

**Submission to the Productivity
Commission Inquiry into Australia's
General Tariff Arrangements**

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Executive Summary

- In the absence of new discoveries and future investment, Australia's self sufficiency in petroleum liquids is expected to fall from around 75 per cent in 1999 to less than 50 per cent by the end of the decade (*Section 1.1*)
- The industry currently contributes around 53 per cent of the nation's energy needs and makes significant direct contributions to Australia's economic well-being (*Section 1.2*)
- Australian suppliers seeking to participate in Australian resource development projects face the same in-principle challenges that Australia faces in attracting scarce international investment capital. Governments should be establishing a framework that fosters international competitiveness (*Section 2*)
- Government's should seeks to tax outputs, not inputs. The net costs associated with tariffs are more severe on investments associated with long term capital intensive projects, with high up-front costs. Uncertainties associated with utilising duty relief provisions are inefficient and should, where possible, be minimised. They merely add additional risk to a project. In APPEA's view, a compelling case exists for the total abolition of tariffs (*Section 3*)
- The suitability of duty relief provisions should be measured against an objective set of criteria, such as those proposed by the IAC in 1982 (*Section 4.1*)
- The current Project By-Law provisions contained in Item 45 should be both maintained and improved (*Section 4.2*). APPEA recommends that:
 - a new PBL item be created for large scale projects
 - a more comprehensive definition of what constitutes a project should be adopted
 - a self assessment type system for eligible claimants be considered
 - intermediate goods used by Australian manufacturers be eligible for duty relief
- Duty relief provided under Item 22 (the oil and gas exploration and development by-law) should be maintained and streamlined to ensure that cumbersome administrative requirements are removed and that duplications of exclusions are deleted (*Section 4.3*)
- A full rebate of duty should be provided for items listed under the tariff concession scheme, rather than the three per cent rate of duty that currently exists (*Section 5*)
- The petroleum exploration and production industry's commitment to local industry participation has been demonstrated by the Australian Competitive Energy (ACE) initiative which aims to involve all stakeholders in the development process (*Attachment B*)

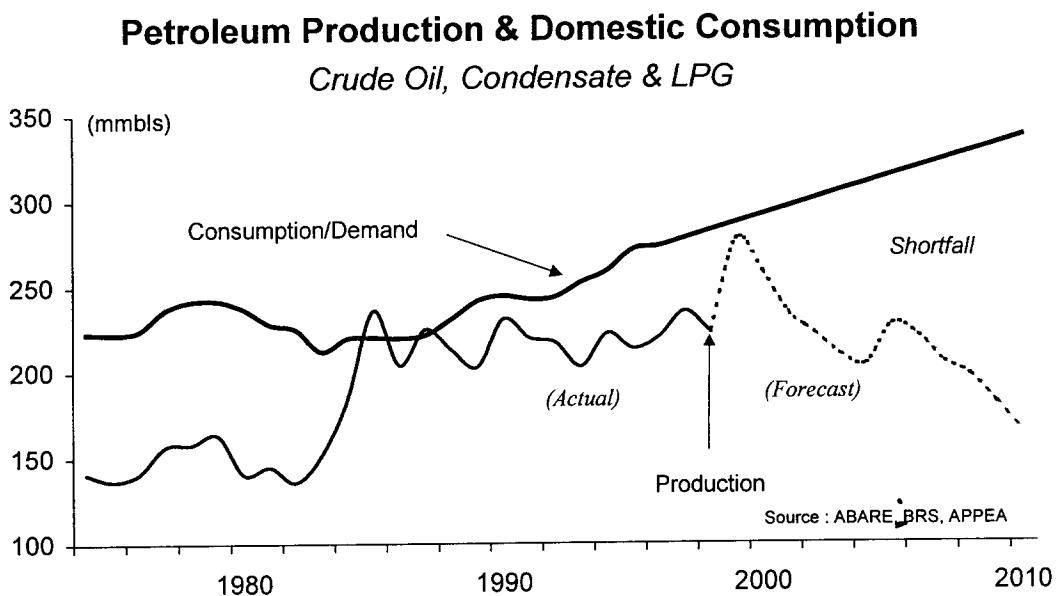
1. Introduction

The Australian Petroleum Production & Exploration Association (APPEA) is the national body that represents companies engaged in the petroleum exploration, development and production industry in Australia. APPEA membership comprises around 50 companies that are actively engaged in exploration and production activities, and around 90 associate member companies that provide support and services to the explorers and producers.

1.1 Australian Oil & Gas Exploration and Production

Production

Australian crude oil, condensate and LPG production is expected to average 590 thousand barrels per day (or 215 million barrels pa) in 1999. Gas production is forecast to be 1060 billion cubic feet (bcf) in 1999, up from 756 bcf in 1992. The Bureau of Resource Sciences has forecast a relatively optimistic production profile for liquids production over the next two to three years, however the prospects after this are less certain.



In the absence of new discoveries and future investment, Australia's self sufficiency in petroleum liquids is expected to fall from around 75 per cent in 1999 to potentially less than 50 per cent by the year 2005. Assuming an oil price of around \$A30 per barrel, this implies a potential net import bill for crude oil and condensate of around \$4 billion per annum by the year 2005.

The Australian Bureau of Agricultural and Resource Economics (ABARE) estimates that natural gas production will grow by up to 5.5 per cent per annum until the end of the next decade. A large portion of this is associated with growth in south-east Australia. Assuming investment funds are available, this will meet both domestic demand and export opportunities.

