of Australian Governments (COAG) and comprises representatives of the Australian and state governments. While it is not a Queensland-specific entity, there are Queensland representatives on the Steering Committee.

The Steering Committee informs Australians about services provided by governments and enables performance comparisons and benchmarking between jurisdictions and within a jurisdiction over time. The Steering Committee and its working groups are supported by a Secretariat located within the Productivity Commission as a neutral body that does not represent any jurisdiction.

Among other things, the Steering Committee:

- measures and publishes annually data on the equity, efficiency and cost effectiveness of government services through the Report on Government Services (RoGS)
- initiates research and reports annually on improvements and innovation in service provision, having regard to the COAG Reform Council's task of highlighting examples of good practice and performance
- perform any other related tasks referred to it by COAG.

Much of the comparative analysis of state service delivery performance presented in Part D of this Report is based on information produced by the Steering Committee in its annual RoGS publication.

Queensland Competition Authority

The Queensland Competition Authority (QCA) is an independent statutory authority consisting of members appointed by the Governor in Council. Its role is to facilitate compliance within Queensland with the principles of National Competition Policy.

The QCA's primary responsibilities relate to competition issues such as monopoly prices oversight, third-party access (see Section B8 of this Report) and other competition issues such as competitive neutrality complaints. In addition, it has a variety of other responsibilities related to the implementation of competition reform. Under section 10(e) of the *Queensland Competition Authority Act 1997*, the QCA can be directed by the Premier and the Treasurer to examine and report to them on any matter relevant to the implementation of competition policy.

In 2012, the Office of Best Practice Regulation (OBPR) was established as a separate unit within the QCA. The OBPR has a key role in reducing unnecessary regulation within government. Key functions of the QBPR are:

- assessing the adequacy of proposed regulations using the Regulatory Impact Statement (RIS) System
- communicating with government agencies and providing advice on how to ensure that regulatory approaches minimise the burden of regulation
- undertaking reviews of policies and regulations that create a burden for business, government and the community.

The OBPR was charged with providing a final report to the Government by end of February 2013 on a framework for reducing the burden of regulation.

Projects Queensland

Projects Queensland, which forms part of Queensland Treasury and Trade (QTT), was established to deliver positive infrastructure outcomes by driving cooperative funding models that encourage private investment, while promoting and protecting the State's interests.

Among other responsibilities, Projects Queensland:

- prepares business cases and manages tender processes and contract negotiations for all traditional government financed infrastructure where the expected capital cost is greater than $100 million (or other projects identified as very high risk)
- for traditional government financed projects with an estimated cost below $100 million, assists line agencies in project assessment, tendering and contract negotiations, and other advisory and review services
- reviews and maintains the Government's key infrastructure policies (currently the Project Assurance Framework and the Value for Money Framework). [2]

Queensland Audit Office

The Queensland Audit Office (QAO) supports the Auditor-General, who is an independent Officer of Parliament, appointed for a seven year term, pursuant to *The Auditor-General Act 2009.* The QAO conducts:

- Financial audits, which provide independent assurance to Parliament and the community that the information contained in the financial statements of public sector entities is presented fairly in accordance with Australian Accounting Standards and applicable legislation.

- Performance audits, which extend beyond the examination of the financial affairs and transactions of a government agency, to encompass wider management issues of significance to the community. This includes evaluating whether an entity, program or activity is achieving its objectives effectively, and doing so economically and efficiently, and in compliance with all relevant legislation. It does not encompass an evaluation of the merits of the Government's policy objectives.

Table C5.1 summarises the key elements of the productivity and efficiency framework in Queensland and other major jurisdictions in Australia. It highlights that Queensland has most of the key elements of a comprehensive productivity and efficiency framework. However, there are several significant points, as follows:

- The role of the PSRB in service delivery evaluation in Queensland is not independent, as it forms part of the administrative arm of Government. In addition, the role of the PSRB is scheduled to be completed in 2014, so there is currently no ongoing role envisaged for this body.

- As already noted, the PSC has the authority to perform a service delivery evaluation function, but has not yet exercised this authority. This role previously rested with the SDPC, which was disbanded in 2008, and absorbed into the PSC.

- Service delivery evaluation is undertaken only on a partial basis in other jurisdictions. In each jurisdiction, the relevant body offers business improvement services, rather than independent, transparent and ongoing evaluation of service delivery objectives, outcomes and performance.

- Projects Queensland evaluates business cases prepared by other agencies. However, there is no independent scrutiny of business cases prepared by Projects Queensland. Infrastructure Australia evaluates business cases prepared by state governments.

- The policy review function forms an important component of the productivity and efficiency framework at the national level, through the work of the Productivity Commission, and in New South Wales and Victoria, through the Independent Pricing and Regulatory Tribunal (IPART) and the Victorian Competition and Efficiency Commission (VCEC) respectively. This function currently is not undertaken in Queensland.

Table C5.1
An efficiency and productivity framework – comparison of major jurisdictions[1]

	Queensland	New South Wales	Victoria	Australia
Service delivery evaluation	Public Service Commission; Public Sector Renewal Board	Public Service Commission	State Services Authority	
Monopoly prices oversight	Queensland Competition Authority	Independent Pricing and Regulatory Tribunal	Essential Services Commission	Australian Competition and Consumer Commission
Access regulation				
Competitive neutrality			Victorian Competition and Efficiency Commission	
Regulation review				Department of Finance and Deregulation
Business case evaluation	Projects Queensland	The Treasury	Department of Treasury and Finance	Infrastructure Australia
Financial audit	Queensland Audit Office	Audit Office of New South Wales	Victorian Auditor General's Office	Australian National Audit Office
Performance audit				
Policy review		Independent Pricing and Regulatory Tribunal	Victorian Competition and Efficiency Commission	Productivity Commission

Notes:

1 The Commission has not used international models for this analysis, because the different legal, economic and cultural frameworks in other countries reduces the utility of the nomenclature adopted for this Report. However, international experience and practice, as referenced in the text of this Report, has been used to analyse the costs and benefits of approaches to government activities, service provision and regulation.

Source: Commission of Audit

C5.2 A QUEENSLAND PRODUCTIVITY COMMISSION

Table C5.1 shows how different jurisdictions have created different organisations to handle competition, efficiency and productivity issues.

Each of these organisations has its own defined role or legislated responsibility. In relation to Queensland, the Commission has sought to identify gaps in coverage in the present framework with a view to strengthening the focus on productivity and efficiency.

In the Commission's view, the gaps in the framework that need to be addressed are the independent review of:

- service delivery
- business cases for major projects
- policy, productivity and performance.

The options available to perform these functions are:

- increase the scope and role of existing organisations, in particular the PSC and/or the QCA

- establish a separate new organisation, with a clear separation of responsibilities between that organisation and existing organisations.

As part of the administrative arm of Government, the PSC would not be in a position to perform an independent scrutiny or review role. Such a role could be undertaken by the QCA, but this would involve a significant change in organisational focus, with few demonstrable synergies.

The functions of the QCA recently have been expanded to include the OBPR, although it is not clear that the review of government regulations is necessarily a 'good fit' with the role of the QCA as competition regulator. Further expansion of the role of the QCA to encompass the functions outlined above would involve a further change in focus, which could detract from the achievement of competition objectives.

On balance, the Commission considers that a new organisation would be best placed to undertake an independent review role in relation to the functions outlined above. The Commission therefore proposes the establishment of a separate independent statutory authority, the Queensland Productivity Commission (QPC).

An independent review of policy, productivity and performance especially would be a new function in the Queensland Government (although a somewhat similar function was performed by the SDPC for a short period). A dedicated body would ensure a strong focus on productivity issues. A significant improvement in productivity is fundamental to the achievement of high economic growth in Queensland in the future.

The Commission considers that the PSRB could be absorbed into the proposed new QPC. This would extend the service delivery review function beyond the current limited life of the PSRB. In addition, the Commission considers that the OBPR should be transferred to the new QPC, as its government regulation review function is more closely aligned with productivity improvement than the QCA's role in promoting competitive markets.

The integration of the PSRB and the OBPR into the QPC would establish an initial critical mass of resources without the need for any substantial new resources to support its activities in the short term.

The establishment of a QPC would ensure a separate and distinct independent focus on improving productivity in Queensland, which is a major long-term challenge, as outlined in Section A1 of this Report. This would complement the role of the QCA, but would ensure a clear separation in much the same manner as at the national level, with the separate roles of the Productivity Commission and the Australian Competition and Consumer Commission.

C5.2.1 Functions

The core functions envisaged for the QPC are outlined below.

Service delivery evaluation

Evaluations of service delivery can be undertaken by agencies themselves, or by central agencies, such as DPC, QTT and the PSC.

While internal reviews can be valuable, they can be limited in scope, as they are not conducted on an independent arm's length basis. Service delivery evaluation is a function which would be better performed by the QPC. The role of the PSC in providing business support and assistance to agencies could be continued, given it is closely linked to the PSC's core business of workforce management.

In addition, the current role of the PSRB is limited, both in terms of its lifespan and its degree of independence. An expanded role could be performed by the QPC, including the absorption of the current resources of the PSRB and the OPSR. As part of this, independent members of the PSRB could be considered for roles as Commissioners for the QPC.

Aspects of the service delivery review role were addressed in more detail in Section C3 of this Report.

Business case evaluation

Business case evaluation is the responsibility of Projects Queensland, which has the expertise and knowledge to carry out this task. However, as the body responsible for developing and implementing business cases for significant projects, Projects Queensland will have a conflict of interest in evaluating whether these business cases were developed according to best practice principles.

The Commission notes the need for independent oversight in this area, a matter recently raised in the Victorian Auditor General's report of 2012, which found, among other things:

> "*While [Major Projects Victoria] has established a generally sound project management framework, there remain gaps that have not been addressed for four years. Ineffective oversight and quality assurance processes mean that the framework and better practice are not routinely applied, resulting in poor project planning that could ultimately lead to poor project outcomes and increased costs.*"[3]

To ensure this independent oversight, while avoiding potential overlap of roles with Projects Queensland, the Commission suggests that the QPC should perform an 'audit' function in relation to business case evaluation.

The respective roles would be as follows:

- Projects Queensland would:
  - retain responsibility for preparing guidelines and other supporting material for the best practice preparation of business cases
  - evaluate business cases prepared by other agencies according to those guidelines
  - prepare business cases for significant projects
- QPC would evaluate the preparation of significant business cases by Projects Queensland, against its guidelines. QPC would report its assessment to the Government, which would decide what action, if any, is required with regard to the business case.

To limit the workload in this function, the Commission suggests that the QPC should undertake audits of business cases for all infrastructure projects with a capital cost in excess of $500 million, and other strategic infrastructure projects, as appropriate.

Policy, productivity and performance review

Independent review of policy, productivity and performance is an important feature in ensuring government activities contribute to improved productivity and efficiency. For example, as noted in Section C5.4 of this Report, government industry assistance policies should be directed more clearly towards improving productivity and efficiency across the economy.

This function would complement the function of service delivery evaluation, especially in canvassing innovative new forms of service delivery, and developing alternative options for achieving government policy objectives. This could cover matters such as innovation, research and development, and infrastructure delivery.

Regulation review

OBPR was established in 2012 as a separate unit within the QCA with responsibility for regulation review. This ensures independence of the function, which previously was undertaken internally within QTT. However, it involves a significant shift in the responsibilities of the QCA, and it is not clear that there are close synergies with existing staff skills and expertise.

As regulation review is more closely related to productivity issues rather than competition regulation, the Commission considers that the OPBR should be absorbed into the QPC.

Allocation of functions

There is a substantive role for the QPC in undertaking the above functions, and thereby enhancing the productivity and efficiency framework in Queensland. In order to avoid duplication and to ensure clarity of purpose within this framework, it is important to confirm the continued roles and responsibilities of existing organisations, in addition to those envisaged for the QPC.

Table C5.2 summarises the proposed allocation of functions for relevant organisations.

Table C5.2
Proposed allocation of functions: Queensland productivity and efficiency framework

Public Service Commission	Queensland Competition Authority	Projects Queensland	Queensland Audit Office	Productivity Commission[1]
• business improvement service to agencies	• monopoly prices oversight • access regulation • competitive neutrality	• business case evaluation	• financial audit • performance audit	• service delivery evaluation • business case audit • regulation review • policy, productivity and performance review

1 Proposed role

Source: Commission of Audit

C5.2.2 Governance

The establishment of strong and effective governance arrangements is vital to the ability of the QPC to perform its role. As noted by the former Chairman of the Productivity Commission, it is important that such a Commission be:

- independent, so as to be objective and to exercise judgement based on facts and analysis

- seen to be independent, to allow the Commission to serve the role of enhancing public understanding and trust in the policy-making process.[4]

To achieve these objectives, a number of considerations are important.

Establishment

The Commission proposes that the QPC be established by separate legislation, similar to that of the Australian Government's Productivity Commission. This would ensure clarity of purpose and role. It would also ensure greater independence for the QPC, as Government would need to explain to the Parliament the rationale for any changes to its role.

Other options for establishing the QPC, which are not favoured, include:

- An administrative arrangement, such as establishing the QPC as an office in an existing department. This would not provide the necessary independence from Government.

- A regulation under an existing Act of Parliament (for example, the Victorian Competition and Efficiency Commission was established by an Order in Council pursuant to the *State Owned Enterprises Act 1992*).

A regulation would have the benefit of simplicity, in that it could state succinctly the role, powers and functions of the QPC and, to the extent those features changed, the regulation could change with it. However, this flexibility might be seen to reduce the independence of the QPC. For example, this would mean that the role of the QPC could be changed by Government, without any public consultation or need to justify that decision.

In view of the nature of its functions, the Commission proposes that the QPC should report to the Treasurer, and be funded by an appropriation from the Consolidated Fund.

Commissioners

Persons appointed as Commissioners of the QPC would need to be independent of Government and clear of any real or perceived conflicts of interest. At the same time, Commissioners would need to have the requisite skills and experience to fulfil their role.

To be independent from Government, statutory office holders should hold their positions in a way the government of the day cannot arbitrarily remove them, short of proven inability to fulfil their role. A common means of achieving this is to appoint office holders for a period longer than the electoral cycle, with grounds for removal limited to serious misbehaviour. The appointment of Commissioners for a significant time period would build continuity in the QPC and would lead to greater consistency in its work. The Commission consider that five years would be an appropriate period of time for appointments.

The means of selection of Commissioners is also an important consideration in maintaining its independence. It is important that Commissioners be seen to be competent to fulfil their role. The (Australian) Productivity Commission Act requires the Governor General to be satisfied the prospective Commissioner has *"… qualifications and experience relevant to the Commission's functions".*[5] A similar provision should apply in respect of legislation to establish the QPC.

The work arrangements of Commissioners also are important. Full-time Commissioners would be able to carry a larger workload (therefore requiring fewer Commissioners for a given workload) and less likely to incur conflicts of interest. On the other hand, part-time Commissioners might have specialist skills or knowledge and would allow a larger pool of available talent for the role. It is likely a mix of full and part-time Commissioners would be appropriate, with that mix possibly changing over time.

Commission staff

The Commission proposes that the QPC would be supported by a small secretariat, initially comprised of officers who would be transferred with the OPSR and the OBPR. In the same way as Commissioners, staff of the QPC would need to be independent of Government to properly perform their roles. For staff, this means remuneration and career progression should be independent of standard public service conditions.

Staff would need to have a range of skills relevant to the functions proposed for the QPC. For example, policy reviews would be undertaken predominantly by economists and policy analysts, while base budget reviews and business case audits would be undertaken by finance professionals. This range of functions within a small organisation will have implications for achieving a 'critical mass' in various skill sets, allowing for rigorous internal debate, and career paths for staff.

There is therefore a tension between achieving sufficient independence for staff and having the scale and internal dynamism within various skill sets. This might be addressed by employing senior staff permanently at the QPC, with more junior staff provided through secondment by government agencies.

Commission's work program

The QPC's primary role is to be an adviser to Government, not to be part of the administration of Government. This requires independence from Government. However, at the same time, the QPC needs to be relevant and useful, so that its advice assists Government to achieve its policy objectives. That is, unlike the QAO, the role of the QPC is not to assess the compliance of government agencies with statutory requirements or the effectiveness and efficiency of how they carry out those requirements.

The work program of the QPC therefore should be approved by the Government.

Public service delivery and regulation reviews are predictable and would benefit from an orderly and systematic approach. For these reviews, the QPC should prepare an annual work program for approval by the Treasurer.

Audits of business cases prepared by Projects Queensland are less predictable. The QPC should liaise with Projects Queensland about the likely timing of completion of business cases, in order to respond in a timely and informed manner when a business case is submitted for audit. Adequate time for QPC review should form part of the project plan of relevant business cases.

Policy inquiries, regulation reviews and other reviews are not predictable, but depend on the issues upon which the Government may seek advice. The QPC would not initiate such reviews. Rather, the Treasurer would seek advice by means of written terms of reference. Those terms of reference would include any limitations on the scope of the inquiry, in terms of content or process, as well as nominating a time frame for completion.

In addition to workload planning, the QPC should seek to inform itself of issues that may require its attention, at the request of the Government. This would require a forward looking research agenda and work program. However, research undertaken by the QPC for this purpose would need to take account of other priorities in its work program.

Recommendation

58 A Queensland Productivity Commission be established as a separate, independent body to advise the Government on measures to improve productivity and efficiency within the economy, with arrangements as follows:

Functions

- ***absorb the role of the Public Sector Renewal Board***
- ***absorb the role of the Office of Best Practice Regulation***
- ***undertake regular reviews of the base budgets of departments, and other reviews of service delivery issues***
- ***undertake audits of business cases for all infrastructure projects with a capital cost in excess of $500 million and other strategic infrastructure projects as appropriate***
- ***as requested by the Treasurer, undertake other reviews and report on measures to improve productivity and efficiency across Queensland.***

Governance

- ***the Commission to comprise Commissioners, appointed for a period of five years, with grounds for removal limited to serious misbehaviour***
- ***the Commission to report to the Treasurer***
- ***funding to be provided through an appropriation from the Consolidated Fund***
- ***the Commission to be supported by a small secretariat comprising officers employed under arrangements independent of the public service.***

C5.3 REGULATION

The Government regulates economic activities, to provide a stable legal and institutional framework in which private enterprise operates. Regulation reform has been an integral feature of economic and competition policy reforms since the 1990s. Ongoing issues in regulation reform are:

- the importance of efficient regulation to productivity and economic development
- the ongoing need to monitor and evaluate regulation.

C5.3.1 Current regulation reforms

The Queensland Government has introduced a range of reforms and red tape reduction initiatives, with the objective of reducing red tape and regulation by 20% by 2018. Key elements of the Government's red tape reduction regime include:

- appointment of an Assistant Minister to the Treasurer and Minister for Trade, with a specific portfolio responsibility for Regulatory Reform
- establishment of the Office of Best Practice Regulation (OBPR) to:
  - review and publicly report on regulatory impact statements submitted by departments for new primary and subordinate legislation
  - publish an annual report of departmental performance against regulatory burden benchmarks
  - establish a process to review the existing stock of Queensland regulations
  - undertake in-depth reviews, principles-based reviews and benchmarking exercises
- improvements to the Regulatory Impact Statement (RIS) system
- 90 Day Red Tape Reduction initiative
- Six Month Action Plan (including specific red tape-related reforms)
- 3 for 1 Regulatory Offset Requirement for regulation impacting on small business
- Queensland's participation (where appropriate) in COAG and inter-jurisdictional reforms
- agencies' ongoing focus on identifying and implementing red tape reduction
- ongoing regulatory policy development aimed at increasing Queensland's competitiveness and productivity by reducing the compliance requirements placed on individuals, business, communities and Government.

The OBPR released an interim report to Government in November 2012, with a final report due in February 2013. The reports cover a range of issues, including assessing the total cost of regulation, a process for reviewing the existing stock of legislation and identifying priority areas for targeted regulatory review.

C5.3.2 Government approval processes

The Commission notes the progress in regulation reform through the measures already initiated by the Government, and the further work being undertaken through the OBPR review. Given this activity, the Commission has not sought to duplicate work in this area.

There are other ways that reducing regulation would assist business growth. One concrete and practical way would be to reduce the time taken in dealing with government, as this imposes significant costs for both industry and government. Across a broad range of government activities, there is scope to shorten timeframes and reduce uncertainty for business, for example, by streamlining approval processes. This is particularly the case for major government approval processes, such as development approvals and Environmental Impact Statements (EISs).

Planning and development approvals

Both state and local governments have a significant effect on economic activity in the property and construction sector, through planning and development approval processes. This guides the future allocation and development of land, with implications for future infrastructure requirements, as well as residential, commercial and industrial construction activity. Planning policies are a key factor in future growth, development and economic prosperity.

It is important, therefore, that the planning regulations of state and local governments encourage innovative solutions to facilitate development, without adding unnecessary costs to development. The Productivity Commission noted that*:*

> *"Over the last 20 years, the number of objectives within the planning system, and thus its complexity, has been continually expanding."*[6]

The Productivity Commission noted that COAG in 2009 added a wide-ranging set of national objectives to existing state and local government objectives. This expanding, and potentially contradictory, list of planning objectives has contributed to additional costs and delays for business in planning approval processes.

The Government has implemented a planning reform program to address industry and community concerns about Queensland's planning system. In November 2012, the Queensland Parliament passed the *Sustainable Planning and Other Legislation Amendment Act* to improve, streamline and simplify Queensland's existing planning and development system by:

- establishing a sole state assessment and referral agency
- removing the structure planning and master planning provisions

- removing the second state interest review on planning scheme reviews, which saves an additional 25 business days from planning approval timeframes

- allowing applicants to apply for a state resource allocation or entitlement concurrent with the assessment process

- allowing minor disputes to be resolved in the Planning and Environment Court.

Additional red tape reduction is being pursued through the ongoing referral reduction program to remove unnecessary referral triggers under the *Sustainable Planning Act 2009* (SPA). This program is aimed at reducing both the number of referral triggers and the number of development applications required to be referred.

The Commission supports other reforms identified by the Department of State Development, Infrastructure and Planning (DSDIP) to reduce timeframes for development planning approval processes, including removal of the unnecessary 10 business day acknowledgement notice step. The extent of regulation could also be reduced by removing unnecessary layers of planning instruments provided for in the SPA.

Timeframes for decision making on the development application process

The Integrated Planning Act 1997 established Queensland's Integrated Development Assessment System (IDAS). Under the legislation, exempt or self-assessment developments do not require a development permit.

The SPA requires the Assessment Manager to assess and decide applications within specified, or statutory, timeframes. Furthermore, each stage of the IDAS has a defined maximum timeframe. However, IDAS provides scope for the Assessment Manager to declare an extension to a staged timeframe, although these extensions are usually limited to doubling the standard timeframe for that component. Further extensions on the decision stage timeframe are possible only by agreement between the applicant and the Assessment Manager.

Table C5.3 shows the maximum specified statutory timeframes for different types of development applications and which party – applicants, councils, or State Government departments – controls the timeframe.

Table C5.3
Development assessment timeframes

Application type	Timeframe determined by	Number of business days
Issue acknowledgement notice after lodgement	Council	10 business days
Applicant refers the application to state referral agencies	Applicant	20 business days[1]
Information request sent to applicant	Referral agencies Council	10 business days, plus 10 business days
Referral agency responds	Referral agencies	20 business days
Applicant responds to the information request	Applicant	Up to six months
Publicly notifying the application (if required by the council's town plan)	Applicant	15 business days, or 30 business days
Notice of compliance that public notification has been completed	Applicant	Once notification is completed
Decision on the application	Council	20 business days, plus 20 business days
Issuing decision notice	Council	Five business days from council's decision

1 Where referral agencies are identified in legislation

Source: Department of State Development, Infrastructure and Planning

If a council has not made a decision on a code assessable application by the due date, then under the SPA the council's right to decide the application is removed, and the application is automatically approved as a 'deemed approval'.

Transparency of performance for the development application process

A Development Assessment Monitoring Performance Program (DAMPP) began in 2009 as a collaborative pilot program involving councils and the State Government. There is no statutory requirement for councils to provide information on compliance with statutory timeframes, and the program works on a voluntary basis within the bounds of a Memorandum of Understanding between the State Government and the participating councils.

On face value, the latest DAMPP report suggests that there is broad compliance with the statutory timeframes for each stage of the development application process. However, property industry stakeholders have raised concerns about the reliability of the performance data presented in these reports. Particular areas of concern are as follows:

- Average timeframes are not necessarily a meaningful performance measure, for example, if a large number of minor applications are dealt with expeditiously but there are a small number of significant applications which experience delays.

- The application lodgement date is often not recorded in the dataset, meaning that total length of time for an application cannot be determined.

- Delays in approval processes may not be reflected in measures of compliance with statutory timeframes if the assessment manager does not immediately 'start the clock' on particular stages once material has been provided by the applicant.

The Commission considers that there would be merit in the publication of performance information on compliance with statutory timeframes and the total length of time taken to determine the outcomes of development applications. Public scrutiny of such information would ensure greater transparency and accountability for these timeframes, and would enable comparisons of performance between councils, which could provide an incentive for innovation and improved performance.

Environmental Impact Statements

Governments also have a significant influence on economic development through the assessment process for Environmental Impact Statements (EISs) for major projects. In Queensland, this process is managed through the Office of the Coordinator General (OCG). The Department of Environment and Heritage Protection (DEHP) also administers an EIS assessment process for certain mining and petroleum development proposals.

The government has recently amended the *State Development and Public Works Organisation Act 1971* to assist in further streamlining EIS approval processes. Reforms which are being implemented include:

- Tripartite Proponent Service Delivery Charters between the OCG, Australian Government Department of Sustainability, Environment, Water, Population and Communities and Proponents

- Timeframes for every stage of the EIS process

- The appointment of a designated Project Manager for each project

- Shortening timeframes by undertaking due diligence information checks within five business days at each stage of the process to ensure proponents are promptly advised about information gaps

- Imposing a strict timeframe of 30 business days for consultation comments

The Commission considers there is scope for further process improvements to shorten the timeframes for EIS decisions. The OCG and DEHP are collaborating on a revised standard terms of reference document that will remove the unnecessary prescriptive content. The OCG is also moving to performance-based and outcomes-focussed environmental requirements to reduce the need for prescriptive conditions and process-orientated conditions. An outcomes-focussed approach is more likely to provide proponents with the flexibility to look creatively at ways to achieve the outcome in the most cost-effective way.

Priority areas for further action

The Commission has formed the strategic view that there is further scope to streamline government approval processes to reduce costs for business and Government. This view has been informed by consultation with DSDIP (including the OCG) and industry stakeholders. High priority areas for further action include:

- shortening timeframes for planning process and approvals, including planning, zoning and development assessments
- shortening EIS timeframes for the activities of the OCG by implementing a risk based approach to the terms of reference to streamline the content of EIS to focus on critical matters
- a move to outcome-focussed conditions
- expanding the scope of compliance and code assessable development to allow assessment managers to focus their efforts on more complex development applications
- continuing to review referral triggers, with a view to reducing both the number of referral triggers and the number of development applications required to be referred, specifically in transport and environmental matters
- making more streamlined and transparent the process for business engagement in the decision and appeal stage of approval processes.

Recommendation

59 The regulatory burden on industry be reduced by significantly shortening timeframes for all major government approval processes (such as Environmental Impact Statement approvals and planning development approvals), without requiring additional government resourcing, including by:

- ***reducing the number of steps in the approval process***
- ***reducing maximum allowable times for particular steps in the process***
- ***streamlining consultation processes with government agencies and other stakeholders***
- ***standardising, codifying or otherwise simplifying approval requirements.***

Other aspects of regulation reform

Governance

Governments are ultimately responsible for regulatory policy and need to ensure there is effective leadership and oversight of the regulatory governance process. An independent body such as the OBPR has important functions, but needs to operate in an environment established and maintained by the Government.

The appointment of an Assistant Minister to the Treasurer and Minister for Trade, with a specific portfolio responsibility for regulatory reform, is an important indicator of the Government's intention to maintain appropriate oversight and control of the regulation reform agenda.

