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Budget Policy Division
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Langton Crescent
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RE: 2019-20 FEDERAL PRE-BUDGET SUBMISSION – AUSTRALIAN PETROLEUM PRODUCTION & EXPLORATION ASSOCIATION

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body that represents companies engaged in oil and gas exploration and production operations in Australia. APPEA has 57 full member companies that account for an estimated 95 per cent of petroleum production in Australian and 130 associate member companies that provide a range of goods and services to the industry.

APPEA seeks to work with Australian governments to help promote the development of the nation's oil and gas resources in a manner that seeks to maximise the benefits of the industry to the Australian industry and community.

The oil and gas industry is an integral part of the Australian economy, including through:

- the supply of reliable and competitively priced energy;
- the investment of hundreds of billions of dollars of capital;
- the direct payment of billions of dollars in taxes and resource charges to governments;
- the direct employment of tens of thousands of Australians; and
- the generation of significant export earnings.

International Outlook

The global liquefied natural gas (LNG) market is undergoing a transformation due to surging growth in global gas trade. Australia is well positioned to enhance its position as the supplier of choice for the growing Asian economies such as China, Japan, Korea, India and other emerging importers. This is due to our geographical proximity to these economies and the massive investment in the LNG infrastructure that has taken place over the last decade.

The share of emerging Asian economies in total LNG demand is set to grow further with additional countries – Bangladesh and potentially Myanmar, Vietnam and the Philippines – joining the ranks of importers of LNG.

The International Energy Agency (IEA) in its *World Energy Outlook 2018* (WEO) estimated that there are 993 million people without electricity and another 2.7 billion do not have access to clean cooking facilities.[1] As the standards of living for these people improve and they move out of poverty, they will

[1] International Energy Agency, World Energy Outlook 2018, November 2018, p. 85, Paris.

consume more energy for household and industrial purposes. The WEO estimates lack of access to clean cooking facilities is the cause of more than 2.6 million deaths globally per year.[2]

The Australian oil and gas industry has invested over $300 billion in natural gas production, transport, liquefaction and export facilities over the last decade. This investment will deliver returns for Australia with export income increasing to more than $50 billion in 2018-19, more than double compared to $22.3 billion in 2016-17.[3] This growth means LNG is one of Australia's greatest export earners.

A key challenge in achieving future growth in the industry is maintaining Australia's competitiveness in the face of a changing global energy sector. Being a relatively high-cost producer combined with a relatively complex domestic regulatory framework and ongoing policy uncertainty will continue to make it challenging for Australia to capture the next wave of global investment in the LNG sector.

If Australia is to capture further investment in LNG production, it is vital to get the policy settings right by maintaining a stable and competitive tax regime and reducing regulatory costs. Key policies include:

- allowing transparent, open and secure access to resources for exploration and development;
- supporting investment and industry productivity through a stable taxation regime that recognises the costs of doing business; and
- facilitating access to domestic and international markets on globally competitive terms.

The Fraser Institute's *Global Petroleum Survey 2018* released in November 2018 ranked 80 jurisdictions on 'barriers to investment' to oil and gas exploration and production. The survey results indicate that New South Wales (73rd), Victoria (77th) and Tasmania (78th) are amongst the worst 10 in the world. Jurisdictions within this group include Venezuela (80th), Yemen (79th), Libya (76th) and Iraq (75th).[4] These are also the 3 jurisdictions in Australia that have banned or restricted onshore gas development. The three states have been poor performers for years, but their investment rankings continue to fall.

Domestic Gas Supply

The east coast gas market is at an important stage of its development. A continuing failure to unlock new gas supplies will place homes and businesses under increasing and unnecessary price and supply pressure. The key way to place downward pressure on prices is to increase investment and supplies. Government actions are needed to address supply tightness and climbing energy costs.

Over the previous two years, the industry has committed to developing and ensuring there is no shortfall in domestic gas supply and has been successful in making natural gas available to the domestic customers at prices lower than the peak of 2017. The release of the Australian Competition and Consumer Commission's (ACCC) latest *Gas Market Inquiry 2017-2020* report confirms that east coast gas prices remain below 2017 peaks, due largely to new supply entering the market.[5]

[2] International Energy Agency, World Energy Outlook 2018, November 2018, p. 85, Paris.
[3] Department of Industry, Innovation and Science, *Resources and Energy Quarterly* publication series.
[4] Fraser Institute, Global Petroleum Survey 2018, November 2018.
[5] ACCC, *Gas inquiry December 2018 interim report*, 18 December 2018.