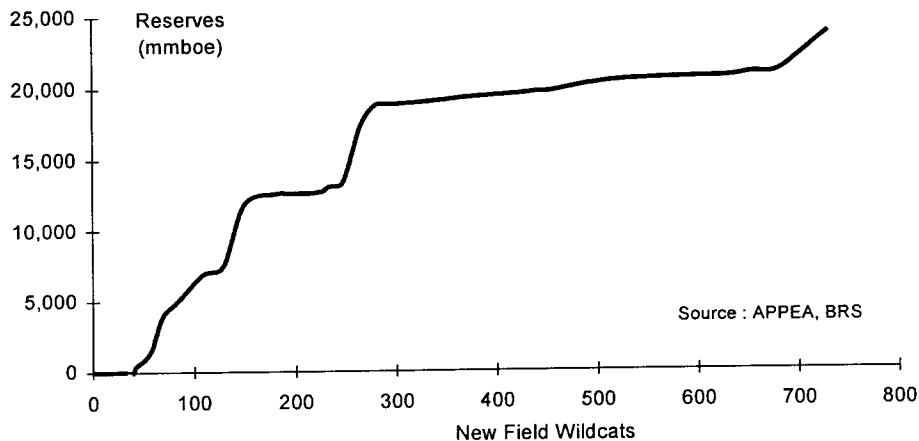
Liquefied natural gas (LNG) has created an opportunity for Australia to market its substantial reserves of natural gas. Exports commenced from the North West Shelf project in 1989.

Additional opportunities exist in terms of a number of potentially large new projects in the north-west region of Australia.

Exploration Activity

Petroleum exploration activity in Australia has fluctuated considerably over the last three decades. Exploration (and production) is affected by a range of factors, including access to acreage, prospectivity, prices, rig and seismic mobilisation costs, geographic location, perceptions of risk/rewards (eg potential field sizes), international competition for funds and the fiscal regime (including taxes and tariffs).

Discovery of Australian Oil & Gas Reserves



In Australia, the above chart illustrates that the first 300 new field wildcat (NFW) wells discovered 80% of Australia's total offshore reserves. Over 400 more NFW wells drilled since this time have only managed to add the remaining 20% of known reserves of gas and liquids.

The vast majority of reserves discovered since the 1960's have been gas which now accounts for over 60% of the total amount. While reserves coverage of ABARE's forecast production to 2010 appears comfortable on a total basis, the liquids position is rather more uncertain given the lower rate of discoveries of liquids.

While further discoveries are likely and have recently occurred in the Timor Gap, discoveries of the scale of those in the Gippsland Basin in the 1960s (whose original liquids reserves account for over half of total liquids discovered in Australia) and in the Carnarvon Basin in the 1970s are by no means certain.

Petroleum exploration in the first half of the next decade will be important for the national economy in view of the projected decline in liquids production.

1.2 Industry Economic Significance

The petroleum exploration and production industry is important to Australia's overall economic welfare. It provides the nation with a reliable and competitively priced source of energy which directly meets 53 per cent of Australia's energy needs.

It's direct economic contributions include the following:

- Value of Production - \$8bn pa
- Exports (1998/99) - \$4.9bn
- Import Replacement - >\$3bn pa
- GDP - 20% production change leads to a 0.5% change in GDP
- Income Tax - >\$1.2 bn pa
- Resource Taxes - >\$1.3bn pa
- Industry Output Multiplier - 1.8 to 2.4
- Employment - 20% production change leads to a 0.4% employment change

While the above contributions reflect direct benefits to the economy, it is important to recognise that companies that operate within the industry provide capital, infrastructure, expertise, technology diffusion and often facilitate the capturing of export market opportunities for related industries. It also supports a significant services sector - a recent study has indicated that nearly 900 businesses in Western Australia alone are involved in providing services to the oil and gas industry. A strong and expanding industry will continue to make a significant long term contribution towards the Federal Government's economic growth targets.

2. Equipment Sourcing Decisions in the Oil and Gas Industry

Petroleum industry developers have a natural inclination to use Australian suppliers due to the benefits of life cycle costing which include the convenience and proximity to supply sources and their associated spare parts and repair facilities. Nonetheless, it must be recognised that there are many factors that can influence the final sourcing decision, including:

- cost
- quality
- safety specifications
- deliverability/capacity
- industrial relations
- on-going serviceability

Decisions made by individual petroleum developers will be based upon a mixture of the above as well as variety of other factors. Petroleum exploration and development companies operate in high risk, internationally competitive markets for oil and gas and must attempt to minimise the risk for those factors that are controllable. It is important that the following factors are considered:

- the economics of project's tend to be heavily influenced by capital expenditures (ie they are incurred up-front);
- delays in the start-up of projects can significantly decrease a projects net present value; and
- quality control is of paramount importance in terms of risk management. Any remedial work that is required damages the economics of projects.

In reality, there is a strong parallel between local suppliers competing to provide goods and services to resource projects and Australia being able to attract scarce investment capital to develop it's resources.

Historically, there has been a gradual shift in the sourcing of equipment. In the 1960's, many items of capital were sourced internationally due to the infancy of many types of resource projects and the lack of manufacturing expertise in Australia. This trend has gradually changed to the extent that local suppliers now actively compete in many phases of the

development process, with local suppliers now often being at the cutting edge of technological advancements. While it is recognised that there are some areas where it is neither practical or efficient for Australian suppliers to compete, the industry is of the view that inputs are sourced locally where it is economically feasible to do so.

