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Ms Karen Chester
Deputy Chair
Productivity Commission
GPO Box 1428
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Dear Ms Chester

APPEA Comment on the Productivity Commission's Draft Report of the *Inquiry into the Horizontal Fiscal Equalisation system*

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

APPEA welcomes the opportunity to comment on the Productivity Commission's Draft Report of the *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 methodology used by the Commonwealth Grants Commission (CGC) to assess the distribution of GST revenue is dated. The methodology could be improved to strengthen the incentives for states and territories to grow their own sources of revenue rather than rely on a redistribution of income from other jurisdictions.

APPEA believes that the Commission in its Draft Report has missed an opportunity to recommend changes which would create a stronger incentive for states and territories to develop their natural resources, including oil and gas resources. The Commission in its Draft Report confirmed that the system for distributing GST revenue between states and territories penalises jurisdictions that develop natural resources because these jurisdictions see their share of the GST pool reduced to 'equalise' revenue across jurisdictions.

The Draft Report acknowledged that the HFE system has the potential to distort state policy, more so for mineral and energy resources than other sectors[1]. The CGC has defined the aims of HFE as:

> *State governments should receive funding from the pool of goods and services tax revenue such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, **if each made the same effort to raise revenue from its own sources** and operated at the same level of efficiency [emphasis added].*[2]

APPEA believes that when a state decides, for political reasons, to ban resource projects, it is not making 'the same effort to raise revenue from its own sources'. If a state plays a political game, it

[1] Productivity Commission Draft Report, *Horizontal Fiscal Equalization*, October 2017, p. 13.
[2] Productivity Commission Draft Report, *Horizontal Fiscal Equalization*, October 2017, p. 7.

should not be rewarded with an increased share of GST revenue. Victoria's political ban on onshore gas development is the most obvious example.

Even the CGC in its 2018 update discussion paper released in August 2017, agreed that it is difficult to conclude that state-wide bans are all environment-related when two states have no such bans on CSG and Uranium.[3]

Indeed, the current HFE system offers perverse incentives for some states that 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 considered by APPEA to be inequitable.

However, it seems that, despite recognising the problem with the policy, the Commission has decided to put this problem into the 'too hard basket'. It offers no solution for the problem, just like the CGC.

APPEA recommends that all state and territory petroleum royalties (from onshore/offshore areas and conventional and unconventional sources) should be excluded from the calculation of states' revenue by the CGC for GST distribution purposes. Treating petroleum royalties in this way would create a stronger incentive for states to develop their resources and therefore discourage non-science based restrictions and moratoria. It would encourage the greater use of our natural resource base, enhance productivity and economic growth in Australia. Importantly, it would also assist in stimulating economic activity in regional areas.

APPEA urges the Commission, as it prepares its final Report to the Treasurer, to recommend a stronger incentive for states and territories to develop their own gas resources and, at the same time, discourage the imposition of non-evidence based restrictions and moratoriums.

Yours sincerely

Malcolm Roberts
Chief Executive

[3] Commonwealth Grants Commission, *New Issues for the 2018 Update*, 2018 Update, Staff Discussion Paper, August 2017, p. 29.