Submission by the Australian Manufacturing Workers' Union to the inquiry into Australia's Oil and Gas Reserves

AMWU Submission – November 2019

Senate Standing Committee on Economics - Australia's Oil and Gas Reserves

Introduction

The Australian Manufacturing Workers' Union (AMWU) represents over 60,000 workers that manufacture and maintain across Australia. We are a union that represents workers in all areas of manufacturing including food and confectionery, metal and engineering, printing, design and packaging, technical, laboratory, supervisory and administrative, and vehicle building, service and repair.

Our union is led by workers in our industries of coverage and has been at the forefront of many campaigns over our 150-year history, both fighting to improve workers' rights industrially, as well as standing up for a fair and equitable society for all Australians.

We campaign for a better deal at work, for strengthening Australian industry, and for good, secure jobs for all Australians. We work to advance our members' interests at a local, national, and global level.

Background

The Australian natural gas market is broken.

It would perhaps be categorised as a textbook example of market failure, if it wasn't for the fact that Australia's natural gas industry bears no resemblance to an actual functioning market. It fundamentally lacks transparency between suppliers and consumers and has seen prices triple over the last few years.

On the east coast of Australia, the natural gas market could be more accurately described as a cartel of producers that set prices to suit their own commercial imperatives.[1] The Australian east coast gas market is effectively controlled by a small number of global multinationals: Shell, Santos, Origin, BHP and ExxonMobil. Australian Competition and Consumer Commission (ACCC) chair Rod Sims rather generously characterised the gas market as "opaque and complicated".[2] Hardly a glowing endorsement.

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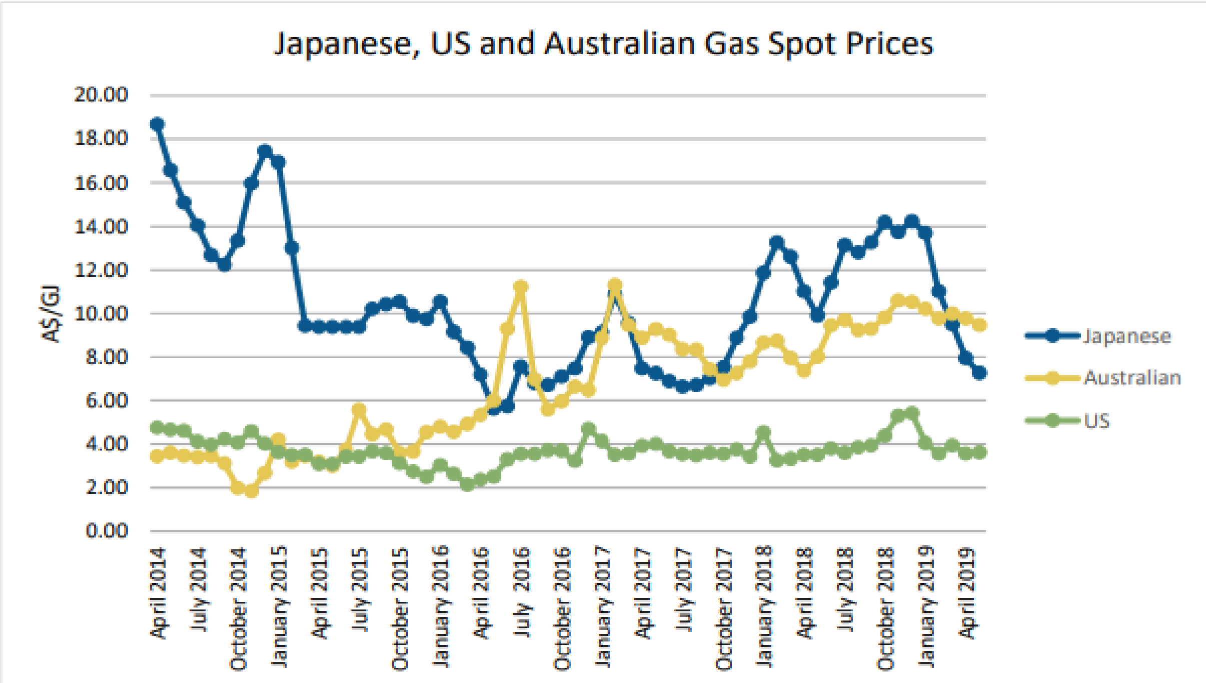
[1] Towards a Domestic Gas Reserve, Institute for Energy Economics and Financial Analysis, 2019, http://ieefa.org/wp-content/uploads/2019/07/Towards-a-Domestic-Gas-Reserve_9-July-2019.pdf