The past year has seen significant announcements from Arrow Energy, Shell Australia, Senex, Cooper Energy, Strike Energy, GLNG, Australia Pacific LNG, Origin Energy, Santos, ExxonMobil and BHP to bring on new gas supply.

The ACCC report confirms, yet again, that customers in New South Wales and Victoria are paying more than necessary for their gas. This is at least in part as a result of state government restrictions on developing local gas resources. Importing gas from Queensland adds $2-$4/GJ to retail prices in the southern states. As the ACCC noted in releasing the report:

> *The most material pricing benefits for domestic gas users are likely to come if additional lower-cost gas is produced in the Southern States …*

APPEA continues to urge state governments to adopt policies that consider and manage the risks of individual gas development projects, rather than implementing blanket moratoria and regulatory restrictions. Governments wanting lower gas prices, more investment and more diversity of supply have the solution to hand – follow the Northern Territory's recent example and support the safe, responsible development of the resources within their jurisdiction.

Developing new reserves in the present market conditions can be challenging. Commodity prices remain relatively subdued. Onshore exploration is an expensive, high-risk activity in a challenging market. It is also costly to develop gas resources. Nevertheless, with the right policy settings, the industry can play its part in securing competitively priced energy supplies.

Until all states support a co-operative COAG agenda to remove regulatory and other barriers to new gas supply, conditions will remain challenged. The stakes for Australia could hardly be greater; a least-cost transition to cleaner energy and energy security for local industry or continuing inconsistent policies that destroy jobs, push up prices and perpetuate higher emissions.

Petroleum Exploration in Australia

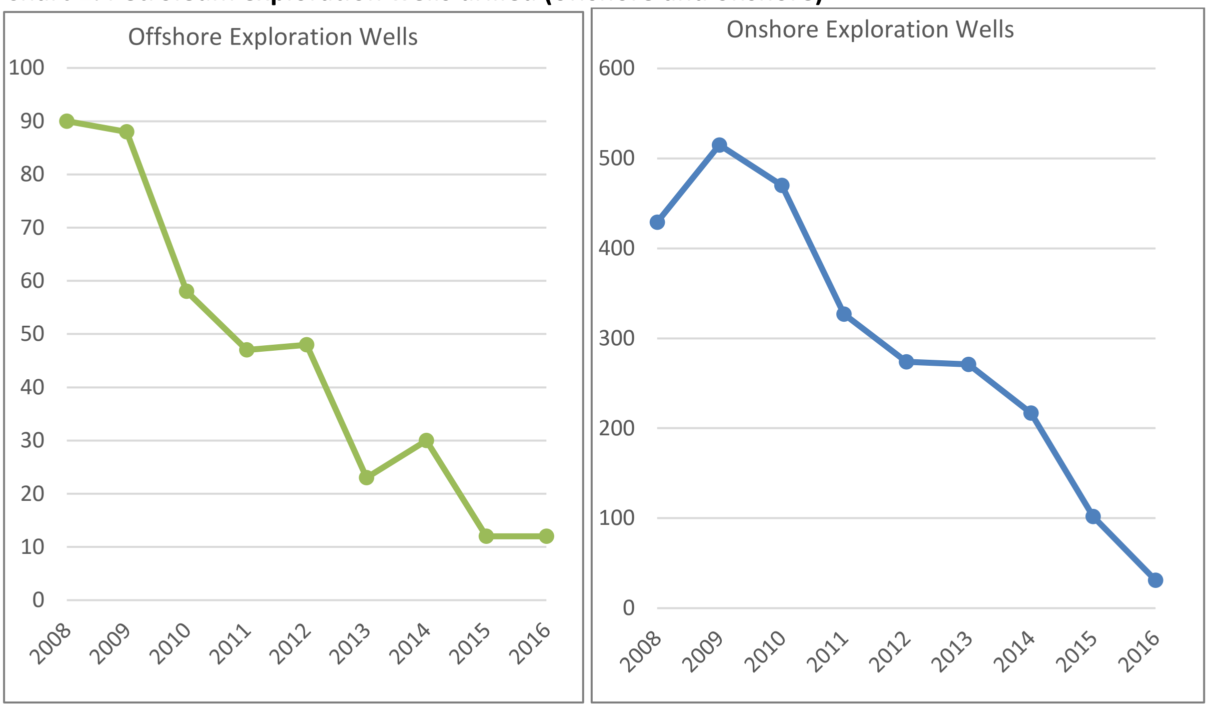
Australia's success as a supplier of oil and gas has been made possible by a long-term commitment to exploration. Without exploration, future production will decline, compromising Australia's energy security and prosperity.

