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The current moratorium on onshore gas exploration benefits no-one

Grattan Institute submission to the Standing Committee on Environment and Planning's Inquiry into Unconventional Gas in Victoria.

Inquiry into Unconventional Gas: Submission from Tony Wood, Energy Program Director, Grattan Institute

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There are no restrictions on publication of this submissions or requirements for anonymity. The submission contains no personal information of third party individuals.

1 Summary points

- Increasing gas prices in eastern Australia are driving the search for new gas resources to meet domestic and international demand.
- Increased prices will have significant, negative impacts on households and businesses that rely on gas. Victorian households are particularly exposed due to the high usage of gas for heating. Additional supply will mitigate these impacts.
- There is no justification for the moratorium's application to conventional gas development and that coverage should be lifted immediately.
- It is unclear whether there are significant, commercially viable, unconventional gas resources in Victoria. The state will benefit economically if such resources are developed within a sound regulatory framework.
- Victoria is part of an interconnected east coast gas market. It is highly desirable that any decision on unconventional gas development in Victoria be part of a nationally consistent approach.
- The moratorium has neither addressed the concerns of Victorian communities nor provided certainty for the gas industry. Lifting the moratorium, in conjunction with an appropriate regulatory framework, would provide certainty for both. A ban on unconventional gas development in Victoria would mean that gas companies would proceed to focus on other forms of gas supply.

2 Introduction

This submission from the Grattan Institute responds to the terms of reference of the Standing Committee on Environment and Planning's Inquiry into unconventional gas in Victoria.

Grattan Institute is an independent think-tank focused on Australian domestic public policy. We aim to improve policy outcomes by engaging with decision-makers and the community.

We understand that the Inquiry is seeking submissions on a range of issues associated with the development of an unconventional gas industry within Victoria. This inquiry is the second in the past three years to explore issues associated with unconventional gas in the state. It also comes after numerous scientific studies, community consultations, community representations and the development of the, albeit limited, National Harmonised Regulatory Framework for coal seam gas.

The most important outcome from this inquiry will be to provide clear recommendations for the Victorian Government to take a decision on the future of unconventional gas. We do not offer a view one way or another, but highlight that the current moratorium does nothing for either the proponents or opponents of unconventional gas.

We make no comments on the technical aspects raised by the Inquiry. The remainder of this submission seeks to address the terms of reference from a policy perspective. Our two most recent reports on gas are attached to provide further context.

3 Addressing the terms of reference

3.1 Domestic wholesale gas prices

The east coast of Australia has historically had a balanced gas market. The production of conventional gas from the Gippsland and Cooper basins has been more than sufficient to meet domestic demand. It has been relatively low cost to develop these resources for a relatively small domestic market. This led to stable wholesale prices of between \$3 and \$4 per gigajoule over several decades.

Recent technological advances have created a new opportunity for the Australian gas market: the development of coal seam gas (CSG) and its export as liquefied natural gas to higher-priced international markets. The current scale of CSG development in Queensland would not have occurred without access to these prices, which have been as high as \$15-20 per gigajoule.

Linking the Australian gas market to the international market means that domestic gas consumers must now compete with international buyers. If a gas supplier can get \$8-10 per gigajoule (before liquefaction and transport) from an international consumer, why would they choose to supply domestic consumers at \$4 per gigajoule?

It has been forecast that domestic wholesale gas prices will peak at around \$9 a gigajoule in 2016 and then fall back to about \$7.50 to \$8 from 2019.¹ While predicting future gas prices is difficult,

¹ Deloitte Access Economics (2014) *Gas market transformation – Economic consequences for the manufacturing sector*.

there appears to be one thing on which all commentators agree: domestic prices will rise.

3.2 Impact of the moratorium

Recent experience in the USA demonstrates that increasing prices can successfully drive new supply. The market then tends to find a new price level that could be expected to lie between the historical position and the immediate, high peak price.

The moratorium in place in Victoria prevents the development of all onshore gas, not just CSG, providing a major barrier to increasing supply. Worse, given this is a moratorium and not a ban, it may deter gas producers from investing in alternative supply options given the potential for the moratorium to be lifted.

Extending the moratorium from fracking to all onshore gas activities in May 2015 has worsened the situation. It is difficult to see any justification for this extension and it should be lifted immediately.

Following the Reith Report in 2013 and the O’Kane Report in New South Wales in 2014, the Victorian Government should have sufficient information following this latest inquiry to make a decision on the future of unconventional gas in Victoria.² Kicking the can further down the road should not be an option.

² Reith, P. (2013) *Gas Market Taskforce*, Victorian Government, October 2013.
O’Kane, M. (2014) *Final report of the Independent Review of coal seam gas activities in NSW*, NSW Government, Chief Scientist & Engineer.