The role of business in reviewing the progress of regulation reform also is important. Many countries use panels or other representatives of business to seek feedback on progress in reducing the burden of regulation.[7]

The importance of engaging business in reviewing performance was recognised by the Victorian Competition and Efficiency Commission (VCEC) in a 2011 report to the Victorian Government.[8] The VCEC recommended responsible ministers seek feedback and input from parties affected by regulation in several stages of the regulatory process, including overall evaluation of the regulatory system.
It is important that there is active and ongoing engagement with business in reviewing the progress of regulatory reform in Queensland.

Exemptions from requirement to undertake a Regulatory Assessment Statement

There is a provision in the Regulatory Assessment Statement (RAS) System Guidelines, published on the QCA website, that the Treasurer may in restricted circumstances exempt a regulatory proposal with significant impacts from the requirement to prepare a RAS. This is subject to a requirement that regulations with such exemptions be subject to a post-implementation review, to be commenced within two years.

The responsible minister must seek an exemption in writing, stating the reason and argument for seeking the exemption. A completed Regulatory Principles Checklist (RPC) and Preliminary Impact Assessment (PIA) must be attached to the application. The grounds for exemption are restricted to cases where:

- an immediate regulatory response is required
- notice of the proposal may render the rule ineffective or unfairly advantage or disadvantage any person likely to be affected by the regulation.

The grounds and process under which the Treasurer may grant an exemption from undertaking a RAS are reasonable and are widely used in similar systems elsewhere in OECD countries.[9] However, there is scope for significant differences in interpretation of the grounds for exemption.

In its 2012 review of regulatory practices in Australia, the Productivity Commission noted the risk that lack of commitment to regulation review could undermine confidence in the regulation review process and compromise economic performance. Box C5.1 presents the detailed comments of the Productivity Commission on this matter.[10]

Box C5.1
Key conclusions of Productivity Commission review of Regulatory Impact Analysis

"*While RIA processes have brought some isolated but significant improvements from more thorough consideration of policy options and their impacts, the primary benefits of RIA have been forfeited through a lack of ministerial and agency commitment."*

"In all jurisdictions, greater attention to leading practices for monitoring, reporting and accountability would go a long way toward improving the efficacy and rigour of RIA processes. In particular:

- *transparency measures such as a draft regulation impact statement (RIS) for early consultation, and publishing all RISs and RIS adequacy assessments, would better inform stakeholders of regulatory impacts and motivate rigour in analysis*

- *requiring ministers to provide reasons to parliament for non-compliance with the RIA process and for the granting of exemptions, could encourage greater commitment to the RIA process and facilitate further discussion on the impacts of proposals*."

Source: Productivity Commission, Regulatory Impact Analysis: Benchmarking, Final Report, 2012

The effectiveness of the RAS framework could be compromised by the way in which the exemption provision is utilised. To ensure the transparency and accountability of the process, the Commission considers that the Treasurer's decision to exempt a regulation from the requirement to complete an RAS should be open to public scrutiny. As both of the two regulatory grounds for exemption are time sensitive, the completed RPC and PIA should be published immediately after the regulation is promulgated, together with the rationale for granting the exemption. This would provide full disclosure of all the relevant information used to support the Treasurer's decision.

Recommendation

60 Where the Treasurer decides to exempt a regulation from the requirement to prepare a Regulatory Assessment Statement, the Treasurer should immediately publish the rationale for granting the exemption, including all relevant information to support that decision.

C5.4 INDUSTRY ASSISTANCE

A major role of governments is to facilitate economic development. This is pursued through a range of broad policy measures, including industry assistance, or industry policy, which is defined as:

> *"… any act that, directly or indirectly: assists a person to carry on a business or activity; or confers a pecuniary benefit on, or results in a pecuniary benefit to, a person in respect of carrying on a business or activity".*[11]

Industry policy is intended to promote economic growth by assisting a targeted industry, or a targeted company, or assist in a targeted way.

The Queensland Government provides a wide range of policies and measures to support industry. There is no comprehensive record of all these measures, Box C5.2 provides examples of the following types of assistance:

- subsidies and bounties
- government purchasing preferences
- services provided free or at less than full cost
- revenues foregone
- underpricing of access to government-owned assets.

Box C5.2
Examples of Industry Assistance Measures
Queensland Government, 2012-13

Type of assistance	Department	Title	Purpose
Subsidies and bounties	Science, IT, Innovation and the Arts	i-lab (technology incubator)	Supports and assists entrepreneurs and early stage, high-tech companies through the first few years of development providing seed funding, team development and mentor networks for founders, creating investor ready companies.
		Proof of Concept Fund	Offers financial assistance to Queensland-based organisations that can demonstrate an innovation (technology, product or process) with the potential for commercial viability.
		Commercialisation Champions Fund	Provides financial incentives to Queensland-based organisations to engage specialists who have experience in commercialising research.
		Co-investment Fund	Provides extra financial support to Queenslanders who have (or need help to secure) funding approval from the Commonwealth Government or a philanthropic organisation for research work that will benefit Queensland.
		Screen Queensland	Provides initiatives for writers, producers and directors to create ideas that can be sold in the marketplace; also works to attract international productions to the State.
	Agriculture, Fisheries and Forestry	Investing in the Sugar Industries Future	Funding to the Bureau of Sugar Experiment Stations for sugar research development.
		Plantation Hardwood Research Fund	Established as a research and development initiative under the state-wide Forests Process to support the development of a viable plantation-based hardwood industry in Queensland.
	Tourism, Major Events, Small Business and the Commonwealth Games	Events Queensland	Aims to identify, attract and develop significant events that contribute to the Queensland economy and industries.
	Energy and Water Supply	Rural irrigation services	Supports the provision of rural irrigation services through CSO payments to SunWater Limited (SunWater) and Seqwater.
Government purchasing preferences	Science, IT, Innovation and the Arts	Creative Sparks	Supports creative projects that enrich Brisbane's communities and develop the professional practice of local artists and cultural workers.

Type of assistance	Department	Title	Purpose
Services, provided free or at less than full cost	Science, IT, Innovation and the Arts	ICT Career Graduate Development Program	Helps graduates begin their career in a growing industry, with an organisation that invests over $1 billion every year, to help improve the way government services are provided throughout Queensland. Includes training and development over a two year program.
	Tourism, Major Events, Small Business and the Commonwealth Games	Small business programs	Supports small business growth through the provision of services and information including Online Portals and Webinars. Facilitates business contact with Queensland Government services essential in starting and running a business, and information on how to improve efficiency and business resilience.
		Tourism Queensland	Facilitates the promotion, marketing and development of Queensland tourism. Aims to increase visitor expenditure, maximise market share and sustainable tourism growth and increase visitor dispersal.
	State Development, Infrastructure and Planning	Productivity improvement programs	Services delivered by performance improvement specialists QMI Solutions to assist industry in adopting leading-edge technologies, practices and processes to reduce costs, lift productivity and growth, and improve access to new business.
		Core Industry Capability Network Queensland (ICN) services	Services to support the participation of local suppliers in major projects, and delivery of the Local Industry Policy.
Revenues forgone	Natural Resources and Mines	Land rental caps	Caps rental increases to certain categories of land leases (residential, divestment and business including tourism leases) at various levels to ease immediate impacts of changes in the land valuation methodology and market movement.
	Treasury and Trade	Payroll tax exemption	Employers who employ in Queensland with an annual Australian payroll of $1 million or less are exempt from payroll tax (increased to $1.1 million from 1 July 2012). This exemption is designed to assist small and medium-sized businesses.
		First Home Owner Construction Grant and stamp duty exemptions	To encourage construction of new homes and provide support for the housing construction industry.
Underpricing of access to government-owned assets	State Development, Infrastructure and Planning	Yarwun Alumina Refinery – Common User Infrastructure financial agreement	Development of one-off Common User Infrastructure facilities at Yarwun Alumina Refinery Gladstone.
		State Development Areas (SDAs)	SDAs are clearly defined areas of land established by the Coordinator-General to promote economic development in Queensland.

Source: State Budget Papers 2012-13, Service Delivery Statements for various agencies

From the information examined by the Commission, it is difficult to determine:

- the effectiveness of these industry policies, or how effectiveness is measured
- the extent and degree of coordination or consistency of industry policy across the Government.

It is also difficult to quantify accurately the budgetary cost of industry assistance, because policies and activities are often not classified as such by the relevant department. The Productivity Commission estimated the Queensland Government provided some $850 million in industry assistance in 2008-09.[12]

It is even more difficult to assess the economic effect of these policies. Many of the measures of performance in the Service Delivery Statements (SDS), published with the 2012-13 State Budget, are partial in nature, for example, referring to the number of inquiries received or workshops completed, or firms reporting improved performance in some measure. There are very few performance measures which demonstrate effectiveness in achieving economic improvement (Table C5.4 below).

Table C5.4
Examples of performance indicators for industry support measures provided by the Queensland Government

Department	Measure	Target
State Development, Infrastructure and Planning	• Estimated value of efficiency savings or new business generated by businesses assisted by the department	• $25 million
	• Proportion of assisted firms reporting improved performance following department's funded innovation and capacity development activities	• 70%
	• Estimated value of additional capital attracted to Queensland as a result of the department's investment and business development assistance	• $100 million
	• Number of business participants in structured development activities	• 5,900
Natural Resources and Mines	• Number of structured programs/activities helping businesses build their capacity, improve their performance and/or access opportunities	• 280
	• Number of business participants in structured development activities	• 1,800
Tourism, Major Events, Small Business and the Commonwealth Games	• Amount of additional capital attracted into tourism investment	• $25 million
	• Number of tourism projects that receive facilitation assistance	• 10
Agriculture, Fisheries and Forestry	• Client businesses implementing new or improved practices, systems, products and technologies as a result of funded innovation and capacity development activities	• 60%
	• Innovative technologies developed through revolutionary research and development	• 8
	• Improved varieties, cultivars and commercial parent lines developed	• 19
Treasury and Trade	• Number of targeted and qualified leads for Queensland businesses generated through overseas trade missions and other trade and export development activities	• 400
	• Number of businesses assisted to export or expand market share	• 2,800

Source: State Budget Papers 2012-13, Service Delivery Statements for various agencies.

Historically, industry policy has been applied on an industry or even firm-specific basis. Over time, there has been a growing realisation of the need to consider economy-wide costs and benefits of industry policy.[13] In Australia, work by the Productivity Commission and its predecessors has demonstrated that the primary effect of selective assistance is to shift resources between sectors of the economy.

In this context, the existence of market failure is not in itself sufficient to justify government intervention. The extent and implications of the market failure need to be weighed against the direct costs of the intervention (the deadweight costs of taxes required to fund government activities as well as the distortion of economic incentives caused by those measures) as well as the possible costs arising from mistaken policy – so called 'government failure'.

In a 1996 inquiry into State Government Assistance to Industry, the Industry Commission examined a wide range of industry assistance policies, and concluded:

> *"... much of the considerable selective assistance provided to industry by State and local governments has little or no positive effect on the economic welfare of Australians as a whole."*[14]

As noted by the former Chairman of the Productivity Commission, industry policy generally now reflects a broad recognition that there is a need to establish the right economic environment for all firms, and to facilitate adjustment to market pressures rather than resisting those pressures. Furthermore, he stated that industry policy can only be effective in improving prosperity if it results in higher overall economic activity. That is, sectoral or industry-specific policies should demonstrably improve overall economic efficiency, not just outcomes in the assisted industry.[15]

As noted by the Steering Committee for the Review of Government Service Provision (2006), the ultimate outcome of a policy may be difficult to measure. Provided the relationships are adequately understood, more partial measures can be proxies for measures of outcomes. For example, the measure of the effectiveness of a tourism strategy aimed at increasing the number of international visitors to a particular location might be a combination of:

- direct measures – such as the number of international tourists to that location
- indirect measures – such as the total international visitors to Queensland in the given period and survey data regarding any changes in travel destinations (particularly within Queensland) undertaken as a result of the campaign.

However, given the underlying rationale for industry policy – to improve productivity and efficiency across the economy – care should be taken to ensure the partial measures used to assess performance are efficient proxies for genuine economic improvement. With regard to the example above, it would first be important to demonstrate that increased visitor numbers translated into increased state economic activity, sufficient to justify the expenditure on the campaign.

It is not clear that performance measures such as those outlined in Table 5.4 are appropriate to demonstrate economy-wide outcomes of industry assistance measures. Furthermore, in designing or implementing industry assistance policies in Queensland, there appears to be little consideration given to improving productivity, as illustrated by the example in Box C5.3.

Box C5.3
Industry policy case study – Tourism

Tourism is one of the sectors or industries around which the State's economic strategy is based. The Government assists the tourism industry through a number of bodies, including the Department of Tourism, Major Events, Small Business and the Commonwealth Games; Events Queensland; and Tourism Queensland Corporation. The budgeted expenditure for these bodies for 2012-13 is some $180 million, comprising staff costs and other supplies and services and grants to industry.[16]

The Queensland Audit Office (QAO) Report on *Tourism Industry Growth and Development* (November 2012)[17] assessed whether Queensland's tourism development framework effectively meets the Government's growth agenda. The report concluded that, across the range of bodies involved, there is a disconnect between measures of performance of the agency and actual results in terms of industry outcomes. None of the bodies was able to demonstrate whether they were meeting their organisational goals or providing value for money to the Government in terms of meeting its objectives.

The report made a number of recommendations in this regard. However, the report highlights a significant gap in the actual objectives set by and for the organisations involved in providing assistance to the tourism industry. With one exception, performance measures are targeted at increasing the number of tourists visiting Queensland or the money they spend while in Queensland. There is no consideration of the effect of tourism assistance on the wider economy or the productivity and standard of living of people in Queensland.

The exception to this observation is the calculation of a 'rate of return' to the State of assistance provided to advertising campaigns and to particular events. The QAO report noted that the use of highly specific 'own costs' overstated the apparent rate of return and recommended using all the State's costs for this calculation.

From an economic perspective, a more important consideration is the very concept of a 'rate of return'. To the extent the resources employed for the event, public or private, would have alternative uses in Queensland, the actual economic effect of an event would be the difference in the level of productivity and economic activity that resulted:

- from the use of those resources for that event
- compared with alternative uses of those resources.

That is, rather than assessing the total expenditure generated by the event or policy, the economic effect would be better measured by calculating the net effect of this event, compared with what otherwise would have happened.[18] Measurement of the net, rather than the gross, effect of assistance provided to an industry provides a more realistic assessment of economic benefits. It also underlines the relative merit of providing general assistance to address identified market failure, rather than providing direct support to specific enterprises or events.

For reasons set out above, it is not possible to obtain sufficient information to list or quantify the range of industry policies in place in Queensland, or to evaluate the objectives, effectiveness or value for money of those policies. The Commission considers that industry policy needs to be more focussed on measures to improve the productivity of business and industry for the broader benefit of the economy.

The Commission notes the work of the Productivity Commission and its predecessors in improving economic outcomes in Australia, through analysing and making transparent the effects of particular policies on economic performance.[19] The Commission also notes the role of the Victorian Competition and Efficiency Commission in conducting inquiries into economic and industry policies at a state level.

In similar vein, the Commission's proposed Queensland Productivity Commission could develop a rigorous, transparent approach to evaluating the effectiveness of industry policies, and their contribution to economic performance in Queensland.

Recommendation

61 The Government rationalise and consolidate industry development and assistance programs to achieve better value for money and to ensure that such programs contribute to greater productivity in the economy.

C5.5 FISCAL SUSTAINABILITY

C5.5.1 Federal–state financial arrangements

Queensland's future economic development also depends heavily on the fiscal sustainability of the Government. As highlighted in the Commission's Interim Report, a weakened financial position will damage future economic growth prospects.

In Australia, state and local governments fund their activities from a combination of own-source revenue and transfers from other levels of government, chiefly the Australian Government. As a result, the fiscal sustainability of the states is heavily dependent on the nature of federal-state financial arrangements.

Section 51 of the Australian Constitution specifies the powers of the Australian Parliament with respect to making laws for the peace, order and good government of the Commonwealth. As these powers are limited, the states have responsibility for matters not specifically mentioned in section 51. Over time, the gap between the spending responsibilities of the states and their ability to fund their activities through own-source revenue has widened, to the point where a significant proportion of state revenue is provided by the Australian Government.

The Commission's Interim Report noted that there is a significant imbalance between Queensland's level of expenditure and revenue raising capacity. In 2012-13, grants from the Australian Government will represent around 46.6% of Queensland's total revenue.

There has been no significant reform of value to the states in this area since the introduction of the Goods and Services Tax in 2000.

This is adversely affecting the fiscal sustainability of the states. Longer term reforms to grow and strengthen the Queensland economy will require reforms to federal financial arrangements.

It is beyond the scope of this Commission's terms of reference to make recommendation on the reform of federal-state financial arrangements. The Commission notes the ongoing discussion of these issues in various forums, in particular the Council of Australian Governments.[20] However, since it is absolutely critical for the future of the State, and since this problem goes to the heart of the State's long-term financial position, the Commission does make some observations on what should be committed in the interim while waiting upon more meaningful reform.

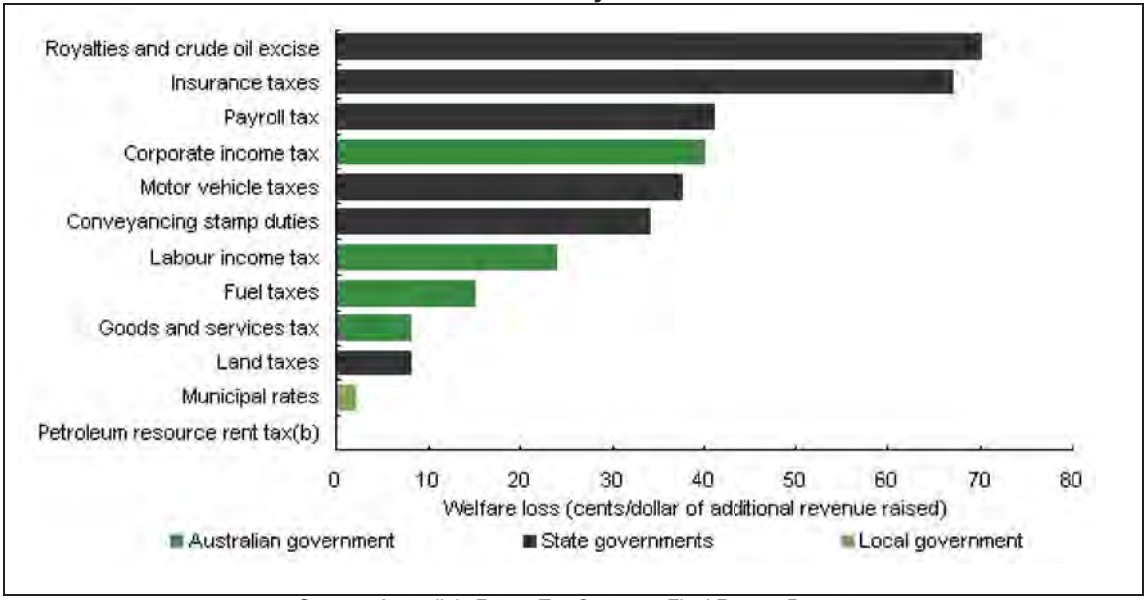
C5.5.2 The federal–state tax mix

The current mix of taxes between the federal and state levels of government in Australia is the product of arrangements that have been developed, negotiated and modified over a long period of time. Taxes levied by any level of government should take into account the following basic principles:

- equity – The tax system should treat individuals with similar economic capacity in the same way.
- efficiency – The tax and transfer system should raise and redistribute revenue at the least possible cost to economic efficiency and with minimal administration and compliance costs.
- simplicity – The tax and transfer system should be easy to understand and simple to comply with.
- sustainability – The tax system should have the capacity to meet the changing revenue needs of government on an ongoing basis without recourse to inefficient taxes.
- policy consistency – Tax policy should be internally consistent. Rules in one part of the system should not contradict those in another part of the system.[21]

As noted in the Commission's Interim Report, the taxes imposed by state governments tend to be narrowly-based and inefficient. In broad terms, the taxes imposed by the Australian Government display a higher degree of tax efficiency (see Chart C5.1).

Chart C5.1
The economic efficiency of Australian taxes



Source: Australia's Future Tax System – Final Report, Box 1.1

This suggests either that states should seek to access more efficient tax bases, or rely even more heavily on revenue sources presently available to the Australian Government to be provided to them by way of federal grants.

It is possible that the efficiency gains from using more efficient taxes would be outweighed by efficiency losses from greater duplication, cost-shifting and confusion over responsibility for outcomes on the expenditure side.

Grant arrangements are governed by the Intergovernmental Agreement on Federal Financial Relations. This agreement deals with:

- The distribution of revenue raised by the Australian Government on behalf of the states and territories by the GST. The GST is distributed to the states on the basis of recommendations made by the Commonwealth Grants Commission (CGC), through application of the principle of horizontal fiscal equalisation (HFE).

- Financial support to the states to assist in specific state services through National Specific Purpose payments, National Partnership payments and National Health Reform payments.

Each of these sections of the agreement has potential for adverse effects on the policy objectives and outcomes of the states. For example, the application of HFE to the distribution of GST revenue results in perverse outcomes:

- As noted in the Queensland Government's submission to the 2012 Review of GST Distribution, the benefits of productivity enhancing and structural changes achieved in a state are reduced because of the consequent adjustment in GST share that occurs under HFE.[22]

- As noted by the Victorian Government, adjustments made to states' GST allocations to reflect Australian Government contributions to infrastructure negate any policy rationale for those contributions (as Australian Government infrastructure contributions are added to the 'GST pool', and then equalised back across the states).[23]

Similarly, as noted in the Commission's Interim Report, Specific Purpose payments and National Partnership payments from the Australian Government also can distort the State's service delivery priorities and compromise the achievement of its policy objectives.

There are significant complexities in the current grant arrangements which limit the capacity of the states to deliver their policy objectives in a way which is fiscally sustainable.

In view of these difficulties, the Queensland Government should seek to ensure that any changes to federal financial arrangements are directed to measures that reduce the reliance of the states on narrowly based and inefficient taxes. This will enhance the future revenue flexibility of the states, and reduce their dependence on payments from the Australian Government.

Recommendation

62 The Queensland Government negotiate with the Australian Government and other state governments on measures to reduce the states' reliance on narrowly based and inefficient taxes.

C5.5.3 Overlapping responsibility between different levels of government

As noted above, section 51 of the Australian Constitution specifies the areas of Australian Government legislative responsibility. Over time, the evolution of public policy and decisions by the High Court of Australia have led to a significant degree of overlap between the responsibilities of the national and state governments. The potential for detrimental effects on productivity and efficiency is serious, through duplication of functions, cost shifting, and lack of transparency.

In Part D of this Report, the Commission has made observations about the need for greater clarity in functional responsibility for service delivery in sectors such as health, aged care, disabilities and education (including vocational education and training). In the absence of broader changes to federal arrangements, the Commission considers that there should be agreement between the different levels of government on a clear delineation of responsibilities for the performance of specific functions.

Where shared responsibilities remain, governments should seek to minimise the costs to the community (for example, in terms of administrative burden, and loss of time and productivity) of complying with different regulatory regimes.

For example, while it would be preferable for environmental approvals to be subject to one jurisdiction, or at the least to one approval process, in the absence of this change, there would be significant benefits in terms of reduced time and compliance costs of establishing a common information request and process requirements for proponents.

Recommendation

63 In the absence of broader changes to federal arrangements (which are beyond the scope of this Report), the Government pursue an agreed and clear protocol that sets out:

- ***functions to be performed by the states, and those which should be performed by the Australian Government***
- ***where shared responsibilities remain, the common performance and compliance arrangements which will reduce the cost of confusing, overlapping and inconsistent requirements of different levels of government.***

ENDNOTES

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[2] Queensland Government, *State Budget Papers 2012-13: Budget Paper 3, Capital Statement*, accessed from www.budget.qld.gov.au

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[4] G Banks, *Independent Policy Advice and the Productivity Commission, Chancellor's Lecture at Swinburne University*, 2011, accessed from www.pc.gov.au

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[8] Victorian Competition and Efficiency Commission, Strengthening Foundations for the Next Decade. An Inquiry into Victoria's regulatory framework, 2011, p 197, accessed from www.vcec.vic.gov.au

[9] See OECD, *Making Reform Happen, Lessons from OECD Countries*, 2010, accessed from www.oecd.org

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[19] See for example the speech to the 'Securing the Future' conference by Ted Evans, former Secretary to the Treasury and Chairman of Westpac Bank, accessed at http://melbourneinstitute.com

[20] See for example, GST Review Panel, *GST Distribution Review*, 2012, accessed from www.gstdistributionreview.gov.au

[21] Adopted from Henry, *Australia's Future Tax System, Report to the Treasurer: Final Report*, 2010, accessed from www.taxreview.treasury.gov.au

[22] Queensland Government, *Queensland Government Submission to the Review of GST Distribution*, 2012, accessed from www.gstdistributionreview.gov.au

[23] Victorian Government, *2012-13 Victorian Budget Update*, 2012, accessed from www.budget.vic.gov.au

APPENDICES

APPENDIX 1

STRUCTURE AND PERFORMANCE OF THE QUEENSLAND ECONOMY

This appendix provides an analysis of the structure and performance of the Queensland economy over two time periods:

- a longer-term historical perspective, covering the 26-year period[1] from 1985-86 to 2011-12
- a detailed focus on the more recent period of the decade since 2001-02.

The analysis is presented in three parts:

- 'what' has happened from a national income perspective – an overview of key macroeconomic aggregates, such as economic, population and employment growth
- 'why' it happened – the 3Ps, population, productivity and participation, framework
- 'where' it happened – focussing on recent economic performance, including industry and regional structure.

1. LONG-TERM ECONOMIC PERFORMANCE

A number of key themes have been evident within Queensland's economic environment over the past two decades, including:

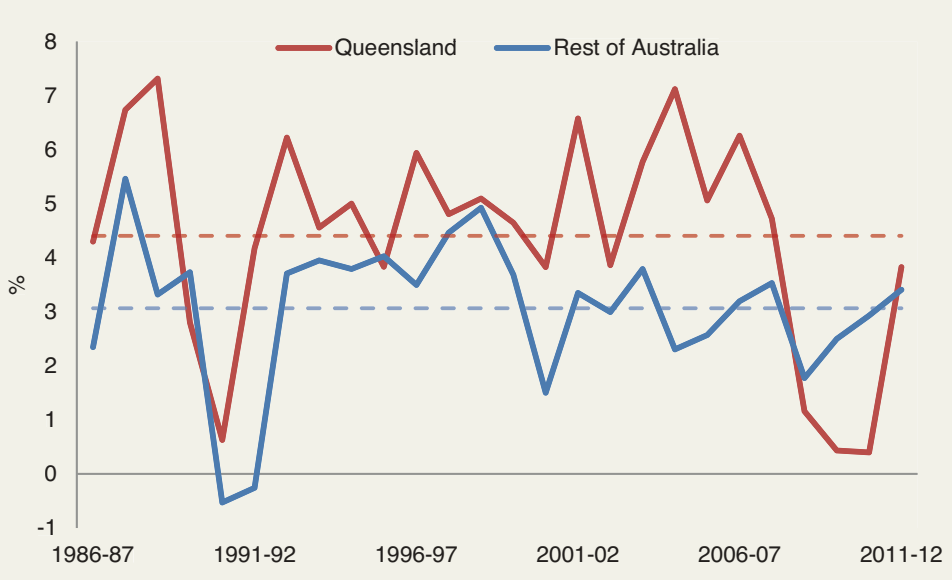
- an extended growth phase
- the more recent impacts of the increase of commodity prices, the global financial crisis (GFC) and natural disasters.

Over the past 26 years, the Queensland economy has tripled in size (increasing 207%) reaching $280 billion in 2011-12. Over the same 26-year period, the rest of Australia grew by 119% to $1,173 billion in 2011-12. As Australia's third largest state, Queensland now accounts for 19.3% of Australian gross domestic product (GDP) and 20.1% of national population.

