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Committee Secretary
Standing Committee on Primary Industries and Regional Services
House of Representatives
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CANBERRA ACT 2600

**INQUIRY INTO INFRASTRUCTURE AND THE DEVELOPMENT OF
AUSTRALIA'S REGIONAL AREAS**

AGL is pleased to make this submission to the Committee's Inquiry. As a major owner and operator of gas and electricity infrastructure in Australia, AGL recognises that appropriate infrastructure development has a vital role to play in stimulating regional growth and employment.

Please contact the undersigned if the Committee has any queries in relation to this submission.

Yours faithfully

P R Blackband
Divisional General Manager Gas Networks
The Australian Gas Light Company

INQUIRY INTO INFRASTRUCTURE AND THE DEVELOPMENT OF AUSTRALIA'S REGIONAL AREAS

1. Introduction

AGL is a major owner and operator of energy infrastructure in Australia. The company's interests include major gas transmission pipelines in NSW, Queensland, the Northern Territory and Western Australia; gas distribution networks in NSW and the ACT; and electricity distribution in Victoria. AGL distributes and retails energy to over 1 million consumers in eastern Australia and many of these are located in regional areas.

Two projects of considerable regional significance currently being developed in NSW by AGL-associated companies are gas pipelines and distribution networks to serve the Central West area (to Dubbo) and the Central Ranges area (to Tamworth). These projects together are expected to make natural gas potentially available to approximately 40,700 households and a wide cross section of commercial and industrial businesses over the next twenty years.

AGL recognises that policy initiatives by governments can be critical to a decision by the private sector to invest in regional infrastructure. As a publicly listed company, AGL also understands the responsibility of the private sector to provide acceptable returns to their shareholders with such investments.

In particular, the economics and speculative nature of regional pipelines can impose a high risk, as country areas may not have sufficient prospective load or be able bear the higher gas prices needed to justify construction. In such circumstances, support from external sources is often required to make the infrastructure investment viable. For example, the pipeline to the Central West of NSW would not have gone ahead without a grant of \$2 million from the Commonwealth's former Regional Development Funding Scheme. Taxation incentives may similarly be the catalyst for making a regional pipeline an economic proposition.

This submission focuses on AGL's experience in developing energy infrastructure in regional areas. In particular, the submission notes impediments to infrastructure development and highlight the issues which need to be resolved to overcome any market failure in this regard.

2. A Case History – the Riverina

Following is an account of how the Riverina region benefited from the provision of gas infrastructure and the new source of energy that was introduced.

2.1 Background: The Market for Energy

In October 1993, AGL extended its NSW gas reticulation system into the Riverina area, comprising the main MIA towns of Griffith, Leeton and Narrandera and a number of smaller centres such as Rockdale and Coolamon.

The region is well known for a number of primary industries based on irrigation, such as rice growing, citrus fruits, vine fruits and stock feeds. There are also poultry farms and abattoirs.

These agricultural and animal products industries undertake a large amount of secondary processing. For example: fruit and rice drying, juice production and meat preparation and processing. These processes require a reliable and competitive source of energy. If a region lacks competitively priced energy, then its industrial processing and its value adding agricultural production may not eventuate or may be at risk. Other areas of Australia, or more ominously, overseas may be able to process at lower cost.

Riverina agricultural production supports a number of other industries such as brickworks, light machine works and common social infrastructure such as schools, hospitals and community amenities. These activities depend to a large extent on the underlying strength of the agricultural and processing industries who are sizeable energy consumers.

Finally, the urban household market is a significant energy user. The winter climate of the Riverina is similar to that of Canberra leading to a sizeable domestic heating requirement.

2.2 A Fuel Alternative

The main sources of energy competing with natural gas in the Riverina were electricity, LPG, diesel fuel and wood. The first three sources were more expensive than gas so an immediate economic benefit was derived from introducing natural gas. Wood is widely regarded as a cheap household fuel in regional areas, but it is an inconvenient and a visibly polluting fuel. Increasingly, wood collection is seen as environmentally damaging.

2.3 Overview of Benefits to the Riverina from Natural Gas

During the first five years after the introduction of natural gas, the region experienced significant growth in the value adding of local produce, predominantly food processing. There is little doubt the arrival of natural gas during this period greatly assisted in the rapid growth of these industries. Previous years had seen opportunities lost to regions south of the Murray River; for example, Shepparton and Echuca (towns connected to Victorian natural gas supplies).

The arrival of natural gas saw the establishment of many service and support industries. Agencies were immediately established for the sales, service and installation of domestic and commercial gas appliances together with account administration.

The colder inland climate encouraged a gas conversion rate of over 50% for residential and commercial premises over the first five years. Natural gas displaced wood fires for heating with resulting environmental benefits. Service agencies also grew within the region to support the strong demand for the installation and service of natural gas furnaces, boilers and dryers.

2.4 New Industries in the Riverina since the Introduction of Natural Gas

Most of the new industries in the Riverina are in the food industry such as Barbers chicken processing factory and Rice Growers milling and drying plant. A new Canola crushing plant is in the planning stages.

Rockdale Feedlot has undertaken significant expansion based on natural gas and the project now incorporates a feedlot, feedmill, and abattoir. A cogeneration plant was also recently installed.

The Riverina has lost several opportunities due to the previous lack of a competitive energy source. For example, the projected Narrandera Wool Processors was lost to Geelong and the Griffith Glass Works was never built.