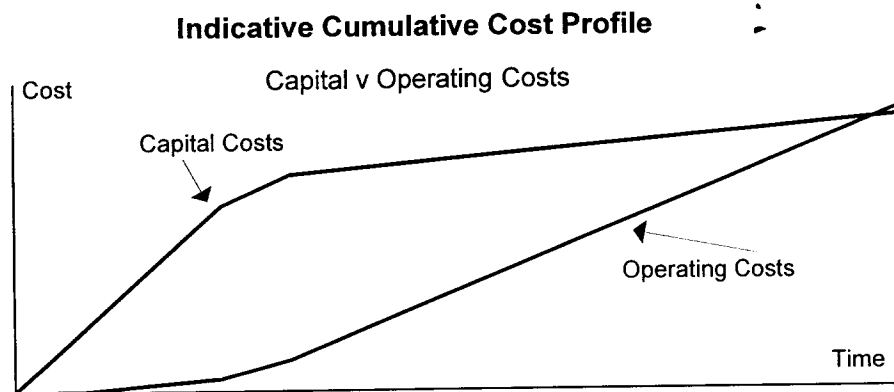
In general, developers largely confine imports to highly specialised equipment for which it is not practical for Australia to supply. Should Australian suppliers wish to establish themselves in these markets, it will be essential that they are price competitive without the assistance of tariffs. Indeed, attempts to foster an internationally competitive supply industry through tariff assistance is counter productive.

APPEA argues that government's should be responsible for implementing policies (including tariff systems) that encourage the development of internationally competitive local supply industries. The creation of complex and time-consuming administrative processes that have as their objective a desire to artificially increase local content levels ultimately come at cost that must be borne by the entire community.

3. The Impact of Tariffs and International Competitiveness

As a general principle, governments should seek to tax the outputs of industry - this indeed was the underlying rationale for the introduction of the GST. Where there are taxes on business inputs, governments should be taking steps towards their removal. Import duties and tariffs that apply to business inputs are taxes on investment at the front end of projects and should ideally be removed to provide a more competitive investment environment. The net cost of tariffs are more severe on investments that are capital intensive and particularly so where costs are focussed at the commencement of a projects life.

This is typically the case for projects in the oil and gas industry and in the most extreme circumstance, for investments in liquefied natural gas (LNG) developments. LNG projects can involve capital expenditure of up to \$10 billion dollars, a large proportion of which is incurred prior to the commencement of production. For technology and supply reasons, much of the equipment that is used in such projects must be imported.



Without the ability that currently exists (at least in part) to obtain duty relief for key imports through the project by-law (PBL) system, components that are imported would, by definition, be more expensive. In terms of project evaluation, the fact that such costs are incurred during the early stages of a project will have a disproportionate impact on projected rates of return than would otherwise be the case if the costs were incurred more evenly over the life of a project.

LNG is a relatively new industry to Australia and it has taken 20 years of planning and development to bring the first LNG export facility (the North West Shelf Project) to fruition. Other prospective Australian LNG Projects of similar size may require similar lead times. Given the international setting within which the LNG industry must operate, there is a need for the Federal Government to provide a tariff system that removes impediments to Australia achieving its share of the wealth that would be created by future LNG developments.

Generally speaking, decisions will be made on new projects at a time when the best return can be achieved on investments. Fiscal and commercial factors that must be considered for large scale LNG types developments include the following:

- LNG is exported into a highly competitive international market;
- restricted 'windows of opportunity' into the market exist due to overseas projects expanding to capture that supply;
- cost disadvantages apply to Australian LNG projects due to import duties, transportation, construction costs, income tax laws and potential greenhouse considerations that are not borne by our major LNG competitors;
- projects are large scale, high cost and involve a high degree of technology with specialised equipment made under international licence eg cryogenic heat exchangers, cryogenic piping;
- there are longer lead times for construction and longer payback periods than most other investments;
- initial imposts on imported equipment have a disproportionate effect on net present values and international competitiveness; and
- large numbers of expensive individual items must be imported so it is essential that the process for gaining a duty relief is efficient, flexible and transparent.

With respect to the applications of tariff duties, uncertainty (both in terms of timing and eligibility) surrounding the ability to utilise duty relief provisions adds a risk premium and therefore increases the returns needed for a project to proceed.

In terms of assessing Australia's capacity to capture international investment funds, it is important that a distinction be drawn between domestic and export oriented projects. The strengths of Australia as an investment destination are the greatest in terms of projects that focus primarily on domestic markets. Australia's proximity to Asian markets also provides the nation with a potential strength in terms of a range of export oriented projects. While there are many factors that can lead to decisions to overlook Australia as an investment destination (including government incentives, transport costs, industry policy and industrial relations), the fiscal framework is an often quoted factor. Taxes or tariffs on imported goods, when high transport costs already make such goods relatively expensive when compared with alternative investment destinations, must be recognised by governments.

The Case for Zero Tariffs

In APPEA's view, there is a compelling case for serious consideration to be given to the complete removal of import duties. This could be achieved either through an item by item reduction regime or through a targeting of specific industries that would be eligible for zero duty entry.

The petroleum exploration and production industry has been active over the last two years in fostering a strong dialogue between all stakeholders in the investment processes. An outline of the broad thrust of these activities, which are part of the Australian Competitive Energy (ACE) initiative, is contained in **Attachments B & C** to this submission.