Queensland recorded stronger economic growth, compared with the rest of Australia, in 21 of the last 26 years. Over this period, Queensland experienced annual economic growth of between 4% and 6%, with the exceptions being the recession in the early 1990s and also the period since 2007-08. Since the early 1990s, Queensland's unemployment rate has been declining, consistent with the national trend.

Chart 1 shows annual real economic growth for Queensland and the rest of Australia between 1985-86 and 2011-12. Over the period since 1985-86, Queensland recorded average annual gross state product (GSP) growth of 4.4%, 1.3 percentage points higher than growth in the rest of Australia.

Chart 1
Gross state product, annual growth (a)



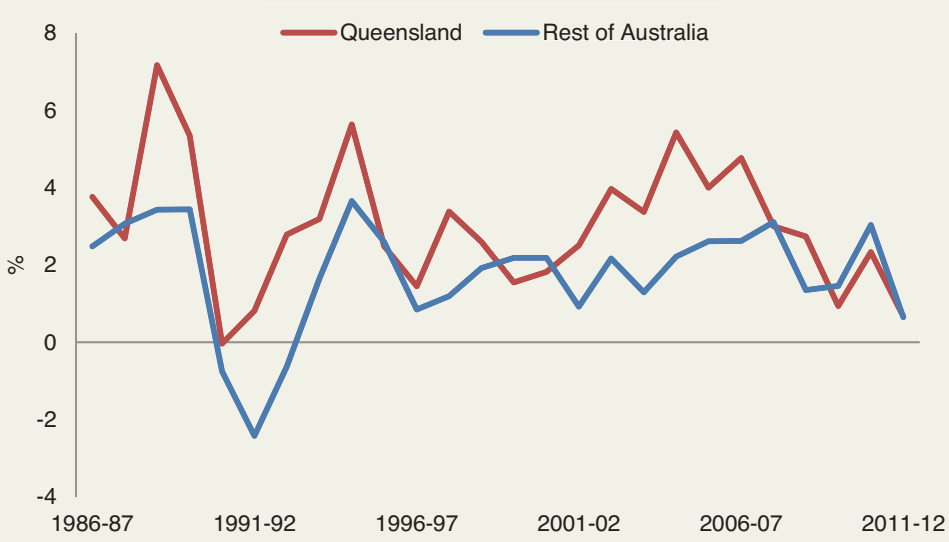
(a) Dashed lines represent respective long-run average annual growth rates.

Source: Queensland Treasury and Trade, Queensland State Accounts, September Quarter 2012

Queensland's long-term economic growth has been driven by a sustained rise in household consumption expenditure, while a ramp-up in business investment, particularly over the past decade, also contributed significantly to growth in economic activity.

Between 1985-86 and 2011-12, the total number of employed persons in Queensland grew by more than 1.2 million, from just under 1.1 million in 1985-86, to more than 2.3 million persons at 30 June 2012. Chart 2 shows the annual growth rates in employment for Queensland and the rest of Australia. Employment growth in Queensland was stronger than the rest of Australia over the majority of the past 26 years, with average annual growth of 3.0% between 1985-86 and 2011-12, 1.2 percentage points higher than that of the rest of Australia.

Chart 2
Employment, annual growth



Source: ABS 6202.0

Table 1 summarises the change in the average annual labour force, employment and participation rates between 1985-86 and 2011-12 for Queensland, others states and Australia. Queensland recorded the highest average annual growth in employment of the mainland states over this period, and was 1.0 percentage point above the national average of 2.0%.

Queensland also experienced the largest change in participation rate of the mainland states between 1985-86 and 2011-12, rising 5.8 percentage points. In comparison, participation rates in New South Wales, Victoria, Western Australia and South Australia increased by 2.9, 4.2, 4.1 and 2.7 percentage points, respectively. The national average increased 4.0 percentage points over the 26 years to 2011-12.

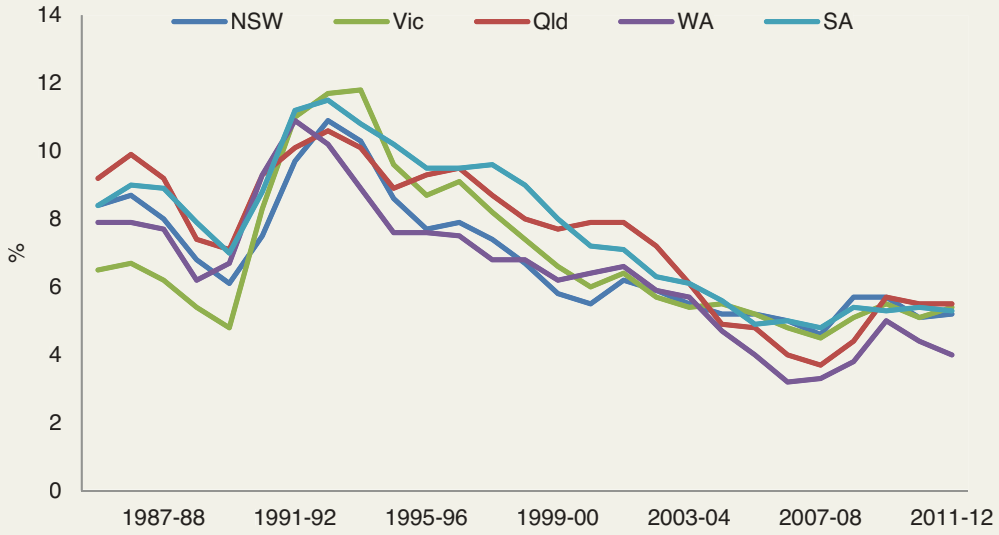
Table 1
Labour force, employment and participation

	Labour force			Employment			Participation rate		
	1985-86	2011-12	Average annual growth	1985-86	2011-12	Average annual growth	1985-86	2011-12	Change
	— Persons ('000) —		%	— Persons ('000) —		%	— % —		% point
New South Wales	2,551	3,799	1.5	2,336	3,602	1.7	60.6	63.5	2.9
Victoria	1,951	3,039	1.7	1,824	2,876	1.8	61.3	65.5	4.2
Queensland	1,195	2,480	2.8	1,086	2,342	3.0	61.3	67.1	5.8
Western Australia	700	1,311	2.4	645	1,258	2.6	64.4	68.5	4.1
South Australia	649	866	1.1	594	820	1.2	60.5	63.2	2.7
Australia	7,451	12,088	1.9	6,860	11,462	2.0	61.4	65.4	4.0

Source: ABS 6202.0

Chart 3 shows the average annual unemployment rates of the states since 1985-86. Following the economic downturn in the early 1990s, the Queensland unemployment rate fell from a peak of 10.6% in 1992-93 to 3.7% in 2007-08, before rising to 5.5% in 2011-12. Queensland's larger increase in the unemployment rate compared with other states over the four years to 2011-12 coincided with a fall in Queensland economic growth to below that of the rest of Australia.

Chart 3
Unemployment rate



Source: ABS 6202.0

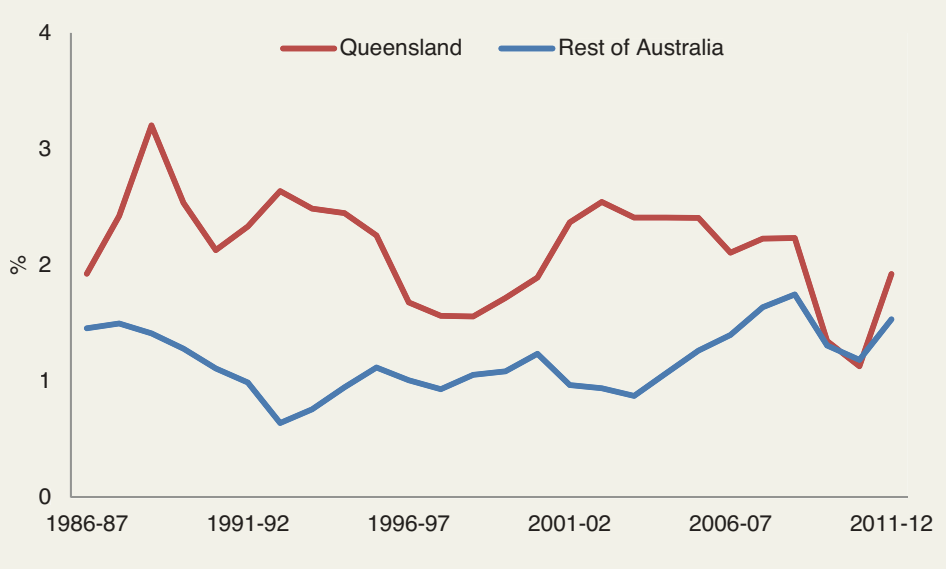
2. THREE P FRAMEWORK

The drivers of economic growth can be assessed within a 3P framework, that is, as a function of participation, productivity and population. This section outlines that, while Queensland economic growth outperformed the rest of Australia over the 26 year period to 2011-12, there is evidence of convergence in the drivers of Queensland and the rest of Australia growth.

2.1 Population

Between 1985-86 and 2011-12, Queensland's population grew by more than 1.9 million people, from just over 2.6 million in 1985-86, to 4.6 million persons at 30 June 2012. Chart 4 shows the annual population growth rates for Queensland and the rest of Australia. Queensland recorded an average annual growth in population of 2.1% between 1985-86 and 2011-12, 0.9 percentage point higher than the rest of Australia over that period. However, the annual population growth rates for Queensland and the rest of Australia have converged more recently.

Chart 4
Population, annual growth



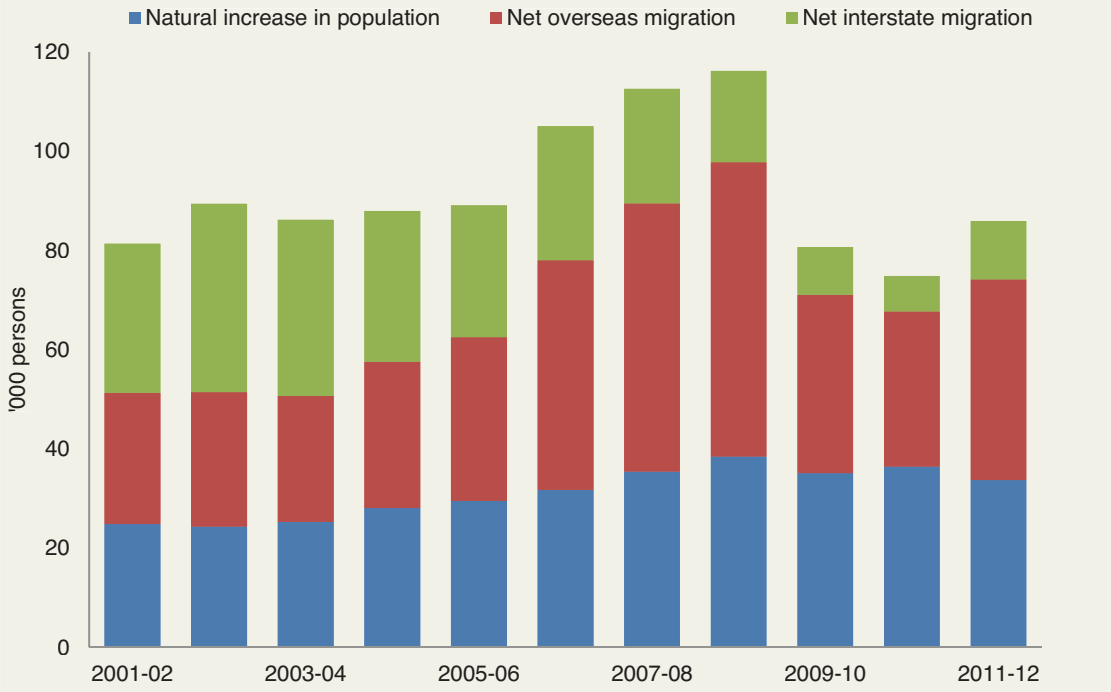
Source: ABS 3101.0

Chart 5 decomposes Queensland's population growth between 2001-02 and 2011-12 into its three components - natural increase, net interstate migration and net overseas migration. A significant portion of Queensland's stronger population growth was driven by net interstate migration. However, the contribution by net interstate migration to Queensland's rising population has slowed significantly in recent years.

As Queensland's share of the Australian population increases, the likely contribution of net interstate migration to Queensland population growth becomes lower. That is, it takes a higher proportion of the rest of Australia's population to migrate to Queensland to maintain interstate migration's contribution to Queensland's population growth rate.

It is also likely that the impact of factors influencing Queensland's relative population performance, for example, greater job opportunities, will converge to those experienced in the rest of Australia. Therefore, it is unlikely that net interstate population growth will return, on a sustained basis, to its previous strong contribution to overall population growth.

Chart 5
Changes in population, Queensland



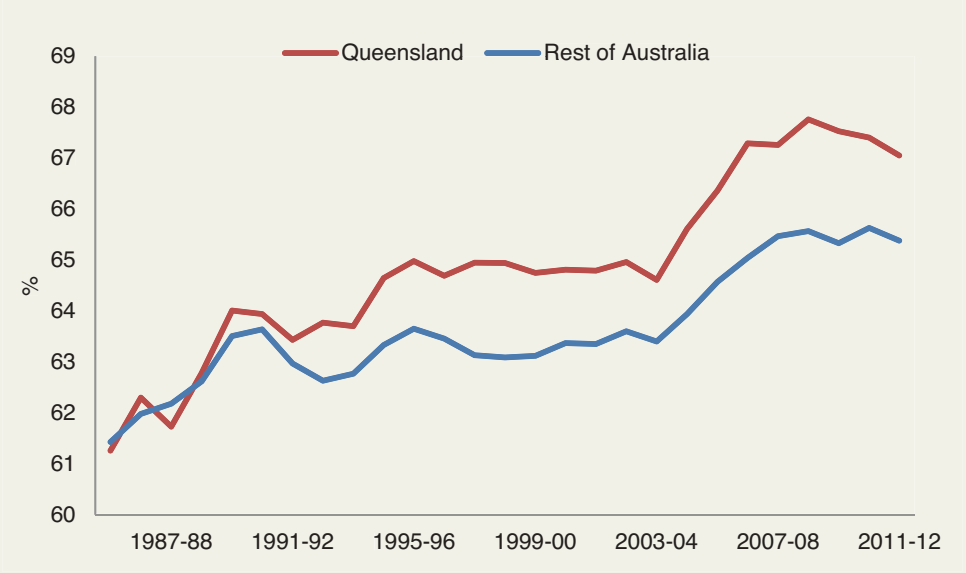
Source: ABS 3101.0

Over the period from 2001-02, net overseas migration increased until 2008-09, when it peaked at 59,000 persons, before moderating to 40,000 persons in 2011-12. Net overseas migration was the major component in the moderation in Queensland's population growth since 2008-09. However, a slowdown in net interstate migration was also a significant factor between 2006-07 and 2011-12. Consequently, there has been a rise in the contribution to total population growth from natural increase since 2008-09.

2.2 Participation

Chart 6 shows that Queensland's annual labour force participation rate has been higher than that recorded in the rest of Australia since the late 1980s. While participation is highly correlated across regions, Queensland's participation rate experienced a stronger rise from 2004-05 and has remained between 67% and 68% over the period since 2006-07.

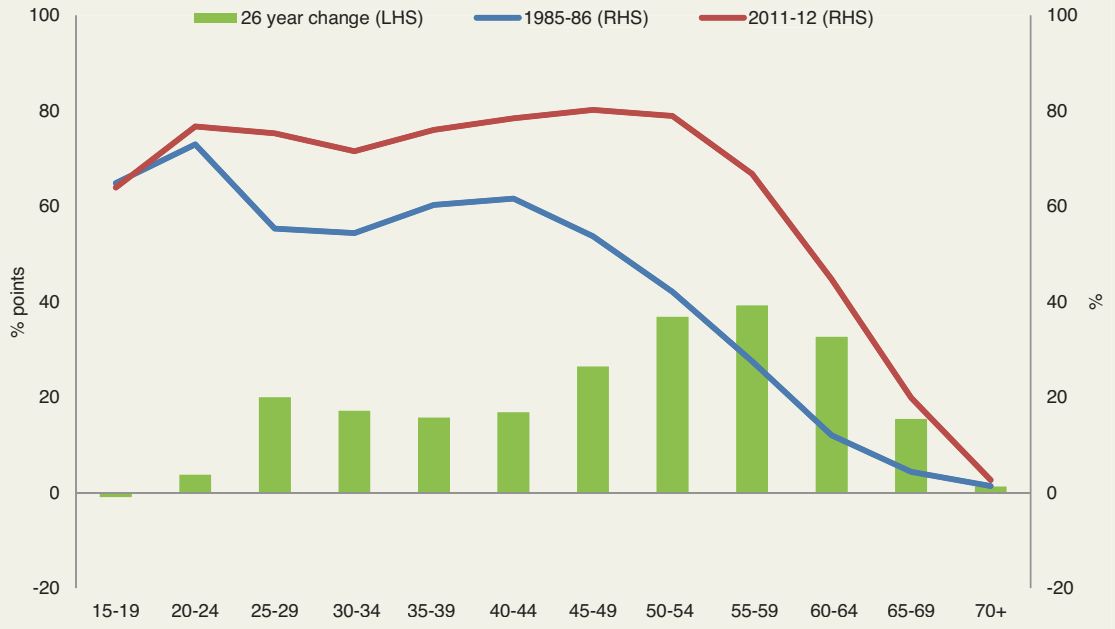
Chart 6
Participation rate, total persons



Source: ABS 6202.0

The most significant driver of the increase in Queensland's participation rate was the large upward shift in the number of females entering the labour market over the last 26 years, along with higher participation of persons aged 50 years and over. Chart 7 shows female participation rates in 2011-12 by five-year age cohort,[2] and how they have changed since 1985-86.

Chart 7
Female participation rates by age, 1985-86 and 2011-12, Queensland



Source: ABS 6291.0

While the participation rates of males across age cohorts between 20 to 54 years of age fell moderately between 1985-86 and 2011-12, female participation increased significantly.

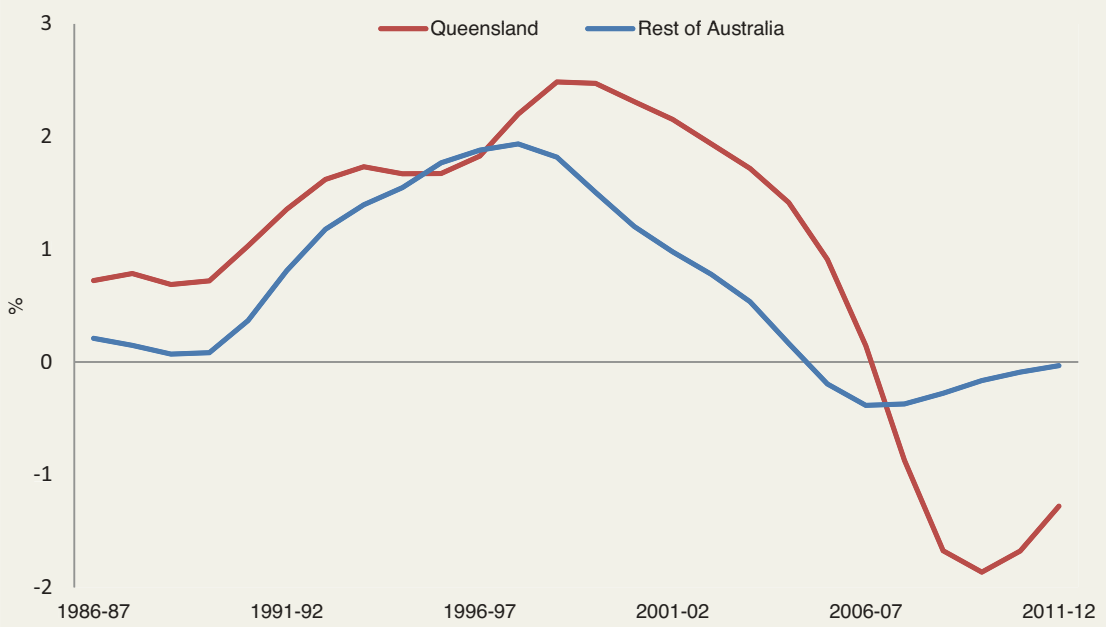
Many of the one-off gains which have driven Queensland's participation rate higher, such as participation by females of child bearing age converging to that of males, will not be repeated. Furthermore, despite increased participation by seniors, the ageing of the population is likely to have an adverse effect on aggregate participation rates across Australia. This leaves productivity as the key to lifting economic growth in the future.

2.3 Productivity

Queensland's productivity performance has played a crucial role in driving economic growth and improving the standard of living for Queenslanders. Multifactor productivity (MFP) is the most appropriate measure of economy-wide productivity and is defined as output per combined labour and capital inputs. The difference between labour productivity[3] and MFP is capital deepening, which is the amount of capital available per person in the production process.

Chart 8 shows the annual per cent change in trend[4] MFP for Queensland and the rest of Australia between 1985-86 and 2011-12. On average over the long-term, Queensland has outperformed the rest of Australia in terms of productivity growth. Queensland's MFP grew by an average annual 0.9% over the 26 years to 2011-12, compared with 0.7% for the rest of Australia.[5]

Chart 8
Multifactor productivity growth, trend (a), 1985-86 to 2011-12



(a) Trend estimates are derived from original MFP data using an 11-term Henderson-weighted moving average.

Source: Queensland Treasury and Trade

Queensland MFP grew at a faster rate than the rest of Australia for the majority of the period to 2006-07. Productivity gains were particularly strong in the mid-to-late 1990s and Queensland's superior MFP growth continued into the subsequent decade. However, since 2007-08, Queensland's MFP has fallen sharply, with larger declines than the rest of Australia. By 2011-12, MFP for both Queensland and the rest of Australia was below the level recorded a decade earlier.

The recent MFP downturn is impacted, in part, by several one-off factors which combine to inhibit MFP growth.

Strong inputs growth has been a central theme for a number of industries (such as mining) over the past decade, particularly in the case of capital accumulation. For several industries, the acceleration in inputs has not been matched by an equivalent increase in output growth.

Part of this is the lag between investment and output. As the Chairman of the Productivity Commission recently stated:

> "*The end of the minerals export price bonanza should see productivity recover somewhat … as new investment subsides and higher output associated with previously 'unrequited' input growth comes on stream."* [6]

An example of how productivity growth can recover is the rebound in national agriculture output following the period of very low rainfall between 2003-04 and 2007-08. This led to an increase in MFP in this industry which was also boosted by a diminished need, for example, for drought-proofing inputs.

Similarly, Queensland's significant capital expenditure to secure water supply, combined with government regulations imposing targets for lower water consumption (output), inhibited MFP growth in the electricity, gas, water and waste services industry. Much of the capital investment was the construction of infrastructure that will not need to be repeated and so MFP performance in this industry should improve relative to recent history.

Despite the prospect that declines in MFP in some industries may be reversed to some extent in coming years, the broader decline in Queensland productivity is a serious concern and will need to be addressed if Queensland is to return to strong MFP growth.

Table 2 quantifies the contribution to Queensland's average annual economic growth from MFP, as well as labour and capital inputs. Queensland's average annual productivity outperformance, when compared to the rest of Australia, likely contains an element of 'catch up' to the more mature economies of New South Wales and Victoria.[7]

It is not possible to quantify the contribution from 'catch up' to Queensland's 0.2 percentage point MFP outperformance relative to the rest of Australia. However, as the Queensland economy matures and its economic characteristics more closely resemble those in the large states, the contribution to Queensland's stronger MFP growth from this 'catch up' factor will diminish. To the extent that Queensland's outperformance is a result of 'catch up', and in the absence of further productivity enhancing action, the strength of Queensland's MFP performance relative to the rest of Australia is likely to decline over the long-term.

Table 2
Long-run productivity growth

1985-86 to 2011-12	Queensland	Rest of Australia
	- average annual % growth -	
Output (a)	**4.5**	**3.1**
Multifactor productivity	**0.9**	**0.7**
Labour productivity	1.6	1.5
less Capital deepening	0.7	0.9
Combined labour and capital inputs (b)	**3.5**	**2.4**
Hours worked	2.8	1.5
Capital services	4.8	4.3

(a) For the purpose of consistency with productivity methodologies, GSP in this analysis excludes the contribution from ownership of dwellings.
(b) Weighted in terms of labour and capital income shares.

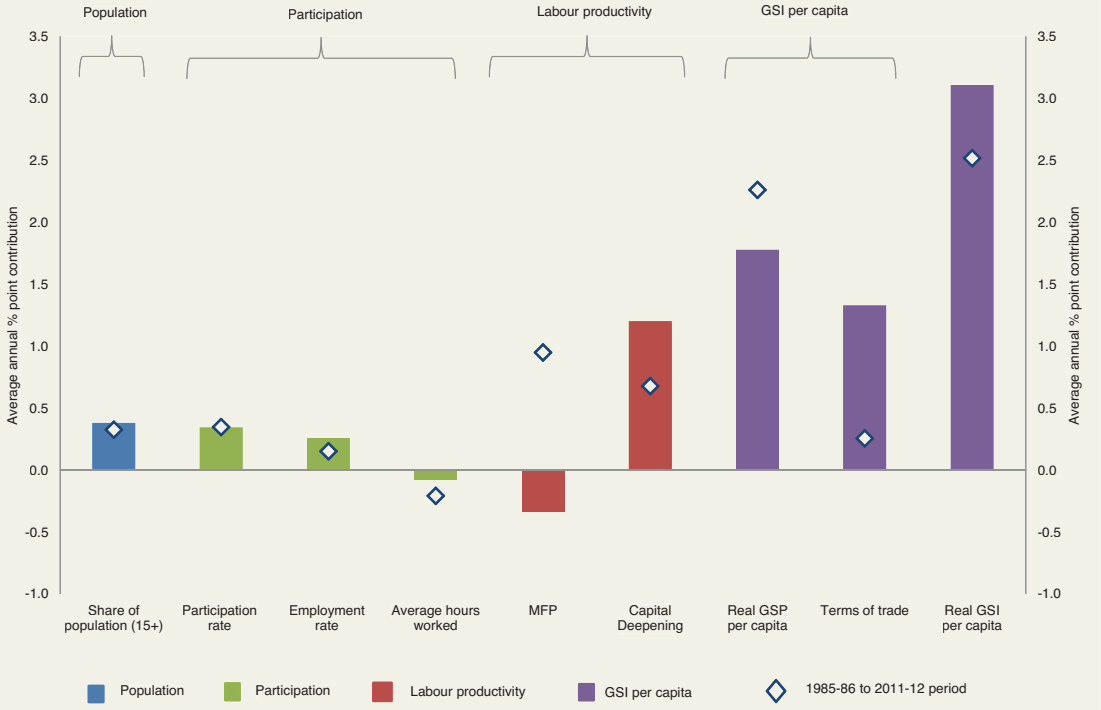
Source: Queensland Treasury and Trade

2.4 Decomposition of gross state income per capita

Gross state income (GSI) per capita is a traditional indicator of living standards. It measures the purchasing power of total income generated by Queensland production on a per capita basis.

Chart 9 shows the contributions of population, participation and productivity, and decomposes Queensland's 1.8% average annual growth in GSP per capita into the percentage point contribution from the 3Ps over the decade to 2011-12. The 1.3 percentage point contribution from the terms of trade can be added to average annual growth in GSP per capita to form GSI per capita growth.

Chart 9
Drivers of real economic income growth, 2001-02 to 2011-12, Queensland (a)



(a) Diamonds show the corresponding value for the longer period 1985-86 to 2011-12.

Source: Queensland Treasury and Trade; ABS 3101.0 and 6202.0

Growth in Queensland's working age share of population contributed 0.4 percentage point to average annual GSI per capita growth of 3.1% between 2001-02 and 2011-12. In comparison, the rest of Australia recorded GSI per capita growth of 2.9% over the 10 years to 2011-12.

