Proceed with caution

The energy industry has cautiously welcomed the election of the Tony Abbott-led coalition in Australia. Damon Evans looks at the new government's policies – and whether they can be delivered

AUSTRALIA'S oil and gas sector is cautiously optimistic following the election of Tony Abbott's business-oriented centre-right Liberal-National coalition in the country's recent federal poll. But it remains to be seen if the coalition can make the switch from opposition to government and deliver on its pro-industry promises.

The result is a boon for the resources sector as it delivered a blow to the dysfunctional Australian Labor Party (ALP), a persistent thorn in the industry's side.

Abbott has plans to repeal a contentious carbon tax and abolish the unpopular Mineral Resources Rent Tax (MRRT). Both are viewed as a drag on investment, hurting the sector's competitiveness, especially at a time when emerging gas exporters in North America and East Africa pose an increasing threat.

Under the minority ALP government, regular policy changes did little to inspire confidence, while construction cost blow-outs at a series of projects inflicted serious damage to Australia's reputation as a resource investment destination, as well as damaging the financial performance of new liquefied natural gas (LNG) developments.

Just as the ALP's leadership seemed to be in permanent flux since it took power in 2010, so too were its fiscal and regulatory policies, much to the dismay of project developers, particularly those in the liquefied natural gas (LNG) business.

At risk

Homegrown players, such as Woodside Petroleum and Santos, as well as the supermajors, were quick to point out that planned, but not committed, projects representing another A$145 billion ($135 billion) in capital investment over and above the A$188 billion in capital already committed to seven LNG schemes under development, is at risk. Following a flurry of investment approvals between 2009 and 2011, no new projects have been sanctioned since January 2012.

To help put that into context, Australia's current hydrocarbon investments and their projected outputs to 2025 represent an increase in the nation's gross domestic product of just over A$260 billion, equal to 20% of the economy's annual output today, data from Deloitte Access Economics shows.

But the LNG market is an increasingly competitive one. And with the price of building new LNG projects in Australia surging – consultants McKinsey & Company reported that the cost is 20-30% higher than competing schemes in North America and East Africa – new investment is undoubtedly at risk.

Clearly, the LNG business is increasingly important to the Australian economy.

Nevertheless, during his first term it's unlikely that Abbott's government will be able to do much to cure the ills which have plagued the sector. Most notably, Australia's LNG business has been hit by escalating costs, triggered by foreign exchange movements, adverse weather and poor labour productivity. It is also hampered by a convoluted approvals process.

However, Matt Howell, an Australian upstream specialist at energy research firm Wood Mackenzie, expects the costs problem will improve. He said "it will be a big but, as to when and by how much. It will be challenging to cut the red and green tape, whilst finding a balance between state and federal power".

Indeed to ease cost pressures, Abbott's government will need to reduce the number of bureaucratic hurdles. Regulations remain in flux and pose tremendous uncertainty for the energy sector, Susan Timbs, executive director of energy-focused law association AMPLA, warned.

Santos' vice president, John Anderson, agreed, adding that if the burden of regulatory duplication does not scare off investment in the first instance, it's invariably delaying projects, and that also adds to costs.

An indicative cost estimate for a one-year delay on a large oil or gas project is in the order of A$700 million, according to a draft report from the Productivity Commission, added Anderson.

Needless to say, the Coalition's pledges to axe the MRRT and carbon taxes, streamline the approvals process for new developments, as well as tackle industrial relations issues, would be positive for the sector – if they bear fruit.

Smaller explorers will take heart from the government's proposed exploration development incentive, designed to boost onshore exploration. Under the scheme, which applies to junior companies, a proportion of expenses could be claimed as tax credits by investors.

But for now "in terms of broader energy policy, there is not much detail", Elisa de Wit, Sydney-based climate change manager at law firm Norton Rose Fulbright told *Petroleum Economist*. The new federal government is expected to release an energy White Paper within a year.

Richard Pritchard, director of the Energy Policy Institute, however, says that to ensure policy integration over the long-term, Australia needs an independent, unbiased, apolitical institution, operating with complete transparency and genuine stakeholder participation.

It is unsurprising then that the uncertainty looks set to continue, at least over the next 12-18 months, as the new government faces a hostile senate, controlled by the ALP and the Green party, both of which oppose Abbott's proposed MRRT and carbon tax repeals.

However, once the current Senate's term expires, in July next year, the situation may improve for Abbott's coalition government. The make-up of the next Senate may be more inclined towards endorsing Abbott's plans, but his government will need to hone its negotiating skills and be ready to compromise if it wants to get legislation through the upper house. As *Petroleum Economist* went to press, it looked as if the balance of power in the new Senate will be held by eight senators, coming from small, often single-issue, parties.