Exploration activity (measured by wells drilled) has been falling (both onshore and offshore) for a number of years. Looking ahead, the most recently disclosed exploration work programs show a very modest recovery may be underway. The causes of the fall in exploration are complex. Commodity prices is just one of the factors responsible for declining exploration; others include regulatory creep, a lack of prospective new acreage, data gaps, diminished access to capital and impediments that are placed on access by governments.

Australia needs to maintain a stable, attractive policy environment to reverse the decline in petroleum exploration investment. Policymakers should not lose sight of the fact that global investment capital is scarce and will always go to the best commercial prospects.

Australia's success in terms of identifying and unlocking new petroleum resources has been underpinned by a long-standing and successful acreage release framework based on the work program bidding system. The re-introduction a number of years ago of cash-bidding for selected offshore exploration acreage has proven to be a failed policy. It was poorly designed and regulators failed to respond to the legitimate concerns of industry at the time of its reintroduction.

Chart 1: Petroleum exploration wells drilled (offshore and onshore)



Source: APPEA

Australia's success in terms of identifying and unlocking new petroleum resources has been underpinned by a long-standing and successful acreage release framework based on the work program bidding system. The re-introduction a number of years ago of cash-bidding for selected offshore exploration acreage has proven to be a failed policy. It was poorly designed and regulators failed to respond to the legitimate concerns of industry at the time of its reintroduction.

The work undertaken by the Department of Industry, Innovation and Science through the Offshore Resource Management Review was supported by industry, however few meaningful actions on the part of regulators are obvious in terms of addressing the ongoing impediments to exploration in underexplored and frontier areas.

APPEA welcomes the Government's continued commitment to providing high-quality, pre-competitive geoscience information. Australia's pre-competitive offshore geoscience work, undertaken at a national level by Geoscience Australia, is highly regarded and provides an essential information base for explorers and governments. A review of Geoscience Australia undertaken by the Department of Finance and Administration in 2011 confirmed that there are strong 'public good' reasons for ongoing public investment in geoscience research. Such investment delivers positive returns to the community.

The announcement of the Australian Government's "Gas Acceleration Program" that seeks to support new supplies of gas into the east coast gas market by fast tracking new developments was supported by industry.[6] These are modest but targeted measures that seek to build confidence and utilise the experience of companies on the ground.

While there are no easy solutions that will deliver a quick recovery of Australia's exploration activity, regulators must understand that a 'business as usual' attitude will not deliver the new reserves needed to sustain and grow one of Australia's most important industries.

Taxation settings

A strong and growing oil and gas industry creates enduring wealth and prosperity for all Australians. The oil and gas industry has been operating successfully in Australia for more than half a century. During that time, it is estimated the industry has paid more than $250 billion – in today's dollars – to governments through resources charges and company tax.

A competitive taxation regime is essential if Australia is to continue to attract investment. Further investment in both existing and future oil and gas projects is needed to underpin secure and reliable energy supplies. Australia's oil and gas exploration in the last three years has seen activity fall to a 30-year low. Industry and governments must work together to identify and remove impediments to exploration and investment in gas supply.

The recent Organisation for Economic Cooperation and Development *Corporate Tax Statistic* study comparing more than 100 countries shows Australia is being left behind as other countries improve the competitiveness of their respective tax systems. For example, the report shows that Australia has the third highest effective corporate tax rate in the world. The Treasurer in the press release[7] on the report noted:

> *The OECD report highlights that tax is a factor that drives cross-jurisdiction competitiveness for investment.*

The industry continues to be confronted with challenging operating conditions. APPEA's oil and gas industry financial survey results for 2016-17 showed the industry recording its third consecutive year of net losses. Reflecting low commodity prices and unprecedented spending on new projects, the industry posted a record, net operating loss of $7.6 billion in 2016-17, compared with a loss of $4.5 billion in 2015-16. Despite recording the highest loss in three decades, tax contributions continued to be strong, with payments estimated at $4.6 billion in 2016-17 (compared with $4.2 billion in 2015-16).[8] These results highlight the enormous investments made by the industry and the solid returns to the community in revenue.