The three components of labour force participation contributed a combined 0.5 percentage point to GSI per capita over the decade to 2011-12, comprising:

- a 0.3 percentage point contribution from the participation rate
- a 0.3 percentage point contribution from employment (equivalent to a reduction in the unemployment rate)
- a 0.1 percentage point detraction from intensity (representing a decrease in the average hours worked per employee).

Labour productivity contributed 0.9 percentage point to average annual growth in GSI per capita between 2001-02 and 2011-12, comprising:

- a 1.2 percentage points contribution from capital deepening
- a 0.3 percentage point detraction from MFP.

The 1.3 percentage points contribution to GSI per capita from changes in the terms of trade, over the decade to 2011-12, is significant and largely reflects the sharp increase in commodity prices in recent years. In comparison, the long-term contribution (shown as a diamond marker in the column) from the terms of trade between 1985-86 and 2011-12 was 0.3 percentage point.

The Reserve Bank Governor recently observed:

> "… *while a high level of the terms of trade continues to add to the level of national income, we can no longer expect that a rising terms of trade will be adding to growth in living standards*".[8]

Even if the terms of trade were to remain unchanged at its current high level, it will make a neutral contribution to future GSI per capita growth. A fall in the terms of trade from current record levels will detract from growth in GSI per capita.

Any future fall in the terms of trade is likely to exert downward pressure on the Australian dollar. As such, the potential for lower mining-related income will be somewhat offset by increased competitiveness of non-mining exporters, including tourism and education exports.

Queensland's strong performance relative to the rest of Australia in the three Ps has slowed in recent years. It would be unrealistic to expect that Queensland's past superior growth in population, participation and productivity relative to the rest of Australia will continue in the long-term. It follows then that, if growth in each component of the 3Ps framework in Queensland converges to that of the rest of Australia, so to will economic growth. Furthermore, the significant boost to Queensland's real income from the terms of trade is expected to unwind, at least in part, over coming years.

3. RECENT ECONOMIC PERFORMANCE

This section outlines Queensland's recent economic performance. The period since 2001-02 included the impact of huge increases in commodity prices, the strong Australian dollar, the financial crisis and natural disasters.

Table 3 shows a breakdown of average annual growth in GSP, population and employment for Queensland and the rest of Australia for the past decade. Also presented is a breakdown for the period from 2001-02 up to the financial crisis of 2007-08, and the subsequent four years 2007-08 to 2011-12.

Queensland recorded stronger economic growth than the rest of Australia over the decade from 2001-02, mainly due to stronger growth from 2001-02 to 2007-08. Since 2007-08, economic growth in Queensland has averaged 1.4% per year, 1.3 percentage points below that recorded in the rest of Australia.

Table 3
Economic, population (a) and employment growth

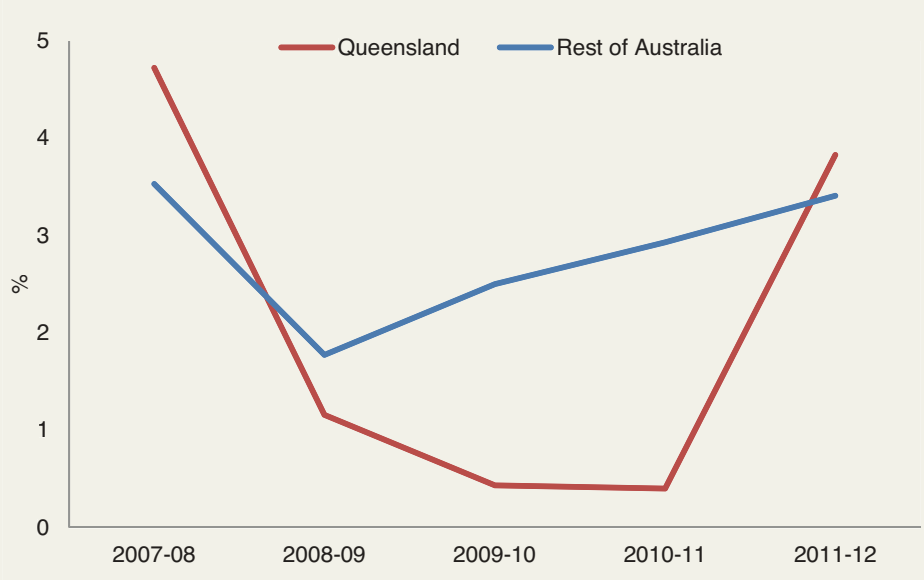
	Queensland			Rest of Australia		
	GSP	Population	Employment	GSP	Population	Employment
	- Average annual % growth -					
2001-02 to 2007-08	5.5	2.3	4.1	3.1	1.2	2.3
2007-08 to 2011-12	1.4	1.7	1.7	2.7	1.4	1.6
2001-02 to 2011-12	**3.8**	**2.1**	**3.1**	**2.9**	**1.3**	**2.1**

(a) Population as at 30 June of reference year.

Source: Queensland Treasury and Trade, Queensland State Accounts, September Quarter 2012; ABS 3101.0 and 6202.0

Chart 10 shows that while both Queensland and the rest of Australia have experienced slower economic growth in recent years, the decline has been more pronounced in Queensland. In 2011 and more recently, severe weather and flooding interrupted coal supply, however, mining has benefited from a huge increase in prices since 2007-08. The strength of the Australian dollar has also inhibited growth in the non-resources sectors, including tourism.

Chart 10
Gross state product, annual growth

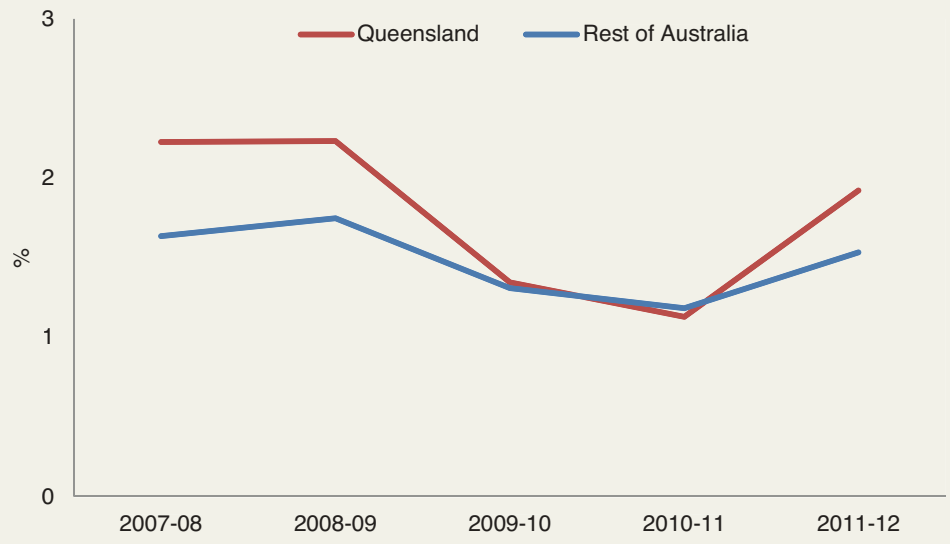


Source: Queensland Treasury and Trade, Queensland State Accounts, September Quarter 2012

Over the 10 years to 30 June 2012, Queensland's average annual population growth was 2.1%, which was 0.8 percentage point higher than in the rest of Australia. However, Queensland's population growth has moderated significantly during this period. In the six years to 30 June 2008, population growth in Queensland averaged 2.3% per annum. Since then, Queensland's average annual rate of population growth declined to 1.7%.

Chart 11 shows annual population growth in Queensland and the rest of Australia since 2007-08. Annual growth in Queensland declined significantly in 2009-10 and 2010-11 to virtually the same rate as the rest of Australia, before picking up again in 2011-12. Since 2007-08, annual population growth in Queensland has averaged 1.7%, 0.3 percentage point above the rest of Australia.

Chart 11
Population, annual growth

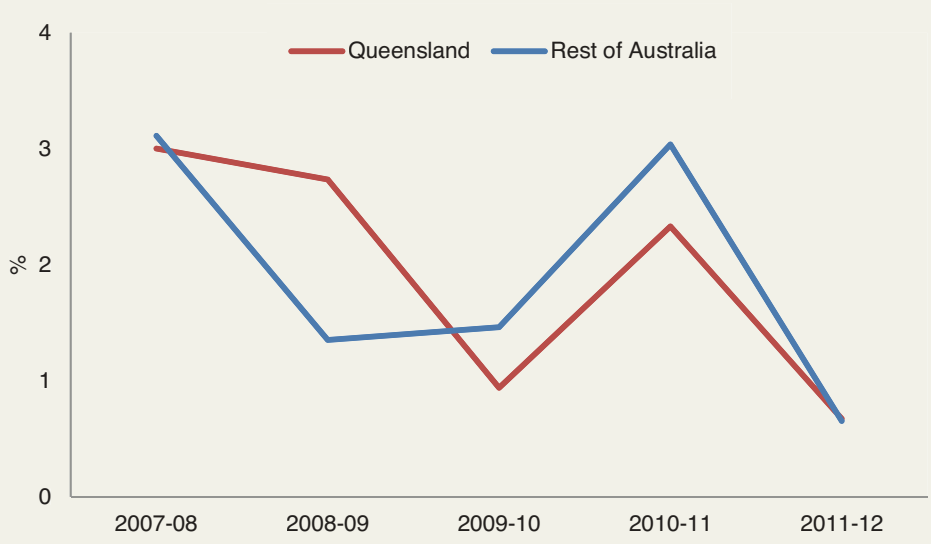


Source: ABS 3101.0

The number of persons employed in Queensland grew by 3.1% in average annual terms over the decade to 2011-12, 1.0 percentage point higher than the rest of Australia. Queensland's employment growth moderated from an average annual rate of 4.1% between 2001-02 and 2007-08 to 1.7% over the four years to 2011-12.

Chart 12 shows annual employment growth in Queensland and the rest of Australia between 2007-08 and 2011-12. Over this period, Queensland's rate of employment growth fell sharply and, in 2009-10 and 2010-11, was below the growth rate in the rest of Australia.

Chart 12
Employment, annual growth

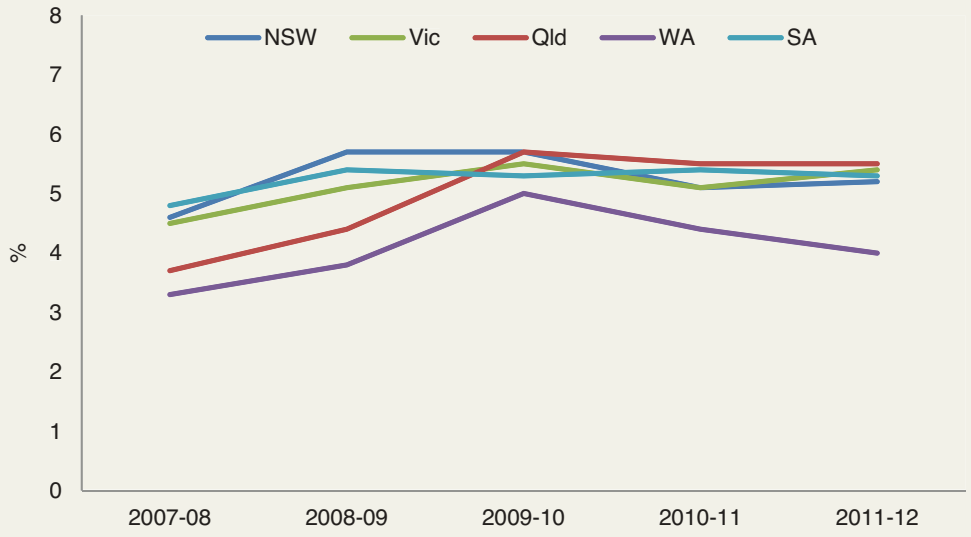


Source: ABS 6202.0

Consistent with a period of weaker economic and employment growth, Queensland's unemployment rate rose from 3.7% in 2007-08 to 5.5% in 2011-12. While other states also experienced rising unemployment rates over this period, the increase in Queensland was 1.1 percentage points higher than the rest of Australia.

Chart 13 shows unemployment rates by state since 2007-08. In 2007-08, Queensland's unemployment rate was lower than all mainland states other than Western Australia. Since 2009-10, Queensland has had the highest unemployment rate of these states.

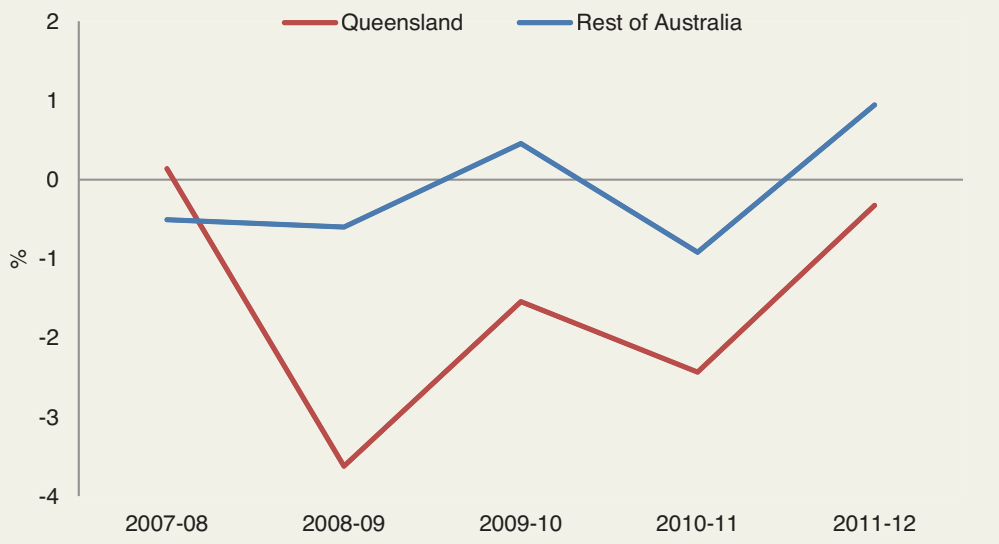
Chart 13
Unemployment rate



Source: ABS 6202.0

As noted previously,[9] the period since 2007-08 has also been characterised by weak productivity performances, both in Queensland and the rest of Australia. Chart 14 shows that MFP in Queensland fell sharply between 2007-08 and 2011-12, with annual growth weaker than that recorded in the rest of Australia over most of this period. Since 2007-08, Queensland has experienced a decline in MFP. In 2011-12, MFP in Queensland was still declining, while growth of 0.9% was recorded in the rest of Australia.

Chart 14
Multifactor productivity growth, original



Source: Queensland Treasury and Trade

One of the key factors in Queensland's recent economic performance was the significant increase in the prices received for resource exports since 2004, as shown in Chart 15. Increased foreign demand and limited global supply led to the sharp rise in Australia's terms of trade and has been a source of considerable wealth creation for both the Australian and Queensland economies. Chart 9 quantified the impact that the terms of trade has had on growth in GSI per capita in Queensland.

Industries servicing the resource sector have also benefited, as mining firms moved through an extended construction phase in order to lift supply and take advantage of higher commodity prices.

Chart 15
Export price index, Queensland's major export commodities (a)

(a) Coal, coke and briquettes and Metal ores and minerals

Source: Queensland Treasury and Trade, Queensland State Accounts, September Quarter 2012

Mining industry profitability, approximated by gross operating surplus and mixed income, grew by an average annual 17.8% between 2003-04 and 2011-12. This increased profitability led to an influx of foreign investment.

The strength of the Australian dollar, in part a consequence of the mining boom, has had implications for structural change within the Queensland economy as resources are diverted from weaker performing areas into expanding sectors. Import-competing industries and businesses relying on international and domestic visitor arrivals have been particularly impacted.

Table 4 shows average annual growth in GSP and its components for Queensland and the rest of Australia from 2001-02 to 2011-12. The table also shows the average annual percentage point contribution of the expenditure components to overall economic growth.

Table 4
Average annual changes and contribution to real economic growth

	Queensland		Rest of Australia	
	Average annual % change 2001-02 to 2011-12	% point contribution to growth in GSP 2001-02 to 2011-12	Average annual % change 2001-02 to 2011-12	% point contribution to growth in GSP 2001-02 to 2011-12
Household consumption	4.4	2.3	3.2	1.7
Private Investment	9.1	2.0	6.6	1.2
Dwelling investment	1.2	0.1	1.7	0.1
Business Investment	14.4	1.7	10.1	1.0
Public final demand	5.0	1.1	3.7	0.8
General government consumption	3.9	0.7	3.1	0.6
Public corporations investment	6.2	0.1	4.3	0.1
General government investment	8.2	0.3	7.0	0.2
Gross state expenditure	5.6	5.4	4.1	3.8
Exports of goods and services	2.1	0.7	2.9	0.7
less Imports of goods and services	7.3	2.3	7.7	1.4
Gross state product	**3.8**	**3.8**	**2.9**	**2.9**

Source: Queensland Treasury and Trade, Queensland State Accounts, September Quarter 2012

The main driver of Queensland's 3.8% average annual real economic growth over the 10 years to 2011-12 was household consumption expenditure, rising 4.4% in average annual terms and contributing 2.3 percentage points to GSP growth. In comparison, household consumption growth in the rest of Australia was 3.2% per year over this period.

The period from the early 2000s was characterised by a substantial boost to household wealth in Queensland through strong growth in asset prices.

Private investment grew by an average annual rate of 9.1% and was the second largest contributor (2.0 percentage points) to average annual economic growth in Queensland over the 10 years to 2011-12. Private investment growth in Queensland was 2.5 percentage points higher than that recorded in the rest of Australia over this period. Business investment in Queensland (comprising non-dwelling construction and machinery and equipment) was the fastest growing component of private investment between 2001-02 and 2011-12, rising 14.4% in average annual terms and contributing 1.7 percentage points to economic growth.

Queensland public final demand grew by an average annual rate of 5.0% from 2001-02 to 2011-12, contributing 1.1 percentage points to average annual GSP growth over this period. General government consumption was the largest contributor to public final demand, rising 3.9% in average annual terms and was 0.8 percentage point above growth recorded for the rest of Australia.

Total exports grew by an average annual rate of 2.1% between 2001-02 and 2011-12, accounting for 0.7 percentage point of growth in Queensland output. Meanwhile, imports of goods and services rose 7.3% in average annual terms over the decade to 2011-12, detracting 2.3 percentage points from GSP growth. Growth in total imports was driven by an 11.4% rise in overseas imports of goods and services.

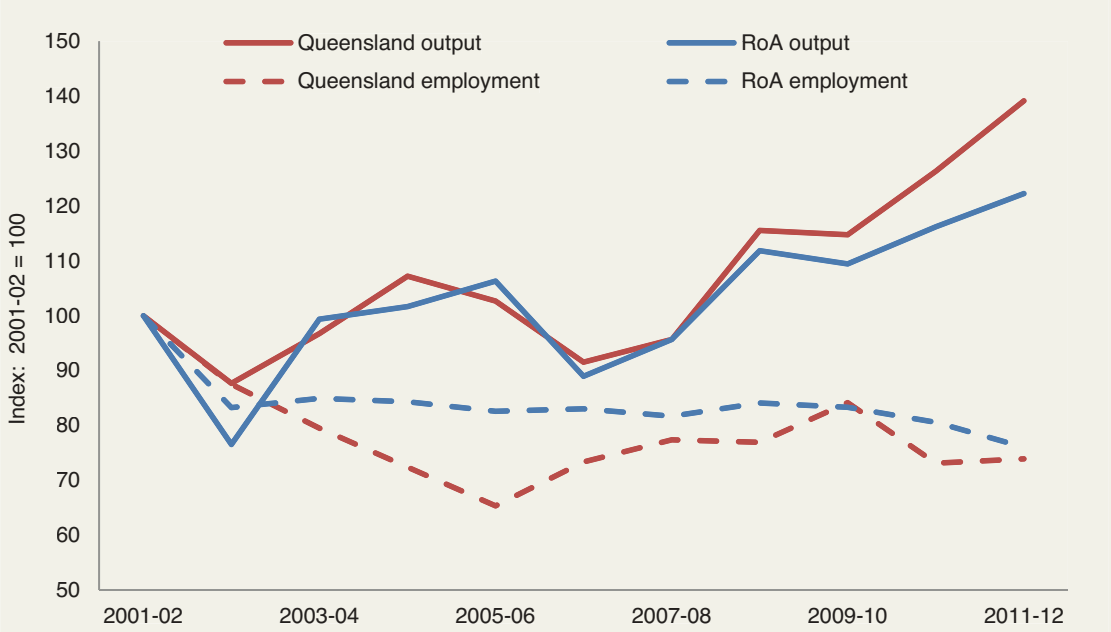
4. QUEENSLAND'S TRADITIONAL STRENGTHS

4.1 Agriculture

Chart 16 shows that agriculture, forestry and fishing output grew by an average annual rate of 3.4% between 2001-02 and 2011-12, contributing 0.1 percentage point to Queensland's economic growth. In comparison, agriculture output in the rest of Australia rose more slowly, growing at 2.0% in average annual terms over the same period.

Queensland employment in agriculture declined by an average annual 3.0% over the decade to 2011-12, similar to the 2.7% annual fall recorded in the rest of Australia (RoA). The combination of stronger output growth and weaker employment growth implies a stronger labour productivity performance in Queensland agriculture.

Chart 16
Output and employment, agriculture, forestry and fishing



Source: ABS 5220.0 and 6291.0

The category of agriculture, forestry and fishing was the only Queensland industry to employ less full-time equivalents (FTEs) in 2011-12 than in 2001-02. Over this period, agriculture FTE employment fell by 24,400 persons or 26.1%.

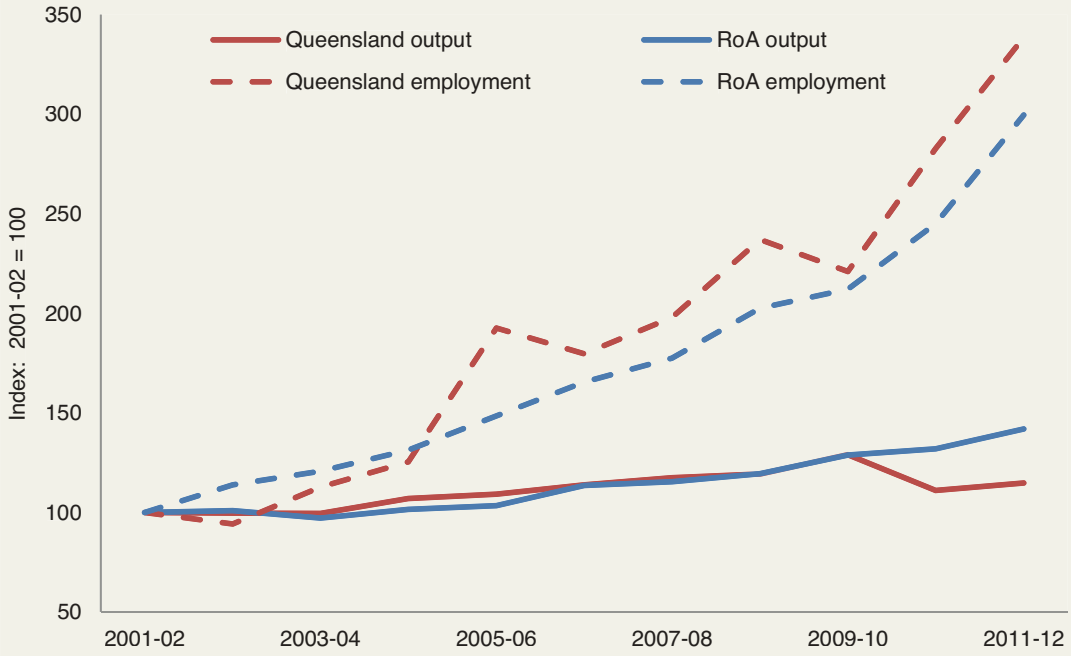
4.2 Mining

The rise in commodity prices since 2004-05 has drawn a significant amount of resources, both labour and capital, into the Queensland mining industry. This investment has been in the form of both the development of new mines and expansion of existing operations.

As yet, there has not been an equivalent surge in output, in part hindered by the 2011 floods. However, the expansion in production capacity is expected to lead to stronger growth in output and, in particular, the volume of coal exports.

Chart 17 shows indexed mining real output and employment growth since 2001-02 for Queensland and the rest of Australia. The mining industry expanded 1.4% in real average annual terms between 2001-02 and 2011-12, contributing 0.2 percentage point to Queensland economic growth.

Chart 17
Output and employment, mining



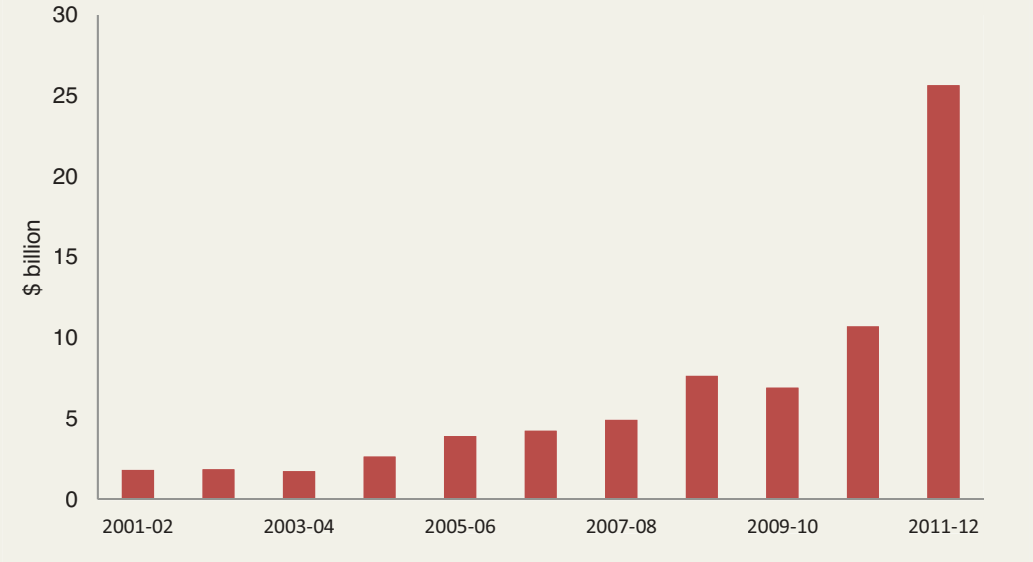
Source: ABS 5220.0 and 6291.0

Mining industry output recorded only modest growth over the past decade. However, this is partly due to a 13.9% fall in mining output in 2010-11. Compared with 2001-02 levels, mining activity was 29.0% higher in 2009-10 but 17.9 percentage points of this output growth was lost in 2010-11. This was largely a result of widespread flooding, and the resultant cessation of production due to flooded mines and the interruption to freight transport corridors.

Despite this modest growth in mining output, labour inputs are more than triple what they were 10 years earlier. Although mining directly remains a relatively small employer of the labour force in Queensland, there is evidence that the expansion in mining has been generating employment in both the construction and professional services sectors.[10]

Chart 17 implies that the mining industry experienced very weak labour productivity outcomes over the past decade. Furthermore, the significant amount of investment in the mining industry over this period implies a deterioration in MFP performance. Chart 18 shows the significant capital expenditure in this industry in recent years and this investment will likely raise output in future periods, as projects take a number of years to become operational.

