Australian Manufacturing Workers' Union WA Branch

Submission to the Economics and Industry Standing Committee of the Western Australian Legislative Assembly inquiry into the impact of floating liquefied natural gas operations on the Western Australian economy

AMWU

August 2013

Foreword

Western Australia's natural resource wealth has been central to our State's increasing prosperity in recent years. Yet it would be a mistake to believe that resource riches inevitably transition into tangible benefits for the community who owns them. The process of converting rocks and gas into traded commodities involves many stakeholders: State and Federal governments, unions and their members, business, creditors and traditional owners just to name a few. Each represents a different set of interests and goals, many of which are not mutually compatible. Yet the complex task of resource development requires coordination and cooperation, and it has generally fallen to government to fulfil this role by setting the conditions of resource extraction through policy and legislation.

Government has always played a central role in balancing stakeholders to develop our natural resources in the best interests of their owners – the Western Australian public. Inevitably there are different interpretations of what constitutes the "public interest" and it falls to our elected representatives to make hard choices on behalf of the state and the country. Acknowledging the complex choices inherent to development strategy implies an absence of a linear trajectory or simply choosing between dichotomous alternatives. Indeed, resource-rich jurisdictions around the world have used a myriad of different techniques to maximise the local benefit of resource wealth with varying degrees of success. We hope the Committee considers the successful approaches taken by other small open economies, notably Norway, in this respect. Regardless of the approaches taken, policy decisions and policy priorities invariably have a profound impact on economic development.

The "local content" debate has been a prominent and recent flashpoint for this tension in Western Australia, of which the WA Branch of the Australian Manufacturing Workers' Union has been at the forefront. Through our "WA Jobs from WA Resources" campaign, we have advocated for an approach to resources development that looks beyond the temporary mining construction boom, beyond royalties as the principal community dividend and beyond volatile commodity prices. Our strong stance is driven by a desire to provide jobs and opportunity for the manufacturing workers who constitute our membership, but also because we believe fundamentally that the 'public interest' is served by leveraging our natural resource wealth into long-term economic opportunity.

The recent controversy over Floating Liquid Natural Gas (FLNG) processing is the latest and most serious developmentin a battle the AMWU has been fighting for years. For the reasons outlined below, we believe FLNG is the most visceral and serious manifestation of the divergence of the objectives of multinational resource companies with Western Australia's public interest so far. The consequences of policymakers' decisions on this issue in the coming months and years will be felt for generations. We are heartened that our State Parliament and in particular the Economics and Industry Standing Committee has grasped the gravity of the situation by commencing an in-depth inquiry into the impact of FLNG on WA's economic development. I thank the Committee for the opportunity to participate in your inquiry and hope our submission is useful to your work.

S McCartney

Steve McCartney
State Secretary
AMWU WA Branch

1. Natural resource development overview

There are widely accepted reasons government should consider natural resource development differently to other forms of economic activity. Perhaps the most important of these is that the community owns the source of the wealth generated through commercial activity. This has important implications for the way governments are obliged to manage the relationship between our natural resources and the commercial interests that exploit them. According to eminent economist and resources taxation expert Ross Garnaut:

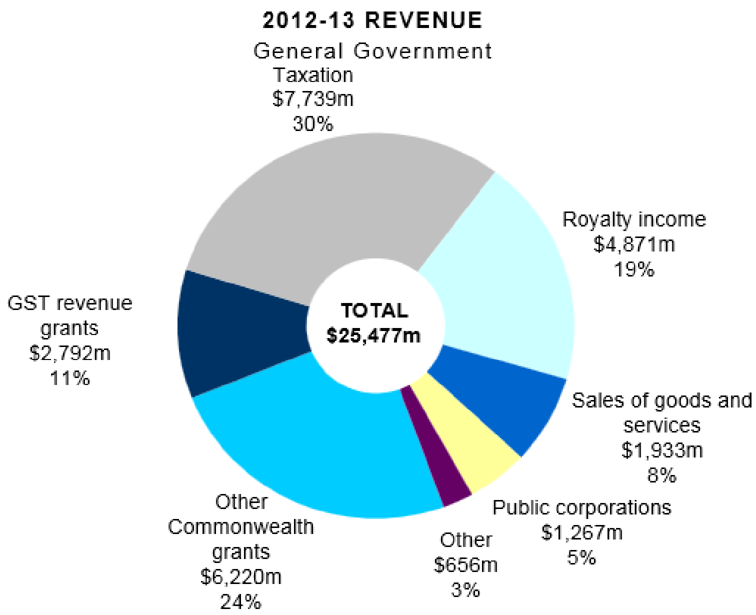
> When an Australian state or territory government, or the Commonwealth in the case of offshore areas, allocates a mining lease, it is giving away a piece of state property to a private party, in the same way as it is giving away state property when it allocates land to a private firm or citizen, or privatises a state-owned business. The community has a reasonable expectation that when some of its property is given to a private party, that party will pay its full value.[1]

Of course, the other defining characteristic of mineral and petroleum deposits is that they are non-renewable. As natural resource deposits are depleted during extraction, value declines commensurably until the deposit is exhausted. This represents the permanent loss of a public asset for current and future generations, and has important implications for the way governments should treat development. The finite supply of non-renewable resources also increases their value. As former Australian Treasury Secretary Dr Ken Henry argued in *Australia's Future Tax System*:

> The finite supply of non-renewable resources allows their owners to earn above-normal profits (economic rents) from exploitation. Rents exist where the proceeds from the sale of resources exceed the cost of exploration and extraction, including a required rate of return to compensate factors of production (labour and capital). In most other sectors of the economy, the existence of economic rents would attract new firms, increasing supply and decreasing prices and reducing the value of the rent. However, economic rents can persist in the resource sector because of the finite supply of non-renewable resources.

These observations are not controversial in themselves. What is controversial are their implications for how government should manage our natural resources. In Australia, royalties have been the primary mechanism through which the public are compensated for the permanent loss of public assets as they are depleted. As the chart below demonstrates,[2] royalty revenue contributes 19 per cent to WA State Government revenue, just shy of $5billion annually. However, the benefits that accrue from resource extraction extend far beyond the revenue gained from State royalties or other forms of taxation specifically designed to account for the unique nature of our non-renewable resources.

[1] Ross Garnaut, University of Melbourne Insights, "The new Australian Resource Rent Tax: the Resources Super Profits Tax", "http://insights.unimelb.edu.au/vol8/02_Garnaut.html
[2] WA Treasury, Budget Fact Sheet, p 3, www.treasury.wa.gov.au/cms/uploadedFiles/State_Budget/Budget_2012_13/2012-13_budget_factsheet_where_the_money_comes_from_and_where_the_money_goes.pdf



A more comprehensive examination of the contribution our natural resource wealth makes to Western Australia reveals a much deeper and broader relationship covering capital investment, employment opportunities, skills development, government revenue and local business opportunities. There is no doubt Western Australia has developed a model of economic growth which relies on continuing capital investment in the resources industry. Royalty regimes are designed to encourage investment to stimulate this economic activity as another vital component of the economic dividend provided to the public. Australian governments have not historically entered into production sharing arrangements like many other oil and gas producing jurisdictions,[3] leaving royalties and involvement in development as the principal means of ensuring the public are appropriately compensated for the loss of their natural assets.

Submission 1: Royalties have only ever constituted part of the economic dividend the public receives for the permanent loss of natural resource assets.

