

ECONOMICS AND INDUSTRY STANDING COMMITTEE

Third Report — “The Potential for the Development of a Centre of Excellence in LNG Industry Design in Western Australia: a Discussion Paper” — Tabling

DR M.D. NAHAN (Riverton) [11.03 am]: I present for tabling the third report of the Economics and Industry Standing Committee entitled “The Potential for the Development of a Centre of Excellence in LNG Industry Design in Western Australia: a Discussion Paper”.

[See paper 1907.]

Dr M.D. NAHAN: The processing of the mineral and energy resources of Western Australia has been a major objective of successive governments for at least 40 years. The rationale is profound and, in many ways, has been perceived to be the Holy Grail. The aim is to get more out of our resources, to create jobs, to diversify the economy and hopefully to offset the natural boom–bust conditions in the resource sector. Gas has long played a major role as a feedstock and an energy source and it has been processed into liquefied natural gas. Although there have been some successes in downstream processing, we have been less successful than we would wish to be in that regard, and there are a range of reasons for that. This discussion paper does not go through those reasons, but focuses on another issue. A couple of decades ago, successive governments realised that there were difficulties with the downstream processing of manufacturing and so they focussed on upstream activity; that is, on the services and design activities that are associated with mineral and energy development. That has included exploration, design work, maintenance and export opportunities.

In the early 1980s, when the North West Shelf project was first mooted, the goal of the then government, which was adhered to by successive governments, was to create a greater engineering design industry in the LNG industry in Western Australia. When the first train of the North West Shelf was designed, about 10 per cent of the heavy engineering was designed in Perth. That figure steadily increased and by 2001–02, the fourth train was designed in full in Western Australia by a joint venture between Clough, Hatch and Kellogg. That was a major achievement. The reason that Western Australia focused on getting high-level engineering design is that it seemed to strongly suit Western Australia. Western Australia has a large number of engineers with a high level of engineering design expertise across many aspects of engineering. Western Australia was competing against firms in areas that were not very cost sensitive. However, most places that do high-level design are in high-cost areas. The three major high-level design hubs are in Reading in the United Kingdom; Houston, Texas; and Yokohama, Japan.

Western Australia has a huge endowment of natural resources, and of LNG in particular. The North West Shelf project is a very large project by world standards. Even in the 1980s we knew that there was a large amount of gas that would eventually be processed. We had a large pool from which to develop. As I said, successive governments focused on incrementally growing the engineering design industry, and they were successful. The fourth train was 100 per cent designed in Western Australia and it involved 500 full-time workers over three or four years. That was a significant achievement and it was the first time that a major design work of that type was done out of three hubs in Reading, Houston and Yokohama. However, after the fourth train was designed here, the fifth train for the North West Shelf, subsequent trains for Pluto, and, it appears, for the Gorgon project, have gone offshore. Since 100 per cent of the engineering design for the fourth train was done in Western Australia, the percentage of design work done in Western Australia has decreased significantly to between five and 10 per cent. The committee decided to examine this issue, about which there has been substantial discussion in the media and other places. This is a big issue. The committee inquired into what has happened. Can we get back to the previous level? What is the rationale for the decrease? Should we focus on something else?

The committee firstly looked at Western Australia’s capabilities and competencies. Of all the major LNG areas, there is no doubt that Western Australia has the competency and the skill base to undertake this work. There are an estimated 4 000 design engineers resident in Western Australia, and many other Western Australians who have experience in this industry are willing and able to come back. Engineers are nomadic. The team that worked on the fourth train comprised people from all around the world, including a large number of Western Australians. Many of the Western Australians who worked on that project left the state and went to Reading in the UK. We have the competence. We lost the fourth train team; it was disbursed. It would have to be put back together. There are some difficulties, but the evidence presented to the committee was that Western Australia has both the competency and the capability; indeed, they are core strengths.

One key problem of the design work is continuity of work. When the fourth train was set up, a project-specific team was assembled to work on that project. That was very expensive. After the project was finished, there was uncertainty about whether there would be other work for the team to continue with. The lack of continuity of work is one of the core weaknesses of Western Australia. However, this was found to be a core strength for companies outside Australia. Companies located in Reading, which are increasingly getting most of the work,

have a huge book of work from around the world. A developer of an LNG project can walk in to one of those companies and say, “I want a train in three years”, and it is just added to an already very large work program. About 60 LNG facilities have been mooted for development around the world over the next few years. Thirty of those projects are expected to be in either Western Australia or Queensland. There is \$89 billion of work in LNG on the books at the moment, with potential for growth. In other words, given the expansion in this area in recent times, although not in the early part of the last decade, there is the potential for continuity of work in Australia, which would overcome this major issue.