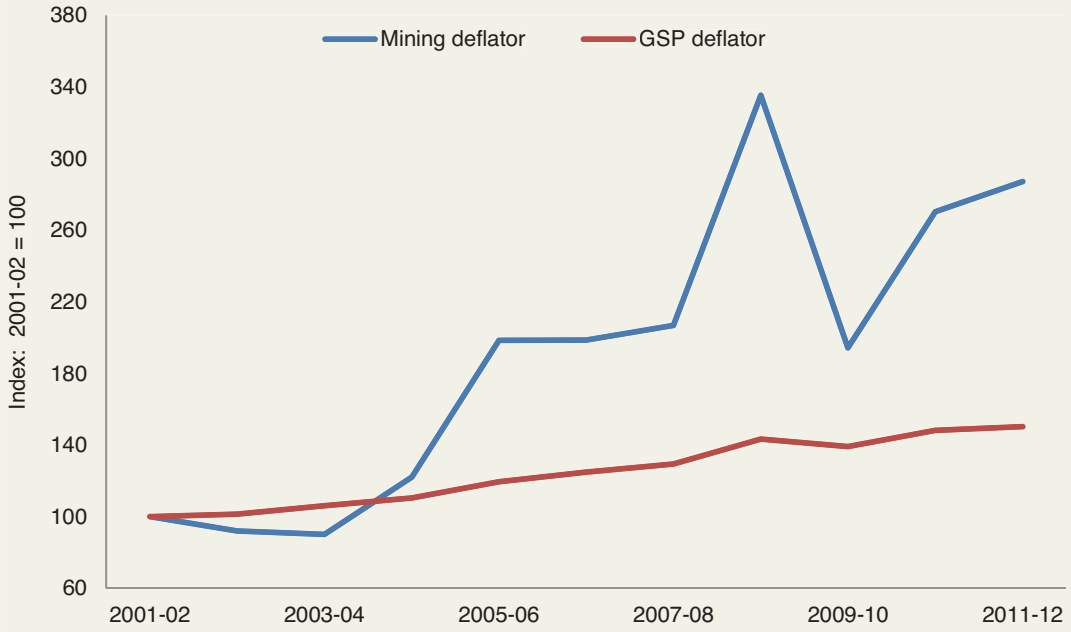
Chart 18
Capital expenditure, mining, Queensland



Source: ABS 5625.0

As shown in Chart 19, the prices received for commodities are high in comparison with long-run averages due to a rapid increase in global demand combined with an inability to significantly increase supply in the short-term. In part, this explains the combination of strong investment at a time of sharp declines in mining MFP. It also suggests that measured MFP for the Queensland mining industry will likely recover over time, as the rate of investment in new projects moderates and new production capacity leads to higher output.

Chart 19
Mining and GSP price indexes, Queensland



Source: Queensland Treasury and Trade, Queensland State Accounts, September Quarter 2012; and ABS 5220.0

There are a number of factors beyond the increase in investment, which have likely influenced the recent fall in mining industry productivity. One possible factor is that the first resources to be mined are generally those with the highest quality deposits (for example, high density ore bodies) and in the most convenient locations with the least amount of overburden to be removed.

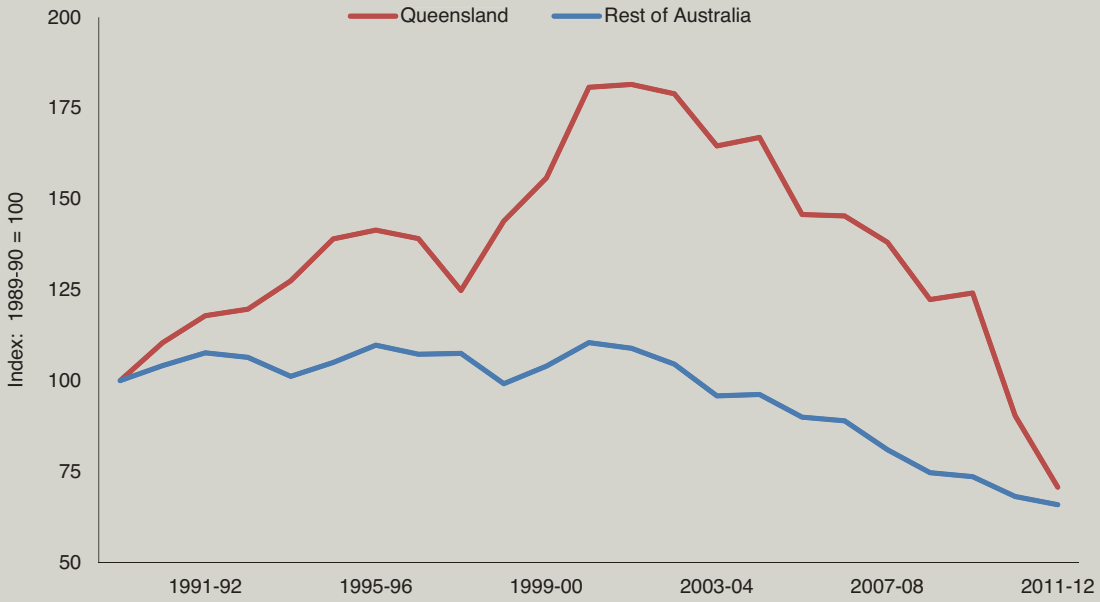
As these sites are depleted and higher commodity prices encourage the exploration of less favourable locations, the same quantity of resources is more costly to extract. The resulting use of more labour and capital inputs for a given amount of output leads to a fall in MFP.

By accounting for the quality of deposits and the overburden removal required, research by Queensland Treasury and Trade (QTT) showed that declining resource quality accounted for some, but not all, of the recent slowdown (see Box 1).

Box 1
Mining industry MFP

Estimates of MFP in the mining industry for Queensland and the rest of Australia over the period 1989-90 to 2011-12 are shown in Chart 20. [11]

Chart 20
Mining MFP index



Source: Queensland Treasury and Trade

MFP for mining in both Queensland and the rest of Australia declined between 1989-90 and 2011-12. In Queensland's mining industry, however, there was a sharp rise in the early 1990s, before falling later in the decade. The temporary weakness in MFP in the late 1990s was likely due to a strong rise in capital investment and the lag between investment expenditure and a commensurate pick-up in output.

Output growth accelerated in 1998-99 and remained strong through to 2001-02, with average annual growth over this four-year period of 11.6%. The acceleration in output over this period was likely a result of the earlier investment being completed and becoming fully operational.

Over the decade since the 2001-02 peak in Queensland mining productivity, MFP has declined by an average annual rate of 9.0%, to be less than half of the level recorded at its peak. Meanwhile, the mining industry in the rest of Australia recorded an average annual decline in MFP of 4.9% over the decade to 2011-12.

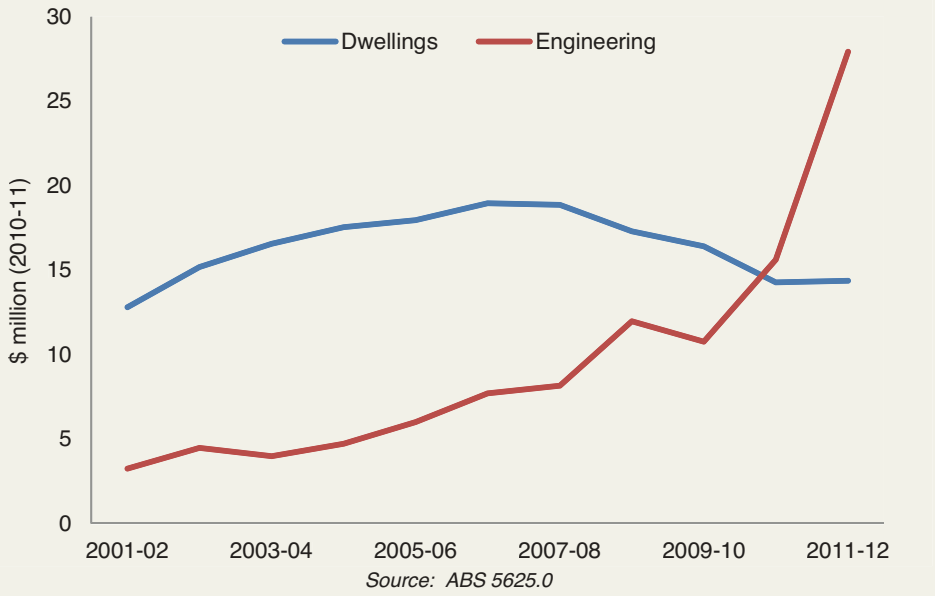
Despite the expectation that mining output in Queensland at some stage will respond to the recent high level of investment, the fall in MFP accelerated over the two most recent years. This is due, in part, to interruptions caused by widespread flooding in Queensland in 2010-11.

The lag between capital investment and a corresponding increase in output growth (exacerbated by interruptions from severe weather events in Queensland) is likely to be a significant influence impacting upon MFP in the mining industry. Cost factors have also been cited by the industry as contributing to a lack of productivity. As explained in Box 1, there is evidence of a similar lag effect providing a surge in Queensland's mining MFP over the four years to 2001-02.

4.3 Construction

Over the decade to 2011-12, Queensland's construction industry output almost doubled in real terms. The construction industry benefited from a strong increase in dwelling investment, the majority of which occurred over the earlier part of the decade. In addition, mining activity boosted engineering construction, particularly in the latter part of the decade. Chart 21 shows the level of private investment in dwellings and engineering construction over the period from 2001-02 to 2011-12.

Chart 21
Real private investment, dwellings and engineering construction, Queensland



Source: ABS 5625.0

There was a substantial increase in dwellings investment between 2001-02 and 2006-07. However, by 2011-12, dwellings investment in Queensland was back below the level recorded in 2002-03 and 24.3% down on the 2006-07 peak.

The moderation in dwelling construction occurred at a time when new engineering construction was ramping up. As discussed previously, the significant amount of investment in the construction of new mines and the expansion of existing projects in the second half of the decade resulted in a level of new engineering construction in 2011-12 almost six times that recorded in 2004-05. Chart 22 shows the annual value of construction work done in Queensland's heavy industry,[12] as well as the value of work yet to be done as at the end of each financial year.

Chart 22
Heavy industry construction activity, Queensland

Source: ABS 8752.0

The value of Queensland's heavy industry construction activity reached just under $20 billion in 2011-12, almost double the previous year. There is also a strong pipeline of resource sector engineering construction activity yet to be done in Queensland, which had risen to a high of $42.3 billion in 2011-12. This represents a nine fold increase on the value of work yet to be done recorded in 2009-10.

4.4 Tourism

Tourism is another traditional strength of the Queensland economy, and has contributed significantly to the state's economic growth since 1985-86. Box 2 outlines issues in the measurement of tourism activity.

Box 2
Tourism statistics

Tourism is not identified as a separate industry in the standard industry classification (ANZSIC) used by the Australian Bureau of Statistics. Rather, it is a bundle of goods and services produced by many industries and consumed by a particular economic agent (tourists) for a specific purpose. This means that most official industry statistics do not separately record tourism activity or its specific contribution to the economy.

However, the Queensland State Accounts include estimates of tourism exports (tourist activity in Queensland) and imports (tourism activity of Queenslanders interstate or overseas). Furthermore, the ABS estimates tourism activity in the Tourism Satellite Accounts (TSA). The TSA measures activity consistent with the national accounting framework, however, the latest available data are for 2010-11. The following discussion on tourism draws on data from these sources.

The appreciation of the Australian dollar over the decade to 2011-12, to historically high levels, had a two-fold impact on tourist activity in Queensland:

- travel to Queensland by foreigners became more expensive relative to tourist destinations overseas

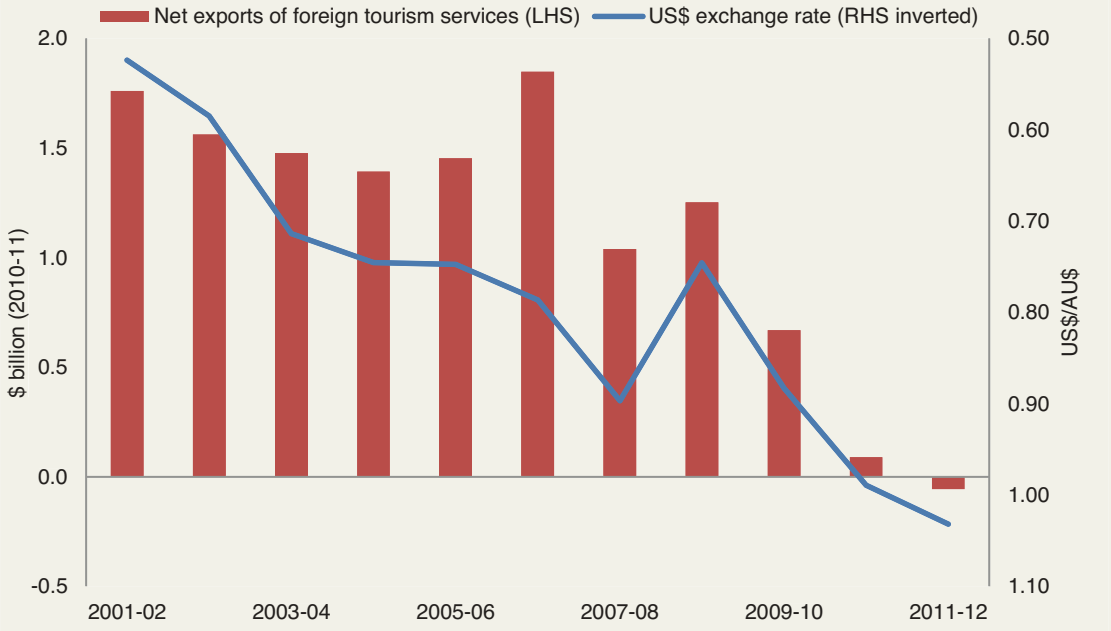
- overseas tourism destinations have been substituted for traditional Queensland holiday destinations as the purchasing power of Australians travelling overseas has risen.

Tourism[13] has become a smaller proportion of the Queensland economy between 2006-07 and 2010-11, declining from 3.9% of Queensland gross value added (GVA) to 3.1% over the period. Similarly, tourism's share of Queensland employment fell from 5.8% in 2006-07 to 5.4% in 2010-11, with the estimated number of persons employed in the sector remaining unchanged at 124,000 persons.

The Queensland State Accounts show overseas tourism exports (international visitor expenditure in Queensland) grew at an average annual rate of 3.0% in real terms between 2001-02 and 2011-12, rising from $2.5 billion to $3.4 billion. In comparison, foreign imports of tourism services (Queenslanders' expenditure when travelling overseas) rose 16.3% on average each year between 2001-02 and 2011-12, increasing from $0.8 billion to $3.5 billion.

This represents a turnaround in net exports of foreign tourism services from a surplus of $1.8 billion in 2001-02 to a small deficit in 2011-12. Chart 23 shows the appreciation in the Australian currency against the US dollar and the change in Queensland's net exports of foreign tourism services.

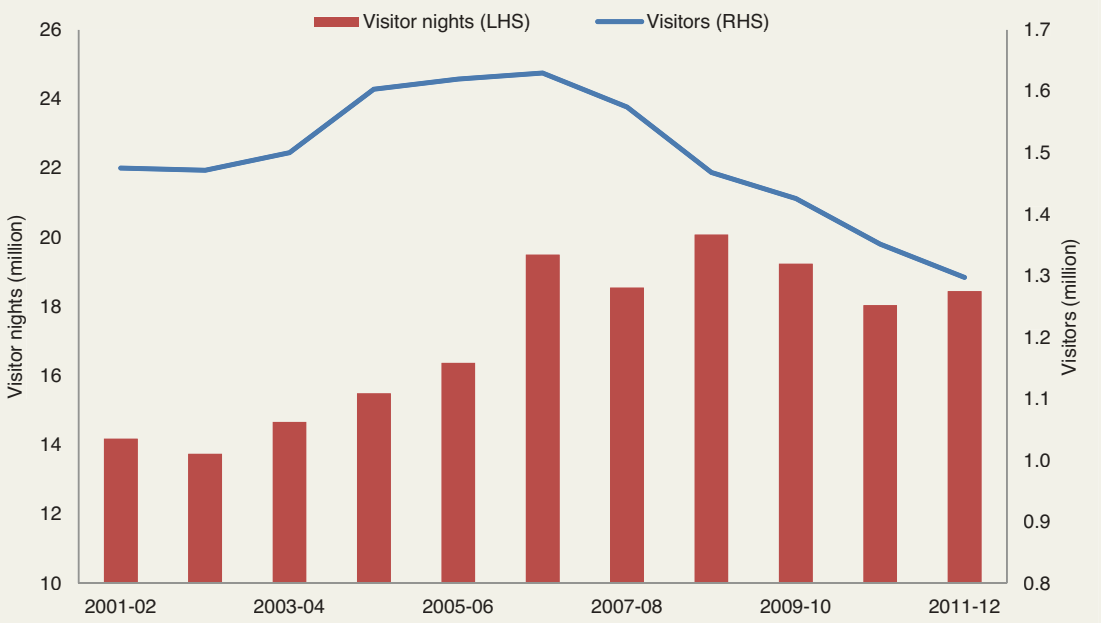
Chart 23
Net exports of Queensland foreign tourism services, and the Australian dollar



Source: Queensland Treasury and Trade, Queensland State Accounts, September Quarter 2012; and ABS 5368.0

In 2011-12, 46% (1.3 million visitors) of international holiday tourists arriving in Australia visited Queensland, down from 55% a decade earlier. Chart 24 shows that the number of visitors arriving in Queensland for the purpose of holidays has declined over the decade to 2011-12. The total number of nights these visitors have stayed remains higher than in 2001-02, but is lower than the peak in 2008-09.

Chart 24
International holiday visitors and visitor nights, Queensland

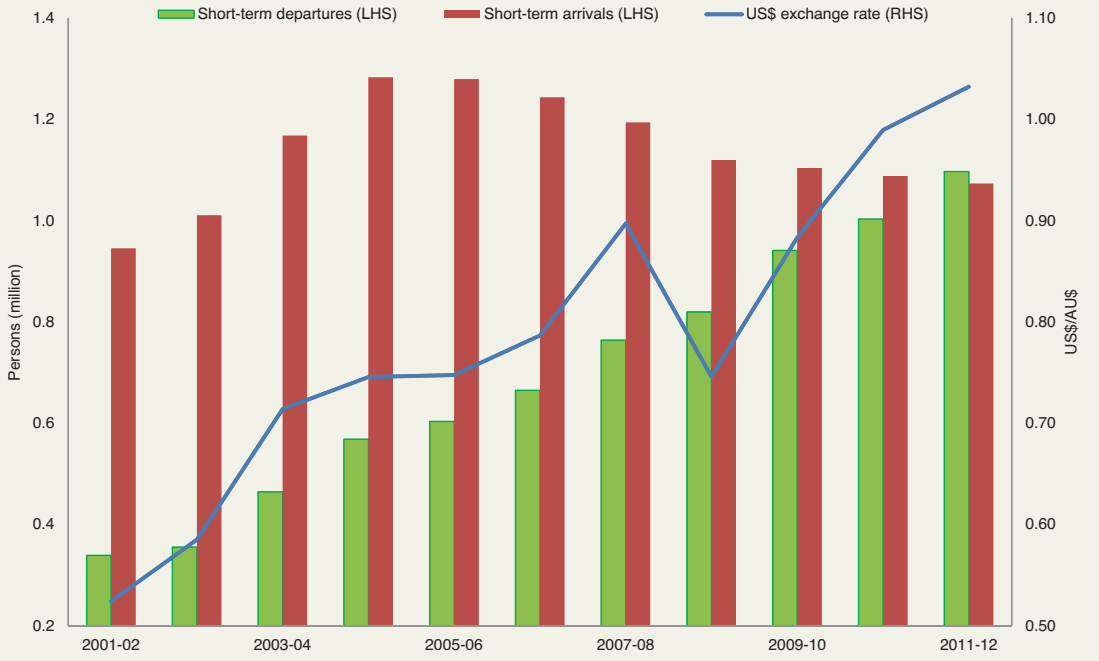


Source: Tourism Research Australia

The Queensland tourism sector faces increased price competition from its overseas competitors as a result of the appreciation of the Australian dollar. Chart 25 shows Queenslanders have been travelling overseas, for holiday or visiting friends and relatives, in increasing numbers, while the number of international visitors arriving in Queensland is down 16.3% from the 2004-05 peak.

The number of Queensland tourist departures outnumbered the number of arrivals in 2011-12, with the two series converging since 2005-06. The number of Queenslanders travelling abroad, for the purpose of holiday or visiting friends and relatives, has almost tripled over the past decade, rising from 339,000 in 2001-02 to 1.1 million in 2011-12.

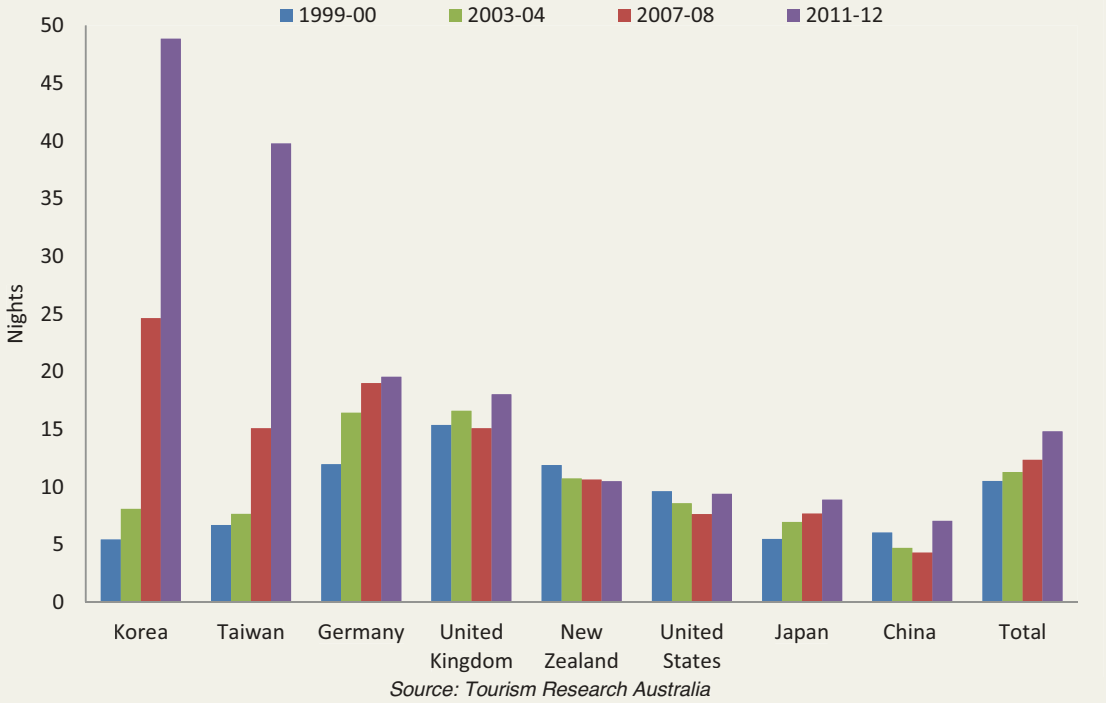
Chart 25
Queensland short-term arrivals and departures and the Australian dollar



Source: ABS unpublished data and 5368.0

Some of the weakness in tourist arrivals from overseas is offset by the fact that international visitors to Queensland, on average, are staying for longer periods. Chart 26 shows the average length of stay by visitors from Queensland's major tourism markets. Asian visitors, in particular, have increased their length of stay over the past decade, with a rise in working holidays and the pursuit of further education while travelling in Australia.

Chart 26
Average length of stay in Queensland by major overseas tourism market



Source: Tourism Research Australia

As shown in Charts 23 and 25, the Australian exchange rate has had a significant impact on tourism activity in Queensland.

Any significant fall in the Australian dollar will increase the competitiveness of Australian tourism operators and encourage Australians to switch from outbound tourism from Australia to traditional domestic holiday alternatives.

5. INDUSTRY STRUCTURE

Table 5 shows industry shares of Queensland's economic activity (measured here as gross value added (GVA)[14] in current price terms) and employment (measured by full-time equivalents (FTEs)) in 2001-02 and 2011-12. It also shows how this structure has changed over the decade.

Table 5

Industry share of output and employment, Queensland

Industry	Gross value added			Employment		
	2001-02 %	2011-12 %	Change in share % point	2001-02 %	2011-12 %	Change in share % point
Agriculture, forestry and fishing	5.1	2.7	-2.4	6.3	3.4	-2.9
Mining	7.5	11.1	3.6	1.3	3.2	1.9
Manufacturing	10.4	7.5	-2.9	11.1	8.3	-2.8
Electricity, gas, water and waste services	2.5	2.7	0.2	1.1	2.0	0.9
Construction	7.3	9.0	1.7	8.5	10.5	2.0
Wholesale trade	5.9	5.8	-0.1	4.4	3.4	-1.0
Retail trade	6.3	5.4	-0.9	10.5	9.5	-1.0
Accommodation and food services	3.3	2.5	-0.8	7.1	5.7	-1.4
Transport, postal and warehousing	6.7	5.8	-0.9	5.6	5.8	0.2
Information, media and telecommunications	3.2	2.1	-1.1	1.5	1.4	-0.1
Finance and insurance services	5.7	6.7	1.0	2.7	3.0	0.3
Rental, hiring and real estate services	2.3	2.5	0.2	2.0	2.3	0.3
Professional, scientific and technical services	4.3	6.0	1.7	5.6	6.6	1.0
Administrative and support services	1.9	2.2	0.3	3.0	3.2	0.2
Public administration and safety	5.9	5.4	-0.5	7.1	7.8	0.7
Education and training	4.7	4.4	-0.3	7.0	7.1	0.1
Health care and social assistance	5.9	6.6	0.7	8.7	11.2	2.5
Arts and recreation services	0.9	0.6	-0.3	1.5	1.6	0.1
Other services	2.4	1.8	-0.6	4.8	3.9	-0.9
Ownership of dwellings	7.6	9.1	1.5	..	..	
All industries	100.0	100.0		100.0	100.0	

.. not applicable

Source: ABS 5220.0 and 6291.0

The major compositional change within the Queensland economy over the 10 years to 2011-12 was mining, which now accounts for a larger share of the Queensland economy than any other industry. This shift in Queensland's industry composition is largely a result of commodity price growth, which has delivered a significant boost to Queensland income.

Despite accounting for 11.1% of Queensland's economic activity in 2011-12, mining remains a relatively small employer, accounting for 3.2% of jobs (up from 1.3% in 2001-02).

The Queensland construction industry accounted for 9.0% of the State's economic activity in 2011-12, up 1.7 percentage points from 7.3% in 2001-02. The majority of this change has been driven by growth in engineering construction, which has been facilitating the significant expansion of the Queensland mining industry. Construction accounts for a relatively large share (10.5%) of Queensland's employment in 2011-12, up 2.0 percentage points from 2001-02.

Agriculture, forestry and fishing has been declining as a share of both industry activity and employment over the past decade. This continues a long-term trend with the agriculture, forestry and fishing output share declining from 6.4% in 1989-90 to 2.7% in 2011-12, where it ranked thirteenth according to its size within the Queensland economy.

Public administration and safety accounted for 5.4% of the Queensland economy in 2011-12, down from 5.9% in 2001-02. Its employment share grew, however, accounting for 7.8% of Queensland's employment in 2011-12, increasing from 7.1% in 2001-02.

Manufacturing, which accounted for 10.4% of Queensland industry activity in 2001-02, recorded the largest decline in industry share of Queensland's output over the decade, down 2.9 percentage points to 7.5% in 2011-12. Similarly, the manufacturing industry in Queensland accounted for 8.3% of the State's employment in 2011-12, a smaller share than a decade earlier when it accounted for 11.1% of jobs in the State.

Health care and social assistance accounted for 6.6% of the Queensland economy in 2011-12. However, its share of Queensland's employment increased by 2.5 percentage points over the decade to 11.2% in 2011-12, overtaking construction as the State's largest employing industry.