[2] "Sims Renews ACCC warning to the gas world," Australian Financial Review, 31 May 2019

This is no way for a nation's energy sector to operate.

The result of this broken market is the truly bizarre scenario where Australia is concurrently the world's largest exporter of Liquified Natural Gas (LNG), overtaking Qatar,[3] while also exploring five separate proposals to construct import gas terminals to meet domestic demand. In mid-2019 Australia's LNG exports had increased year on year by 21.2 per cent creating a $50 billion export industry shipping 75.1 million tonnes of LNG. Despite these remarkable export numbers there remains a distinct shortage of gas for domestic supply and use. This rather head scratching reality only adds another instance to the already long list of regulatory and policy failures that has seen the energy sector careen uncontrollably over the last decade.

The construction of the Australian Pacific, Curtis Island and Gladstone LNG facilities within a year of each other caused a fundamental change in local domestic gas production and supply. Australian East Coast gas supply tripled. These three large projects were constructed to supply international markets where gas prices significantly outpaced domestic prices that had historically hovered between $3-$4/GJ (Giga Joule) – refer to Table 1 below. Global markets, especially those in east Asia, had traded at a higher price – closer to $10-12/GJ. As Australian producers gravitated towards large foreign markets with higher gas spot prices domestic supply was constrained.



Source: US Energy Information Administration, Ministry of Economy, Trade and Industry, Australian Energy Market Operator, Reserve Bank of Australia.

[3] "Australia grabs world's biggest LNG exporter crown from Qatar in November," Reuters, 10 December 2018

Table 1 – Japanese, US and Australian Gas Spot Prices
Source: Towards a Domestic Gas Reservation in Australia, 2019, Institute for Energy Economics and Financial Analysis (IEEFA)

This resulted in local manufacturers and consumers having to compete against international demand for gas to secure supply contracts.

Australia has traditionally been an energy cheap nation. This has been reflective of the natural energy resources at our disposal and has been a point of competitive advantage for Australian industry. Yet the tripling of natural gas costs in the space of a few years led to manufacturers being forced to close doors and resulted in investment flight from Australian manufacturing and heavy industry.

Resources Minister Matt Canavan quite glibly defended the price of gas and government policy, or lack thereof, by stating "the price of gas at Wallumbilla…it's sitting below $9.50/GJ…The price prevailing in north-east Asia is between $13-14/GJ, so our prices are much lower than those in Asia."[4] A single example of cheaper gas prices of course speaks nothing of the fact that since 2014 there has been a tripling in the price of gas and the impact that it has had on Australian businesses and Australian consumers.

The failure of Australia's gas market is further highlighted by the current global oversupply. The ACCC publish an LNG netback price series. This is used to show what the cost of gas should be in Australia and excludes the cost to convert the gas into LNG and any shipping cost. The historical netback price in May 2019 was $5.46/GJ.[5] This was the price that Australian consumers could be expected to pay. Instead they paid $9.46/GJ in May – or a 73% mark-up.[6] This discrepancy in price, between what the regulator determines is a fair price and what is actually charged, demonstrates the clear dysfunction that underpins domestic gas prices – and the need for urgent reform.

Manufacturing

Manufacturing is an energy intensive industry.