One issue that kept coming up was cost. This was one reason for and a rationale behind the design work for the fifth train moving offshore. It is true that work on the fourth train went over budget. It is also true that there was a nascent mining boom in Western Australia during 2003 and 2004 and there was a shortage of labour, particularly of skilled labour. There were cost pressures. However, the evidence the committee received was that Western Australia is cost competitive, particularly in high-level design. More importantly, the location of the design costs is not a significant factor because the cost of the design work is not large—probably costing \$200 million to \$300 million out of a \$10 billion project. Cost is a consideration, but the majority of people thought Western Australia has substantial strength in this area. Engineers in Reading and Houston would be no cheaper or more effective than those in Perth.

One issue the committee considered was the regulatory environment. There was overwhelming agreement that the regulatory environment in Western Australia, indeed in Australia, is very open and conducive to development and design work, and that sovereign risk is about zero. The regulations contain no barriers to these developments—we were given a big tick.

One major issue concerned the benefits of incumbency. This happens in all industries, but particularly when things are done on a large scale. Only about nine firms around the world undertake the development of this activity. All are located and concentrated in three hubs. Those companies have huge benefits of incumbency; that is, they have done it all before, they are low risk, they are very mobile, they can draw on a global supply chain and, importantly, they have pre-approval and accreditation all the way along the line. When I was a junior officer in the Department of Resources Development between 1985 and 1990, one of my tasks was the Gorgon file. During that time we tried to get a large number of the firms that were working on the North West Shelf project accredited so that they could work with the large firms, such as M.W. Kellogg Ltd and others. We did a large amount of work on that issue. Nonetheless, it is a major disadvantage to having those firms locate here.

I go to challenges. One question that was asked was: why did we lose the fifth train? That is significant. I reiterate that this is an area in which we should have had comparative advantage. One hundred per cent of the engineering for the fourth train was undertaken locally, but now local contribution is down to five to 10 per cent. A number of factors have been involved. First, it happened during the boom and there were cost and people pressures. Second, even though successive governments have focused on trying to develop Western Australia as an engineering design hub for both mining and oil and gas, the priority of governments has long been on steel manufacturing—that is, on the modulation and provision of fabrication services for local content. That is an appropriate area. Successive governments have gone to a great deal of effort to make local firms more competitive. They have provided many hundreds of millions of dollars to the Henderson facility. They have encouraged local firms to adopt new technology and robotic welding and have assisted in the acquisition of overseas skilled labour. However, when the issue of the fifth train came about, the government’s priority was on steel fabrication rather than design. I argue that there should be a shift, although not everyone would agree with me. There are trade-offs.

One of the major challenges for government is that the percentage of local content in the larger projects has been declining. When the fourth train of the North West Shelf was built, 72 per cent of the total expenditure of the project was done locally. During the Pluto project, it declined to 50 per cent. It was mooted to be 66 per cent for the Gorgon project, but the evidence we received indicates that it has declined to 50 per cent. Those are very large declines that involve huge amounts of money. Of course, the decline is even more significant when one considers steel fabrication. The report does not have data on this. However, conversations that I have had with people and anecdotal evidence suggest that there has been a large drop in local steel fabrication in the Gorgon and other projects. I am not criticising that. The issue is fundamental. We have a hard time competing both with the costs and delivery methods of offshore operations. There have been significant improvements in modularisation and design and shipping of the designer projects that facilitate offshore construction. There have been huge improvements in the competitiveness of offshore facilities, particularly in Thailand, Indonesia and Vietnam, and there have been huge improvements in wages and the shortage of skilled workers. During the boom the books of some of our fabricators were full. However, much of the work was done by 457-visa holders who were brought in from overseas. A decline in local content becomes a political issue for all governments. I read in a newspaper article that a recent contract worth between \$200 million and \$300 million was let for the

Gorgon project. It involved the set of projects in which we thought local firms would be most competitive. The previous government did a lot of work preparing local firms to be competitive in those projects. However, I was told clearly by some of the proponents of the team who did the bidding that they were at least 30 per cent off in their competitiveness. The issue is that although there are projects in Western Australia and large numbers associated with them, local participation in those projects is declining. I fear that our local content in manufacturing metal fabrication will also decline. We need to get local value out of them. We must focus on shifting the areas in which we are internationally competitive, which, from the evidence I have received anecdotally and from the evidence received by the committee, are in the services area, which is our future.