2. Capital investment

Natural resource development contributes disproportionally to capital investment and economic growth in Western Australia. The AMWU believes the term 'resources boom' significantly mischaracterises the nature of the surge in resource related economic activity over the past decade. A more apt description is 'resources construction boom' which identifies the major component of the State's recent economic growth. The importance of resource industry construction to the WA economy is illustrated by the fact that in September 2012, there was $167billion worth of resource projects under construction or committed in a State with a GSP of around $230billion.[4] Land-based LNG projects contributed significantly to that figure. Of the $167billion of projects committed or under construction, $110billion was in the oil and gas

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[3] http://www.theaustralian.com.au/business/in-depth/flng-should-maximise-jobs-santos/story-fnivd8cj-1226672225406

[4] WA Department of State Development, "WA Economic Profile" July 2013 Edition, p 3, available from http://www.dsd.wa.gov.au/8476.aspx

industry. The Gorgon and Wheatstone LNG projects made up a majority of the $58 billion of engineering construction work in the pipeline at the end of 2011-12.[5]

Submission 2: FLNG development on oil and gas resources that could be developed onshore will greatly reduce capital inflows to Western Australia, severely disrupting its historic model of economic growth.

3. Construction opportunities

Facilitated by governments of all persuasions over the past decade, one of the most important effects of the construction boom is the development of a large transient construction workforce. A recent report puts Western Australia's resource construction workforce at 27,000, which is down from a peak of 35,000 at the beginning of the year.[6] The need for temporary construction workers has been the driving force behind the 'skills shortage' Western Australia has experienced over the past decade. Both State and Federal governments have facilitated the expansion of the resource construction workforce, encouraging workers to change career path or through temporary and permanent migration. The AMWU holds particular concern for the construction workers and their families who have been encouraged to take up jobs in the resources sector if new construction projects do not go ahead in Western Australia. A failure to deliver new resource construction projects will result in disruption to Western Australia's economic model and increase in unemployment in WA.

As LNG projects move into production phase, they typically require around ten per cent of the construction workforce to operate, as the following chart from the Department of State Development illustrates:

Major selected resource projects: February 2013

Projects	*$ billion*	*Mtpa(target)*	*Construction jobs*	*Operationjobs*	*Start up*
Iron and steel					
Rio Tinto – Pilbara 290Iron Ore Expansion	10.1	53	n.a.	n.a.	2013
Hancock Prospecting – Iron Ore Mine& Infrastructure – Roy Hill[1]	9.5	55	8,500	2,000	2014
Fortescue Metals Group – Chichester & Solomon Hub T155 (Includes Port & Rail)	9.4	60	7,000	6,000	2013
Australian Premium Iron Ore JV – West Pilbara Mine, Rail & Port (Stage 1)[1]	7.4	30	3,500	1,000	2014
Rio Tinto – Pilbara 360 Iron Ore Expansion	5.7	70	n.a.	n.a.	2015
Oil and gas					
Gorgon JV Gas Processing Plant	52.0	15.6 (26)	5,000	300	2014
Browse LNG Precinct[1]	30.0	12 (50)	8,000	600	2017
Chevron – Wheatstone LNG	29.0	8.9 (25)	5,500	400	2016
Inpex/Total – Ichthys Gas Field	15.3*	- (8.4 NT)	1,000	400	2016
Gorgon JV Train 4[1]	13.1	5.2 (26)	n.a.	n.a.	2017
Shell – Prelude Floating LNG Plant	12.0	3.6	n.a.	350	2017

[5] Ibid

[6] MacDonald, K, *The West Australian*, "Worst is over for resources job losses" p 15, August 21 2013

Other projects					
Oakajee Port, Rail & Industrial Estate[1]	5.9	45 (100)	2,500	250	2017
Anketell Port & Strategic Industrial Area[1]	4.6	115 (350)	n.a.	n.a.	2014

[1]Under consideration.
Mtpa - Million tonnes per annum.
Exchange rate conversion = $US1.0393 (2012 average).
* DSD estimate.
Source: Department of State Development, Prospect Magazine;Deloitte Access Economics, Investment Monitor; WA Chamber of Commerce and Industry, Resource and Energy Projects Service; Bureau of Resource and Energy Economics, Mining Industry Major Projects; Australian Securities Exchange (Announcements); and project proponent reports and presentations.