In summary, ACE is a process that has focussed on the use of a 'systems' based approach to assist Australian industry participation in petroleum exploration and development procurement decisions. The underlying objective is that all potential developers should be given full and fair opportunity to contribute in the development processes. The industry's commitment to adopt such an approach should provide a solid foundation for the removal of duties on all imported items that are utilised by developers where they are participants in the broader ACE process.

It is also significant to note that in the Federal Government's response to the recent Parliamentary Inquiry into Australian Participation in Major Projects, a strong endorsement was given to the direction and principles associated with the ACE process.

From a broader perspective, the ability of local producers and suppliers to develop business opportunities and enterprises is dependent upon being able to compete on a large scale. While niche market opportunities will always to some extent exist, it remains inevitable that local manufacturers must target their performance towards meeting international competition benchmarks if they wish to be sustainable in the medium to long term.

For many industries, the question must be asked as to whether tariffs merely act to delay inevitable efficiency decisions that must be made, or indeed whether efficient sectors of the Australian economy must continue to provide support to those areas where structural reform is required. In any case, doubt must be placed on the benefit to industries on the wholesale retention of tariffs.

4. Duty Relief Provisions

4.1 Desirable Criteria

In terms of designing an effective and efficient duty relief system, the Industries Assistance Commission in its 1982 report into the Commercial By-Law System (Report No.305) identified the following core criteria as being desirable for any duty relief system (p.86-87):

- a) be simple to administer;
- b) be easily understood and predictable;
- c) produce consistent results;
- d) operate at minimum administrative cost;
- e) operate quickly and enable speedy decision making;
- f) be open to public scrutiny;
- g) provide incentive for compliance; and
- h) provide an independent avenue for appeal.

These criteria remain as relevant today as they were in 1982, and in APPEA's view, should be the standard by which the current system is assessed.

4.2 Project Development and Production Activities – The Project By-Law System

4.2.1 Eligibility Provisions

The Project By-Law (PBL) provisions are an integral component to the overall tariff system in Australia. Given the high costs of petroleum projects and the technical requirements that material and equipment must on occasions be sourced from overseas, it is essential that artificial cost increases that are generated through the imposition of tariffs be minimised. In

this context, it is essential that the PBL system arrangements be maintained and be administered in an effective and efficient manner.

In terms of its operation, the PBL system provides a significant mechanism for duty relief for certain imported equipment for major projects where it can be established that the equipment cannot be sourced within Australia. The PBL scheme is composed of a number of items which target relief towards certain types of activities. The primary provision used by the petroleum exploration and production industry at the development stage of project developments is Item 45, which deals with capital equipment used in mining and resource processing industries.

Australian Customs Notice No.98/22 outlines the policy objective of Item 45 as follows:

'For the purposes of *item 45*, appropriate industrial activities are those which recover minerals and transform and add value to primary or natural resources within the mining or resource processing project concerned. Primary inputs can be from recycled or waste products generated from a separate or integral industrial project. Primary and intermediate stage resource processing activities are included. Consideration may be given to final stage resource processing or waste recycling activities provided they are integrated with earlier stages.

Transportation activities, such as pipelines, are not eligible industrial activities. Infrastructure proposals, such as stand-alone power stations that are not dedicated to an eligible industrial activity are not eligible for a PBL Scheme determination'

It is necessary for a project proponent to undertake a variety of actions prior to obtaining duty relief:

- project advice must be lodged, on a prospective basis, with Customs;
- proponents must demonstrate that they have advertised in national newspapers or trade journals and with relevant industry associations (unspecified) for expressions of supply from Australian manufacturers;
- satisfy the requirement that expenditure exceeds \$10 million for each significant phase of a project; and
- demonstrate that the goods for which duty relief is sought are not produced in Australia in the ordinary course of business.

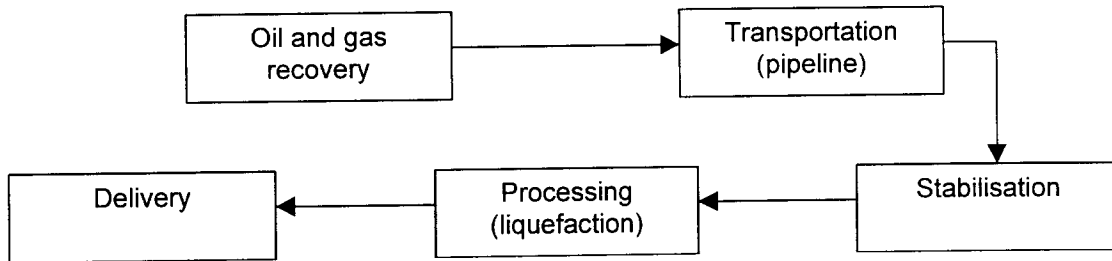
In terms of the last criteria, this can be satisfied through either identifying a Tariff Concession Order (TCO) for the equipment which is in force when the goods request is lodged or providing a statement from the Industrial Supplies Office (ISO) stating that it is not aware of an Australian manufacturer or producer that is capable of producing the equipment or an equivalent good for the applicant's project. Goods are considered to be equivalent if they meet the applicant's engineering and technical requirements – they need not be identical nor do they need to meet what are considered to be unduly specific design criteria. A range of criteria exist that determines whether there is an Australian manufacturing capability.

4.2.2 *Application to Oil and Gas Operations*

For many projects within the oil and gas industry, it is clear from the above definition that the system does not always extend to the totality of a development.