What should we do? We have to be pragmatic. The committee did not address this in any great detail; therefore, I am expressing my own views. Firstly, federal and state governments must work together. Most of the liquefied natural gas resources are owned and controlled by the commonwealth. This report is a discussion paper, not a full-blown inquiry, because the committee, on my interpretation of it, was of the conclusion that without the input of the commonwealth, very little could be effectively done about this issue. Federal involvement is vital.

Secondly, our various policies for facilitating local participation must undergo a fundamental shift away from metal fabrication, to services and upstream design. In reality, we have done that in certain areas of sub-sea, maintenance, and research and development, and firms such as Woodside and Chevron have invested in those areas. That must be augmented.

I return to the subject of future design. Even though there could easily be 11 to 15 trains put in place over the next decade in Western Australia, it will be difficult to attract a major contractor to Perth, and it will be very difficult to get those design teams to Western Australia to plan for the long term, but it should be a priority. We should also look at diversification of the work to other things such as sub-sea, for example.

There will be other changes in this industry. A large amount of the design work, even though its headquarters are in, let us say, Reading in the United Kingdom, is done in Singapore and Malaysia, and, increasingly, India; it is a globalised business. A lot of the add-on contracting is done in our region, and it is an area that may provide us with the potential to develop close links between firms in Western Australia and firms in Singapore and Malaysia in particular.

This industry has other real challenges. It is quite clear that a number of the major contractors have, for a variety of reasons, invested in floating platforms, and a large amount of the new projects—particularly the smaller, more isolated ones—will not touch Western Australian shores. There will be the capacity to have most of the engineering and design, and all of the fabrication, done offshore and then floated and anchored here. That is a big challenge, but it is where the market is going and we should ensure that Western Australia does not just accept it, as it could become a reality, but actually participate in the design and development of those trends. We have to accept the trends as they are.

In closing, I would like to thank very much the fellow members of the committee. I must admit that I, as the chairman, pushed this issue more than everyone else. The committee, however, went along with my whims, and I thank members from both parties for that. I also thank Loraine Abernethie, who is the leader of this team and did most of the write-up. Although she is sociology qualified, she had a foray into the oil and gas industry some years ago and her expertise aided the write-up of this report significantly. I urge the government and others to read this report, because not only is this a political issue, it also deals with the core of the economic future of our state.

MR W.J. JOHNSTON (Cannington) [11.23 am]: I rise to speak briefly on this report. The committee chose to not make recommendations after its hearings because it believed that that was not appropriate in this case. Speaking for myself, one issue is that many of the levers of this industry belong to the commonwealth. This whole issue of how Australia can benefit not just from the revenue streams, but from the work involved in these massive infrastructure projects, which is what these oil and gas projects are, is a major challenge for the nation.

We have adopted a particular brand of approach to the development of these projects over the best part of the last century that has had consequences. We need to think about that model for development, and that is not a partisan comment because we have taken the bipartisan approach of allowing the proponents to effectively own and manage these projects and to say anything different is actually a radical departure. I ran into a friend the other day who works for Woodside and I was joking that if I said something like that, the senior executives of Woodside and Chevron would send me the PowerPoint presentation to explain the benefits that they provide to the community. I do not doubt those benefits but I think the committee report demonstrates that we need to stop and think about how we approach these projects to maximise that benefit.

I draw the chamber's attention to a couple of matters. The first matter is the Premier's comments about raising royalty rates for the onshore mineral industry. His position is about how much industry pays for the resource that we own that it sells on our behalf. That is a very legitimate argument and, of course, it is the same with the

offshore industry. The offshore industry, thanks to Paul Keating, has a resource rent tax, so there is a higher take—although it takes longer to get the money—and a better return from the offshore industry than there is from the onshore industry. However, it is clear that that is a legitimate issue.

The next matter is a question that goes to the heart of a debate that we never really had in Western Australia during the height of the previous boom—that is, what do we do with these unexpected revenues? I remember reading in *Hansard* on a number of occasions the exchanges between the now Treasurer and the former Treasurer who is now the Leader of the Opposition. The current Treasurer always called for significant tax reform. He challenged the former Treasurer by asking him why he did not use the one-off boom for significant tax reform. The problem of course is that if it is a boom and it is a one-off, it is only for that period of time. Therefore, what do we do with the money? In Western Australia the Labor government chose to keep that money as a large surplus and reduce the state's debt so that infrastructure, such as the Mandurah rail line, could be provided debt free, which is an extraordinary achievement. The government built a 100-year asset out of surpluses, which had not been done in this state before. On the other hand, the commonwealth government chose to use the revenues of that extraordinary boom to give money away. An article in *The Australian Financial Review* on 29 April, 2009 quoted from a federal government Treasury report on revenues from the boom. *The Australian Financial Review's* conclusion was that —

... from 2004–05 new spending decisions and income tax cuts reduced the budget surplus by \$314 billion, out of a total revenue increase of \$334 billion.