The petroleum resource rent tax (PRRT) has been operating successfully since the 1980s. It remains a global benchmark for profits-based resources taxation and has provided a stable framework that has underpinned investment in the industry over many years. The PRRT has been instrumental in promoting a long-term and robust exploration effort in Australia. It remains a perfect fit for oil and gas operations in Australia. The reforms announced in late 2018 to the tax have the potential underpin the next wave of investment in the industry over the next decade.

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[6] Media Release, Senator the Hon Matthew Canavan, Gas Acceleration Program Grant Guidelines Released, 20 December 2017.
[7] Media Release, Treasurer the Hon Josh Frydenberg, *OECD report highlights low taxes are key to competitiveness*, 15 January 2019.
[8] APPEA Financial Survey 2016-17

An area where the industry recommends reform relates to the taxation treatment of petroleum asset swaps and realignments. Prior to 2013, where certain conditions were met, the cost of acquiring an interest in a petroleum permit from another taxpayer was immediately deductible, which generally made a petroleum title swap both efficient and tax-neutral.

Following the May 2013 Federal Budget, immediate deductibility was replaced with deductibility over 15 years or a project's effective life. The impact of the change was to potentially make it costlier for investors to swap assets to aid resource development decisions. Some realignments that were executed prior to the law change may not have proceeded under the present law, given the large upfront cash that would have been required to meet both parties' tax obligations.

Post the 2013 announcement, the petroleum industry demonstrated the need for rollover relief for commercial transactions involving interest realignment permit swaps on the basis that these transactions were not the threat to revenue that the original law change was intended to address. The Government agreed to implement rollover relief for interest realignments within projects, however this did not extend to permit swaps across projects.

There is now a focus around the need to develop discovered gas resources and ensure the economic life of existing infrastructure is maximised. Challenges nevertheless remain in aligning the operational and commercial interests of the participants in different projects, including some that have significant taxation impacts. For example, where companies wish to swap their interests in a permit in exchange for an interest in a separate permit or infrastructure, parties are subject to potentially significant tax liabilities despite no immediate economic gain being generated.

To address the above concern, the industry recommends that the Government seeks to implement reforms to ensure that transactions involving swaps of permits and existing infrastructure in Australia, to the extent value has been merely exchanged, are tax neutral. Industry recognises that any cash component of a transaction (such as where differences in the values of permits or infrastructure exchanged are not the same) should still be subject to tax upfront as per the current law.

Such a "like for like asset" exchange rollover could achieve this outcome, similar to enacted laws applicable in the US and the UK. Rollover relief in these situations should not pose significant revenue concerns as there are no upfront deductions being claimed to reduce the other tax profits of the purchaser and there is no forgone tax revenue as the transaction may not have likely otherwise proceeded. The tax liability on the transaction itself is only deferred, not removed. Importantly, the broader picture here is that a new revenue stream for Government will potentially be unlocked.

Given Australia's vast size, remote terrain and distance from markets (both domestic and export), many permit areas which contain discovered resources cannot individually underpin the infrastructure required to undertake high cost exploration and/or development activities.

This presents challenges for both industry and governments. Government policy decisions need to consider facilitating access to multi-user infrastructure to better connect resource to markets. Industry needs to identify options where existing infrastructure can be jointly utilised to reduce costs and open up new opportunities.

Conclusion

Australia's upstream oil and gas industry remains committed to ongoing policy reforms that overcome the nation's high cost challenges and lead to more investment being secured to develop our abundant natural resources. To discuss any aspect of APPEA's submission, please contact Mr Damian Dwyer, Director – Economics at ddwyer@appea.com.au.

Yours sincerely

Malcolm Roberts
Chief Executive

Appendix

THE ECONOMIC CONTRIBUTION OF AUSTRALIA'S OIL AND GAS INDUSTRY

Since the middle of the nineteenth century, the Australian oil and gas industry has contributed significantly to the Australian economy. The industry has supplied energy to Australia and through exports to our major trading partners, particularly in Asia.