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[4] "Gas reservation may be needed to lower prices, save manufacturers: ACCC Chair," ABC News, 19 October 2018
[5] LNG Netback Price Series – Public Version – 16 October 2019, https://www.accc.gov.au/regulated-infrastructure/energy/gas-inquiry-2017-2020/lng-netback-price-series
[6] Towards a Domestic Gas Reserve, Institute for Energy Economics and Financial Analysis, 2019

In the Department of Environment and Energy's Australian Energy Update 2018, manufacturing is listed as the third largest of consumer of energy by industry – behind only Electricity Supply and Transport[7] constituting almost 18% of Australia's energy consumption.

Local manufacturers who rely on gas for power generation, heat or steam, or as a feedstock have been increasingly forced to meet the international price of gas to obtain supply. The impact of higher gas prices has not been felt evenly across the manufacturing sector. Manufacturers who relied on gas for onsite electricity generation have sometimes been able to substitute this with coal or renewables and been able to minimise their exposure. Manufacturers that rely on gas for heat or steam requirements such as the cement industry, pulp and paper, glass and food and beverage manufacture face higher barriers to finding a substitute and often at significant cost. And finally, those manufacturers who use gas as a feedstock – chemical products, plastics, fertilisers, explosives, have no alternatives.

Since 2014 the Australian manufacturing sector has contracted by approximately 100,000 workers or almost 10% of all manufacturing jobs (refer to Table 2). That this has aligned with rising gas prices is not pure coincidence.

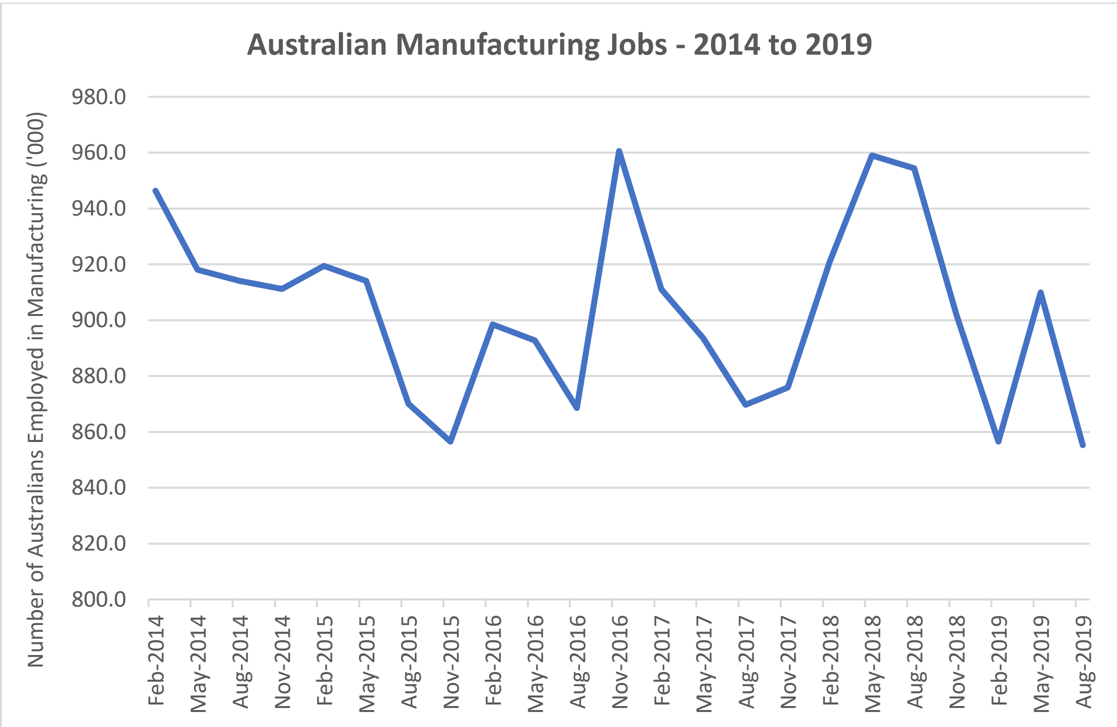

Table 2: ABS Labour Force Trend Data

[7] https://www.energy.gov.au/sites/default/files/australian_energy_update_2018.pdf