The article quoted directly from that federal government report, which stated —

Effectively, the additional revenue from the commodity boom has been spent, or provided as tax cuts ...

My point is that we get to sell these commodities only once, so what legacy will we leave? The federal government during that extraordinary boom period decided to give all the money away to the community so it could spend it how it wanted. At the time of a booming economy that actually generated more activity in the economy and we had a superheated economic period. In Western Australia we decided to save the money. One problem we have is that we are spending money from a finite resource and we are leaving nothing behind. The committee's report says one thing we could leave behind is an expansion of the engineering services capacity of Western Australia as part of the global engineering activity. Plenty of people explained to us how extraordinary specialist skills in Western Australia service the globe in particular aspects of this industry; people come to Western Australia for those particular services. This report is a discussion about how we can expand that opportunity to other areas and other activities. As a father of three teenage children, I worry very strongly about what is going to be left to them and to their children. If we are spending the revenue now like the federal government did during that period, there will not be much left over. We do need to have a think about that. Let us look at what Norway did to avoid the so-called Dutch disease. The Dutch had enormous revenues from North Sea oil, which pushed up all their costs, and when the oil ran out they had a high-cost economy with very little income. Norway therefore established an offshore account so that petroleum revenues were actually held in foreign currencies. The interesting aspect about that is it had the effect of driving down the value of the domestic currency. One problem with a high-value dollar, which Australia has because of the extraordinary export prices we are getting, is that it makes it hard for the service sector, such as engineering services, to compete internationally. We must think about the mechanism we can use to not artificially, but actually, drive down the value of the dollar. We could cut interest rates, but that would generate inflation. How can we have a lower value dollar to allow the expansion of these high-skilled, high-wage service industries? One of those ways might be for the commonwealth to think about an offshore holding account.

Mr T.R. Buswell: Make Barnaby Joyce finance minister!

Mr W.J. JOHNSTON: The Treasurer can join me and vote for the return of the Kevin Rudd Labor government this year, and support the Premier's friend, and we will keep the levers away from Barnaby Joyce. That would help stabilise the economy.

Ms R. Saffioti interjected.

Mr W.J. JOHNSTON: Yes, they would; they are both internationally famous.

Getting back to the issues, they are serious issues about the future of Australia and about the future of the state. They deserve proper discussion. I am always disappointed that the Chamber of Commerce and Industry of Western Australia and *WA Business News* do not discuss these issues; I think they should. This report, I am sure, will be reported in *The Australian Financial Review*, as I have read the *Financial Review's* interest in these issues. These are important issues for the state. Although the committee has produced only a discussion paper and not a series of specific recommendations, they are issues that are worthy of further examination.

MR M. McGOWAN (Rockingham) [11.32 am]: I seek the leave of the house to make a few brief remarks in relation to this report.

Leave granted.

Mr M. McGOWAN: Thank you, Mr Deputy Speaker.

Mr R.F. Johnson: You are lucky I did not say no because of what you did to me the other time. I just remind you of that, manager of opposition business.

Mr M. McGOWAN: Right.

Mr R.F. Johnson: Remember the cooperation from this side of the house to you.

Mr M. McGOWAN: Mr Deputy Speaker, I just want to make a few remarks about this report. I welcome the report and I congratulate the member for Riverton as chair of the committee for putting this on the agenda.

