

**ECONOMICS AND INDUSTRY
STANDING COMMITTEE**

INQUIRY INTO DOMESTIC GAS PRICES

**TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 29 NOVEMBER 2010**

SESSION TWO

Members

Dr M.D. Nahan (Chairman)
Mr W.J. Johnston (Deputy Chairman)
Mr M.P. Murray
Mrs L.M. Harvey
Mr J.E. McGrath

Hearing commenced at 12.34 pm

NICOLAOU, MR JOHN ANDREW

Chief Officer, Chamber of Commerce and Industry of Western Australia, examined:

RICHARDS, MR NOEL

Policy Adviser, Chamber of Commerce and Industry of Western Australia, examined:

The CHAIRMAN: Welcome, and thanks for your attendance. This committee hearing is a proceeding of Parliament and warrants the same respect that proceedings in the house itself demand. Even though you are not required to give evidence on oath, any deliberate misleading of the committee may be regarded as a contempt of Parliament. Have you completed the “Details of Witness” form?

Mr Nicolaou: I have.

The CHAIRMAN: Do you understand the notes at the bottom of the form?

Mr Nicolaou: I do.

The CHAIRMAN: That is always a dumb question, is it not? Did you receive and read the information for witnesses briefing sheet regarding giving evidence before parliamentary committees?

Mr Nicolaou: We did.

The CHAIRMAN: Do you have any issues about giving evidence before a parliamentary committee?

Mr Richards: No; I do not.

Mr Nicolaou: No.

The CHAIRMAN: Thanks for your appearance today. Before we ask any questions, do you want to make an opening statement?

Mr Nicolaou: I might start by providing a very brief opening statement on the background to the CCI appearing before this committee. We did not provide a formal submission to the committee, but we are pleased to appear and give evidence on the back of some research that we did back in 2007—a major discussion paper that was a six-month study into WA’s future gas needs, and our views will reflect, largely, the recommendations and positions that were articulated in that paper. If any of the committee do not have a copy of that paper, we are happy to provide one here today.

We did that research primarily as a consequence of business concerns around the appropriateness of the government’s policy on gas reservation. We held concerns as a chamber group, but also we were getting feedback from our membership, which is diverse across the whole supply chain from producers through to retailers, about the implications of the gas reservation policy. It was on that basis that we undertook a major study into our future gas needs and the appropriate policy response that we believe would be more successful in delivering the future gas that the state requires. The members of that review group who participated in the study were across the spectrum of the supply chain as well, and included Alcoa; APT; BHP Billiton; CSBP; Dampier to Bunbury natural gas pipeline; Griffin; Horizon Power; Midland Brick; North West Shelf gas; Origin Energy; Synergy; and Tiwest. We believe that we had an appropriate representation across that supply chain that informed the positions that we came to.

Overall, the positions that we held were that we did not believe that a gas reservation policy, which we believe is a form of market intervention, would achieve the policy intent that was set out in the

policy paper that the then government released back in 2006. Rather, we believe that the key to bringing more supply to the domestic market is more about addressing the institutional and regulatory settings that impede the supply of new gas coming to the domestic market. On that basis, the key recommendations that came out of our study were, firstly, in relation to retention lease processes. We believed that it was important that a review be undertaken on that process, to make sure that it is more open and encourages third parties to evaluate the commercial viability of different retention leases. We are pleased to say, since that study, a number of reviews have been initiated at a federal government level.

Secondly, we believed that the introduction of a flow sheet through share scheme would provide an incentive to encourage exploration of new fields, particularly smaller fields. Again, this is another consideration that has been undertaken by the federal government, but at this stage we have not seen any policy change on that front.

Thirdly, in terms of streamlining the approvals processes, we have seen some activity there and we are very supportive of the current state government's process to streamline those approvals processes that relate to the gas sector. Fourthly, are the joint marketing arrangements. Our position was more that the validity of joint marketing needed to be tested by the ACCC as the umpire in the game. We note, also, that a test has been undertaken this year, and we really do not have much to offer beyond that decision by the ACCC.