Offshore oil and gas projects are typically composed of a number of fully integrated segments that allow for the recovery, stabilisation and storage of hydrocarbons. In some instances, processing activities can also be within the integrated structure. An example of such a project would be one that is structured around an offshore production facility (possibly

a production platform), a pipeline that transports hydrocarbons to shore, a stabilisation and/or separation plant, and storage facilities to handle product prior to sale.



Based on the ACN definition, offshore production and onshore processing facilities are seemingly covered, however the interconnecting pipeline, which represents a crucial element of the overall capital structure of the project, falls outside of the scope of the PBL. (Unlike a gas transmission pipeline which transports processed gas to customers, this form of pipeline is similar to a conveyor belt within a mining project.) In some cases, a pipeline may need to cover many hundreds of kilometres due to the remoteness of oil and gas resources. The exclusion of this portion of a project, particularly where a pipeline represents an integral component of a wider project, is discriminatory and illogical.

In terms of the administration of item 45, a number of concerns exist with respect to the present provisions and their interpretation. From the outset, the most practical (and timely) mechanism by which a developer can satisfy the PBL criteria is through the quotation of an operative TCO number. The use of such an arrangement does provide a useful mechanism to short-circuit a potentially time consuming phase of the process, but it ignores the problem that not all items eligible for a TCO are ruled eligible for a PBL. There has been a situation where the goods are classified to Chapter 85 of the Customs Tariff (ie electrical machinery and equipment), have a TCO and have still been ruled as ineligible under the PBL system on the basis that they are not "significant capital equipment". The goods in question were valued at \$4,000 per metre, which is hardly considered to be insignificant.

The administrative requirements associated with processing tariff concession applications is time consuming and there is a clear duplication of measures associated with local industry participation requirement (ie the ISO process and national advertising). There is the possibility of time delays in the processing of applications that can result in a project having to pay duty up front and seek refunds after the importation of equipment. In addition, for projects the size of LNG developments, the split consignment provisions within the PBL system can impose administrative constraints on the way that equipment must be imported to ensure that full duty relief can be obtained.

4.2.3 Recommended Improvements

It is essential that the economy wide benefits associated with large scale resource development investment are captured by Australia. In a bid to achieve this objective through an improvement of the current PBL provisions as they apply to large scale resource projects, APPEA recommends that a number of modifications be made to the current PBL arrangements.

- Creation of a New PBL Item

To ensure that the system is responsive to large scale projects, a new PBL item should be created that caters solely for projects with capital expenditures over a threshold

amount. This would allow for an effective differentiation between small, medium and large investments which is not provided for under the current provisions. Specifically, this will help avoid potentially costly delays for large projects where many hundreds of capital items must be imported.

- Accreditation/Self Assessment Provisions

A mechanism could be adopted whereby project proponents can apply for accreditation which would allow for a self-assessment arrangement for duty relief. Under such an arrangement, the project operator would be required to report on the status of importations on an annual basis which would then be subject to a prudential audit. Alternatively, the ACS could conduct their own audit.

- Practical Project Definition

Rather than the current ad-hoc and prescriptive definitions as to what represents a capital investment within a project, all capital items within a project should be covered by the PBL provisions. For example, in the case of an LNG project, all aspects of the project should be covered, including the offshore production facility, interconnecting pipelines, processing and storage facilities, as well as off-take and transportation requirements. This represents the totality of the project, not some theoretical concept of project segments. In addition, capital and stand-by equipment that is purchased for the on-going operations of a project should also be eligible.

- Intermediate Goods

To ensure that local fabricators and engineering groups are able to maximise their potential contribution to such projects, consideration should be given to allowing duty free entry for intermediate goods that are to be used by such groups to supply capital equipment to major projects. At present, the best that can be achieved is the payment of 3 per cent duty if an item is on the TCO list.

- Role of the Industrial Supplies Office

APPEA is concerned that the key role of the ISO's, which is to facilitate linkages between project developers and local suppliers, is potentially hindered by the requirements that they are active participants in the PBL process. In APPEA's view, the greatest area of value adding that can be made by the ISO's is through the facilitation role.

4.3 Exploration and Development Activities - Item 22

4.3.1 Evolution of Item 22

Exploration represents the foundation for all operations in the oil and gas industry in Australia. Exploration budgets are generally set on the basis of a series of fixed outlays, with the number of wells and amount of geophysical activity being highly dependent on the costs associated with conducting such activities. It is important to realise that an inevitable consequence of an increase in the cost of exploration is that the overall level of exploration activity will be reduced.

In recognition of the strategic significance of maintaining a strong and robust petroleum exploration effort in Australia, the government introduced in the 1960's, a tariff concession that was designed to cover equipment and materials imported for use in oil exploration and

the development of fields to the stage at which commercial production is practical. This was slightly modified later in that decade to extend the scope from oil to petroleum, and to make reference to goods for use in connection with the exploration for petroleum and in the development of petroleum wells. The wellhead assembly point was regarded as the cut-off point for the concession.

Prior to this time, concessions were generally extended to participants in oil exploration by means of ad hoc ministerial determinations which virtually gave the holder the opportunity to import all equipment duty free.

Through the development of the item, a key component has been the listing of 'exclusions' from the concession as the Australian supply sector became more active. The item, which in itself is an exclusion from the payment of duty, therefore contains exclusions to the exclusion. The provisions has been gradually modified over the last three decades to the stage where the current provisions are now contained within Australian Customs Notice No. 97/06.