The promotion of methods of resource development that remove the ability of Australians to gain employment in the resource sector represents a significant threat to the economic dividend received from the permanent loss of our natural resources. While each project has a finite construction period, rolling construction jobs have provided lifetime employment for thousands of Western Australians. The table also shows the construction workforce for three current major LNG projects off the WA coast - Gorgon, Wheatstone and Ichthys - adds up to 11,500 jobs. The comparison with Shell's FLNG-based Prelude development starkly illustrates the disparity: it requires not a single Australian construction job. Rather Prelude's 6,000 vessel construction jobs are predominantly based in South Korea and scattered throughout the Middle East.[7] Needless to say, the offshoring of up to of 8,000 direct construction jobs is of paramount concern to the AMWU.

Loss of direct resource industry jobs for Australians, and more particularly Western Australians, is compounded by the fact that for every resource sector job, the WA Government estimates another three extra jobs are created in "retail (clothing, supermarkets), hospitality (hotels, restaurants), support services (IT, administration) and manufacturing (machinery, parts)."[8] Applying the Department's formula to the 8,000 Browse Hub construction jobs shows the decision to move to a floating facility means 32,000 fewer jobs in Western Australia. Woodside CEO Peter Coleman has dismissed such calculations as a "hollow discussion"[9] and from the perspective of a multinational corporation it may well be. However, from the perspective of Western Australian workers, their union representatives and the local companies they work for, the disruption FLNG presents to Western Australia's traditional model of economic growth is anything but hypothetical.

Although there has been much speculation about the opportunities available to Western Australia as an early adopter of FLNG, there has been little detail on what this means in reality. Publicly available information reveals little opportunity for Western Australian firms to break into FLNG design or construction supply chains. In 2009, Shell awarded a contract to a consortium of French company Technip and South Korean Samsung Heavy Industries for the design, construction and installation of multiple FLNG vessels over 15 years.[10] Such a contract makes it very difficult to imagine how a WA firm could get into the supply chain in a global oil and gas sector already notoriously difficult to break into.

Indeed, practical suggestions of how Western Australian companies might enter the supply chain for construction or installation of FLNG vessels are rare. One exception has been the sub-sea

[7] http://www.shell.com.au/aboutshell/who-we-are/shell-au/operations/upstream/prelude.html
[8] Department of Mines and Petroleum Resources Industry fact sheet, available at http://www.dmp.wa.gov.au/documents/132431_Resource_Industry_Fact_Sheet.pdf
[9] Klinger, P, *The West Australian*, "Woodside challenges critics" p 61, August 22 2013
[10] http://www.shell.com.au/aboutshell/who-we-are/shell-au/operations/upstream/prelude.html

installation and mooring phase of FLNG projects. Federal Resources Minister Gray Gray has argued WA firms could supply sub-sea anchoring mechanisms: "If you were to become the global owner of the technology that can locate this floating production facility over the gas field and anchor it in conditions that include cyclonic conditions, do you reckon you could sell that technology elsewhere?"[11] However, there are certainly no guarantees this work would be awarded locally. Shell's public statements on WA particpation for the Prelude project indicate the bar for local participation on that project has been set quite low. Commercial Manager East Browse Ian Grose told the WA Parliament Economics and Industry Committee in June 2013 that even if 70 per cent local content could be achieved on the project it would see a meagre $200million benefit to the WA economy from a $13billion project. On the drilling and sub-sea installation front, Shell was aiming for just 37 per cent and 20 per cent local content, respectively. Many of the supporting contracts for Prelude have already been awarded to overseas ventures.[12]

Submission 3: FLNG creates no opportunities for Western Australian fabricators and manufacturers in the construction phase. A best case scenario would see some minor contracts awarded for installation and drilling.

4. Production opportunities

Limited Western Australian business opportunities in the production phase of FLNG facilities is also of significant concern to the AMWU. As has been argued above, LNG production workforces are typically just one-tenth of construction workforces. Woodside CEO Coleman has argued that "operational employment opportunities from the FLNG concept, including during support and maintenance periods, would likely be greater than for an equivalent land-based processing plant."[13] The AMWU is sceptical of this claim, and believes it cannot be separated from its context, which is that thousands of jobs will go offshore during the construction phase. In addition, a lack of involvement during design and construction significantly reduces the chances of operational participation. Even if it is proven correct, to reduce the argument to a either-or equation is spurious when Browse could be providing both construction and operational opportunities to Australian businesses and workers.