The second last point was in relation to pipeline capacity. There were two key areas of policy that we believe warranted review; firstly, in relation to the pressure limitations, which we believe were potentially limiting supply. We understand that that is being investigated at this point in time by Standards Australia. Finally, gas quality specifications—a really important change that we are pleased that the government acted upon, and that has underpinned the development of the Macedon project, which will be a domestic-only gas field. Finally—apologies for taking up more than my allotted time—a state energy policy is certainly a critical component in addressing our future gas needs to ensure that you are getting consistency of policy across a whole range of different issues.

In conclusion, our views today express the views we expressed in the 2007 paper. We do not support the gas reservation policy, and we believe that a policy should, instead, be focused on encouraging competition rather than mandating a certain amount of supply coming to the market from LNG fields. With that, I thank you for that.

[12.40 pm]

The CHAIRMAN: Welcome back, Noel. Noel has been in the UK for a while. We have a couple of issues. The origin of this inquiry is—your members would have indicated this to you, at least some of them—that there is a perception that we have very large volumes of gas off the north west, and very high prospectivity for future discoveries. But domestic prices are increasing rapidly, at least under new or renewed contracts. Also, there is some concern that the domestic price is higher than the netback LNG price. So the situation is that the large projects are taking the gas and exporting it to lower-priced markets, or constraining the domestic market through a higher price. As you well know, because of the history of the gas industry here in Western Australia, we have a very high level of penetration of gas for electricity and for feedstock, and we are very highly reliant on it. The recent rises in gas prices have caused some dislocation. Some of the people who you listed as being involved in your energy strategy would know that firsthand. Do you think that is an accurate diagnosis of the situation now?

Mr Nicolaou: We certainly agree that there is no supply problem per se. There are vast quantities of gas in reserve off the coast of this state, and on coast for that matter as well. We do understand the concerns of our membership in relation to price and price rises and what impact that is having on them. Our view, though, holds that we do not believe that the government has a role in setting the price of gas, but rather encouraging and focusing on building competition, because once you build

competition, I think price will sort itself out. So I guess your synopsis is fair in terms of the state of play.

The CHAIRMAN: One of the structural issues with us is that the history is that we have dominated by a few large producers whose focus is necessarily LNG; otherwise, projects would not happen. There has been an expansion of smaller domestic-orientated projects, largely like Apache and others, coming onto the market, but they are not going to be replacing the North West Shelf. Secondly, we do have a large number of projects on the boil, such as Gorgon, but they are largely LNG focused; that is why they exist. The other ones are all LNG focused. There is a concern that without a reservation requirement, these operations would not want the hassle and the potential troubles of going into domestic but would just put everything offshore; and then you would have the issue of the state having huge volumes of gas—one of the highest levels of any place in the world—but a shortage onshore. Can you comment on that? That was the origin of the reservation policy. It came up in the context, I believe, of negotiating the Gorgon project.

Mr Nicolaou: I am not really in a position to comment too widely. I will note, though, that the feedback we have received from our members, particularly as a result of our inquiry back in 2007, was that supplying domestic gas is a critical element to underpinning a project of that magnitude. The North West Shelf is an example where supplying to the domestic economy was critical in underpinning the future development, and therefore the significant export revenue that has been generated. So that is certainly one element that I would put forward to the committee today. The other component is, again, that there are going to be projects that are of different scales, sizes, qualities and so forth. What I think is important is that you get the fields and encourage the fields that are more tailored to supplying to the domestic market than are others. That is where getting those policy settings right to encourage more smaller field developments would assist in addressing our gas needs as a domestic economy, while at the same time facilitating the great opportunity that comes with LNG export.

Mr W.J. JOHNSTON: Could you name some of the fields that you are referring to—those smaller fields that you think should be brought on line for domestic production?

Mr Nicolaou: I cannot name them offhand. The example is Macedon, though, which is under development now; but at the time of our inquiry back in 2007, it was not, and the feedback we received from BHP Billiton was that this was a project that was for domestic only purposes—it was not suitable for export—and if we did have the policy changes in place to address some of the regulatory barriers, they would bring that on stream to the domestic market. I think that has been a great outcome, from a policy front, that the state government was able to change those gas specifications to encourage those sorts of fields through regulation.