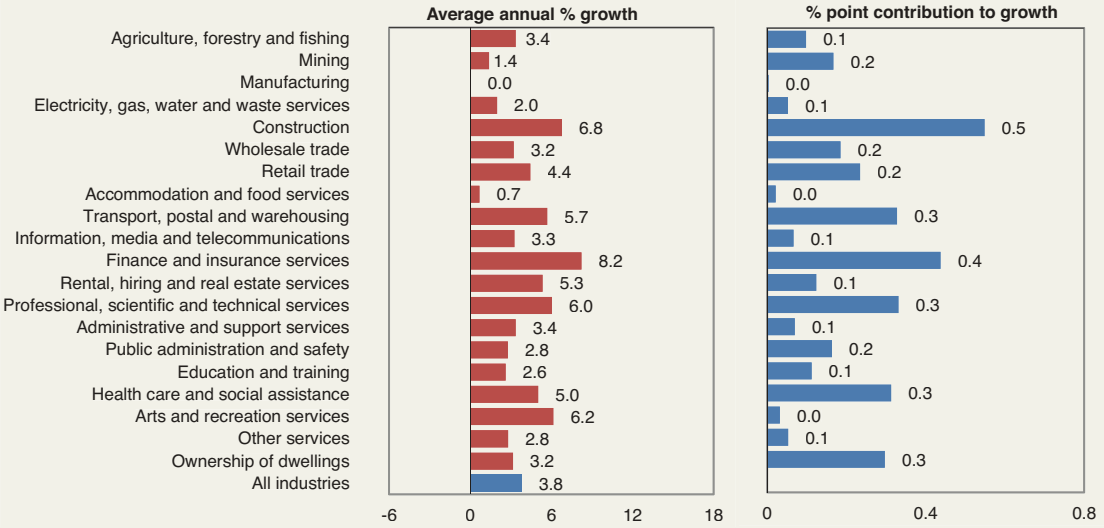
5.1 Industry performance

Chart 27 shows real average annual growth in industry gross value added (GVA) between 2001-02 and 2011-12, as well as each industry's contribution to growth in the broader economy over this period. The percentage point contribution to growth is a means of standardising industry growth by its size, and therefore, relative significance within the Queensland economy. For example, while arts and recreation services grew by 6.2% in average annual terms between 2001-02 and 2011-12, it had only a very minor contribution to growth in Queensland economic activity as it only accounted for 0.6% of the Queensland economy in 2011-12.

As shown in Chart 27, the fastest growing industries in Queensland over the 10 years to 2011-12 were:

- finance and insurance services (8.2% average annual growth)
- construction (6.8%)
- arts and recreation services (6.2%).

Chart 27
Growth in real GVA[15], 2001-02 to 2011-12, Queensland (a)



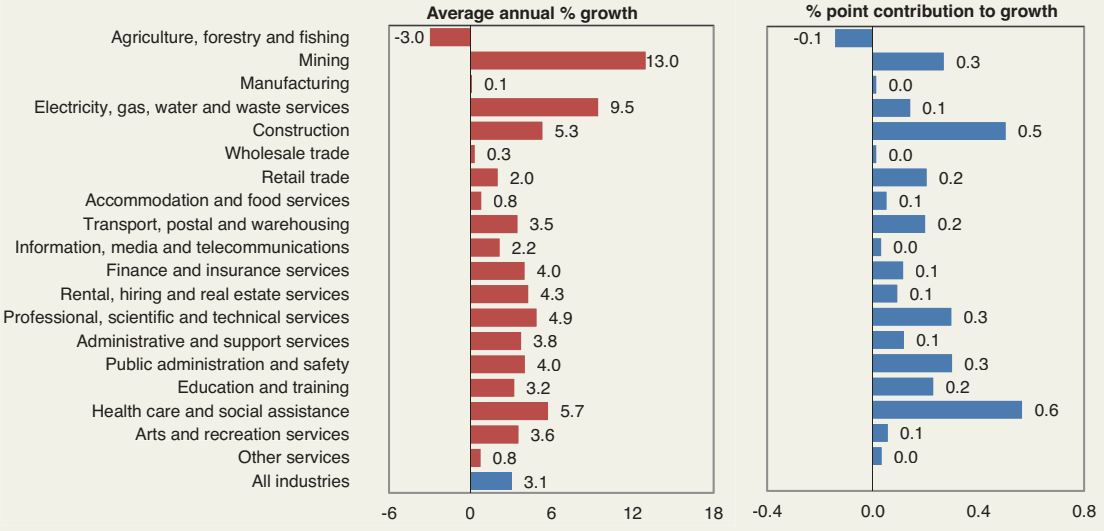
(a) Industry contributions may not sum to all industries GVA growth as chain volume measures are non-additive.

Source: ABS 5220.0; and Commission of Audit

The two main industry contributors to economic growth in Queensland over the period were construction and finance and insurance services, with a combined annual contribution of 0.9 percentage point to the 3.8% average annual growth in Queensland industry activity. Professional, scientific and technical services, transport, postal and warehousing, and health care and social assistance each contributed 0.3 percentage point to Queensland's growth over the 10 years to 2011-12.

Between 2001-02 and 2011-12, the Queensland economy added more than half a million full-time equivalent (FTE) jobs. The number of employed FTEs rose 35.5% over this 10 year period to 2 million in 2011-12. Chart 28 shows the industry composition of average annual FTE employment growth and the contribution to the growth in Queensland FTE positions between 2001-02 and 2011-12.

Chart 28
Average annual growth in FTE employment, 2001-02 to 2011-12, Queensland



Source: ABS 6291.0; and Commission of Audit

Employment in the Queensland mining industry grew by an average annual rate of 13.0% between 2001-02 and 2011-12, contributing 0.3 percentage point to Queensland's average annual employment growth of 3.1%.

Manufacturing remains a relatively large employer within the Queensland economy, with 167,700 FTE positions in 2011-12, up 1.3% from 2001-02. However, growth in Queensland's manufacturing employment over this period was the second slowest Queensland industry, behind agriculture.

Manufacturing has been affected by the rise in the Australian dollar and increased price competition from overseas as imports of overseas manufactured goods became cheaper for Australians and the export of Australian manufactured goods more expensive to foreigners. The Queensland manufacturing industry accounted for 8.3% of Queensland jobs in 2011-12.

Health care and social assistance and construction were the two largest drivers of Queensland's employment growth between 2001-02 and 2011-12, contributing 0.6 and 0.5 percentage point, respectively.

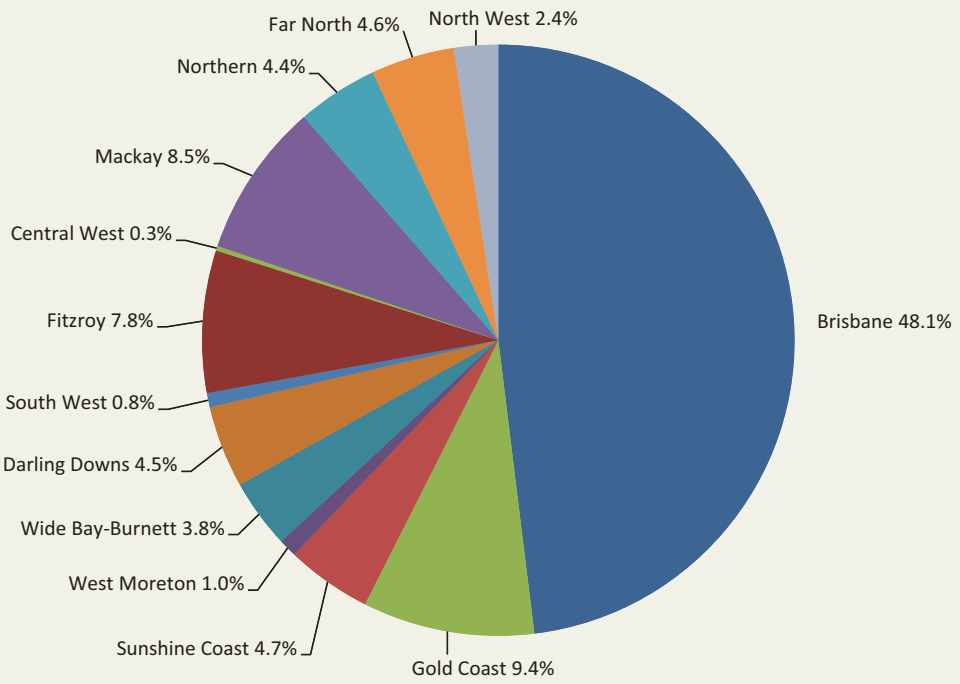
6. Regional Economic Performance

Due to limited data availability, regional economic activity data in this section are presented for the years 2000-01, 2006-07 and 2010-11. As such, regional comparisons and contributions to state-wide economic growth are made over the 10 years to 2010-11, which is a different period to the GSP estimates presented earlier.

Recent economic events, such as the strong expansion in mining, have created disparities in Queensland's regional economic performance. This has resulted in an element of structural adjustment within the Queensland economy as more resources have been diverted to areas of the economy experiencing higher returns, both in terms of higher wages and returns to capital.

Chart 29 shows the regional composition of Queensland economic activity in 2010-11.

Chart 29
Regional share of Queensland economy, 2010-11



Source: Queensland Treasury and Trade

Chart 30 shows real average annual growth in gross regional product (GRP) for the 13 statistical divisions of Queensland between 2000-01 and 2010-11, as well as each region's average annual percentage point contribution to Queensland's 4.1% average annual growth over this period.

Chart 30
Growth in real gross regional product, 2000-01 to 2010-11

Source: Queensland Treasury and Trade

Accounting for almost half ($130 billion) of Queensland's economic activity in 2010-11, the Brisbane region contributed more than half of the growth in the Queensland economy over the period 2000-01 to 2010-11. Brisbane output expanded at an average annual rate of 4.7% between 2000-01 and 2010-11, contributing 2.2 percentage points to the 4.1% average annual growth for Queensland.

Mackay and Fitzroy (where mining accounted for 52% and 33% of GRP, respectively in 2010-11) recorded average annual growth of 4.6% and 3.5%, respectively over the 10 years to 2010-11. These two regions were the third and fourth largest regional economies in Queensland in 2010-11, accounting for 8.5% and 7.8% of Queensland's economic activity, respectively. Mackay and Fitzroy contributed 0.4 and 0.3 percentage point, respectively to Queensland's economic growth between 2000-01 and 2010-11.

Central West was the only region that recorded a lower level of output in 2010-11 than a decade earlier. The fall in GRP in Central West was driven by contractions in manufacturing, construction and mining activity over this period. West Moreton, South West, Central West and North West each had a neutral impact on Queensland's economic growth between 2000-01 and 2010-11.

For most regions, and for the state average, there was a significant turnaround in performance between the earlier and latter part of the decade to 2010-11. Table 6 presents real GRP growth for the two sub-periods 2000-01 to 2006-07 and 2006-07 to 2010-11.

Table 6
Real Gross Regional Product (a), Queensland

	2000-01	2006-07	2010-11	2000-01 to 2006-07	2006-07 to 2010-11	2000-01 to 2010-11
	— $ million —			— Average annual % growth —		
Brisbane	81,554	119,744	129,681	6.6	2.0	4.7
Gold Coast	15,768	24,767	25,312	7.8	0.5	4.8
Sunshine Coast	7,690	11,879	12,600	7.5	1.5	5.1
West Moreton	2,043	2,283	2,651	1.9	3.8	2.6
Wide Bay-Burnett	7,581	10,057	10,209	4.8	0.4	3.0
Darling Downs	8,395	11,068	12,126	4.7	2.3	3.7
South West	2,043	1,624	2,100	-3.8	6.6	0.3
Fitzroy	14,894	19,996	20,974	5.0	1.2	3.5
Central West	830	580	687	-5.8	4.3	-1.9
Mackay	14,486	21,026	22,807	6.4	2.1	4.6
Northern	8,959	11,527	11,923	4.3	0.8	2.9
Far North	9,742	12,310	12,286	4.0	0.0	2.3
North West	6,459	5,790	6,511	-1.8	3.0	0.1
Total Queensland	**180,444**	**252,650**	**269,868**	**5.8**	**1.7**	**4.1**

(a) Chained volume measures ($2010-11)

Source: Queensland Treasury and Trade

Over the first part of the decade, the traditional domestic tourism regions of the Gold Coast and Sunshine Coast recorded the strongest average annual economic growth of 7.8% and 7.5%, respectively. Far North, which is more reliant on international tourist activity, rose 4.0% per year between 2000-01 and 2006-07.

Regions particularly dependent upon tourism activity have not experienced the same level of growth as the mining regions in recent years. The accommodation and food services industry, which is heavily reliant on tourism activity, contracted for every regional economy of Queensland between 2006-07 and 2010-11, apart from Central West where no growth was recorded.

Between 2006-07 and 2010-11, Gold Coast and Sunshine Coast recorded average annual growth of 0.5% and 1.5% respectively, while Far North GRP was unchanged over this period. The slowdown recorded in Gold Coast and Sunshine Coast represented a turnaround in economic performance of 7.3 and 6.0 percentage points, respectively.

ENDNOTES

[1] The first release of Queensland State Accounts was September quarter 1985. Therefore, due to data availability and for consistency purposes, discussion of long-term trends relates to the period from 1985-86.

[2] The green columns represent the 26-year change (from 1985-86 to 2011-12) in the participation rate of each age cohort. A higher green column, therefore, represents a larger change in the participation rate of that age cohort and potentially a larger contribution to the change in the aggregate Queensland participation rate.

[3] Labour productivity is the most commonly used measure of productivity due to its ease of calculation and availability of data. However, it is only a partial measure as it does not account for changes in capital inputs and, therefore, can mask the true rate of change in productivity.

[4] The trending process is consistent with the method used by the ABS in determining productivity growth cycles (see ABS 5204.0, Australian System of National Accounts, 2007-08).

[5] *Queensland Productivity Update: 2011-12*, Queensland Treasury and Trade

[6] *Productivity policies: the 'to do' list*, Economic and Social Outlook Conference, 'Securing the Future', Melbourne, 1 November 2012

[7] The maturity of economic characteristics in these large states is a result of earlier settlement and infrastructure development, as well as a more concentrated development area, implying potentially greater agglomeration efficiency. For example, as at 30 June 1986, Queensland had a significantly lower population density (1.5 persons/km^2) than New South Wales (6.9 persons/km^2) and Victoria (18.3 persons/km^2).

[8] *Producing Prosperity*, speech by Glenn Stevens to the Committee for Economic Development of Australia (CEDA) Annual Dinner, Melbourne, 20 November 2012.

[9] The discussion in Section 2.3 related to trend estimates derived from the original MFP data, which are shown as growth rates in Chart 14. Queensland Treasury and Trade's MFP publication shows that 2007-08 was the end year in the most recent productivity growth cycle (2001-02 to 2007-08). See *Queensland Productivity Update: 2011-12*

[10] For detailed information on inter-industry linkages, see Queensland Treasury and Trade, *Queensland Industry Structure, 2006-07.*

[11] *Estimates of Queensland Mining Productivity Performance, 1989-90 to 2011-12*, Queensland Treasury and Trade.

[12] Heavy industry is defined as oil, gas, and other hydrocarbons infrastructure; bauxite, alumina and aluminium infrastructure; coal and coal handling infrastructure; infrastructure for other minerals (primarily iron ore); and other heavy industry.

[13] Tourism's contribution to the Queensland economy is only available for the period 2006-07 to 2010-11, Tourism Research Australia.

[14] GVA is a common measure for industry output. The conceptual difference between all industries GVA and GSP is taxes less subsidies on products and there is no adequate method to allocate these net taxes across industries.

[15] The appearance of an incongruity between the data in Table 5 and Chart 27 arises due to the fact that the former are implicitly linked to economy-wide price changes while the latter use industry-specific price deflators to estimate real GVA. Therefore, when price growth in specific industries deviates significantly from price growth in the broader economy, as was the case for mining (see Chart 19), an industry's compositional change can differ significantly from its real growth performance.

APPENDIX 2

LONG-TERM ECONOMIC PROJECTIONS – BACKGROUND AND METHODOLOGY

This appendix outlines the assumptions and methodology used to develop the long term economic and financial projections presented in Section A1. It also provides more detailed and additional results that were not included in that section.

1. OVERVIEW

The broad approach

The long-term economic projections are based on a 3Ps approach, where economic growth is determined as a function of population, participation and productivity.

Under this approach, key assumptions regarding future changes to population, workforce participation, and productivity are imposed in the modelling in order to determine long-run economic growth.

Overlaying this broad approach, assumptions also have been made to address:

- changes to household preferences
- shifts in world demand
- domestic and global carbon pricing policies
- resource constraints
- recent developments in the resources sector, including the development of coal seam gas and liquefied natural gas sectors.

Two scenarios were developed, as follows:

- a **lower growth scenario**, which takes a more pessimistic view of long-run economic growth

- a **higher growth scenario**, which takes a more optimistic view of long-run economic growth.

These two scenarios are intended to provide some indication of the sensitivity of the results to different assumptions but should not be interpreted as providing upper or lower bounds for estimates.

The model

The projections have been constructed using a whole-of-economy model: the Queensland General Equilibrium Model for Forecasting (QGEMF). QGEMF is a computable general equilibrium (CGE) model developed by Queensland Treasury and Trade. It is based on the Monash Multi-Regional Forecasting (MMRF) model[1] developed by the Centre of Policy Studies at Monash University.[2]

The QGEMF model uses detailed industry-level data for Queensland and the rest of Australia (RoA) and allows for the effects of compositional change to be captured in the results.

QGEMF explicitly models:

- two regions: Queensland and RoA
- 122 commodities/industries.

Each region is modelled as a separate economy, with region-specific government, household and industry. The behavioural rules in the model generally follow neoclassical economic assumptions, that is, markets are assumed to be competitive, markets are assumed to clear, and price relativities play a key role.

Key enhancements have been made to facilitate:

- the inclusion of domestic and international carbon pricing policies
- projections of age and gender-specific demographic change
- fiscal accounting for state and local governments in Queensland and RoA and for the Australian Government.

The core economic data underpinning QGEMF is derived from the ABS 2006-07 national input-output (I-O) tables, disaggregated into a Queensland and RoA CGE databases.[3] The disaggregation method utilises a wide range of secondary data, including labour force, trade, manufacturing, agricultural and mining surveys, and ABS state accounts to produce state-specific economic stocks and flows.[4]

Caveats

While every effort has been made to ensure that the long-term projections are internally consistent and reflect the assumptions used, the projections should be considered as scenarios rather than forecasts of future economic and demographic change.

Although CGE models draw on a large set of data, they use a number of simplifying assumptions that may mean results are best interpreted as longer-run trends, providing reasonable projections of the average impacts over time, rather than year-to-year forecasts.

2. DETAILED ASSUMPTIONS

2.1 Population

Population is modelled explicitly in QGEMF. The model includes a demographic module that interacts with QGEMF's core economic equations. This population module and the assumptions underpinning it have largely been adopted from the Productivity Commission's modelling of the COAG National Reform Agenda.[5]

The population module distinguishes population by single year age, gender and region, and has an explicit treatment for:

- ageing
- fertility
- net overseas migration (immigration less emigration)

- net interstate migration (interstate arrivals less departures)
- mortality.

Fertility

Changes to the aggregate state fertility rate (Table 1) are determined by assumed changes to age-specific fertility rates and changes to the age structure of the population.

The assumed changes to fertility rates are based on historical trends and, nationally, are broadly in line with fertility rate assumptions used by the Queensland Government population projections[6] and the Australian Government *Intergenerational Report 2010* (IGR).[7]

Table 1
Queensland Total fertility rate projections to 2050

Projection	2020	2030	2040	2050
Qld Government – low series	1.7	1.7	1.7	1.7
Qld Government – high series	2.1	2.1	2.1	2.1
Productivity Commission 2011 (a)	2.04	1.98	1.92	1.85
Commission of Audit (b)	2.06	2.00	1.94	1.88

(a) 2050 figure is for 2049-50
(b) The Productivity Commission and Commission of Audit estimates differ because the Commission of Audit estimates are based on more recent data, showing historically high fertility rates in recent periods.

Source: Queensland Government population projections – 2011 edition; Productivity Commission, 2012; and Commission of Audit

Mortality

Life expectancy projections are generated from assumed changes to age and gender-specific mortality rates and changes to population. Assumptions relating to changes to mortality rates presume a continual linear trend improvement in life expectancy. The resulting life expectancy assumptions (Table 2) are similar to Queensland Government 2011 population projections and IGR 2010 projections.

Table 2
Projections of life expectancy at birth to 2050-51

Projection	2020		2030		2040		2050	
	Male	Female	Male	Female	Male	Female	Male	Female
Qld Government (Low series)	82.0	86.2	82.9	86.9	83.7	87.4	84.5	87.9
Qld Government (High series)	83.1	87.3	86.1	89.8	89.1	92.3	92.1	94.8
IGR 2010 (a)	82.5	86.2	84.5	87.8	86.1	89.2	87.7	90.5
Commission of Audit:								
Australian average	81.0	86.9	83.3	89.2	85.5	91.4	87.9	93.7
Queensland	81.9	86.2	84.1	88.3	86.0	90.5	87.7	93.3

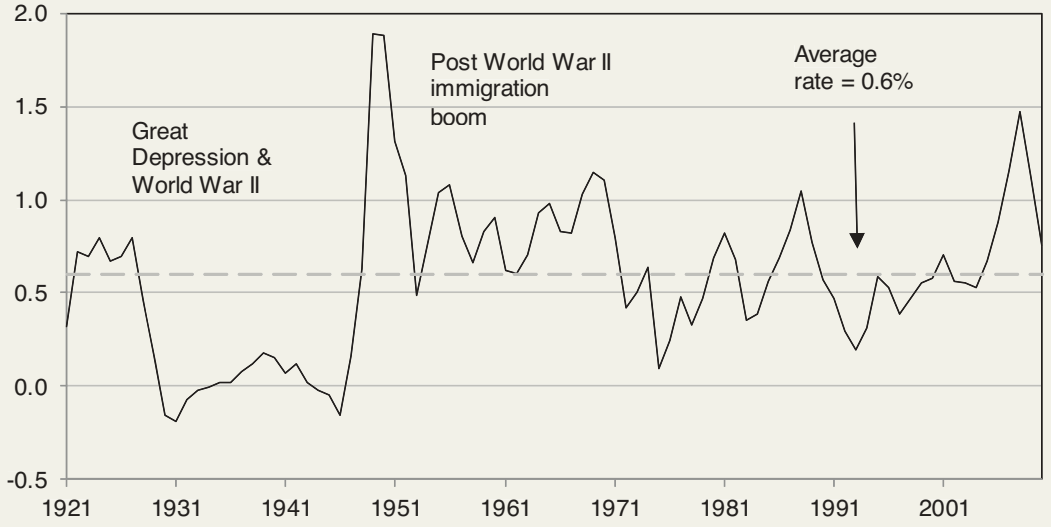
(a) 2050 figures are for 2049-50

Source: Queensland Government population projections – 2011 edition; Australian Government, 2010; and Productivity Commission, 2012

Net overseas migration (NOM)

The level of NOM has varied substantially over time and is largely determined by Australian Government policy. Despite this, the long-run average ratio of NOM to population has remained fairly stable at 0.6% of the population (Chart 1).

Chart 1
Australian net overseas migration as a share of population (%), 1921 to 2010



Source: Productivity Commission, 2012

From 2016-17, NOM is assumed to grow at a rate such that it remains at 0.6% of the national population.[8] The age and gender shares for foreign migrants are derived from ABS migration data[9] and are assumed constant over the projection period.

Net interstate migration

Net interstate migration is determined by relative employment conditions in each region. The model's core equations determine economic conditions and demand for labour for each jurisdiction. Workers are assumed to move between regions in response to employment conditions, such that the wage relativities between jurisdictions do not change over time.[10]

The movement of workers between jurisdictions forces a resultant shift in population with:

- an allowance for family members of migrating workers
- age and gender characteristics of interstate migrants reflecting historical averages.

2.2 Participation

Labour supply is determined by:

- the working age population
- the participation rate.

The working age population is determined by the demographic module which provides estimates of population by single year age cohort.

Future participation rates are imposed by age, gender and state. As a result, changes in the population of each age cohort determine the overall participation rate in each region.

In the higher growth scenario, age-specific participation rates are assumed to rise slightly, particularly for older cohorts. In the lower growth scenario, age-specific participation rates for Queensland are assumed to converge to national rates and then remain fixed.

2.3 Unemployment rates

Assumptions around the long-term unemployment rate are based on the concept of a rate that can be sustained without generating upward pressure on inflation. This is commonly referred to as the non-accelerating inflation rate of unemployment (NAIRU).

The NAIRU depends on a complex range of economic, demographic and institutional factors, including the way inflation expectations are formed, the wage-setting environment, the tax–transfer system, and the education and skills of people in the labour force. The NAIRU varies over time and cannot be measured directly. It is typically estimated using economic models which provide a range of estimates, with a considerable margin of imprecision around these estimates.

A constant NAIRU of 5% at the state level is assumed in the modelling, the same rate used in IGR 2010.

2.4 Productivity

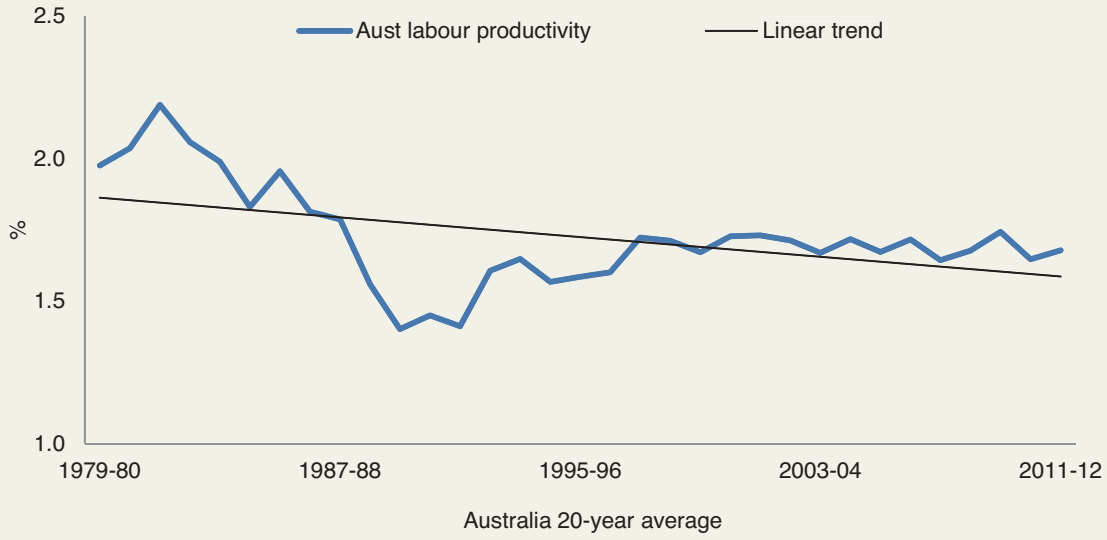
The modelling adopts an approach to productivity growth similar to the modelling recently conducted by the Productivity Commission. Under this approach, long-run average sector-specific labour productivity growth rates are used, with the compositional mix of industrial production determining aggregate productivity growth.

This approach differs significantly from the approach used in most Australian Government modelling exercises such as the *Intergenerational Report 2010*, and the Strong Growth Low Pollution modelling.[11] In both of these exercises, long run productivity growth is assumed to converge to the 30-year historical average growth rate in labour productivity.

While the use of long-run average productivity growth rates is appealing for its simplicity, it ignores trends in productivity growth rates, particularly those that are driven by long-term structural changes. Long-run trends showing shifts in employment towards service industries are likely to depress productivity growth[12] because many of these service industries have low or zero measured productivity growth[13] once capital deepening effects are taken into account.[14]

A long-run analysis of labour productivity trends shows that labour productivity has fallen over time (Chart 2).

