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Business Council of Australia

01 November 2019

Mr Mark Fitt
Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Inquiry into Australia's oil and gas reserves

Dear Mr Fitt

Thank you for your invitation to make a submission to the Senate Economics References Committee Inquiry into Australia's oil and gas reserves.

The Business Council believes that Australia's resource tax arrangements, which include royalties and the Petroleum Resource Rent Tax (PRRT), have worked appropriately to date. The latest data from the Australian Petroleum Production & Exploration Association indicate that the oil and gas industry's total payments to government have been over $70 billion during the past decade.

The tax system is an important influence on decisions to invest in Australia. The stability and certainty of the existing resource tax regime has helped to encourage over $200 billion worth of investment in petroleum projects over the past few years. This investment will continue to deliver a wide range of community benefits through jobs, tax revenue, contracts with local suppliers and investment in universities and research institutes (including impact assessment studies, monitoring programs, environmental baseline studies, and peer review research papers).

The Australian economy is heavily reliant on trade and foreign investment to generate higher living standards. At the same time, investment is highly mobile globally and operates in an intensely competitive environment. Investors demand a globally competitive after-tax return on their investments in Australia, otherwise they will invest elsewhere. That takes jobs and investment that could have been in Australia and puts them somewhere else. To continue to be an attractive destination for investment, Australia must remain competitive. A stable and competitive tax regime, as well as growth-enhancing policy settings are key to this.

The Business Council has long advocated for comprehensive tax reform. Australia needs to move to a more modern, sensible mix of taxes that will best promote the wellbeing of the Australian community and support job creation. It is not about one tax, but the combination of taxes, and setting an overall tax mix that is most able to achieve the goal of growing the economy and creating jobs while funding vital government services.

A competitive Australia is the best way to achieve an economy which is strong, builds investor confidence and continues to grow. But investment and exploration are less likely to occur if the investment environment becomes even less attractive. The cumulative impact of business regulation, unduly protracted planning and environmental approval processes and uncertainty about the tax system should not be underestimated.

Continued investment in the exploration and extraction of oil and gas resources is also vital for Australia's future energy supply. Increasing gas supply is critical to industrial users of gas and for reducing the cost of generating electricity. Access to affordable and reliable energy sources is vital to protect Australian jobs. Gas will also play an important role in delivering a secure and reliable energy system as we transition to a lower emission electricity sector. Increasing the tax burden on the energy sector will simply impose yet another hurdle to energy producers obtaining access to the fuel sources that are desperately needed in Australia's current energy system.

Concerns about Australia's existing resource tax regimes, particularly the PRRT must be placed in the context of a project life cycle. Oil and gas projects operate on long cycles that can extend for many decades, from exploration through to development, production and decommissioning. The task is highly complex and risky, and many projects may not make it past the exploration stage.

- For example, the fields that provided the basis for the North West Shelf project were discovered through exploration between 1967 and 1972; the project received approval in 1979; first gas was received in 1984; and the project has since expanded as additional discoveries were made, technology and viability changed and the project began exports. In its totality it is a 50-year project – so far.

The PRRT is operating as intended and designed, with current revenues reflecting the confluence of the unique stage of the industry's cycle and oil prices. After almost a decade of large-scale investments, in a high-cost environment, the oil price has fallen relative to what it was several years ago. Taxes, including company tax, will be paid in future when production and profits flow from those investments.

The diversity in petroleum projects makes it difficult to make comparisons between projects and understand how profits and taxes intersect. The sector has also changed over the past few decades. For example, the oil sector was much larger than LNG when the PRRT was introduced. This context is critical to understanding both project outcomes and implications for tax.

- The length and nature of risks at each stage of the project life cycle may differ between the two sectors. For example, development of an oil platform can take place in as little as 18 months, while an LNG plant can take up to eight years to construct prior to the commencement of production.
- The payback periods for oil versus LNG projects can differ greatly, such as due to different production profiles.
- Differences around taxing points.
- Older projects were developed at a different time with different constraints. For example, the recent construction phase has faced cost challenges and complexities due to simultaneous demands being placed on limited resources in Australia.

The years of upfront heavy investment need to be recouped before tax is paid. The rate at which such recoupment occurs may vary, such as between oil projects and gas projects, but this is a design feature of the PRRT, not a flaw, to ensure that socially productive capital investment is not discouraged. The timing of this recoupment will also depend on factors such as commodity prices, exchange rates and project costs.

Project costs are important as they ultimately impact project returns. The Business Council previously observed the high cost of investing in Australia and low labour productivity compared with other nations, leading to reduced competitiveness of project delivery. (See *Pipeline or Pipe Dream: Securing Australia's Investment Future* and *Report of the BCA Project Costs Task Force* for more detail.)

The drivers that impact project costs include the efficiency of government processes for planning, project approvals and conditions, quality of project design and management, workplace productivity and relations, and the development of projects in remote areas. While Australia benefits from a regulatory system that safeguards environmental, safety and cultural standards, other countries may be less strict. There may also be multiple, inefficient processes across and between governments that are ill-equipped to deal with multiple cross-jurisdictional major projects. This can significantly add to project costs and delay commencement.

While a comparison of projects within Australia is difficult, a comparison across countries is even more complex and must be carefully assessed. The costs of any resource project will reflect many unique factors and any comparison of the level of taxes paid should take these into account. Potential issues include:

- The characteristics of the project, including technical, geological and operational factors. Project characteristics differ across Australia, let alone the world. Australian LNG projects, such as for coal seam gas, were a world-first and as such presented different challenges to those based on conventional offshore resources.
- The stage of the project life cycle. Is it new or mature? Have costs been recovered?
- Are taxes like-for-like? How do tax systems compare? Is the taxing point the same? What other taxes are paid?
- Geography – is the area remote or close to urban areas? Is climate an issue, such as cyclones? Are there environmental considerations, such as nature reserves?
- Differences in input costs, including those driven by labour market conditions and workplace regulations, and broader regulations including environmental regulation.
- How do taxes compare over the life of a project?

Changing the basis for the PRRT would risk undesirable consequences such as reduced competitiveness, diminished investor confidence (not just in the oil and gas industry) and deterrence of vital new investment. Changes that retrospectively affect current projects, where investment decisions have already been made, would be of particular concern as they would increase risks and uncertainty for future investments.

Of course, the tax system must ensure the community receives an appropriate return for its resources. But the community does not receive a return from resources that are left in the ground. Appropriately compensating the community also requires ensuring that investment is not discouraged.

Changes to the tax system should be about getting the incentives right and bringing together the best tax system overall. It should not be about ad hoc measures which are designed primarily to be a quick fix to the budget. Higher taxes are not budget savings and will only dampen growth and incomes over time.

Yours sincerely

Jennifer A. Westacott AO
Chief Executive