MEDIA RELEASE

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Gas market reform and increased supply urgently needed to reduce damaging impacts of higher gas prices

An alliance of six industry associations has today released the first comprehensive analysis of the impact of rapidly escalating gas prices on the Australian economy. The report projects significant negative impacts on Australia's manufacturing sector and adverse effects extending to the mining, transport and agriculture sectors. These are significantly larger than the output impacts of the carbon tax.

The impacts are the result of sharply higher gas prices as Liquefied Natural Gas exports ramp up on the East Coast, tripling domestic gas prices to export parity levels.

The detailed quantitative analysis was undertaken by Deloitte Access Economics on behalf of six major industry associations representing the bulk of Australia's manufacturing sector, which employs 950,000 workers. It underlines the urgent need for gas market reform and greater gas production to cushion the impact of higher gas prices already being felt across eastern Australia.

The report, "*Gas Market Transformations - Economic Consequences for the Manufacturing Sector*", anticipates that under current policies and realistic gas price forecasts:

- Australia's manufacturing output will contract by $118 billion over the next seven years;
- 14,600 manufacturing jobs will be lost;
- The mining sector will contract by $34 billion and the agriculture sector by $4.5 billion;
- Queensland, New South Wales and Victoria will suffer serious declines in manufacturing.

The projected impacts on sectoral output in 2020-21 are significantly larger than those associated with repeal of the carbon tax, based on a comparison with the Government's Regulation Impact Statement for repeal.

The report also finds these impacts would be significantly lower if the upstream domestic gas market was more competitive.

For the first time, the report presents six case studies on the impact on companies in sectors as diverse as aluminium, chemicals, food and beverage, paper and galvanising to give real illustrations of how higher gas prices impact on manufacturing operations and jobs.

Australian Industry Group Chief Executive Innes Willox said it was a paradox that bringing Australia's abundant gas supplies to market could have such a damaging effect on the manufacturing sector.

"Gas exports should be pure good news for Australia. However, the strong benefits for investment and export earnings come with serious side effects for domestic manufacturing: tight supply and surging prices. Without reform, our rich energy reserves will no longer contribute to Australia's competitiveness.

"We need both a growing LNG export industry and a diverse industry base with a strong manufacturing sector. We need action on two fronts – get more gas flowing, by replacing blanket bans on gas production with strong but workable regulation; and reform the market that gas is sold in to boost competition and transparency," Mr Willox said.

Mr Phil Barresi, CEO of the Energy Users Association of Australia echoed the call for urgent action from all governments, suppliers and infrastructure operators.

"Australian companies seeking to renew or establish gas supply contracts for domestic operations are already facing an escalation in prices, uncertainty of supply and an inability to lock in long term supply contracts.

“If the domestic gas market were functioning efficiently these price signals would already be stimulating increased supply but instead we are seeing a shortage of gas from excessive regulatory barriers, retention of reserves to await higher export prices and the exercise of market power at the expense of gas users,” Mr Barresi said.

The Australian Aluminium Council, the Australian Steel Institute, the Australian Food and Grocery Council and the Plastics and Chemicals Industries Association said the impact of higher gas prices was already being felt across the manufacturing sectors they represent.

Executive Director of the Aluminium Council, Miles Prosser, said action on multiple fronts was needed to avert dire consequences for Australian manufacturing.

“Alumina refining is a gas intensive process and the forecast price rise is already seeing investments put on hold.

“We welcome the commitment from the pipelines industry to publish pipeline capacity information. Now we also need greater transparency and basic information about the upstream gas supplies, which is currently obscure - contract availability, pricing and penalty clauses.

“An ACCC investigation into the depth, liquidity and competitiveness of the domestic gas market, particularly the upstream industry, would help to shine a light on current inadequacies,” Mr Prosser said.

Australian Food and Grocery Council CEO Gary Dawson said in a trade exposed sector like food and grocery, Australian producers had limited or no capacity to pass through higher utility costs.