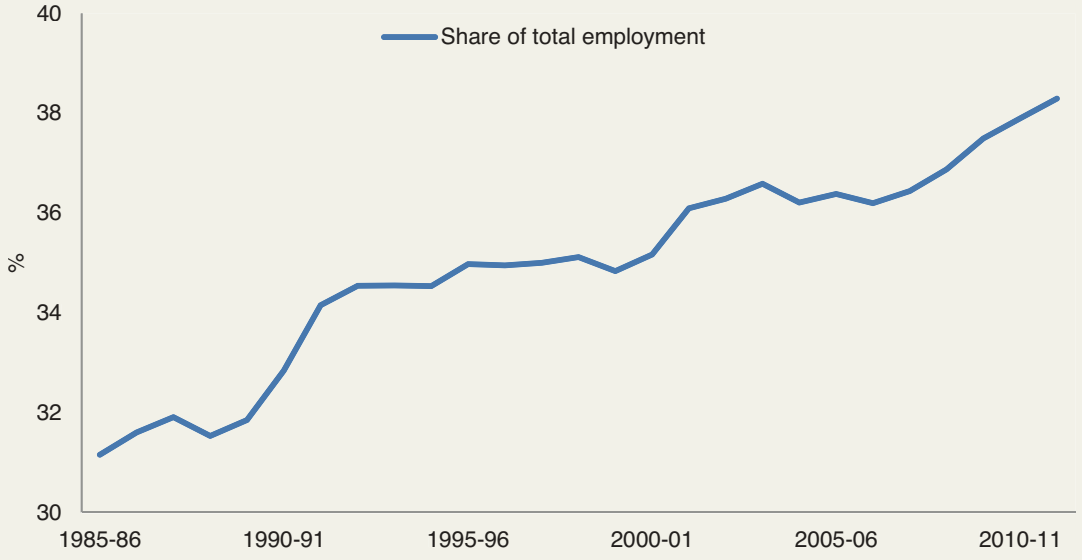
Chart 2
Australian labour productivity growth, 20-year moving average[15]



Source: ABS 5206.0 and 6291.0

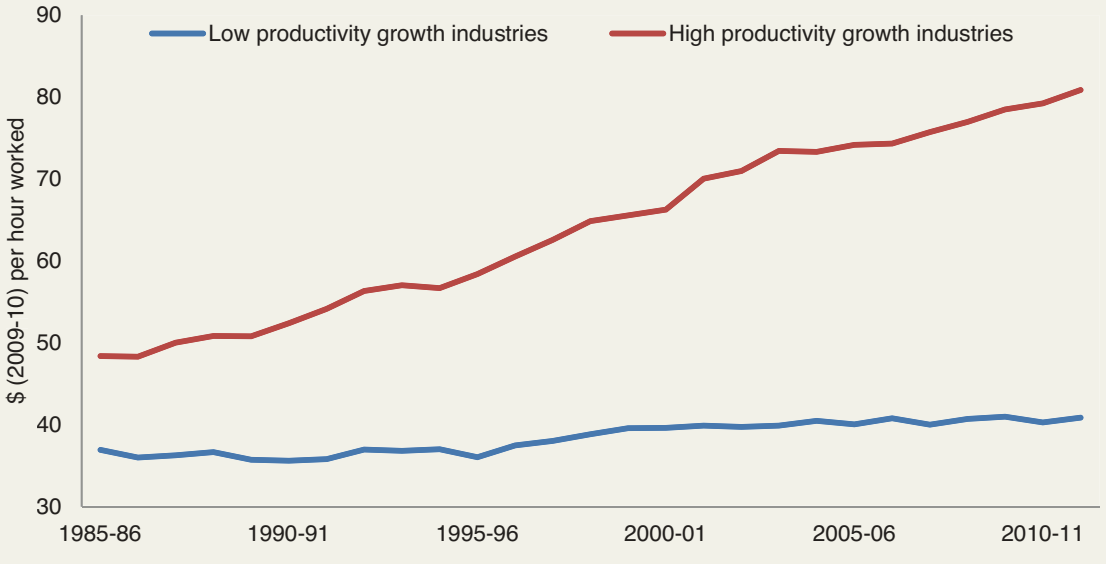
Further evidence suggesting that future structural changes will have a downward effect on measured productivity is provided in Chart 3 and Chart 4. Chart 3 shows that the share of employment in industries with lower than average productivity has increased over time, while Chart 4 shows that real gross value added (a measure of output) per hour worked has remained unchanged over the last 25 years.

Chart 3
Share of low productivity growth industries[16] in total employment, Australia



Source: ABS 6291.0

Chart 4
Real gross value added per hour worked, Australia



Source: ABS 5206.0 and 6291.0

Over the projection period, industry-specific labour productivity is assumed to reflect recent changes and longer-term historical trends. Capital deepening is modelled on the basis of relative returns to capital across industries. For market sector industries, the component of projected labour productivity that is not captured by capital deepening is assumed to be multifactor productivity (MFP) arising from 'primary factor augmenting' technical change. For non-market industries, MFP growth is assumed to be zero, in line with Australian National Accounting practices.

Over the forward estimates period (to 2015-16), aggregate labour productivity is consistent with that assumed in the Queensland Budget 2012-13. Over the period to 2020, multifactor productivity in the mining industry is endogenously determined within the model, and reflects recent and predicted growth in capital stocks and assumed growth in mine output.

The concept of measured productivity is important for the government sector since the ABS does not currently construct multifactor productivity estimates for the non-market sector (which incorporates industries prominent in government service delivery such as public administration and safety, health care and social assistance, and education and training). These services are not included in the ABS productivity estimates because their outputs are either not sold or not sold at full market prices and/or their outputs are derived as a function of their inputs.[17]

There is also considerable difficulty in capturing changes in the quality of output in service industries. Although some quality improvements may be implicitly captured, such as through the price data used to deflate current price estimates, the difficulties of explicitly and objectively quantifying quality improvements are such that final measures of industry output may not adequately capture all quality changes. This can then result in output growth and MFP being understated.

2.5 Global demand

Over the long run, global growth is determined by:

- the growth rates of countries at the frontier of production (a function of productivity, population and participation)
- the rate at which other countries' per capita incomes converge with these countries.

For this modelling exercise, long-run global assumptions are derived from a global modelling scenario conducted using the Global Trade and Environment Model (GTEM) for the Garnaut Review.[18] This scenario includes the impacts of global policies to reduce carbon emissions and is broadly consistent with the global modelling conducted for the Australian Government's *Strong Growth, Low Pollution* report. The GTEM modelling provides an internally consistent set of assumptions about the effect of global growth on both demand for Australian commodities and the price of foreign goods consumed in Australia.

While it would be ideal to conduct global modelling using more recent assumptions, this was not possible in the time frame available for the Commission's modelling exercise. To minimise any shortcomings of using slightly dated global modelling, the GTEM global outlook is supplemented with more current commodity outlooks over the short to medium term.

In addition, the modelling incorporates exogenously imposed adjustments to the terms of trade over the medium term. In line with previous modelling exercises conducted by Queensland and Australian Treasuries and the Productivity Commission, the terms of trade assumptions are imposed through changes to foreign demand schedules for key commodities.

2.6 Household demand

Household expenditure patterns are determined by:

- the relative prices of different goods
- household income
- consumer preferences.

The relative prices of goods and household incomes are determined within QGEMF and reflect a wide range of economic influences such as resource constraints, the terms of trade and exchange rates, returns to land, labour and capital, and redistributive policies.

Expenditure on specific goods is determined in QGEMF with households purchasing a bundle of goods which maximise a utility function subject to a budget constraint.

Household taste shifts account for any additional change in consumption patterns after accounting for changes in incomes and relative prices. Assumed changes to household tastes are based on historical decomposition analysis by the Centre of Policy Studies[19] and the Australian Treasury.[20] The taste shift terms are assumed to decline to zero in a linear fashion between 2020 and 2050, reflecting uncertainty about how persistent these trends will be in the future.

Projected shifts in household consumption patterns suggest a continuation of the long-run trends, showing a declining proportion of expenditures on basic commodities (such as food and energy) and an increasing proportion of expenditures on elaborately prepared goods and services including personal services, restaurants, holidays and communication services.

2.7 Government expenditures

Government expenditures are determined by:

- the level of services provided
- the cost of providing these services.

Level of service provision

In general, the level of government service provision is assumed to move with real household consumption. This assumption reflects the idea that, as its citizens become wealthier, there are increasing expectations regarding the quantity and quality of services provided by their governments.

Government expenditure on health-related care is also assumed to be heavily influenced by changes in the age structure of the population. Under this assumption, real expenditure on age-related health and other care increases with the proportion of the population aged over 65.

While the level of real per capita service provision is assumed to grow over time, it is assumed to be the same in all modelled scenarios.

Cost of service provision

Over the long run, the cost of providing government service is largely dependent on:

- wage rates
- the level of productivity in the government sector.

Wage rates are determined within the model and reflect the supply of labour and demands for labour services across the economy. The impact of this on the cost of service provision is that, while the level of real per capita service provision is assumed to be the same in all modelled scenarios, higher wage growth (as occurs in scenarios with higher productivity) will lead to a higher cost of service provision. This outcome is particularly relevant for government services since the majority of government services are delivered by sectors with lower productivity growth than the market sector.

Productivity in the government sector in this modelling is determined by productivity of those industries that contribute a large share of output to government final consumption expenditures. These include the industries of public administration and safety, health care and social assistance, and education and training. As discussed previously, assumptions for these industries reflect historically observed trends in labour productivity.

2.8 Fiscal accounts

QGEMF includes a Government Finance Statistics (GFS) module that provides fiscal projections that are consistent with the projected changes to the structure and size of the broader economy.

The GFS module provides some detail on the individual components of revenues and expenditures and net acquisition of non-financial assets. This allows the calculation of net operating and net lending/borrowing (the fiscal balance) positions and allows the estimation of changes to government debt.

The GFS module covers three levels of government:

- Queensland State Government
- Rest of Australia state and local government
- Federal government.

The data underpinning the GFS module are derived from ABS Government Finance Statistics. Key components of the GFS data (such as GST and general taxes) are reconcilable with the economic data in QGEMF's economic database, and hence are driven by economic factors in the model. For other components, such as other grants there is no corresponding economic factor and a proxy driver is used.

Over the forward estimates period, the fiscal components reflect estimates provided in the 2012-13 State Budget.[21] After this, fiscal projections are determined within the model.

A summary of the GFS accounts and their associated drivers for the General Government sector is provided in Table 3. Further detail for three key items is provided below.

Table 3
Government Finance Accounts (General Government Sector)

Government Revenue Accounts	Drivers
Taxation income	
• GST and general taxes	The usage and price of commodities for intermediate and final use
• Taxes on international trade	Price of imports, exchange rate, import volumes
• Taxes on motor vehicles	Nominal GSP
• Payroll taxes	Wages and employment; tax rates are assumed fixed
• Municipal rates	Nominal GSP
• Other property taxes	Price and use of non-labour factor inputs; tax rates are assumed fixed
• Income taxes on individuals	Wages and employment; tax rates are assumed fixed
• Income taxes on enterprises	Firms' gross operating surplus; tax rates are assumed fixed
• Income taxes on foreigners	Nominal GDP
Grants	
• GST tied Australian Government grants to states	GST is apportioned between states based on horizontal fiscal equalisation principles
• Other Australian Government grants to states	Equal to the Australian Government grant expense and apportioned between states based on their relative populations
• Other grants	Nominal GSP
Sales of goods and services	Nominal government consumption
Dividends	Nominal gross operating surplus of public non-financial corporations (PNFCs)
Interest revenue	Nominal GSP/GDP
Royalties	Price and quantity movements for relevant mining commodities; nominal GDP for mineral resource rent tax
Other revenue	Nominal GSP/GDP
Government Expenditure Accounts	**Drivers**
Gross operating expenses	Nominal government consumption
Personal benefit payments expenses	CPI plus the unemployment rate or population growth
Grant expenses	
• GST tied Australian Government grants to states	Equals sum of state GST grant income
• Other Australian Government grants to states	Total tax revenue
• Other grant expenses	Nominal GSP/GDP
• Subsidies to private industries	Nominal activity of non-PNFC related industries
Interest expenses	Growth in borrowings plus changes in the interest rate
Nominal superannuation interest expenses	Nominal GSP/GDP
Other expenses	Nominal GSP/GDP
Government Budget Accounts	**Drivers**
Net lending/borrowing	Net operating balance less net acquisition of non-financial assets
Net operating balance	Income less expenses
Net acquisition of non-financial assets	GFCF less depreciation plus change in inventories plus other transactions in non-financial assets
• Gross fixed capital formation	Nominal GSP/GDP
• Depreciation	Equal to depreciation portion of gross operating expenses
• Change in inventories	Fixed
• Other transactions in non-financial assets	Nominal GSP/GDP
Borrowing	Net lending/borrowing in the previous year

Source: Queensland Treasury and Trade - QGEMF

Distribution of GST

GST is distributed to state governments on the principle of horizontal fiscal equalisation (HFE). Broadly speaking, HFE aims to equalise each state's revenue per capita, after allowing for differences in tax bases and the relative costs of service provision in each jurisdiction. For these projections, Queensland's relative cost of service provision is assumed to remain constant across the projection period.

The GFS module distributes GST revenues, accounting for relative changes in Queensland's population and changes to tax and mining royalty bases. This implies that, assuming no change to population, if a state's tax or royalty revenue increases relative to other states, this increase will, largely, be offset by a reduction in its GST distributions from the Commonwealth.

Gross fixed capital formation

Over the forward estimates period, gross fixed capital formation (GFCF) reflects Budget estimates. After 2016-17, General Government GFCF is moved to a long-run sustainable level and then held fixed as a proportion of GSP/GDP. This ratio reflects observed long-run historical averages of per capita investment in public infrastructure (such as roads, hospitals and schools) by general government.

Borrowing and interest expenses

Any fiscal deficits (surpluses) are funded by additional borrowing (lending). Gross borrowings are used to estimate interest expenses. While interest expenses are a function of gross debt and the rate of interest on government debt, the model does not account for any changes to credit ratings and associated debt risk premiums.

3. SELECTED ADDITIONAL RESULTS

This Section provides selected additional results that provide further context for the results presented in Section A1 of this Report.

3.1 Population

Queensland's population is projected to grow to 7.4 million people under the lower economic growth scenario and 7.8 million people under the higher economic growth scenario. These projections are the result of the demographic assumptions outlined in Section 2.1 of this Appendix, and reflect the assumption that interstate migration is mainly driven by economic rather than demographic factors.

Tables 4 to 6 show the Commission's population projections, compared with other published population projections. The Commission's projected Queensland population for 2050, for both the lower growth and higher growth scenarios, are within the range of the Queensland Government projections.[22]

Table 4 Australian population projections to 2050 (millions of persons)				
Projection	**2020**	**2030**	**2040**	**2050**
ABS series A	26.1	30.5	35.0	39.6
ABS series B	25.3	28.5	31.3	34.0
ABS series C	24.6	26.9	28.7	30.2
Intergenerational Report 2010 (a)	25.7	29.2	32.6	35.9
Productivity Commission 2012 (a)	25.5	28.5	32.0	34.9
Commission of Audit	25.0	28.1	31.3	34.7

(a) 2050 figures are for 2049-50

Sources: ABS 3222.0; Australian Government, 2010; Productivity Commission, 2012; and Commission of Audit

Table 5 Queensland population projections to 2050 (millions of persons)				
Projection	**2020**	**2030**	**2040**	**2050**
Queensland Government - Low series	5.22	5.89	6.49	7.02
Queensland Government - High series	5.77	7.13	8.57	10.14
Commission of Audit - lower economic growth	5.00	5.70	6.31	7.44
Commission of Audit - higher economic growth	5.10	5.86	6.54	7.75

Sources: Queensland Government population projections – 2011 edition; Australian Government, 2010; Productivity Commission, 2012; and Commission of Audit

Table 6 Queensland average yearly net migration projections (persons)				
Projection	**2011-20**	**2021-30**	**2031-40**	**2041-50**
Queensland Government - Low series	43,439	44,809	46,064	47,318
Queensland Government - High series	78,190	81,557	84,227	86,896
Commission of Audit - lower economic growth	39,234	40,427	37,630	35,511
Commission of Audit - higher economic growth	37,283	44,418	48,057	49,366

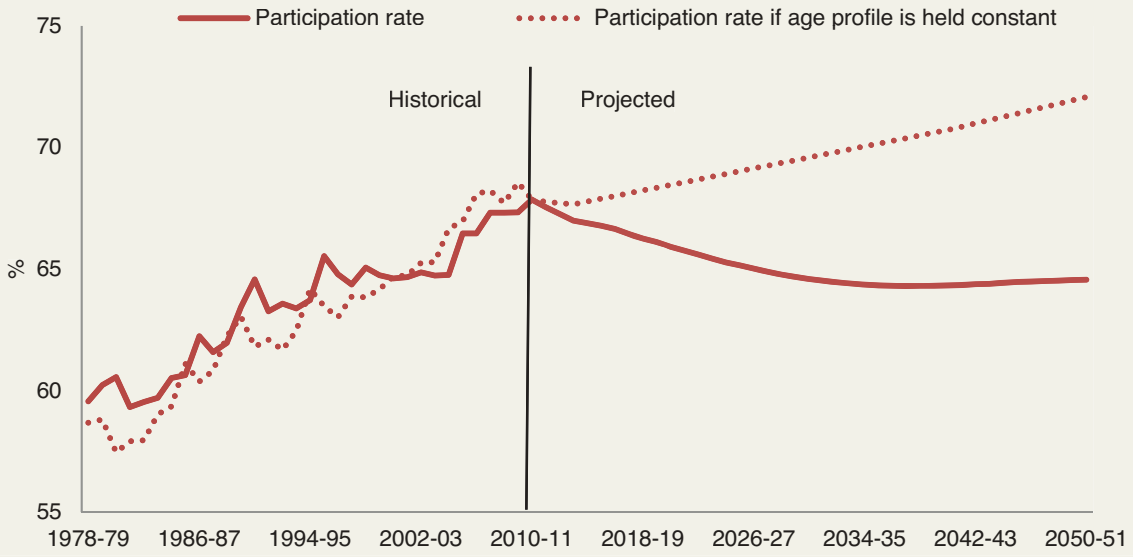
Sources: Queensland Government population projections – 2011 edition; and Commission of Audit

3.2 Participation

While aggregate participation rates have increased steadily since 1978, mainly due to increasing female participation, this trend is likely to reverse over the coming decades. The reason for this is twofold. Firstly, the rate of convergence between male and female participation has slowed considerably in recent decades, and is likely to slow further in the near future. Secondly, as the population ages, a greater share of the population will be in age cohorts with lower participation rates.

This is illustrated in Chart 5, which shows the impact of ageing on participation by comparing actual and projected aggregate participation rates with the aggregate participation rates that would eventuate if the age profile of the population did not change. The historical and projected participation rates with fixed age profiles are estimated by applying time-specific age and gender participation rates to the population profile that existed at 2010-11.

Chart 5
Labour force participation, Queensland, historical and projected



Source: ABS 6291.0

Projected aggregate participation rates are reported in Table 7, and compared with projections from the Productivity Commission and the IGR 2010 of the Australian Government.

Table 7
Projections of changes in Australian and Queensland participation rates to 2050-51

Projection	Region	Participation rate	
		2010-11	2050-51
Productivity Commission (2012) (a)	Aus	64.1	55.8
Productivity Commission (2012) (b)	Qld	65.6	56.8
Intergenerational Report 2010 (b)	Aus	65.1	60.6
Commission of Audit - Higher scenario (c)	Aus	66.6	59.2
Commission of Audit- Higher scenario (c)	Qld	67.4	60.6
Commission of Audit - Lower scenario (c)	Aus	66.6	52.4
Commission of Audit - Lower scenario (c)	Qld	67.4	53.7

(a) 2050-51 figure is for 2049-50
(b) The 2050-51 figures is the Commission of Audit's estimate of their projection.
(c) Commission of Audit projections include defence personnel in counts, therefore participation rates differ.

Source: Australian Government, 2010; Productivity Commission, 2012; and Commission of Audit

3.3 Structural change

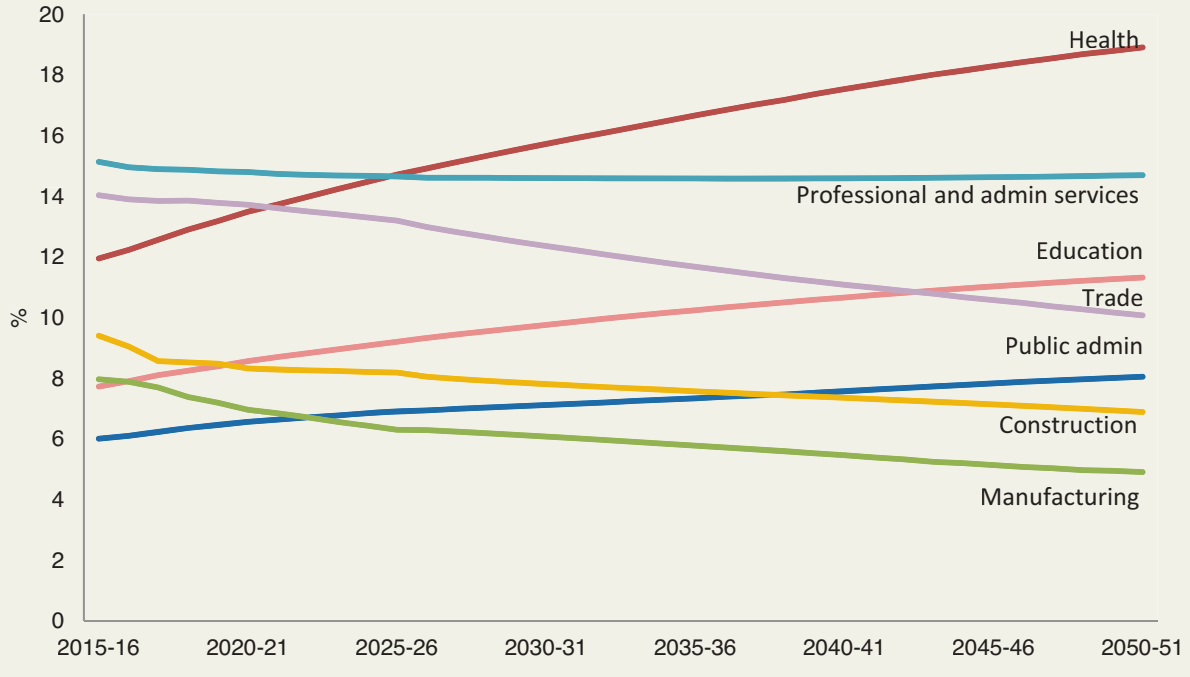
The Queensland economy is likely to undergo significant structural change over the projection period. In the medium term, the main drivers of structural change relate to events in the resources sector, with mining's share of GVA projected to increase substantially over the period to 2020-21.

Over the longer run, the share of service employment, particularly for those industries with lower than average measured productivity (such as health and education), is projected to increase significantly.

These structural changes have significant implications for future productivity growth. The shift in employment to service industries, which have lower measured productivity growth, is the key driver behind the slowing of aggregate productivity growth over the projection period. Chart 6 and Chart 7 show projected changes to industry employment shares over the period 2010-11 to 2050-51. Industries with larger shares of Queensland employment, such as health and education are shown in Chart 6, and industries with smaller employment shares are shown in Chart 7. Changes in employment shares are mainly driven by the relative growth in industry output and the industry-specific growth in labour productivity. Key features include:

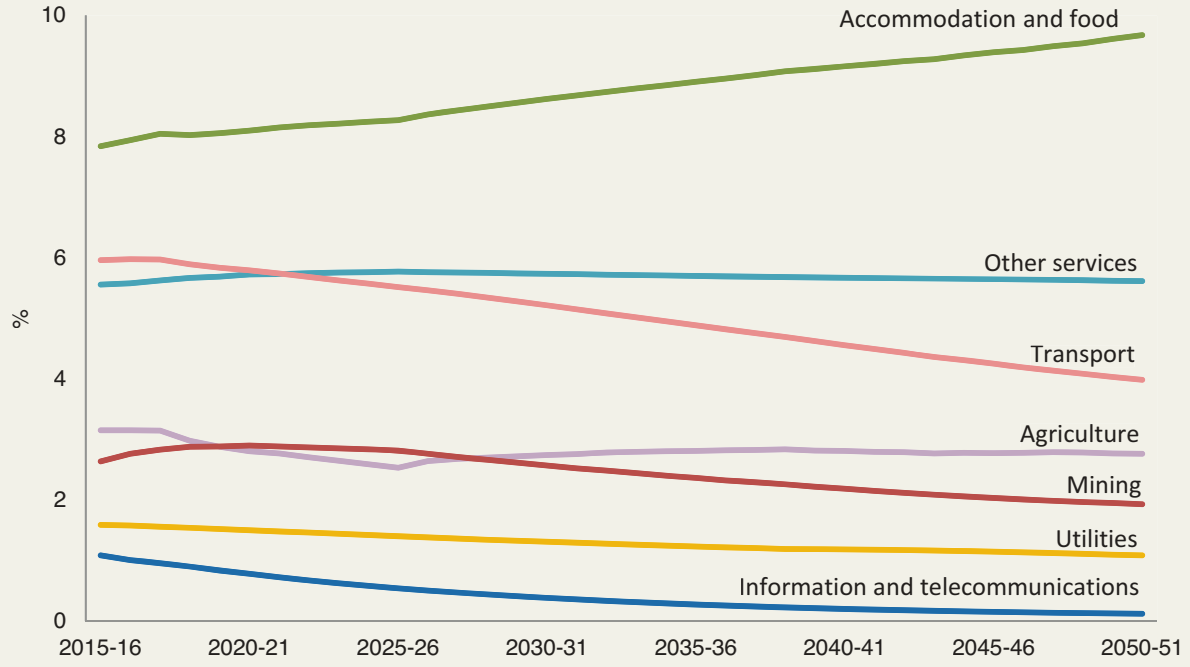
- Only small changes in the share of employment for mining, in the short run, despite large projected increases in output. This occurs since mining is expected to undergo significant increases in labour productivity as previous investments in infrastructure come online over this period.
- A declining employment share for retail trade and wholesale trade, reflecting assumed high labour productivity growth in the industry.
- A large increase in the share of persons employed in health. This reflects both faster than average growth in output as well as slower than average growth in labour productivity.
- A fall in the employment share for construction, reflecting the peaking of investment activity in the resources sector.
- Rising employment shares for public administration, education and accommodation and food services, reflecting slower than average productivity growth, with output projected to grow, broadly, in line with economic growth.

Chart 6
Shares of employment – larger industries, higher growth scenario (persons)



Source: Commission of Audit

Chart 7
Shares of employment – smaller industries, higher growth scenario (persons)

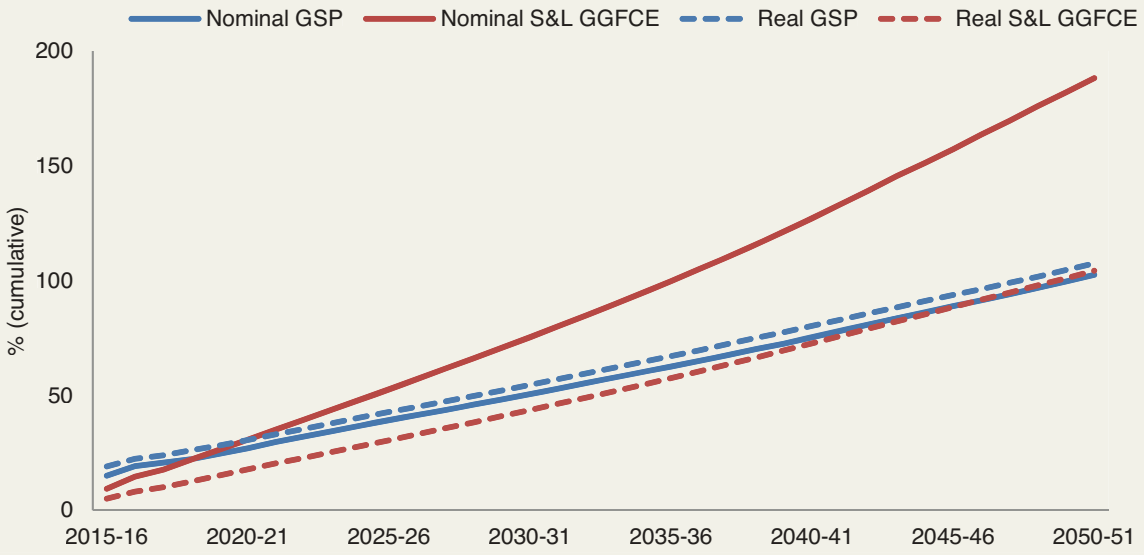


Source: Commission of Audit

3.4 Demand for government services

Over the period to 2050-51, demand for government consumption expenditure is projected to rise roughly in line with GSP in real terms, but significantly outpace GSP growth in nominal terms (see Chart 8). The difference between real and nominal government consumption to GSP ratios occurs because productivity in those industries providing government services is projected to be much lower than the economy-wide average. This results in the cost of government service provision rising faster than costs in the rest of the economy.