Mr W.J. JOHNSTON: But that is one field, and it has gone ahead regardless of the fact that there is a 15 per cent gas reservation policy. So is there any conclusion that you draw from the fact that it has gone ahead even though there is that 15 per cent reservation policy?

Mr Nicolaou: I would suggest, then, that it does make the gas reservation policy a toothless tiger. It has not achieved any policy intent, because that project was tailored to the domestic market only. It had nothing to do with the gas reservation policy.

Mr W.J. JOHNSTON: Okay. Fair enough. If that is your answer, that is fine,

The CHAIRMAN: One of the issues is that one of the dangers of the gas reservation policy is that it would, if applied rigidly, lead to a hell of a lot of gas coming onto the market, and BHP, which knows the market very well, given that it is in a lot of joint ventures, would look at that and say, well, yes, why bring on Macedon if the price is going to drop by a huge policy-induced supply response? Obviously you look at Macedon and you say at least it has had no significant distortionary effect on the decision to take Macedon on board. Would you agree?

Mr Nicolaou: It is certainly a concern where you have these unintended consequences from imposing a policy of this nature on a market that is small in nature, and if you are supplying great supplies of gas it is not going to do the supplier any justice in terms of maximising shareholder returns, and at the same time it is not going to spread and encourage competition more broadly through the domestic market, because it will crowd out smaller fields that would effectively provide a degree of competition and security to our future gas needs.

The CHAIRMAN: When you look at the market, one trend you can see is that the technologies available to bring gas fields, even smaller gas fields, into the LNG market are increasing, with floating platforms, reticulation systems and spare capacity, let us say, in the future, perhaps, in one of those joint ventures like the North West Shelf. So you might see projects such as Macedon get sucked in if Macedon has some gas content issues. But we are seeing a risk of small fields being brought into the LNG net, and once brought into the LNG net, there are some commercial benefits; that is, you can sell it off over long-term contracts of 20 to 25 years, you can monetise the price almost immediately without a great deal of consideration of the contestability of the domestic market.

[12.50 pm]

Floating platforms, of course, mean the state has no leverage over the producers to bring gas onshore. One of our first instances is not just the price; it is the security supply of gas. Note that we use 65 per cent of electricity generated capacity with this gas. We are highly reliant on gas. I cannot see that changing too much. Given the importance of LNG, particularly for scale and amortising the resources, and given the technological trends of floating platforms and reticulation, are you confident that the market signals and the market process will lead to adequate gas onto the domestic market?

Mr Nicolaou: I guess I have an optimistic view that markets, when operating efficiently, will deliver the outcomes that we need as a state. Really, in the end it comes down to price. If the price signals are not there and there is a market failure—if it is determined there is a market failure—that will require a role for government. I do not believe that there is that market failure at this point in time. I see no evidence of it at this stage. I am not aware of those trends in terms of technology to bring what was once “domestic only” fields into LNG production. I cannot comment.

The CHAIRMAN: Shell has proposed three floating platforms—one for Prelude and some others. As to whether those would be brought onto the market, or could, but you do not know. Look at the market structure here—a few producers, two regulated pipelines and five buyers, effectively. There is a lack of competition on all segments of the market. Poor information—you tell me what the gas prices are. It is shrouded in secrecy; little liquidity. It has an incestuous nature—you see the same players on all sides of the game up and above the producers’ market and the consumers’ market. You can see a structure that is not conducive to competition. The question is: given that market, it is not like you have now on the eastern seaboard—large numbers of producers interacting on regulated pipelines and spot markets and liquidity—if you look at our market, that is not a competitive market. In that type of market structure, can you not see a diminution of market signals? You tell me what the gas price is now for a long-term contract.

Mr Nicolaou: I certainly cannot provide you that. I am not aware of what the price is at this point in time and I think —

The CHAIRMAN: How can you get to this market structure?