4.3.2 Scope and Operation of Item 22

Item 22 provides for the duty free of goods as follows:

'Goods, as prescribed by by-law, as follows:

- (a) that are for use in connection with the exploration for petroleum or natural gas; or
- (b) that are for use in connection with the development of petroleum or natural gas wells to the stage where a well-head assembly is attached, other than goods for, or for use in connection with, controlling, treating, conveying or storing petroleum or natural gas after leaving the well-head assembly,
other than goods in respect of which substitutable goods are produced in Australia or are capable of being produced in Australia by any person in the ordinary course of business'

A broadly similar substitution test applies for goods that are seeking duty relief under this item as is the case for those under item 45. Specifically, an importer must be able to demonstrate that substitutable goods are not produced, or are not capable of being produced, in Australia by a person in the ordinary course of business. Proof may take the form of one of the following

- a TCO that applies at the time of entry of the goods for home consumption; or
- a letter from a prescribed organisation such as the Industrial Supplies Office; or
- a letter from a relevant industry association, or
- a letter from a Chamber of Manufactures or a like body.

APPEA sees the continued operation of this item as being an essential component of a well balanced and totally integrated oil and gas industry policy. It is because of the importance that the industry places on the provision that APPEA has been an active participant in periodic discussions with the Australian Customs Service on the interpretation and operation of the item. Issues of concern that APPEA has raised include the following matters.

- Scope of the Item

The Australian Customs Service has argued that the scope of item refers to a point in time when the well-head assembly is attached. APPEA considers that if this had

been the intention of the provision, then the word 'when' would have been used. This is an important point because to incorrectly attach such a narrow construction excludes many exploration and development activities that are carried out physically prior to the wellhead. This therefore acts excludes many legitimate exploration and development activities from the scope of the provision.

- Exclusions Clause

The item currently lists 33 exclusions that by definition do not qualify for duty free importation. These are goods in respect of which it is contended, at least by implication, that substitutable goods are produced in Australia or are capable of being produced in Australia by a person in the ordinary course of business. The item also specifies that either a TCO or a successful approach to the Industrial Supplies Office, Chamber of Manufacturers and/or other manufacturers representative is required. It seems illogical to have both a full substitutable goods test combined with an exclusions list.

- Substitutable Goods Test

Item 22 is crucial to the efficient supply of goods for petroleum exploration and development activities. The 1997 decision to include a substitutable goods test has created greater time delays than was the case when it operated purely via an exclusions test. This problem has been greatly exacerbated by the fact that many of the goods that are potentially covered by the item are relatively small in terms of both size and cost. The need to obtain advice from a relevant body as evidence that a goods is not produced (or is not capable of being produced) is time consuming and costly.

5. Other Duty Relief Provisions

5.1 Tariff Concession Scheme

The Tariff Concession Scheme has been an important element of Australia's tariff policy since its introduction in the early 1980's. From APPEA's perspective, one of the greatest strengths of the Scheme has been the adoption of a broad basis of application that has allowed all importers to access the concession rather than it being limited to a specific applicant.

With respect to the procedures for the inclusion of items on the Tariff Concession Order list, little weight continues to be given to the over-arching competitiveness aspects of price, deliverability, quality or safety in determining substitutability. In addition, the process for including items on the TCO list, while providing a degree of transparency, is time consuming. In addition, there is uncertainty as to whether an applicant will gain approval even though the Industrial Supplies Offices may have identified that no Australian manufacturers for the goods exists.

The most significant concern however that is held by industry relates to the 1996 decision to increase the concessional rate of duty from zero per cent to 3 per cent. While the stated rationale for the decision to increase the rate of duty was to address concerns with the then budget deficit, the failure to revert to the original zero per cent has seriously undermined what is an important provision within the tariff system. Specifically, the current arrangement where a three per cent duty exists is at odds with the broader principle that goods, when imported as a business inputs, should not incur a duty if they are not capable of being produced in Australia.

APPEA notes that in the 1991 Industry Commission review of this aspect of the tariff system (Report No.9 of 1991 – The Commercial Tariff Concession and By-Law Systems), the Commission supported the continuation of the then provisions, subject to a number of modifications that were intended to improve the effectiveness and operation of the system. The recommendations remain as valid today as they were in 1991.

5.2 Temporary Importation Provisions

The *Customs Act 1901* enables the temporary importation of goods into Australia without the payment of duty. Section 162 allows for the importation of non-commercial and industrial purpose goods, while Section 162A caters for goods that are covered by international agreements to which Australia is a party.

Companies with petroleum exploration and production operations have similar demands to those in many other sectors of the economy that requires the temporary importation of goods for relatively short periods of time.

Section 162 provides a concession for temporarily imported goods, which are intended for a prescribed purpose. Regulation 124 of the Customs Regulations sets out that a prescribed purpose includes “other industrial purposes approved by the Collector”.

The current interpretation of the “other industrial purposes” is that the only type of goods that qualify under Section 162 are those goods where an action or function is performed on those goods. Where the imported goods perform an action or function on other goods then the imported goods are treated as ineligible. This is an extremely narrow construction of the phrase “other industrial purposes” and is considered not to reflect the original intention to reduce the capital cost of equipment temporarily imported for a project.

Section 162A provides a concession where goods are included in a class of goods to which an inter-governmental agreement applies.