Neither is there any way to ensure Australians will actually be employed on FLNG vessels at all. Although the Browse Joint Venture Partners have not publicly released comparative personnel figures, the Prelude project provides important insights. Shell's Commercial Manager East Browse Ian Grose told the WA Parliament Economics and Industry Committee in June 2013 that the Prelude FLNG vessel would employ just 350 people directly during the operations phase and 650 indirectly.[14] Mr Grose did not specifically mention how many of these would be Australians. Although Shell Australia General Manager Steven Phimister also told the Committee Shell was recruiting on an "Australia-first principle" the AMWU remains highly sceptical without a formal mechanism to ensure this outcome.

[11] Kerr, P, *The West Business*, "WA urged to develop, embrace new technology" p 4, May 23 2013
[12] http://www.ship-technology.com/projects/prelude-floating-liquefied-natural-gas-flng/
[13] Klinger, P, *The West Australian*, "Woodside challenges critics" p 61, August 22 2013
[14] http://au.news.yahoo.com/thewest/a/-/breaking/18460314/wa-to-benefit-from-prelude-flng-shell/

Aside from the production workforce, it is well known in the oil and gas sector that expansion and maintenance is generally awarded to companies that have involvement during the design phase. The Prelude agreement between Technip and Samsung mentioned earlier does set a concerning precedent if future vessels follow this model. Without any involvement in the initial design or construction phases, it is very difficult to see how Western Australian businesses will be awarded any work on modifications or expansion beyond basic maintenance of FLNG vessels. The modular nature of FLNG construction makes it a convenient option to replace entire modules that have been constructed overseas. The AMWU sees FLNG as the ultimate conclusion of a local content battle that Western Australia has been losing for the better part of a decade.

Premier Colin Barnett has raised the idea of using James Price Point as a supply base for future Browse Basin FLNG vessels. While the AMWU believes this is a poor substitute for land based processing, the union supports this measure as a means to salvage some Western Australian economic development from Browse. However, we note with disappointment that Shell has already indicated the Prelude supply base will be located in Darwin.[15] In the event FLNG is chosen for Browse, we support retaining an obligation for the joint venture partners to use James Price point in this capacity. Without such an option, it is difficult to see how Western Australia will be able to participate in the economic activity surrounding Browse gas, even the resources that lie within State jurisdiction.

Submission 4: There is no mechanism to guarantee Western Australian employee or business involvement in the operations phase of an FLNG project, even for LNG resources within Western Australia's territorial jurisdiction. Contracts already awarded for Prelude have set a concerning precedent.

5. Other considerations

If there is no chance of Western Australian involvement in FLNG design or construction phases and very little chance of securing participation during the operations phase, it calls into question the economic dividend we receive from the permanent depletion of our natural resources. Of course royalties is one answer, yet as we have already submitted, royalties must be seen in the context of the other economic dividends the public receives. The division of royalties between the State and the Commonwealth is the subject of ongoing discussions; however these negotiations would have been necessary regardless of where processing takes place. The real question we hope the Committee will address is the net cost of FLNG to the Australian public, taking a holistic approach that considers all aspects of economic development beyond royalties.

On the other hand, the benefits to the multinational organisations that comprise the Browse joint venture are clear, as put forward recently by Macquarie Securities analyst Adrian Wood:

> "The fact that Prelude, producing 3.5 million tonnes per annum of gas, is a prototype means you might get more capacity as ensuing vessels become more efficient, while the joint venture pays less royalties (than an onshore plant) and may not have any domestic gas requirements attached."[16]

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[15] http://maritime-connector.com/news/offshore-oil-gas-news/shell-lays-keel-for-world-s-first-floating-lng-project/

[16] http://www.perthnow.com.au/business/browse-saves-30-billion-going-offshore/story-fnhocr4x-1226703662942

In these comments, we can see a clear divergence between the interests of the Australians who own the resources and the private interests that facilitate extraction on their behalf. For example, by avoiding bringing the gas onshore, the Browse proponents are able to avoid the 15 per cent domestic reservation policy. Woodside and Chevron are on record as opposing the reservation policy.[17] While there are countless other forums where the merits of domestic reservation policy has been debated and discussed, the AMWU sees this as a subversion of a bipartisan government policy designed to secure energy security for Western Australia. Indeed, there are very few other global jurisdictions that would allow proponents complete freedom to export a strategic natural asset like LNG.