The majority of new Senators are thought to favour market-based emissions regulation. "But it's far from a foregone conclusion that there will be full support for the carbon tax repeal," Hugh Grossman, executive director of Australian analysts RepuTex, told *Petroleum Economist*. "That's largely because of the uncertainty surrounding the coalition's replacement policy, the Direct Action Plan."

It's not clear if the coalition is seeking to scrap the Carbon Price Mechanism (CPM) – which includes a floating carbon price from 2016 – by abolishing the Clean Energy

Tipping point: BG's LNG facility in Queensland could feel the impact of revised laws

Act entirely, or if it is seeking to axe only the fixed price element, known as the carbon tax. Its pre-election language suggests only the carbon tax, but until the legislation is tabled, nothing is clear.

In Australia, it's largely the LNG producers, as well as the bigger oil and gas players, such as Santos, that are liable to pay the carbon price, though domestically much of this can be passed on to the buyers.

"It's not a major cause for concern, but again it sparks a sense of uncertainty," says Howell.

Certainly the price on carbon will continue. "It's just a question of what shape that price will take in 2015," said Grossman. He added that he expects to see some significant changes in the coalition's policy itself before it, in turn, sees much movement from either the current or new senate.

The price of carbon

According to RepuTex's analysis, the coalition will need the support of six of the eight minor party senators to pass legislation in the new senate, while the ALP-Green bloc would only need the support of three of them to block it.

If the coalition waits until the new senate sits, the earliest the carbon tax could be abolished is the end of 2014, just six months before it was scheduled to be superceded by the ALP's emissions trading scheme (ETS).

Rather than place a price on carbon, Abbott's Direct Action Plan would establish an Emissions Reduction Fund (ERF) to support carbon abatement activities carried out by industries.

RepuTex forecasts that the Direct Action Plan would lead to emissions growth of 16% on 2000 levels by 2020, driven by higher emissions from the power and industrial sectors. This is much higher than Australia's committed target to cut emissions by 5% over the same period.

With about A$5.6 billion set aside for the ERF through to 2020, the Melbourne-based carbon analysts predict another A$6 billion is needed each year for the fund to buy enough abatement to hit the country's emissions target.

In response to the findings and similar research from Sinclair Knight Merz and Monash University, the coalition said it will not boost funding, but instead seek "as much environmental improvement as it can for the budgeted spending".

If the Abbott government succeeded in withdrawing the carbon tax, the estimated foregone revenue from that decision would be A$13.5 billion. After offsetting savings – the removal of compensation measures to businesses and the energy market – the net drain on the budget would be around A$6 billion, a report in the *Global Mail* said. And scrapping the MRRT, originally forecast to net the government A$22.5 billion over four years, would surely add further stress to the treasury.

It's a touch ironic, given that, for the past three years in opposition, the coalition has focused, terrier-like, on budget emergencies and the ALP's handling of the economy. Ahead of the September election, Joseph Stiglitz, an economist and Nobel laureate, wrote that substantial cuts to Australia's budget, as planned by the coalition, would be a grave mistake. Stiglitz said the federal government should instead focus on converting the strength of Australia's economy into resilience for the future. He added further that the economic slowdown Australia experienced this year was not the result of flaws in government policy, but of an adverse external environment. "It would be a crime to compound these problems with domestic policy mistakes," Stiglitz added.

Given the energy sector is significant to the Australian economy, it will be crucial for Abbott to introduce a stable regulatory and fiscal environment as soon as possible.

Industry lobby group, the Australian Petroleum Production & Exploration Association (APPEA) says it is critical that steps are taken to ensure Australia secures its share of the next wave of global oil and gas projects.

The effect the coalition's policies will have on the industry is unclear, but ahead of the election leading coalition politicians implied that the changes will make things easier, in terms of more efficient and cost effective processes, as well as improved stability, Frances Cullen, as Australian-focused energy specialist at consultancy IHS told *Petroleum Economist.*

Whether the coalition can deliver is another question altogether.

Talk of government interference in the east coast gas markets, where planned LNG exports have started to push up domestic prices, will do little to ease the industry's nerves.

But given coalition's broadly pro-industry stance, there is room for optimism.

The new energy minister, Ian Macfarlane, is both experienced and well-versed in the sector; indeed, Macfarlane was energy minister from 2001-2007, during the last coalition government, led by John Howard.

Howell adds: "On the whole, the industry is quietly confident the coalition will do the right thing by them." ●