Stephen Bell, Chief Executive of Qenos a manufacturer of polyethylene and other polymers described the impact of rising gas prices as follows:

"In 2016 we paid $8 million for electricity and in 2018 we paid $18 million…We've taken more than $60 million of cost increases over that time. We can't pass a dollar of that on to our customers because our competition, who all come from overseas, don't have any of these increased costs."[8]

Qenos have also reduced their workforce by 15 per cent in the past year and a half.

The Energy Users Association of Australia (EUAA) which is the peak body representing Australian commercial and industrial energy users have flagged similar concerns regrading the nature of the gas market with their belief that there is a distinct tipping point with many manufacturers facing an uncertain future.[9]

Natural Gas Import Projects

Support for the idea that Australia can simply import gas to meet local demand is growing. There are five gas import terminal proposals that are at various states of approval and completion and are situated in Newcastle and Wollongong in New South Wales, Cribb and Gippsland in Victoria, and Pelican Point in South Australia.

Other than the counter-intuitive proposition of being the world's largest exporter of gas and still relying on importing for local supply, the problem underpinning the import of natural gas is that it embeds higher international prices in local markets. It also requires Australian businesses to pay for the additional costs of liquefaction, shipping and re-gasification when this could all occur locally in the first instance.

Fundamental reform of the gas market is required rather than seeking out short term quick fixes of supply that do not address the true underlying problem of price.

[8] "Gas exports blamed for soaring electricity prices and job losses," ABC News, 17 May 2019, https://www.abc.net.au/news/2019-05-17/gas-exports-blamed-for-elecricity-price-rises-job-losses/11121120
[9] National Gas Strategy Options – Discussion Paper, Energy Users Association of Australia, April 2019

Gas Reservation Policy

Every single major gas producing country in the world has some form of reservation policy. Even in Australia, Western Australia has long held a domestic reservation policy, leaving the Australia East Coast as a global outlier.

In 2017 the shortage in local gas supplied forced Prime Minster Turnbull to introduce the Australian Domestic Gas Security Mechanism (ADGSM) that allowed the Federal Energy Minister to bring in export restrictions if local gas shortages were forecast.

Despite the price of gas tripling this mechanism has never been used.

The criticism surrounding the ADGSM is linked to the fact that it only targets a shortfall in supply but ignores rising prices.

It has become increasingly clear that Australia can little afford to continue the policy malaise and inaction that have characterised the gas sector. Even ACCC chair Rod Simms has admitted that although initially supportive of not intervening in the gas market, that the experience of the past few years have proven this to be a mistake and that "…if there was more gas found then making sure it flows to domestic uses would make a lot of sense."[10]

If there is widespread consensus from manufacturers, consumers, regulators, unions and civil society that some action needs to be taken to ensure affordable domestic supply of gas the question turns to the nature of the mechanism that will facilitate this.

National Interest Tests are in place in both the United States and Canada. When a producer seeks to make an application for a natural gas export license these tests must first be satisfied. National Interest Tests can be used as a handbrake on natural gas exports by allowing regulators or Governments to limit the size and volume of exports to ensure that local demand is prioritised.

[10] "Gas reservation may be needed to lower prices, save manufacturers: ACCC Chair," ABC News, 19 October 2018

National Interest Tests have associated drawbacks. The approval or denial of an export licence creates an all or nothing decision for regulators and policy makers.[11] The nature of the test can also become highly politicised and in the cases of the US and Canada has meant that it has sparingly been used to veto natural gas exports.

A superior approach to natural gas policy is the implementation of a domestic gas reserve. This is no great leap in the realm of public policy because it has existed in Western Australia for close to 15 years.