The AMWU is also concerned about the loss of the $1.5billion benefits package to the traditional owners of James Price Point. The Union has a very good working relationship with both the Kimberley Land Council and its corporate arm, KRED and supports their aims regarding economic development in the area. Industrial development also would have provided employment and skills development opportunities for thousands of Kimberley locals. Bringing gas onshore would have also spurred industrial development and opened up a range of mineral and chemical processing opportunities. If LNG processing does not occur at James Price Point, we urge State and Federal governments to investigate alternative options for bringing economic opportunities to the Kimberley.

Woodside has also raised higher costs in Western Australia as an impediment to development. The AMWU submits that a number of important contextual factors must be acknowledged in relation to this claim. The first is that the most profitable outcome for a multinational company is just one aspect of what should be a mutually beneficial outcome for all parties concerned. As a recent McKinsey Institute report found, potential savings that may arise from FLNG processing included reduced government revenues and other community obligations.[18] Certainly by avoiding domestic obligations such as the $1.5billion payment to the traditional owners and domestic gas reservations, the Browse Joint Venture can increase its profits irrespective of the margins on the originally mooted project. The AMWU contends that increased profitability at the expense of almost all economic development in Australia fails to acknowledge the mutual benefit the public expects from permanent depletion of its natural assets.

As we have demonstrated, the FLNG scenario leaves Australia, and Western Australia in particular, with very little opportunity to participate in the economic activity surrounding LNG extraction and processing. Using FLNG for projects that would previously have been developed onshore represents a marked change in rhetoric from Shell, which in the past had contended:

> "For Australia, the Prelude FLNG project will demonstrate a means of developing some of Australia's "stranded" offshore gas reserves - those considered uneconomic for development via an onshore plant because they are too small or remote."[19]

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[17] http://www.theaustralian.com.au/business/companies/western-australias-domestic-gas-policy-angers-producers/story-fn91v9q3-1226111964044

[18] McKinsey Institute, "Extending the LNG boom: improving Australian LNG productivity and competitiveness", p 25, available at www.mckinsey.com/locations/australia/.../pdf/extending_lng_boom.pdf

[19] http://www.shell.com.au/aboutshell/who-we-are/shell-au/operations/upstream/prelude.html

As Premier Colin Barnett has argued, Browse Basin is not too small or too remote to be "economically" developed using land-based processing. It is not a "stranded" field and exposes the joint venture partners to claims that a significant attraction of FLNG lies in avoidance of government revenue and minimisation of community obligations. While FLNG offers obvious advantages to multinational oil and gas companies, it remains for them to demonstrate how it benefits Australian people where it replaces onshore development. The AMWU submits FLNG proponents have not made that case.

Conclusion

FLNG presents a serious challenge to a highly significant component of Western Australia's economic growth model. If we are indeed at a turning point and FLNG becomes the norm for LNG processing that would have previously occurred onshore, the AMWU submits we can expect:

- Lower aggregate economic return for the permanent loss of natural assets;
- Lower amounts of capital flowing into Western Australia leading to lower economic growth;
- Higher unemployment due to underutilisation of Western Australia's resource construction workforce;
- No opportunity for Western Australian business and workers to participate in construction;
- Negligible opportunity for Western Australian business and workers participate in installation;
- Very limited operational opportunities for Western Australian business and workers;[20] and
- Diminished ancillary benefits such as domestic gas reservation and community development projects.

[20] Based on contracts already awarded for Prelude.