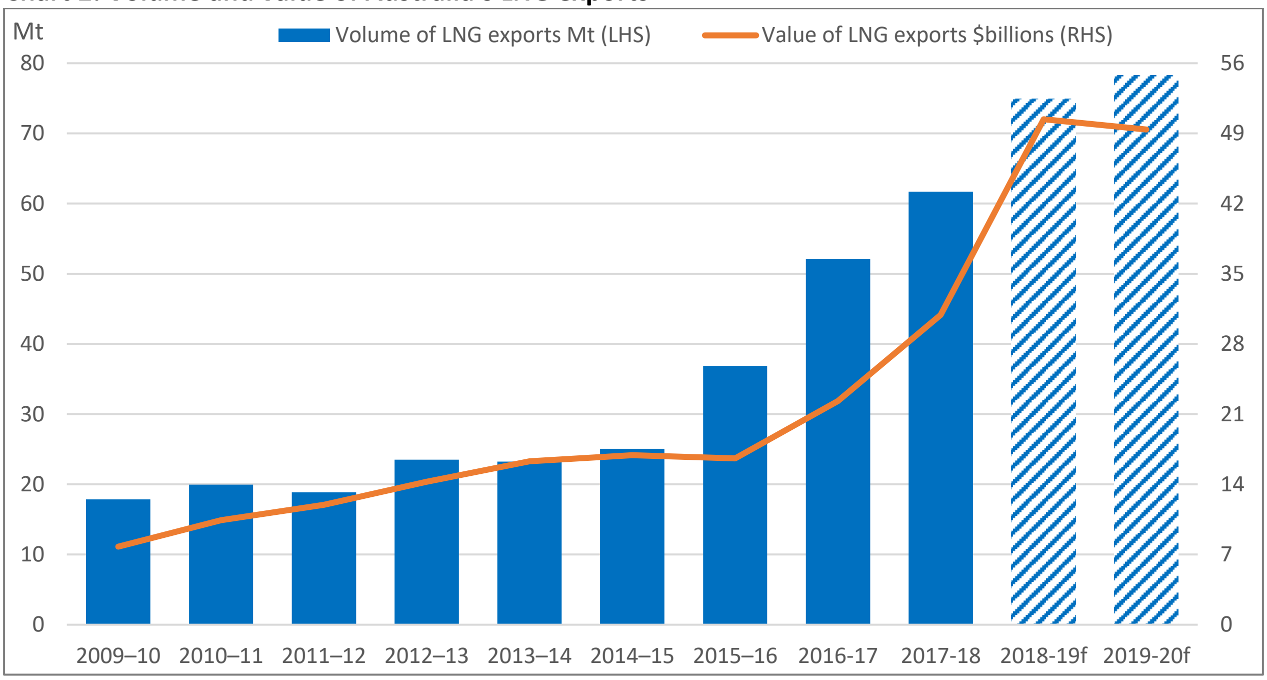
The industry enters 2019 off the back of major investment in natural gas infrastructure and exploration totaling more than $300 billion over the last decade that will benefit Australia through export revenue for decades to come.

National Economic Benefits

The Australian oil and gas industry directly employed more than 27,400 persons at the end of November 2018. This is 4 per cent increase year on year and more than double the employment from a decade ago.[9]

LNG is Australia's third largest commodity export after iron ore and coal. According to the Department of Industry, Innovation and Science, LNG exports have increased significantly over the last decade and totaled $31 billion in 2017-18, an increase of 39 per cent, compared with a year ago and more than three times as compared to a decade ago. LNG exports are forecast to increase to $50.4 billion in 2018-19 as new plants commissioned in the last 12 months start producing.[10]

Chart 2: Volume and value of Australia's LNG exports



Source: Department of Industry, Innovation and Science, Resources and Energy Quarterly publication series

[9] Australian Bureau of Statistics, catalogue number 6291.0.55.003 - *Labour Force, Australia, Detailed,* Quarterly, Nov 2018, table 06, released on 21 December 2018.
[10] Department of Industry, Innovation and Science, *Resources and Energy Quarterly, December 2018*, Canberra, Dec 2018, p. 50.

Contribution to domestic energy consumption

The Australian oil and gas industry plays a critical role in supplying energy in Australia, to residential and commercial customers, directly and through electricity generation. Gas powered electricity generation provides security, reliability, affordability to the electricity grid, and has half the emissions compared to coal.