The Western Australian gas reservation policy was first implemented in 2006 and stipulates that 15 per cent of all gas produced in the state must be offered back for domestic supply. Western Australian gas prices are lower than those found on the east coast, and the state's domestic gas supply is set to exceed forecasted demand for the next ten years.

One of the common arguments against domestic gas reservation policies is that they stifle investment. This has not been the experience in Western Australia. There has been a boom in Western Australian LNG projects that has coincided with a domestic gas reservation policy with the projects such as the North West Shelf, Gorgon and Wheatstone flourishing under this framework.

Recommendation:

- **That the East Coast of Australia adopt a National Gas Reservation Policy of 15%, in line with Western Australia. The aim of this policy should be focused on driving the price of LNG down for domestic users. The price of LNG should be benchmarked in Australia against similar gas producing countries like the United States. As detailed by Bruce Robertson's report into Australia's natural gas industry a reasonable target for domestic gas prices would be $5/GJ.**

[11] "The Economic Impact of LNG Exports on Manufacturing and the Economy – How should we respond to the looming crisis?" BIS Shrapnel, September 2014

Commonwealth Gas Company

The EUAA in their Discussion Paper regarding the future of the gas sector propose the creation of a publicly owned national gas company. They correctly identify a list of factors that have caused reluctance between gas companies and large commercial and industrial gas buyers to reach agreement on future contracts, such as:

- Information asymmetry between the parties;
- Seller pricing strategies linked to international markets;
- Uncertainty about future supply and demand; and
- A refusal to offer long term (5 years plus) contracts.

A publicly owned Gas Company could be used as a coordinative body for the industry as a whole and also a wholesale buyer of gas. This would bring increased competition to the market and allow a Government Gas Company to peg the price of gas to a netback price – like the $5/GJ suggested above. It would also seek to lock in long term contracts so that consumers and the manufacturing sector could have increased certainty regarding gas pricing. The creation of a publicly owned Gas Company could not be done in isolation but would be introduced in conjunction with the other policies listed in this submission.

Recommendation:

- **In line with the EUAA's discussion paper – establish a Government owned Gas Company to act as both a coordinative body for gas industry policy and as a gas wholesaler to bring increased competition to the market.**

Fracking

Adding more high cost gas production will do nothing to decrease the cost of gas domestically. Instead it will entrench the high costs that consumers are currently exposed to.

Hydraulic Fracturing or 'fracking' has been mooted as a possible solution to put downward pressure on natural gas prices. Proponents of fracking believe that by opening new wells to extract natural gas will lead to a substantial increase in supply. Their targets are the various moratoriums that State Governments have put in place to prevent fracking from occurring.

This flies in the face of the experience of the last five years – where the supply side issue has not been a lack of volume of gas supplies. Instead what impacts domestic gas prices is actually about how much of this is made available to the local market and what mechanisms there are to enforce this.

Since 2014 gas supply on the east coast of Australia has tripled, and so have the gas prices of Australian manufacturers and consumers.[12] The fracking process is a comparatively high cost one. By using onshore high cost methods to fuel east coast gas shortfalls fracking would only further entrench the high prices that currently exist, hobbling the manufacturing sector and putting further jobs at risk.

And this says nothing of the significant environmental concerns that fracking entails.

Recommendation:

- **Fracking is not the solution to high gas prices. It will more likely entrench high prices for Australian manufacturers and consumers. A national gas reservation policy is a far more effective tool in unravelling the supply side knot that has impacted the Australian gas industry. States should be encouraged to continue their moratoriums on fracking and consider the full social, economic and environmental impacts of these policies.**

Tax and Oil & Gas companies

As Australia races neck and neck with Qatar to be the world's largest exporter of LNG the taxation mechanisms that determine what benefits are returned to Australia must also be examined. The Petroleum Resource Rent Tax (PRRT) has been used to extract the cost of private companies exploiting Australia's sovereign oil and gas resources. But the PRRT was designed for the oil industry in the late 1980's, not for the current natural gas industry. This has meant that the PRRT is overly generous to the industry, offers incentives that are unavailable anywhere else in the world, and ultimately operating effectively.