Mr Nicolaou: A market structure like that requires competition. It requires information to be available. I think there are some issues there in relation to Western Australia’s market which does impact on the efficiency of the market here in this state. We are in a unique situation which makes it difficult to impose the policy solutions in other jurisdictions compared to WA. It is on that basis, therefore, that the key response, from CCI’s perspective, is really to get those policy settings in

place that encourage competition first and foremost at all levels of the supply chain. That, in the end, will set in place the supply response that this state needs for its future development requirements. Unfortunately, I cannot provide any more scope beyond that. Noel, do you have anything to add?

Mr Richards: I will just add that the characteristics you describe are very much what the ACCC drew upon in their decision on joint marketing as well. I guess the focus of the state ought to be on trying to get a competitive market operating in the medium to long term. That should really be the goal for this state. That is very much what we highlight in our report as well—collectively those policy issues which John highlighted at the start—getting those right would take a great step forward towards establishing a competitive market in the medium to long term.

Mr W.J. JOHNSTON: We have one pipeline running down the coast, and that is a regulated pipeline. Do you think while there is only one, it should be a regulated asset?

Mr Nicolaou: I think when there is one providing the infrastructure, that does warrant government regulation to ensure efficient outcomes; otherwise you will be subject to monopolistic behaviour.

Mr W.J. JOHNSTON: Do you have any suggestion as to why create a second pipeline to compete with the existing pipeline? Do you think it would even be worthwhile trying?

Mr Nicolaou: That is a good question, but if the market has not responded and built up a business case to develop a second pipeline, there is not a demonstrable case at this point in time. That is certainly backed up by others that we have spoken to over the years—the market is not big enough yet to warrant it. All you are going to do, if you build a second pipeline, is increase the price because they are going to have to get a return on their capital.

Mr W.J. JOHNSTON: If I could go further: do you think there is any opportunity for government to apply a similar type of regulatory regime to the gas processing plant on the Burrup? There are two gas processing plants there that the North West Shelf joint venture operate—should those plants be opened up to third-party access?

Mr Nicolaou: That is a slightly different scenario in that it is not clear that there are those barriers to entry that you would find with a pipeline of such significance in this state with the Dampier to Bunbury natural gas pipeline. It is not clear to me that there are those barriers to entry that would mean it should be opened up to third-party access. That is something that should be tested. There is an appropriate mechanism by which it can be tested through the ACCC.

The CHAIRMAN: Processing facilities can be tested for, let us say public interest regulation?

Mr Nicolaou: I cannot see why not, in the same way that rail, truck, or gas pipelines are. But again that is my assumption. I guess we would need to get feedback from the ACCC on that. It is a piece of infrastructure of significance. Whether it meets the tests of essential infrastructure that cannot be duplicated, that is something I cannot respond to.

The CHAIRMAN: Are you involved in making submissions to the Strategic Energy Initiative?

Mr Richards: Yes. The CCI made a submission earlier this year to the initial issues paper. We have been involved in discussions and work on that since.

The CHAIRMAN: What are you focussing on, in terms of your advice?

Mr Richards: I guess our key message there, in terms of the cost of energy, particularly electricity tariffs, has very much been supporting the move towards full cost reflectivity in electricity tariffs. The key issue there for us is encouraging competition in the downstream energy sector. We think that is a big step towards full retail contestability in electricity. We have been big supporters of that, and also for the independent setting of electricity tariffs as well. There seems to be quite a political process in this state. In other states they have independent price setting or tariff setting bodies. That is something that we would like to see here. By and large that has been the goal of ours in the CCI

process, to try to encourage policy that encourages competition in the energy sector in Western Australia.

The CHAIRMAN: Are you involved in the energy mix issue; that is, coal versus gas in the generation of electricity?

Mr Richards: Not significantly. We did touch on it in terms of this 2007 paper. One of our concerns at that time, and the concerns of our members, was that having a reservation policy may unduly give gas a leg-up over coal or renewable energy sources. In terms of competition, it is not only within the sector but also across the sector as well in terms of the different energy mixes. I guess what we like to see is competition across the different energy sources as well.