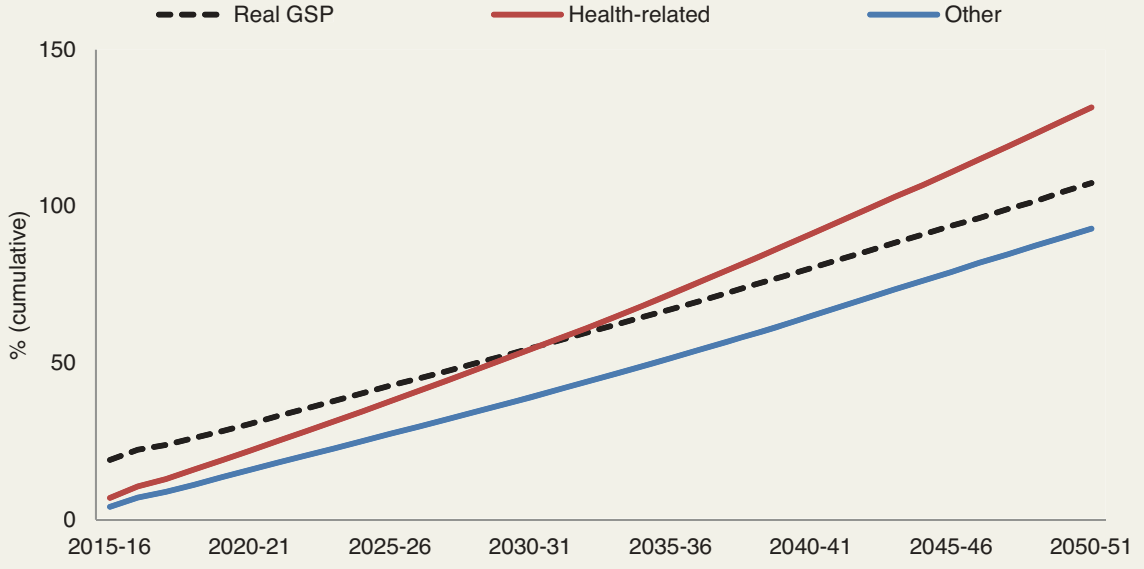
Chart 8
Real and nominal GSP and State and local general government final consumption expenditure, lower growth scenario



Source: Commission of Audit

In terms of real expenditures, as discussed earlier, an ageing population, combined with community expectations regarding the provision of health services, will cause real health-related expenditures to rise faster than other expenditures (Chart 9).

Chart 9
Demand for government services, real State and local general government final consumption expenditure, lower growth scenario



Source: Commission of Audit

The combination of faster than average growth in demand for health-related services and slower than average productivity growth in the health sector causes health-related expenditures to rise rapidly over the projection period.

State Government spending on health care and social assistance in Queensland is projected to rise from 3.4% of GSP in 2015-16 to between 5.1% and 5.3% of GSP in 2050-51 for the higher and lower scenarios respectively.

These results are consistent with recent studies investigating the implications of Australia's ageing population. For example:

- The Productivity Commission[23] projects that government health expenditure (excluding aged care) will rise from 5.7% of GDP in 2002-03 to 10.3% in 2044-45. Ageing is projected to account for about half of the increase in health expenditure as a proportion of GDP.

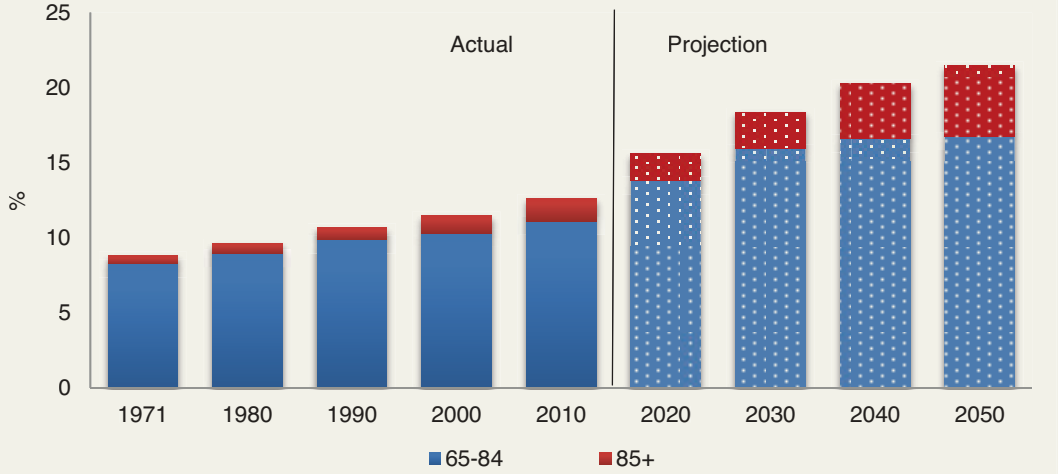
- Begg et al found that health expenditure was expected to increase from 9.4% of GDP in 2002-03 to 10.8% in 2032-33, and that one-third of this increase could be attributed to population ageing, one-third to an increase in population, and another third to non-demographic factors such as changes in technology or treatment practices.[24]

- The Intergenerational Report 2010 found that health spending is projected to grow from 4.0% of GDP in 2009-10 to 7.1% of GDP in 2049-50, while aged care spending is projected to grow from 0.8% of GDP in 2009-10 to 1.8% in 2049-50.

3.5 Results from higher growth scenario

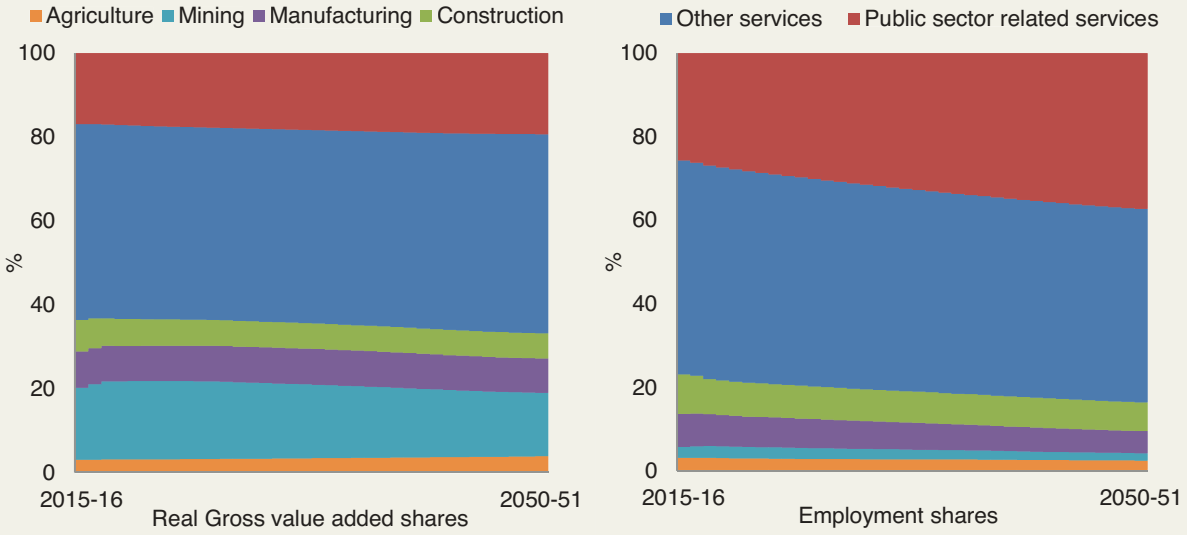
This section provides additional charts (Chart 10 and Chart 11) for the higher growth scenario that complement the lower growth charts that appear in Section A1.2 of this Report.

Chart 10
Historical and projected proportion of the Queensland population aged 65+, higher growth scenario



Source: Commission of Audit

Chart 11
Industry real gross value added and employment shares, higher growth scenario



Source: Commission of Audit

ENDNOTES

[1] MMRF has been used for a wide range of analysis, including in the analysis of carbon pricing by the Garnaut Climate Change Review and the Australian Treasury.

[2] For more information on MMRF, see P D Adams, J Dixon, J Giesecke & M J Horridge, MMRF: Monash Multi-Regional Forecasting Model: A Dynamic Multi-Regional Applied General Equilibrium Model of the Australian Economy, Working Paper, G-223, 2011, Centre of Policy Studies, Monash University.

[3] For details on the disaggregation method, see M Horridge, Preparation of a CGE data base from the 1996-97 Australian Input-Output Tables, Centre of Policy Studies, Monash University, 2002.

[4] More information on the Queensland dataset can be found in Queensland Treasury and Trade, 2012, Queensland industry structure: 2006-07, available at www.oesr.qld.gov.au

[5] Productivity Commission, Impacts of COAG Reforms: Business and VET: Supplement to the Research Report, Australian Government, 2012

[6] Queensland Treasury and Trade, Queensland Government population projections, 2011 edition

[7] Australian Government, *Intergenerational Report 2010, Australia to 2050: future challenges*, Australian Government, Canberra, 2010.

[8] This approach is consistent with the Australian Government's Intergenerational Report and Productivity Commission's modelling of the COAG National Reform Agenda.

[9] Australian Bureau of Statistics, *Migration, Australia,* 2009, (3412.0)

[10] More information on the labour market dynamics in QGEMF can be found in P D Adams, J Dixon, J Giesecke, & M J Horridge, '*MMRF: Monash Multi-Regional Forecasting Model: A Dynamic Multi-Regional Applied General Equilibrium Model of the Australian Economy*', Working Paper, G-223, 2011, available from the Centre of Policy Studies, Monash University.

[11] Australian Treasury, *Strong Growth, Low Pollution: modelling a carbon price,* Australian Government, Canberra, 2011

[12] Downes, 'Productivity Projections to 2050'; unpublished analysis prepared for the Garnaut Climate Change Review, Centre for International Economics, Canberra, 2008.

[13] The concept of measured productivity is important. The ABS measures the production of a number of industries as the sum of inputs. This implies that productivity after capital deepening is accounted for must be zero. While it could be argued that *actual* productivity differs from *measured* productivity, revising measured productivity would also require revisions to production (and GSP). This modelling exercise reports production (and GSP) as it is currently defined and measured by the ABS.

[14] Service industries can be split into two kinds: those that provide impersonal services (such as telecommunications, finance and electricity) and those that provide face-to-face services (such as hair dressing, medical services, respite care and policing). While the former are characterised by relatively high productivity growth, the latter tend to be characterised by both low levels of measured productivity and little, if any, measured growth.

[15] A long-run moving average is a useful measure since it allows the analysis of trends not relating to productivity growth cycles. Productivity growth tends to cycle through time as new innovations (such as ICT) or policy reforms eventuate and then disperse through the economy.

[16] Low productivity industries include accommodation and food services, public administration and safety, education and training, health care and social assistance, arts and recreation and other services.

[17] While it could be argued that actual productivity differs from measured productivity, revising measured productivity would also require revisions to production (and GSP). This modelling exercise reports production (and GSP) as it is currently defined and measured by the ABS.

[18] More information on the global scenario is available in Garnaut Climate Change Review*, 'Technical Paper 4'*, Australian Treasury, 2008.

[19] P D Adams, P B Dixon, D McDonald, G A Meagher, & B R Parmenter, '*Forecasts for Australian economy using the MONASH model*', *International Journal of Forecasting*, vol.10, no.4, 1994, pp. 557-571.; P.B. Dixon, & M T Rimmer, '*Dynamic general equilibrium modelling for forecasting and policy: a practical guide and documentation of MONASH'*: Contributions to Economic Analysis 256, North-Holland, Amsterdam, 2002; and J Giesecke, '*The extent and consequences of recent structural changes in the Australian economy, 1997-2002: Results from historical decomposition simulations with MONASH'*, Centre of Policy Studies, general working paper No. G-151, December 2004.

[20] Commonwealth Treasury, *'Australia's Low Pollution Future: the Economics of Climate Change Mitigation,* 2008, Australian Government, Canberra.

[21] In the time available, it was not possible to incorporate the updated forward estimates presented in the 2012-13 Mid Year Fiscal and Economic Review (MYFER).

[22] The Commission's population estimates for 2020 are around 100,000 persons below the range of the Queensland Government population projections (2011 edition). However, the Queensland Government 2011 population projections were released prior to the ABS 2011 Census. In a recent publication (ABS 3101.0), the ABS has noted an intercensal error of over 100,000 for Queensland between 2006 and 2011. As a result, the ABS has foreshadowed a downward revision to population estimates for Queensland back to 1991.

[23] Productivity Commission, '*Economic Implications of an Ageing Australia'*, Research Report, Canberra, 2005.

[24] S Begg, T Vos, J Goss, N Mann, '*An alternative approach to projecting health expenditure in Australia*', *Australian Health Review*, vol. 32, no.1, 2008, pp.148-155.

GLOSSARY

GLOSSARY

ABF	Activity based funding
ABS	Australian Bureau of Statistics
ACARA	Australian Curriculum Assessment and Reporting Authority
ACCC	Australian Competition and Consumer Commission
ACE	Adult Community Education
ACER	Australian Council for Educational Research
ACFI	Aged Care Funding Instrument
ACT	Australian Capital Territory
AEIG	Australian Government Intergenerational Report
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AFP	Australian Federal Police
AGA	Australian Government Actuary
AHIA	Australian Health Infrastructure Alliance
AICD	Australian Institute of Company Directors
AIHW	Australian Institute of Health and Welfare
AIRG	Australian Government's Intergenerational Report
ANA	Australian System of National Accounts
ANCOR	Australian National Child Offender Register
ANTA	Australian National Training Authority
ANZSIC	Australian and New Zealand Standard Industrial Classification
AO	Administrative Officer
APCC	Acute Primary Care Clinic
APG	Australian Property Group
APS	Australian Public Service
APSED	Australian Public Service Employment Database
ARC	At Risk Component
ARCT	Australian Rail and Track Corporation
ARG	Australian Railroad Group
ARI	Attraction and retention incentive
ARTC	Australian Rail and Track Corporation
AS&RS	Accommodation Support and Respite Services
ASCO	Australian Standard Classification of Occupations
ASIC	Australian Securities and Investment Commission
ASX	Australian Securities Exchange
AUL	Audio-visual link
AusHFG	Australasian Health Facility Guidelines
AVL	Automatic vehicle location
BCC	Brisbane City Council
BCEC	Brisbane Convention and Exhibition Centre
BER	Building the Education Revolution
BHC	Brisbane Housing Company Ltd
BOOT	Build, own, operate and transfer
BRC	Border Rivers Commission
BRCI	Benchmark Retail Cost Index
BT	Brisbane Transport
CAA	Corporate Administration Agency
CAC	Community Ambulance Cover

CAD	Computer-aided dispatch
CAGR	Compound annual growth rate
CAPS	Corporate and Professional Services
CBRC	Cabinet Budget Review Committee
CBU	Commercial Business Unit
CCC	Corruption and Crime Commission
CDBS	Child Dental Benefits Schedule
CEO	Chief Executive Officer
CGC	Commonwealth Grants Commission
CGE	Computable general equilibrium
CHART	Common homelessness assessment and referral tool
CIO	Chief Information Officer
CIRA	Competition and Infrastructure Reform Agreement
CM	Construction and Management
CMA	Crime and Misconduct Act
CMC	Crime and Misconduct Commission
CO	Construct only
COAG	Council of Australian Governments
COPE	Commonwealth Own Purpose Expenses
CPOR	Child Protection Offender Registry
CRA	Commonwealth Rent Assistance
CRC	COAG Reform Council
CSA	Corporate Services Agency
CSO	Community Service Obligation
CSP	Corporate Solutions Program
CSS	Child Safety Services
CTP	Compulsory Third Party
CUA	Common use arrangements
D&C	Design and Construct
DAE	Deloitte Access Economics
DAFF	Department of Agriculture, Fisheries and Forestry
DAMPP	Development Assessment Monitoring Performance Program
DATSIMA	Department of Aboriginal and Torres Strait Islander and Multicultural Affairs
DBCT	Dalrymple Bay Coal Terminal
DC&M	Design, construct and maintain
DCCSDS	Department of Communities, Child Safety and Disability Services
DCS	Department of Community Safety
DEEDI	Department of Employment, Economic Development and Industry
DEHP	Department of Environment and Heritage Protection
DETE	Department of Education, Training and Employment
DEWS	Department of Energy and Water Supply
DHA	Defence Housing Australia
DHPW	Department of Housing and Public Works
DJAG	Department of Justice and Attorney-General
DLG	Department of Local Government
DNPRSR	Department of National Parks, Recreation, Sport and Racing
DNR	Department of Natural Resources
DNRM	Department of Natural Resources and Mines
DNSP	Distribution network service provider
DoH	Department of Health
DPC	Department of the Premier and Cabinet
DPF	Developing Performance Framework

DPT	Director of Public Transport (Victoria)
DR	Distributor–retailer
DRG	Diagnosis related group
DRM	Documents and records management
DSDIP	Department of State Development, Infrastructure and Planning
DSITIA	Department of Science, Information Technology, Innovation and the Arts
DTF	Department of Treasury and Finance (South Australia)
DTFSSC	Department of Treasury and Finance Share Service Centre (Western Australia)
DTMESBCG	Department of Tourism, Major Events, Small Business and the Commonwealth Games
DTMR	Department of Transport and Main Roads
DVA	Department of Veterans' Affairs
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
ECI	Early Contractor Involvement
ECP	Extended Care Paramedic
EEQ	Ergon Energy Queensland Pty Ltd
EIS	Environmental impact statement
ELS	Empowering Local Schools
EMQ	Emergency Management Queensland
ENCAP	Energy Network Capital Program
ERA	Economic Regulation Authority
ERP	Estimated Resident Population
ESC	Essential Services Commission
ESCOSA	Essential Services Commission of South Australia
ESCS	Economic, social and cultural status
FaCS	Funding and Contracting Services
FCE	Final consumption expenditure
FPMS	Financial and Performance Management Standard
FTE	Full-time equivalent
FUM	Funds under management
GAWB	Gladstone Area Water Board
GDP	Gross Domestic Product
GEA	Government Enterprise Architecture
GEC	Gas Electricity Certificate
GENCO	Government owned generation companies
GFC	Global Financial Crisis
GFCF	Gross fixed capital formation
GFS	Government Finance Statistics
GOC	Government Owned Corporation
GOC Act	Government Owned Corporations Act
GP	General Practitioner
GP	Government Procurement
GPC	Gladstone Ports Corporation
GRP	Gateway Review Process
GRP	Gross Regional Product
GSC	Grid service charges
GSI	Gross State Income
GSP	Gross State Product
GST	Goods and Services Tax
GTEM	Global Trade and Environment Model

gtks	Gross tonne kilometres
GVA	Gross value added
HACC	Home and Community Care
HARP	Hospital Admission Risk Program
HCCB	Housing Construction Convertible Bonds
HFE	Horizontal fiscal equalisation
HHS	Hospital and Health Service
HITH	Hospital in the Home
HR	Human Resources
HUF	Headworks Utilisation Factor
IBAC	Independent Broad-based Anti-corruption Commission
ICC	In-car camera
ICL	Income contingent loan
ICT	Information and Communication Technology
ICTC	Information and Communication Technology Consolidation Program
IDAS	Integrated Development Assessment System
IDES	Identity, Directory and Email Services
IGR	Intergenerational Report
IHPA	Independent Hospital Pricing Authority
ILF	Integrated Leadership Framework
IPART	Independent Pricing and Regulatory Tribunal
IPS	Independent Public School
IPTAAS	Isolated Patient Travel and Accommodation Scheme
IR	Industrial Relations
IRP	Independent Review Panel (on network costs)
ISTC	Independent Sector Treatment Centre
JEMS	Job Evaluation Management System
KPI	Key Performance Indicator
LDC	Long Day Care
LGA	Local Government Authority
LGC	Large scale generation certificate
LHS	Left hand side
LNG	Liquefied Natural Gas
LTABB	Long Term Asset Advisory Board
MAIC	Motor Accident Insurance Commission
MASS	Medical Aids Subsidy Scheme
MBS	Medical Benefits Schedule
MC	Managing Contractor
MCE	Ministerial Council on Energy
MCF	Multi Cargo Facility
MDC	Major Diagnostic Category
MDN	Mobile data network
MEDAI	Metropolitan Emergency Department Access Initiative
MFP	Multifactor productivity
MIWB	Mount Isa Water Board
MMRF	Monash Multi-Regional Forecasting model
MoG	Machinery of Government
MOHRI	Minimum Obligatory Human Resource Information
MSQ	Maritime Safety Queensland
Mtpa	Million tonnes per annum
MW	Megawatt
MWh	Megawatt hour
NAHA	National Affordable Housing Agreement

NAHASPP	National Affordable Housing Agreement Specific Purpose Payment
NAIRU	Non-accelerating inflation rate of unemployment
NAPLAN	National Assessment Program – Literacy and Numeracy
NBN	National Broadband Network
NCP	National Competition Policy
NCVER	National Centre for Vocational Education Research
NDA	National Disability Agreement
NDIA	National Disability Insurance Agency
NDIS	National Disability Insurance Scheme
NDRRA	National Disaster Reconstruction Recovery Assistance
NEA	National Education Agreement
NEM	National Electricity Market
NEP	National Efficient Price
NEVAC	National Vocational Education and Training Equity Advisory Council
NGOs	Non-Government Organisations
NHCA	National Health Care Agreement
NHRA	National Health Reform Agreement
NHS	National Health Service
NHTP	Nursing Home Type Patient
NIIS	National Injury Insurance Scheme
NMHC	National Mental Health Commission
NOM	Net Overseas Migration
NPA	National Partnerships Agreement
NPAH	National Partnership Agreement on Homelessness
NPARIH	National Partnership Agreement on Remote Indigenous Housing
NPAT	Net profit after tax
NPSI	National Plan for School Improvement
NQBP	North Queensland Bulk Ports
NRAS	National Rental Affordability Scheme
NRS	National Regulatory System
NVEAC	National VET Equity Advisory Council
NWAU	National Weighted Activity Unit
NWI	National Water Initiative
NWMP	North West Minerals Province
OBPR	Office of Best Practice Regulation
OCG	Office of the Coordinator General
OECD	Organisation for Economic Co-operation and Development
OGOC	Office of Government Owned Corporations
OHFSS	Oral Health Fee for Service Scheme
OOS	Occasions of service
OPR	Operational Performance Review
OPSC	Office of the Public Service Commission
OPSR	Office of Public Sector Renewal
OSA	Operational Shift Allowance
OSHS	One Social Housing System
OSS	Office of Shared Services (Western Australia)
PAF	Project Assurance Framework
PBS	Pharmaceutical Benefits Scheme
PCMC	Parliamentary Crime and Misconduct Commission
PIA	Preliminary Impact Assessment
PISA	Program for International Student Assessment
PMRN	Police Metropolitan Radio Network
PMU	Print Management Unit

PN	Pacific National
PNFC	Public Non-financial Corporation
POTL	Port of Townsville Limited
PPP	Public Private Partnership
PSC	Public Sector Comparator
PSC	Public Service Commission
PSG	Property Services Group
PSI	Property Standard Index
PSMC	Public Sector Management Commission
PSRB	Public Sector Renewal Board
PTSS	Patient Transport Subsidy Scheme
PV	Photovoltaic
PwC	PricewaterhouseCoopers
QACIR	Queensland Ambulance Case Information Report
QAO	Queensland Audit Office
QAS	Queensland Ambulance Service
QCA	Queensland Competition Authority
QCAT	Queensland Civil Administrative Tribunal
QCS	Queensland Corrective Services
QCS on-line	Queensland Court Service on-line
QFCOI	Queensland Floods Commission of Inquiry
QFRS	Queensland Fire and Rescue Service
QGAP	Queensland Government Agent Program
QGCIO	Queensland Government Chief Information Office
QGCPO	Queensland Government Chief Procurement Office
QGCTO	Queensland Government Chief Technology Office
QGEA	Queensland Government Enterprise Architecture
QGEMF	Queensland General Equilibrium Model for Forecasting
QH	Queensland Health
QHAT	Queensland Health Authorised Transport
QHSSP	Queensland Health Shared Service Provider
QIC	Queensland Investment Corporation
QIP	Queensland Infrastructure Plan
QIRC	Queensland Industrial Relations Commission
QPC	Queensland Productivity Commission
QPRIME	Queensland Police Records and Information Management Exchange
QPS	Queensland Police Service
QR	Queensland Rail
QRAA	Queensland Rural Adjustment Authority
QSPC	Queensland Schools Planning Commission
QSS	Queensland Shared Services
QTC	Queensland Treasury Corporation
QTT	Queensland Treasury and Trade
QWC	Queensland Water Commission
RAB	Regulated asset base
RACF	Residential Aged Care Facility
RAS	Regulatory Assessment Statement
RCO	Residential Care Officers
RET	Renewable Energy Target
RHS	Right hand side
RIS	Regulatory Impact Statement
ROA	Return on assets
RoA	Rest of Australia

ROA Act	Railways (Operations and Access) Act
RoG	Rest of Government
RoGS	Report on Government Services
ROP	Resource Operations Plan
RTO	Registered Training Organisation
SBBs	Social Benefits Bonds
SBFA Act	Statutory Bodies Financial Arrangements Act
SBP	State Borrowing Program
SCER	Standing Council on Energy and Resources
SCI	Statement of Corporate Intent
SCRN	State Controlled Road Network
SDPC	Service Delivery and Performance Commission
SDS	Sales and Distribution Services
SDS	Service Delivery Statement
SEQ	South East Queensland
SEQIP	South East Queensland Infrastructure Plan
SEQIPP	South East Queensland Infrastructure Plan and Program
SES	Senior Executive Service
SES	Socio-economic status
SIP	State Infrastructure Plan
SLA	Service level agreement
SME	Small and medium enterprise
SO	Senior Officer
SOA	Standing Offer Arrangements
SOMIH	State Owned and Managed Indigenous Housing
SOSR	State of the Service Report
SPA	Sustainable Planning Act
SPP	Specific Purpose Payment
SPP	State Procurement Policy
SPPB	Strategic Project Program Board
SPV	Special purpose vehicle
SRES	Small-scale renewable energy scheme
SSA	Shared Services Agency
SSI	Shared Service Initiative
SSNP	Smarter Schools National Partnerships
SSP	Shared Service Provider
SSQ	Smart Service Queensland
SSSA	Share Services SA (South Australia)
STAR	Secondary triage and referral program
TAFE	Technical and Further Education
TAMP	Total Asset Management Plan
TICS	Transport Infrastructure Capability Scheme
TMS	Travel Management System
TSC	Transport Service Contracts
TW	Terawatt
TWh	Terawatt hour
TWPP	Time-weighted pool price
UFL	Urban Fire Levy
UGS	United Group Services
UK	United Kingdom
UPF	Uniform Presentation Framework
UTP	Uniform tariff policy
VCEC	Victorian Competition and Efficiency Commission

VCMS	Vacancy Capacity Management System
VET	Vocational Education and Training
VfM	Value for Money
VFMC	Victoria Funds Management Corporation
VICTAC	Victorian Information and Communications Technology Advisory Committee
VMO	Visiting Medical Officer
VPTAS	Victorian Patient Transport Assistance Scheme
VSP	Voluntary Separation Program
WACA	Workforce analysis and collection application
WACC	Weighted average cost of capital
WAU	Weighted activity unit
WGM	Water Grid Manager
WICET	Wiggins Island Coal Export Terminal