[12] Towards a Domestic Gas Reserve, Institute for Energy Economics and Financial Analysis, 2019

The PRRT will in most cases not capture new revenue from LNG projects for years, possibly decades.[13] PRRT credits can be held over to be used to offset future revenue, with the industry already accumulating $248 billion in PRRT credits. The Gorgon project will not pay any PRRT for two decades.[14]

Compare this to the Government of Qatar that collects $26.6 billion in royalties alone from LNG revenues. Which does not consider the substantial dividends that are received by the Qatari government as the LNG industry is operated by state owned companies.

Australia consistently falls behind its neighbours and competitors when it comes to reaping the benefits from its oil and natural gas reserves. In a comparison of Qatar, Malaysia, Nigeria, Indonesia and Australia in 2014 it was determined that the Australian government collected US$7.3 billion in revenues from oil and gas production. Over the same period the Malaysian government received US$20.2 billion in oil and gas revenues.

The solution put forward by the Tax Justice Network Australia in their submission to the Senate Inquiry into Corporate Tax Avoidance is to extend the 10 per cent Commonwealth royalty to all current and future offshore oil and gas projects that usually only incur PRRT. This already exists for some LNG projects such as the North West Shelf in WA and the three Coal Seam Gas Projects in Queensland.

By extending this royalty to all other oil and gas projects such as Chevron's Gorgon and Wheatstone, and the Ichthys, Pluto and Prelude projects, this would deliver an additional $30 billion to $45 billion in taxation revenue over 30 years.

Further tightening of the PRRT and oil and gas regulatory regime could target the lack of transparency in the market that shrouds in accounting mist the value of gas, especially in the case of vertically integrated gas to LNG projects that rely on arm's-length transactions. This could be achieved by shifting the point of taxation of the PRRT from the processing of gas to the point of LNG sale.

[13] Submission to the Senate Inquiry into Corporate Tax Avoidance – Australia's Oil & Gas Industry, Tax Justice Network Australia, March 2017
[14] Ibid

The PRRT credit system should also be revamped so that projects cannot avoid paying PRRT for years or decades on end. Australia is a lucky country very much in the sense of Donald Horne's seminal text, and nothing demonstrates this more clearly than the wealth of our mineral reserves and the complete lack of gumption, leadership and knowhow to exploit them for the greater benefit of its citizens.

Recommendation:

- **Extend the 10% royalty to all new LNG projects, change the point of taxation to target the LNG sales and not minimally processed gas, and curtail the use of overly generous tax offsets that minimise PRRT.**

Conclusion

There currently exists a real opportunity to make lasting change and reform to Australia's oil and gas industry. The demand for change is increasingly apparent as the east coast market stutters and fails to meet the demands of Australian consumers and manufacturers. By reforming the system that currently exists we can fundamentally change the way in which our country reaps the benefits from its vast mineral reserves.

The Federal Government must look at implementing a gas reservation policy for east coast markets, like what is already implemented in Western Australia. The goal of any gas reservation policy must be the driving down of domestic natural gas costs. A publicly owned Federal Gas Company can further assist in achieving this.

Quick fix solutions to gas prices that only entrench high cost supplies of natural gas are not the solution – whether they be fracking or importing natural gas from overseas.

Reforms must also be made to the PRRT to ensure that the Federal Government captures the full benefit of this industry. This must include a royalty that covers all new LNG projects and tightening of regulations on when sales are recognised and how much can be offset by tax credits.

These changes are not extreme. They are in fact exactly what we need to be doing as a country to bring Australia's natural gas industry in line with the regulatory environment of other gas producing countries.

Australia’s gas market may be in a state of market failure, however if governments refuse to act to reform then the crisis is not only that of market failure but also government failure and Australian manufacturers and workers cannot afford further inaction.