“Food and grocery processing is the lifeblood of many regional economies and higher gas costs have a direct impact on the profitability and competitiveness of food companies. If a food processing plant shuts down there is a direct flow on effect to farmers supplying that plant when they lose their key customer,” Mr Dawson said.

Plastics and Chemicals Industries Association CEO Samantha Read said gas was not only an important fuel source for the sector but also an essential feedstock for chemicals and plastics manufacturing. The industry transforms gas through chemistry to create products that are critical inputs to supply chains across Australia.

“A key contribution of this report is that it reveals how important natural gas is to the Australian economy. A supply and price shock to the extent forecast from the LNG export boom requires a broad national response. It’s not too late to avert some of the damaging consequences,” Ms Read said.

Steel Institute CEO Don McDonald said that compared to the huge volumes of gas slated for LNG export, domestic manufacturing consumed relatively small quantities of gas, meaning domestic users lacked the market muscle to drive long term supply contracts.

“Market power is a long recognised problem and one that must be addressed if the domestic market is to operate efficiently, respond to the transformation that will flow from the export boom and ensure gas continues to flow to relatively small domestic users,” Mr McDonald said.

The six industry associations have called on governments, gas suppliers, pipeline operators, users and the community to take a constructive approach to addressing the short and longer term impacts of the gas market transformation. The Federal Government’s Energy Policy White Paper is an important venue for doing this.

This project was part funded by the Consumer Advocacy Panel (www.advocacypanel.com.au) as part of its grants process for consumer advocacy projects and research projects for the benefit of consumers of electricity and natural gas. The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission.

Summary below covers key findings of the report, and policy responses recommended by the associations FULL REPORT (embargoed for publication until 21 July): http://www.aigroup.com.au/link/k5

***For Further Comment*:**

Ai Group, Tony Melville, 0419 190 347
Australian Aluminium Council, Miles Prosser, 0429 923 605
Australian Food and Grocery Council, Natalie Wimmer, 0450 728 660
Australian Steel Institute, Ian Cairns, 0417 426 002
Energy Users Association of Australia, Brian Green, Chair, 0407 804 490
Plastics and Chemicals Industries Association, Claire Selby, 0448 028 876

SUMMARY

Key findings of the report '*Gas Market Transformations – Economic Consequences for the Manufacturing Sector'*; and Policy recommendations from the manufacturing associations

Both the energy export and manufacturing industries are critical to Australia's economy, yet under current policy settings the boom in liquefied natural gas (LNG) exports is accompanied by serious side effects for Australian manufacturing.

The Deloitte Access Economics report, *Gas Market Transformations - Economic Consequences for the Manufacturing Sector,* contains new economic modelling and case studies that highlight the extent of these consequences for the first time.

The report was commissioned by an alliance of groups representing the bulk of Australian manufacturing, including the Australian Industry Group, the Australian Aluminium Council, the Australian Food and Grocery Council, the Australian Steel Institute, the Energy Users Association of Australia, and the Plastics and Chemicals Industries Association.

The project also received partial funding from the Consumer Advocacy Panel (www.advocacypanel.com.au) as part of its grants process for consumer advocacy projects and research projects for the benefit of consumers of electricity and natural gas. The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission.

The full report (embargoed for publication until 21 July) is available at: **http://www.aigroup.com.au/link/k5**

The **key findings of the report** are that under current policy settings and realistic gas price projections, the boom in LNG exports, while having a positive impact on Australia's GDP, will lead to:

- A loss of manufacturing output of approximately $118 billion in net present value terms by 2021.
- A loss of approximately 14,600 manufacturing jobs by 2021.
- Impacts on output from other sectors of the Australian economy, including non-gas mining and agriculture, which will contract by approximately $34 billion and $4.5 billion respectively.
- Despite overall benefits from LNG gas exports, Queensland's economy will also suffer the most severe decline in non-gas sectors, with a cumulative $60 billion contraction in manufacturing output and a $22 billion contraction in mining output in net present value terms to 2021.
- New South Wales and Victoria see serious declines in manufacturing output, accumulating to around $24 billion and $23 billion respectively in net present value terms by 2021.
- Overall manufacturing output is projected to be 3.61% lower in 2021; mining output 3.59% lower; agriculture 2.01% lower; and transport 1.79% lower.[1]
- Importantly, the negative impacts on manufacturing would be significantly lower in a modelled scenario where gas prices are set by a more competitive upstream gas market.
    - The loss of manufacturing output is halved in NSW, reduced by nine tenths in Victoria, and is $30.3 billion lower across Australia as a whole.
- In general, transformations occurring on the East and West Coast gas markets will have the most adverse consequences for manufacturing businesses that:
    - Use gas most intensively, and therefore incur significant increases in input costs.

[1] For comparison, the Federal Government's Regulation Impact Statement for the repeal of the carbon tax projected that in 2020 the tax would reduce gross output in mining by 0.9%, agriculture by 0.4% and transport by 0.1-0.2% - and increase manufacturing output by 0.3%. See Australian Government, *Regulation Impact Statement – Repeal of the Carbon Tax* (28 November 2013) pp 5-6 (http://ris.dpmc.gov.au/2013/11/28/repeal-of-the-carbon-tax-details-stage-regulation-impact-statement-department-of-the-environment/).

- Are substantially trade-exposed, or face other market imperfections, which limit their ability to pass on increased input costs.

- The case studies presented in this report provide real life evidence of the negative consequences that are already beginning to be felt by various manufacturing businesses.

Policy recommendations from the alliance of manufacturing associations
With this new evidence to hand, the manufacturing industry's objectives are clear – we need an efficient and competitive gas market to avoid dire consequences for Australia's manufacturing industry and to ensure the diversity and resilience of the Australian economy. Robust competition should extend to every part of the market – from production to trading to retail.
The alliance of associations now calls for urgent commitment and swift action from all levels of government, gas suppliers, pipeline operators, users and the community to a gas market reform agenda focussed on three areas:

1. Expanding the Market (increasing quantity of gas supply)

- Remove excessive regulatory barriers to new gas production, including by removing the Victorian fracking/CSG moratorium and the NSW CSG exclusion zones, by streamlining approvals processes while maintaining strong standards, and by harmonising regulation across all jurisdictions as much as possible.
- Joint efforts by gas developers, Governments and domestic gas-using industry to earn a social licence for gas developments, including in regional communities.
- Prevent retention or withholding of existing reserves that are commercially viable – for example, a use-it-or-lose-it approach to retention leases or mandatory development of such reserves.

2. Strengthening the Market (increasing competition in gas supply)

- The capacity for the exercise of market power is very real. In light of this and the rapid change in market dynamics, the ACCC and/ or the Productivity Commission, as appropriate, should be immediately commissioned to conduct a review, aimed at increasing the efficiency, transparency and competitiveness of the eastern gas market, into:
  - Joint marketing arrangements for gas producers, with the objective of moving away from them.
  - The depth, liquidity and competitiveness of the upstream domestic gas market including but not limited to: pricing, availability of supply, duration of supply, contractual terms and number of potential suppliers.
  - Gas infrastructure, including pipeline capacity, access arrangements (including for upstream infrastructure), efficiency, investment, planning and risk management mechanisms in gas markets.
- It is important to complete current reforms, including bedding down the Wallumbilla hub and supporting voluntary pipeline capacity trading.

3. Supporting the Market (increasing transparency and information)

- Better information is needed on many basic facts about the market which are currently obscure or disputed: the availability of contracts; average prices; and ability of the exporters to meet their full commitments, the nature of any penalty clauses for short supply in their contracts, and the consequent scope for domestic prices to exceed export parity.
- Improve planning and transparency mechanisms such as the Gas Statement of Opportunities and Bulletin Board.
- Continuing reforms already underway to publish available transmission pipeline capacity and accelerating efforts to develop a published gas price index.
- In future the impacts of major gas market decisions and developments need to be independently assessed in light of the national economic interest before investments are made.