Future of gas industry needs a fair hand at the pump

Published by The Australian Financial Review, Page 47, Monday 17 June 2013

The domestic gas market needs to mature fast so it can efficiently respond to price and demand signals, writes ***Tony Wood***

After several years of electricity and gas price rises, there is more to come. In the next few years, Australian households could pay up to $170 more on their annual gas bills. Big industrial gas users also face increases of up to $3.2 billion a year in total. The gas industry, meanwhile, is furiously debating the prospect of running out of gas in NSW. Governments are worried.

Yet why are prices going up when global resources are enough to meet more than 200 years of current consumption? The world is awash with gas, and Australia is poised to become the biggest supplier of it. By 2018 it is likely to have a liquefied natural gas (LNG) export industry worth more than $50 billion a year.

Grattan Institute's new report, ***Getting gas right: Australia's energy challenge***, explains how this apparent contradiction has come about and what governments and industry need to do in response.

Global gas markets are in a period of revolutionary growth. The continuing rise of Asian economies, the abandonment of nuclear power in Japan and Germany, the accessibility of low-cost shale gas in the US and the fact that gas produces far fewer carbon emissions than coal in electricity generation are all driving the change.

The Australian industry is rising to the challenge: $160 billion of LNG investment is under way. Yet our domestic gas market is relatively immature by global standards. Now it has to grow up fast.

Low domestic gas prices will move toward parity with export prices, as domestic consumers will have to pay the price that suppliers can get for exporting. That means big increases for households, and a big struggle for some industrial gas users to remain competitive.

Commercial answers to a commercial problem

The rapid expansion of LNG exports on the east coast could also mean short-term gas shortages at peak winter periods, since LNG export terminals will draw heavily on Queensland's coal seam gas reserves as producers ramp up to full production. Gas retailers claim they cannot get gas for the next few years at any price while producers claim they can and will supply, but at higher prices.

It is a commercial problem that should be solved by commercial deals, but the tension is high. It is not relieved by the current impasse on coal seam gas development in NSW, the only mainland state with almost total reliance on interstate supplies of gas. And some of the supply alternatives require new infrastructure that could take years to build.

Other shifts have also caught government and industry by surprise. The introduction of a carbon price was expected to turn gas-fired power generation into a major source of carbon emissions' reduction, albeit a transitional one, as gas produces too much carbon dioxide to meet long-term targets. But a perfect storm of falling electricity demand, policies that force more renewable energy into the supply mix, and increasing gas prices mean that the "dash for gas" is not happening.

How should governments respond to the gas challenge? First, the NSW government must resolve the impasse over coal seam gas development. If extraction is to proceed, with appropriate regulations in place, it should begin soon. If not, the market must be clearly informed, so that it can find another source of supply.

Secondly, governments should move to create a more transparent and competitive gas market. Steps include accelerating the development of gas trading hubs, introducing a published price index, freeing up trading in pipeline capacity and tighter constraints on joint marketing arrangements by gas producers as the market matures.

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These changes will not directly reduce prices or guarantee supply, but they will help to ensure that the market responds efficiently to demand and price signals, another sign of a maturing market.

The benefits and costs that come as Australia turns up the gas will not be evenly distributed. Vested interests are pushing hard to take a bigger share of the wealth, and avoid sharing the pain. Some representatives of big gas customers want government to intervene to keep prices low. Some have called for a moratorium on new LNG developments or the reservation of a proportion of gas for domestic consumption. The Western Australian government has had a domestic reservation policy for some years.

Despite their seductiveness, these demands for intervention are all pleas for protectionism. They are a poor alternative to a resources rent tax, a far better way to help Australians share in the value of our natural resources. They will lead to distorted price signals, inefficient industries, lower investment and ultimately higher prices. For three decades, the Australian economy has thrived from opening trade. We should not turn the other way now.

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