In Australia, oil and gas are the largest and third largest fuel sources of energy consumption, together accounting for more than 62 per cent of energy consumption in 2016-17 (oil – 38 per cent, gas – 25 per cent).[11]

Oil is used mainly in the transport sector (70 per cent), mining (10 per cent), manufacturing (9 per cent), agriculture (4.6 per cent) and in commercial, services, electricity generation, residential and construction sectors.

Natural gas accounted for almost quarter of all energy consumption in Australia in 2016-17 up from 19 per cent in 2000-01. Natural gas is used in electricity generation (37 per cent), manufacturing (27 per cent), mining (21 per cent), residential use (12 per cent), in commercial services, transport and the construction sectors.[12]

Natural gas is both a source of energy and an essential raw material for the manufacturing of everyday products like glass, ceramics, bricks, cement, plastic packaging for food and beverages, fertilisers, antifreeze, metals like aluminium, copper, zinc, tin and in processes of food preparation, fermentation and brewing. In most cases, there is no substitute for gas.

Natural gas is also a critical fuel for electricity generation in Australia. It currently accounts for around 10 per cent of National Electricity Market (NEM) generation and 21 per cent of Australian electricity generation. However, it is widely acknowledged that the path to lower emissions needs a lot more gas-fired generation.

Intermittent renewable energy requires "on call' electricity generation to manage falls in renewable output or spikes in demand. Gas-fired generation is a key technology capable of delivering that flexible response since it can ramp up and down quickly. On-call gas-fired electricity generation will continue to back up intermittent renewable generation into the foreseeable future. Renewable projects will also have a new incentive to create firm dispatchable power. This will provide new opportunities for natural gas and renewables to partner in providing affordable, reliable and low-emissions energy to Australian consumers and industry.

APPEA believes if Australia is to achieve its 2030 Paris agreement emissions targets in a cost-effective manner and ensure supply stability, by 2030, gas-fired generation would need to produce about half of Australia's electricity.
Globally, as well the Australian oil and gas industry is playing its part in reducing CO_2 emissions. According to recent government estimates, Australian LNG exports are reducing emissions by at least 130 million

[11] Department of the Environment and Energy, *Australian Energy Update 2018*, September 2018, Table C.
[12] Department of the Environment and Energy, *Australian Energy Update 2018*, September 2018, Table F.

tonnes in our customer nations – equivalent to almost a quarter of Australia's emissions. [13] Australian LNG is doing its bit in addressing the global problem of climate change.

Global gas demand – the economic opportunity

According to the International Energy Agency (IEA), global gas demand is forecast to increase by 43 per cent to 2040 at an annual rate of 1.6 per cent.[14] Gas share of global energy demand will increase to a quarter, overtaking coal to be the second largest fuel source after oil. By 2040, industrial use of gas is forecast to increase by 66 per cent.[15]

The IEA forecasts inter-regional gas trade is expected to increase by 67 per cent, totaling 1289 bcm by 2040. By 2040, 59 per cent of international gas trade is expected to be in the form of LNG, with LNG trade accounting for 84 per cent of the growth to 2040. The Australian oil and gas industry is well placed to capitalize on the opportunity ahead with a significant investment in production capacity over the last decade.

INDUSTRY CHALLENGES

The outlook for the Australian oil and gas sector is one with significant opportunities as well as significant challenges. The benefits of a growing LNG industry cannot be taken for granted. Looking forward to 2019 and beyond, Australia faces intense competition from established and emerging low-cost producers in the global market, particularly the United States, which is expected to triple its LNG capacity by 2020 to total 70 million tonnes.