Currently where goods are imported on a temporary basis for an exploration or appraisal well, then those goods are eligible for the concession. However, where goods are imported on a temporary basis for a development well which involves the exploitation of natural resources, then these goods are excluded from the concession. This is considered an inequitable outcome and should be changed to allow for concessional treatment for both exploration and exploitation activities.

Inquiry Terms of Reference

I, Rod Kemp, Assistant Treasurer, pursuant to Parts 2 and 3 of the Productivity Commission Act 1998, hereby:

1. refer the scope for a post-2000 reduction in the general tariff (covering only rates of 5 per cent or less, and excluding the PMV and TCF sectors) for inquiry and report within 9 months of receipt of this reference;
2. request that the Commission consider the Government's desire to:
 - (a) improve the overall efficiency of the Australian economy;
 - (b) encourage the development of sustainable, prosperous and internationally competitive industries in Australia;
 - (c) promote the provisions of high quality, competitively priced goods and services to Australian businesses and consumers;
 - (d) abide by Australia's international commitments, including the commitment under APEC to review its post-2000 general tariff arrangements by 2000; and
 - (e) participate in a new round of multilateral trade negotiations in which bound tariff reductions will be considered by Australia and other WTO members;
3. request that the Commission report on the costs and benefits to Australian consumers, industries and their employees, and the general community, of a reduction of all general tariff rates under reference;
4. specify that the Commission's report includes options, including a preferred option, and implementation strategies for any recommended changes to general tariff arrangements that take into account:
 - (a) the impact of microeconomic reform and pace of structural adjustment on Australian industry;
 - (b) recent and prospective progress in regional and international trade liberalisation of interest to Australia;
 - (c) other international economic and trade developments;
 - (d) the impact of the floating exchange rate on the competitiveness of Australian industry;
 - (e) implications for trade negotiation strategies, including how the timing of any reductions in general tariffs would best assist Australia's negotiating position at the forthcoming WTO round;
 - (f) interaction with the various tariff concession arrangements including the *Manufacture in Bond* and *TRADEX* schemes;
 - (g) budgetary implications, including the effects of any changes in domestic economic activity flowing from tariff reductions;
 - (h) the economic, social, environmental and regional policy objectives, including employment objectives, of Australian governments;
 - (i) existing preferential trade agreements
 - (j) the Government's commitment to the APEC goal of free and open trade and investment in the Asia Pacific by 2010 for industrialised economies and 2020 for development economies; and
 - (k) the schedule for tariff reform in the PMV and TCF industries;
5. specify that the Commission, as part of its review:
 - (a) report on all matter identified in 4(a) to (g) above;
 - (b) identify and report on the costs and benefits of removing tariffs on tariff lines at the 8-digit level for which there is no significant Australian production; and
 - (c) consider the appropriateness of the Tariff Concession System and the Project By-Law arrangements; and
6. specify that the Commission take account of any recent substantive studies relevant to the above issues.

Attachment B

Australian Competitive Energy

B.1 A Joint Approach to Resource Development

APPEA is a strong advocate of the view that Australian industry should be given 'full and fair' opportunity to bid for project related work. This has been demonstrated through the development and dissemination of a recommended local content code of practice and the publication of an annual review of potential future petroleum developments that is widely circulated throughout the business community.

An integral component of the industry's desire to ensure that efficiencies are maximised in project developments is through the Australian Competitive Energy (ACE) initiative. ACE is an oil and gas industry forum for dialogue between developers and suppliers to maximise competitiveness. It involves a cross section of industry and seeks to:

- maximise the recovery of national resources;
- develop solutions to provide value enhancing and cost reducing outcomes for developers and suppliers;
- maximise employment opportunities; and
- promote high standards of quality, safety and environmental management.

In order to increase the competitiveness of the Australian oil and gas industry, it is necessary for the industry to engage all stakeholders in the supply chain. This includes the developer, designer, contractor, vendor and government. ACE is intended to provide a forum for industry and the workforce to share ideas and concerns and develop a stakeholders view. It is also a mechanism for industry participants at all levels to communicate best practice ideas.

The petroleum industry's commitment to generating efficiencies in the development and production processes and the overriding objective of the Government's tariff policies in relation to promoting local industry are closely linked. The Government expects developers to recognise that local participation in major resource projects is important to the growth of the Australian economy and that it is desirable to achieve the highest level of local supply of goods, labour and services where they are competitive in relation to price, quality and delivery requirements. In APPEA's view, the best way of meeting these objectives is through closer relationships between all groups in the development process, not through the imposition of distorting tariffs or taxes.

B.2 Operation of the Australian Competitive Energy (ACE) Initiative

B.2.1 A Systems Based Approach

APPEA has fostered the development of the ACE process and has focussed on the use of a 'systems' based approach to assist Australian industry participation in petroleum exploration and production procurement decisions. Underlying this objective is the premise that all potential suppliers should be given full and fair opportunity to contribute in the development process.

Oil and gas activities are generally undertaken within an unincorporated joint venture structure which allows risks and rewards to be shared between the various participants. It is

generally the case that one of the participants is appointed as the project operator and as part of this role, assumes control of the management of the project. The organisational structure is an early consideration for any new project. It inevitably impacts on the subsequent contracting strategies and may involve the formation of a team or partnering arrangement called an alliance. Alliances can take many forms and can have an impact on the subsequent sourcing decisions, and therefore the local industry participation and systems adopted for their project.