The issue of maximising the benefits from our resources and energy industries in Western Australia, to ensure that the benefits are spread throughout the broader community, has been an ongoing issue for 40 years. Although governments have talked and talked about, and often we seem to go with the ebb and flow of how the economy goes, how many projects are out there in the community and of how much benefit comes about as a consequence of them, when there is a large number of activities in the oil and gas industry or the mineral industry there seems to be a big reduction in unemployment. During the last boom, unemployment went down to 2.3 per cent, which is as low as it possibly can go, and is now sitting at five per cent. There was a huge reduction in unemployment, basically because so many projects came online that a very low rate of unemployment was a natural consequence. Unemployment is now much higher and we have to look at what to do to ensure that we get the maximum benefit out of the minerals and energy industries located in Western Australia. The notion of an LNG centre of excellence with companies undertaking their engineering design work predominantly in Perth is a wonderful idea. It is a matter of making it happen. The member for Riverton mentioned a couple of examples of a higher rate of engineering design in Perth that was undertaken 15 to 20 years ago for projects off the Western Australian coast than are now being undertaken. It does not make sense that 10 or 15 years ago there were higher rates of engineering and design here in Perth than there are now. It is not a rational situation. The reason I say that is that the people who work in these industries are very mobile. They can be employed anywhere around the world. I went to university with lots of people who are brilliant at mathematics and brilliant at physics. They can get jobs anywhere. They work in Singapore; London; Dubai; Houston, Texas; and so forth. But I will tell members one thing they all say about a place like Perth, like Brisbane or like Melbourne: the lifestyle in these cities is better than it is anywhere else. We have a lifestyle that suits them. They want to live in an environment that is safe, where the schooling is good, where the lifestyle is enjoyable and where they can earn a good income. All those things are possible here. I find it hard to understand why the people who work within the industry are not voting more with their feet to come and live here.

Mr T.R. Buswell: Member, that is an interesting point. The heads of most of the major resource companies, the Committee for Perth and groups such as that tell us that they want things like—I know there are a whole range of other issues—extended trading hours and a more liberal approach to liquor laws. So it is not just an economic decision; there are also other factors such as quality of life, which is interesting.

Mr E.S. Ripper: The member on his feet actually delivered a liquor reform —

Mr T.R. Buswell: I know.

Mr E.S. Ripper: — which is very good.

Mr T.R. Buswell: You're right. It is good, and we supported it. I love small bars.

Mr E.S. Ripper: I think you should stop there!

Mr M. McGOWAN: Maybe the Treasurer should be debarred from small bars!

I agree that lifestyle choices are an important component of it. Therefore, we need to make the lifestyle here in Western Australia as good as it can be. It is often said that Perth is “Dullsville” and so forth. I find that an extraordinary thing for people to say. It is one of the most open, enjoyable places to live anywhere on the planet, yet we always find ways to try to run it down. It is a wonderful place to live. There can be improvements at the edges. I realise that the former government's liquor reforms were probably one of the best things to happen in Western Australia in the past 175 years—I realise that—and I know that the Treasurer agrees with me. They were probably the best thing to happen in the past 175 years. That is one point I wanted to make. Ensuring that the benefits of the lifestyle here in Western Australia are promulgated to people working in this industry is very important. Selling that may be the problem; perhaps we do not sell it well enough.

The other point I was going to raise—the member for Riverton raised it—is that I believe the local content issue will get stronger and stronger as an issue. I met with a bunch of fabricators on the Kwinana strip recently. They have metal fabrication workshops. They are operating at 30 per cent capacity. We have an unemployment rate of five per cent, yet they are operating at 30 per cent capacity, and all this work is going on. I met with four or so of them, and each one of those men runs a workshop employing scores of people.

Mr T.R. Buswell: Are they in that group, Western Australian —

Mr M. McGOWAN: I do not think it was a group; it was just a group of people who got together and came to see me. We met in my electorate office, and we discussed the situation for an hour. The key point I got out of it was that they have lots of excess capacity. They said, “All these projects are going on up there in the north west for which we can provide subcontracted fabrication work, yet we are not getting it, and we are operating at 30 per cent capacity.” I find that extraordinary. I think there needs to be a more interventionist approach. I am a supporter of a more interventionist approach in this area. I have suggested some ideas to the government. I have suggested that we use the enormous public sector we have in this state to put some people permanently on the case for the Gorgon project. I do not think that is an unreasonable ask.

Mr T.R. Buswell: There is.

Mr M. McGOWAN: There is not.

Mr T.R. Buswell: The ICN (WA) team is on —

Mr M. McGOWAN: There is not. I have the questions here. No-one is permanently on the case—not one single person. There is a group of four people, and one of their responsibilities is to meet with the Gorgon project people once every three months and monitor.

Mr T.R. Buswell: You set it up.

Mr M. McGOWAN: We established the industry capability network; I know what it is, but there is not one person whose sole role is to maximise local content out of Gorgon. There is something absolutely and completely wrong with the local content approach in this state if the government cannot permanently dedicate one person to Gorgon out of a public sector of 101 800 people. I say to the government: establish a Gorgon project office and put some people on the job permanently; one never knows the benefits that might flow to this state as a consequence.