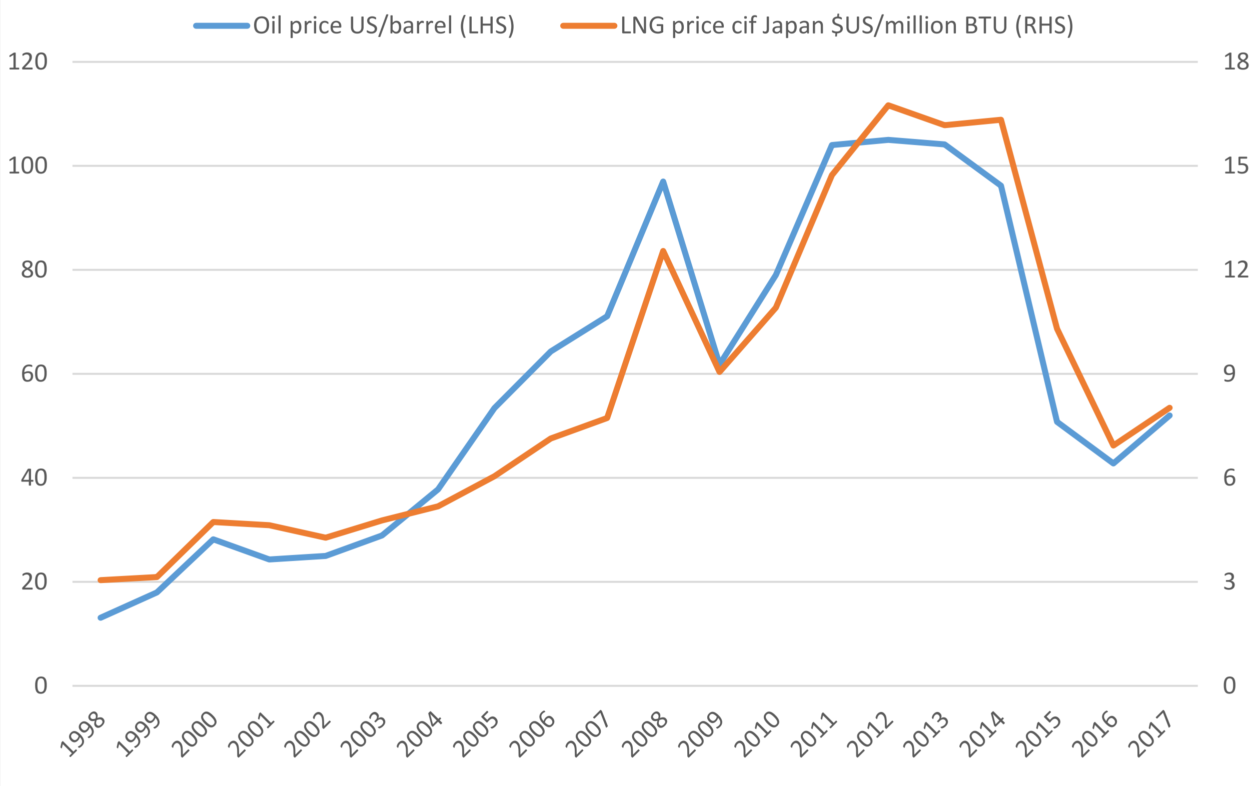
Low Prices

Global prices for oil and gas fell significantly in 2016, but have staged a recovery over the last two years. Despite the recovery, the prices for both oil and gas are lower than forecast, when investment decisions were made resulting in losses and write-downs for many projects. The declining prices resulted in very challenging conditions for the sector. The industry responded to the steep decline in prices by acting to lower costs across the board, introduce more innovative work practices and re-examine existing business models.

Exploration expenditure has been affected significantly. According to ABS data, total petroleum exploration expenditure (offshore and onshore) in 2017-18 was $1 billion, down 25 per cent as compared with 2016-17 and at levels last seen in 2004-05.[16]

[13] Hon. Melissa Price, Minister for the Environment, *June Quarterly Update of Australia's National Greenhouse Gas Inventory released*, media release, 30 November 2018.
[14] International Energy Agency, World Energy Outlook 2018, November 2018, p. 526, Paris.
[15] International Energy Agency, World Energy Outlook 2018, November 2018, p. 526, Paris.
[16] ABS, *Mineral and Petroleum Exploration*, Catalogue No. 8412.0, released 3 December 2018, Table 6a.