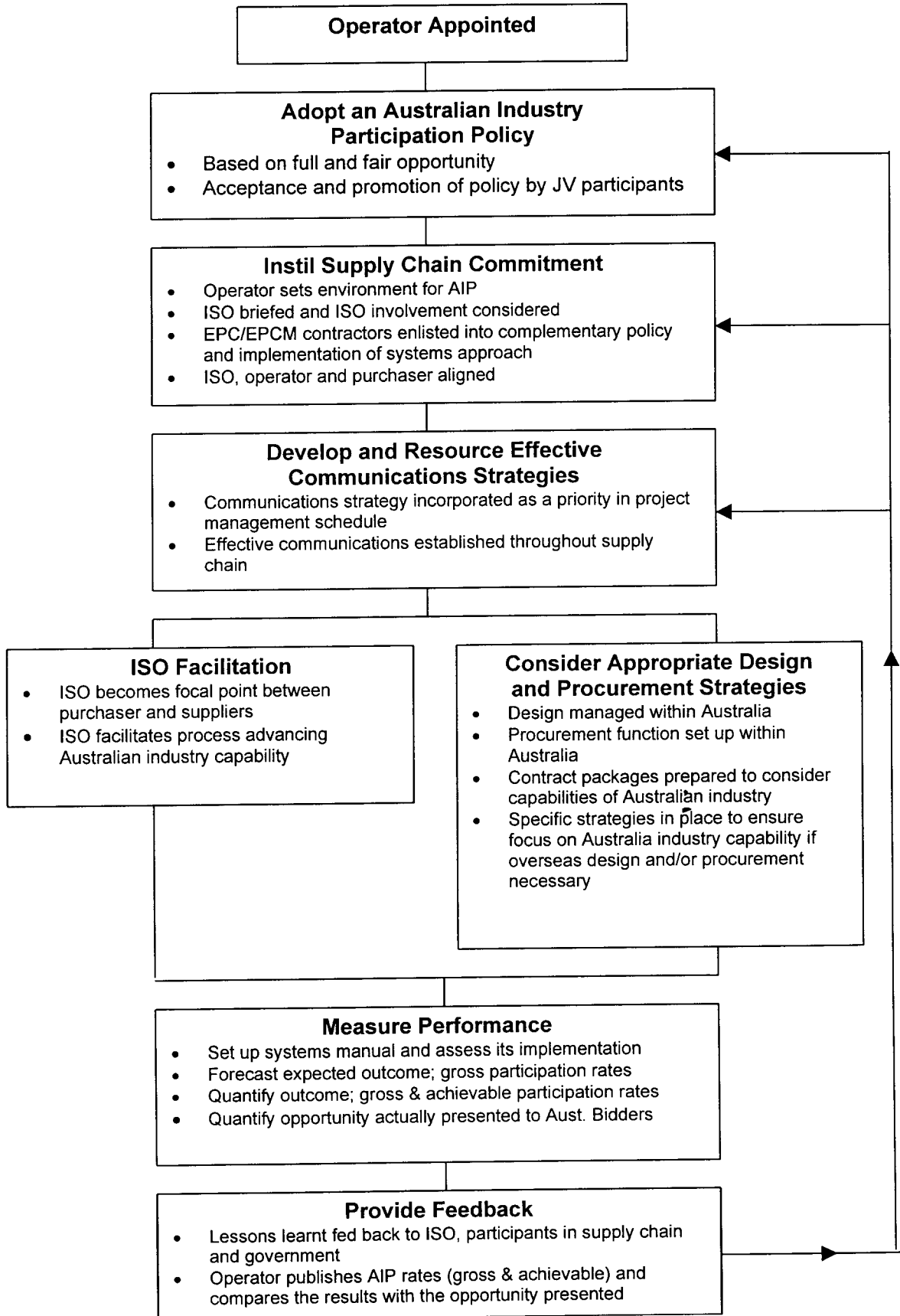
With respect to the development of systems based approach, it is important that a commitment to the principles of full and fair opportunity are integrated within the system. While overall responsibility for decisions rests with the project operator, all stakeholders must play all a role. A schematic example of the operation of a 'systems' based approach in the oil and gas development process is at **Attachment C**.

B.2.2 Vendor Registration Database Initiative

A key component of the activities of ACE is the development of a standardised vendor registration system. Central to the development of such a system is the participation of key operators and contractors. Australian Industry Participation sets out a systems based approach to providing 'full and fair' opportunity for Australian suppliers and the vendor registration project provides a key communication tool to facilitate the involvement of Australian content in developments.

The vendor registration project will provide developers and contractors with a centralised oil and gas supplier register which can be used as the initial point for selecting Australian companies to be assessed in tender lists. It is intended to be a centralised information base, which aims to remove the inefficiencies and costs associated with project developers and procurement contractors from maintaining their own databases.

Maximising Australian Industry Participation in Petroleum Exploration & Production: A Systems Approach



List of Definitions

ABARE	Australian Bureau of Agricultural and Resource Economics
ACE	Australian Competitive Energy
ACS	Australian Customs Service
AIP	Australian Industry Participation
APPEA	Australian Petroleum Production & Exploration Association
bcf	billions of cubic feet
GDP	gross domestic product
GST	goods and services tax
ISO	Industrial Supplies Office
ISONET	Industrial Supplies Office Network
JV	joint venture
LNG	liquefied natural gas
LPG	liquefied petroleum gas
NFW	new field wildcat
PBL	project by-law
TCO	tariff concession order