2.5 Direct Employment from the Riverina Project

Direct employment from the Riverina natural gas infrastructure project occurred in three areas :

- *Pipeline construction* - more than 100 contract employees for the relatively short construction period although few local people were directly involved;
- *Gas network construction* - approximately 60 people for a longer period including many local people;
- *Support services* - agents, service people, new businesses - approximately another 50 - nearly all local people.

2.6 Multiplier Effects from the Natural Gas Project

The arrival of natural gas to a region such as the Riverina, Central West or Central Ranges, has the effect of starting a new industry. For example, this means new skills being required resulting in a demand for new courses at TAFE and new business opportunities. There is a flow on of activity around the region with the local community gaining the most benefit.

These additional activities include:

- appliance sales, service and installation;
- gas network installation, repairs and maintenance;
- gas meter reading and billing;
- technical support;
- support services such as plant hire, construction materials, local surveying, legal services etc.

2.7 Overall Economic Effects

While AGL has no means of measuring the total economic impact of the introduction of natural gas to the Riverina, the Griffith Development Corporation estimates that the area now has approximately \$500 million per annum of primary production and a further \$500 million in value added processing. A comparison of population growth, building activity and industrial establishments in the area before and after the arrival of natural gas shows a strong acceleration in growth after 1993.

3. Potential Impediments to Regional Infrastructure Investment

3.1 General

The decision to invest in the Riverina area has from AGL's perspective been a worthwhile investment. The project met the company's initial investment criteria, and once established, the project generated further growth.

However, if a project cannot be justified on economic criteria in the first instance, the opportunity for potential regional growth may be lost. In such cases, energy infrastructure such as gas pipelines and networks can only be made viable with external assistance such as a direct government grant or tax relief.

The impediments that an infrastructure owner may face in justifying an investment is not limited to the potential market size. They may also include regulatory and environmental conditions imposed on a potential development which may increase risk and therefore reduce the attractiveness of a project. The following sections discuss these other project impediments in more detail.

3.2 Other Project Impediments

The introduction of natural gas to a new area requires substantial infrastructure investment. The viability of the investment is dependent on the following factors:

- Identification of substantial base load
- Opportunities for growth
- Flexibility in infrastructure pricing

3.2.1 Regulatory Regimes and Infrastructure Pricing

The prices charged by pipelines and networks are regulated by either Commonwealth or State authorities. Pricing is of primary importance in regional areas for a number of reasons.

The physical nature of the projects, that is, the layout of towns and routes of pipelines, mean that standard pricing regimes required under current regulatory regimes are not suitable.

Stand alone and distance based pricing structures can result in wide variances in pricing which are not practical in the market place. For example, towns at the start of the pipeline would receive a low price and those at the end of the pipeline an unreasonably high price. For the individual towns further along the pipeline, this means that they may be disadvantaged in not being able to attract industry with significant economic consequences.

For the infrastructure investor, it means that natural gas cannot be supplied at a competitive price, therefore decreasing potential load and jeopardising the investment. This can be overcome with zonal pricing as long as the investor is not at risk of bypass. Also, the current process of obtaining authorisation for zonal pricing involving the release of an access arrangement, makes the process complicated.

It is worth noting that such infrastructure investments are long term. Current periodic reviews add a large degree of uncertainty for the investor acting as a deterrent for investment.

An example is the \$100 million Central Ranges Project consisting of a pipeline from Dubbo to Tamworth (where 75% of the load is located). If distance based pricing was adopted, the natural gas prices at Tamworth would be prohibitive, making the entire project non viable.

3.2.2 Taxation Issues

The viability of an infrastructure project may be highly sensitive to changes in the prevailing taxation regime. The proposed Central Ranges pipeline is again used as an example.

The pipeline will introduce natural gas to the regional centres of Gilgandra, Coonabarabran, Gunnedah, Tamworth City, Quirindi, Werris Creek, Dunedoo, Coolah, Gulgong and Mudgee. A total of 27,000 homes will be accessible by the proposed distribution network, as well as industrial and commercial energy users.

The Commonwealth Government, following the options presented in the recent Ralph Review of Business Taxation, is proposing to eliminate the accelerated depreciation provisions for long lived assets introduced by the former Labour Government in 1992. At the same time, it is proposing to reduce the company tax rate from 36% to 30%.

On AGL's calculations, the net impact of the removal of accelerated depreciation and the reduction in the company tax rate is to either increase delivery costs to consumers, resulting in increased prices, or to significantly decrease the investment attractiveness of future projects to equity investors. For new investments in long term assets, the overall effect of the proposed change is negative.

Market and regulatory pressures would make it difficult for AGL to implement the necessary increase in tariffs to recover increased costs. This is likely to require a re-evaluation of the project, possibly delaying it until sufficient additional potential gas demand can be identified.

3.3.3 Environmental Issues

Establishing new infrastructure in regional areas usually involves more environmental planning and consultation than in built up urban areas where a complex network infrastructure exists, and where the infrastructure providers are already licenced to extend their network.

To supply a new region, gas pipeline and network owners must obtain the necessary new licences or augmentation of their existing licences. Authorities are able to attach new rigorous environmental conditions to these licences.

4. Conclusion

The introduction of natural gas into the Riverina region by AGL in 1993 has produced significant growth in the existing food processing industry. This has been coupled with the establishment of new service and support for the gas appliance industry.

While the pipeline and network construction activities provided employment opportunity for many it was only over the construction period. However, additional permanent employment was created in those value adding industries attracted to the area and in the support components of the natural gas industry.