Chart 3: Global oil and LNG price



Source: BP Statistical Review of World Energy, IndexMundi, World Bank

Industry Financial Performance

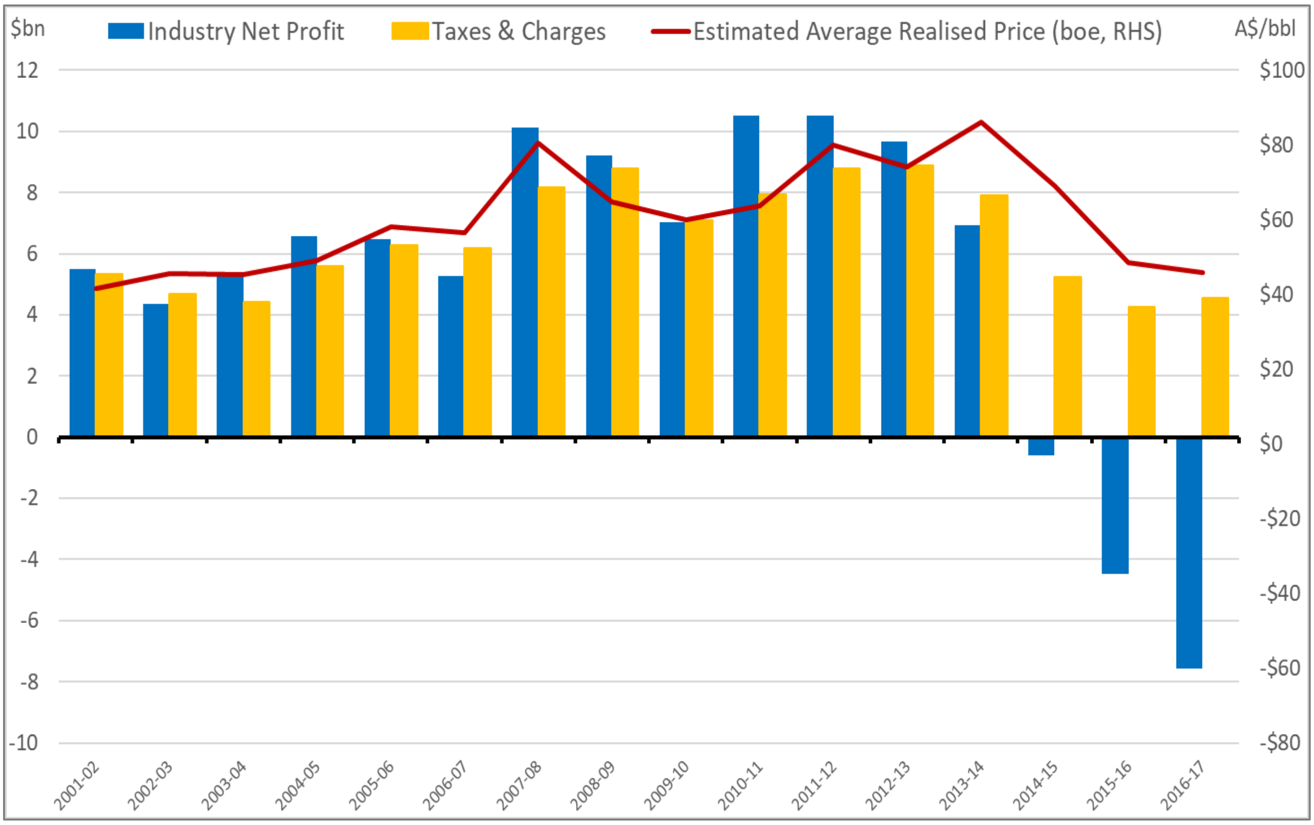
The Australian oil and gas industry is confronted with a variety of taxes, charges and fees in relation to petroleum activities. These include resource taxes (including the petroleum resource rent tax, petroleum royalties and production excise), company income tax and numerous other taxes, fees and charges ranging from import duties to state based licencing fees and duties.

Since its inception, the Australian oil and gas industry has contributed more than $250 billion – in today's dollars – to governments through resources charges and company tax. APPEA's 2016-17 financial survey results highlighted the challenging operating conditions confronting the oil and gas industry in Australia. The industry recorded a third consecutive year of net operating loss in 2016-17, recording a net operating loss of $7.6 billion (compared with a loss of $4.5 billion in 2015-16), reflecting low commodity prices and unprecedented spending on new projects.

The average price received for the sale of oil and gas fell from $A49 in 2015-16 to $A46 on a barrel of oil equivalent basis in 2016-17. Despite the significant deterioration in the industry's overall financial position, the industry paid an estimated $4.6 billion in total tax payments in 2016-17 (compared with $4.3 billion in 2015-16) to governments – dispelling the myth that the industry is not paying its way.[17]

[17] APPEA, *Financial Survey 2016-17*.

Chart 4: Oil and Gas Industry: Profitability, Taxes Paid and Average Realised Prices



Source: APPEA Financial Survey