3.3 Impact of a Victorian unconventional gas industry on gas prices

New gas developments would provide economic benefits to the state in the form of increased Gross State Product, jobs and royalties. The scale and cost of such developments is unclear, and so also, therefore, is the potential for such developments to mitigate price increases.

The current long-term price outlook sees a doubling of gas prices from their historical levels. With current coal prices and in the absence of a very high carbon price, gas will be priced out of electricity generation, both in terms of existing capacity and any new capacity that was required, except to meet short term peaks in demand. Residential consumers will consider switching from gas to electricity. Some gas-intensive businesses will face hard decisions. This is particularly so for industries where gas is used as a feedstock for manufacturing rather than as an energy source because there are limited, if any, substitutes. (For more information on the impact of higher gas prices, please see our report *Gas at the Crossroads; Australia's hard choice* which is attached).

The development of new gas supplies will help balance the increase in demand from international customers. Failure to do so rules out even the potential for this mitigating effect. However, unlike the United States' experience, where domestic consumption dominates demand, a shift back to historical price levels in Australia is unlikely. As a result:

- The ability of unconventional gas to provide a competitive source of energy and non-energy inputs for Victorian

industries is unclear. It will be impacted by other factors such as outcomes in the electricity market and exchange rates etc.;

- It is already the case that gas is a more expensive energy source than electricity for most domestic consumers. Unconventional gas development is unlikely to reverse this position;
- When burned for power, gas produces less carbon dioxide emissions than coal. This is generally also true when fugitive emissions from unconventional gas are included. Climate change policy uncertainty makes the role of gas as a low-emissions source unclear, although, other things being equal, additional unconventional gas resources could assist in role.

3.4 The prospectivity for unconventional gas in Victoria

The majority of Victoria's coal seams consist of brown coal rather than the black coal seams that have been the source of CSG in Queensland. To our knowledge, there has been no commercial development of CSG from brown coal anywhere in the world. The exploration company Lakes Oil discovered tight gas in Gippsland in 2004, although they have yet to develop the resource. To date this appears to be the only known find of unconventional gas in Victoria.³

This does not mean that CSG or other forms of unconventional gas do not exist within Victoria. However, as with CSG in other

³ Ross, C & Darby, P. (2013) *Unconventional Gas: Coal Seam gas, Shale Gas and Tight Gas*, Research Paper, Department of Parliamentary Services, Parliament of Victoria.

places, technical factors such as the depth and permeability of the gas-containing coal seams will be just as important for commercial development as the simple existence of the gas. There is little available evidence to provide any guidance whether Victoria contains a resource that could substantially add value to the state's economy and its energy needs.

3.5 Community concerns with CSG

Community and environment groups have expressed concern about the risk that the production of CSG can have on the environment. In particular, concerns have focussed on the impacts of hydraulic fracturing of coal seams, otherwise known as fracking, and the risks that this process poses for water supplies. Despite reports, such as that from the New South Wales Chief Scientist, Mary O'Kane, finding that CSG production can be undertaken safely under the right regulatory settings, these concerns remain.⁴

In part these continued concerns may reflect frustration faced by communities at the disruption to livelihoods caused by gas developments, such as noise and the impact on both the landscape and local roads. Under the current regulatory regimes, communities are not compensated for these impacts, which may help explain the strong opposition to coal seam gas. Any aggressive actions by companies will heighten such concerns.

CSG producers have failed to adequately respond to the legitimate concerns of landowners, local communities and environmentalists. Whatever claims that the gas industry may

have to the safety of its activities, its failure to address these concerns has made it easier for more extreme claims about the risk to the environment and livelihoods gain traction in local communities.

On a broader scale, the mining industry along with both state and federal governments have failed to effectively inform both the communities affected and the broader community of the benefits of mining and how the mining and regulatory processes work. While it should be acknowledged that parties have made the attempt, the fact that there is such a strong opposition to CSG in a state where there have been no actual discoveries suggests that these attempts have been unsuccessful.

3.6 Conclusion

The moratorium has not resolved the concerns of gas developers land owners or environmentalists. It will also do nothing to relieve gas supply or cost pressures. A clear decision is needed in which the Victorian Government provides clarity and certainty to deliver a stable environment for future gas development.

If the Victorian Government decides to lift the moratorium a clear regulatory regime would need to be developed. Given that gas moves freely across state boundaries, the Victorian Government would need to work with other jurisdictions to develop a nationally consistent and effective regulatory process.

If it is decided that the risks of CSG development are unacceptable, the Government should introduce a permanent ban. This would provide certainty for concerned communities. It will also allow gas developers to focus on other forms of gas

⁴ O'Kane (2014)

supply. Such a ban would have flow-on effects outside Victoria.

The current situation, where the Victorian Government has decided neither for nor against unconventional gas development, is the worst of both worlds. After two separate inquiries in Victoria, in addition to the O'Kane Report in New South Wales, a clear way forward is an imperative.

For any queries, please contact:

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