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Ms Karen Chester
Deputy Chair
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601

Dear Ms Chester

RE: APPEA SUBMISSION TO THE PRODUCTIVITY COMMISSION'S *INQUIRY INTO HORIZONTAL FISCAL EQUALISATION*

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body that represents companies engaged in oil and gas exploration and production operations in Australia. APPEA's members account for the vast majority of Australia's oil and gas production and petroleum exploration. APPEA also represents more than 150 companies that provide goods and services to the oil and gas industry.

APPEA welcomes the opportunity to make a submission to the Productivity Commission's *Inquiry into Horizontal Fiscal Equalisation* system (HFE). The system underpins the distribution of goods and services tax (GST) revenue to the Australian states and territories.

In our view, the present methodology used by the Commonwealth Grants Commission (CGC) to assess the distribution of GST revenue is dated and would benefit from some modifications to reflect the policy decisions of different jurisdictions. This is evident from the CGC recommended GST distribution arrangements for 2016-17 wherein, one jurisdiction (Western Australia) received just 30 cents per dollar, while another (excluding the Northern Territory) received as much as $1.78 (Tasmania) per dollar. Only relatively minor adjustments are expected in 2017-18 (see Table 1).

Table 1: Relativities for GST distribution, 2016-17 (actual) and 2017-18 (proposed)[1]

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
2016-17	0.905	0.910	1.171	0.303	1.417	1.777	1.157	5.285
2017-18	0.877	0.932	1.188	0.344	1.440	1.805	1.195	4.660

We are encouraged to see that the Commission is specifically looking into the potential influence and/or impact of the HFE system on state policies to facilitate, restrict or tax the

[1] Commonwealth Grants Commission, 2017 Update Report, Table 1 p.2.

development of economic activity. This is particularly relevant in the context of energy and mineral resources.

Since the turn of the century, mining and petroleum revenues have contributed significantly to state and territory revenues and changed the way GST revenue is materially distributed. For example, Western Australia's fiscal situation improved substantially from the mining boom, to the effect that it shifted from being a net recipient in the GST distribution framework to being a net donor.

This encouragement of substantial development has, however, impacted the GST distribution process to the point where jurisdictions that promote and facilitate the development of their petroleum resource bases are being disadvantaged relative to those that have imposed restrictions or moratoria on the same economic activity.

This is particularly the case for gas, whereby some jurisdictions continue to promote the consumption of gas, but at the same time restrict exploration and production activities within their own jurisdictions. Indeed, the HFE system offers perverse incentives to prohibit or limit gas activities for non-scientific reasons, as the loss of revenue from such decisions is in part shielded by increased shares of GST revenue. Not only is this hampering economic development, it is placing even further pressure on those states and territories that have chosen not to impose restrictions. Such an outcome is inequitable.

The CGC has acknowledged that mining revenue assessments (including petroleum revenue) typically produce significant redistributions in GST. The CGC also acknowledges that states pursue 'different policies' in relation to resource developments, and discussed the issues in some detail in its 2015 review of the GST revenue sharing relativities. However, it claimed in the review that it would be too hard to develop a new approach which could resolve the issues identified with its current approach and be satisfactory for all states and territories.

This view is though, contradicted by international experience from nations that face broadly similar issues. Canada, which has significant distribution of resource endowment through its provinces, has developed arrangements under which only a percentage of a province's mining revenue is taken into account for its horizontal fiscal distribution calculations.

Recommendation

To this effect, APPEA therefore recommends that all state and territory petroleum royalties (from onshore/offshore areas and conventional and unconventional sources) be excluded from the calculation of state and territory revenues by the CGC for GST distribution purposes. Treating petroleum royalties in this way would create a stronger incentive for states and territories to develop their resources and therefore discourage the imposition of non-science based restrictions and moratoria.

It would allow for the greater utilisation of our natural resource base, improve energy security and enhance productivity in Australia. Importantly, it would also assist in stimulating economic activity in regional areas.

APPEA looks forward to further engagement with the Commission after the release of its draft report into Australia's Horizontal Fiscal Equalisation system.

Yours sincerely

Noel Mullen
Deputy Chief Executive