[1.00 pm]

Mr W.J. JOHNSTON: I am just interested in energy across different providers. As I understand it, many of these large processing companies have invested in gas-fired infrastructure and it is difficult for them to use alternative fuel sources. Is that your understanding of the situation? Basically, once you make a decision to install a gas-fired plant, you cannot really then use a different fuel source? Is that your understanding?

Mr Richards: Yes. I am not hugely familiar in depth with the structure of the industry, but I do understand that there are those sorts of combined or stand-alone facilities in terms of coal or gas.

The CHAIRMAN: When you put together that paper in 2007, many of the names you read out were people who are on the DomGas Alliance. Alcoa comes to mind, and I think the pipeline is also on that. In fact, the chairman used to be very active in it. You said that you came out with a view against reservation. How did you get consensus amongst that group, or did you?

Mr Nicolaou: This paper was not really about gaining consensus in the end. It was about articulating the views of different parts of the sector along the supply chain. This is a CCI paper, and in the end we formed our positions on the basis of feedback from the whole supply chain. We did note the concerns of Synergy and Alcoa, which have a concern from a retail perspective—the end of the supply chain perspective. But we had a strong view on balance that a gas reservation policy was not in the state's best interests and was a form of market intervention that would be counterproductive to the policy in turn.

Mr W.J. JOHNSTON: Do you know of any jurisdiction in the world that allows LNG exports that does not have some form of either direct government involvement in the project or domestic reservation?

Mr Richards: No, we do not know enough about the global energy market to comment confidently about that.

Mr Nicolaou: There was some research in the paper that I would need to draw on. I would be happy to take that question on notice, but I cannot answer that sufficiently at this point in time.

Mr W.J. JOHNSTON: Do you also know of any LNG project that has not been able to get financial closure because of the domestic gas reservation policy?

Mr Nicolaou: Since this paper was produced back in 2007, I have not been as close to the issue. Again, I would have to take that question on notice. I am not aware of anything, but that is not because I have not been looking.

Mr W.J. JOHNSTON: Are you aware of any LNG projects in Western Australia that do not have a domestic supply component?

Mr Richards: No. At the moment, it is really only the North West Shelf in terms of the LNG component that is operating, and they obviously have a domestic gas —

Mr W.J. JOHNSTON: Pluto is near completion. There is a domestic component to that, is there not?

Mr Richards: Yes.

Mr W.J. JOHNSTON: Gorgon has a domestic component as part of their state agreement. Wheatstone and Scarborough have domestic components.

Mr Nicolaou: Yes. We are certainly aware of those. It is a good question as to whether the gas reservation policy is the driver for that or whether it would have been a normal business response, given the benefits of supplying on.

Mr W.J. JOHNSTON: We had public evidence from BP, which is part of the Io field, saying that none of its gas supply is being used for domestic sale and it is not covered by any domestic reservation whatsoever.

Mr Nicolaou: And that is because it is offshore?

Mr W.J. JOHNSTON: Part of it is being processed through Gorgon. You can draw a conclusion out of that, can you not?

The CHAIRMAN: The key issue is that given the limited infrastructure, there is no spare capacity in the processing unit. There is only one processing unit, and that is essentially Apache's and the North West Shelf's. There is no spare capacity; therefore, you have to build your own. The real question is: would these large projects, which are necessarily focused primarily and, indeed, overwhelmingly on LNG—some of them do not even come onshore, such as Barrow Island—be interested in building a plant to get into a fickle, small domestic market that brings with it a whole range of contractual, marketing and other hassles without the pressure of a reservation? From a government perspective, given the importance of gas, can you take the risk that it would happen solely out of market signals if you have a market, particularly with a market structure like this? If you had it on, for instance, the eastern seaboard, you would be very safe and comfortable. If you find gas close to a pipeline, you can get it in. This one is quite different.

Mr Nicolaou: It is quite different. The whole “build it and they will come” quote cannot really apply effectively here because the risks attached to it are so high. That is why you need to look at things from a whole of supply chain perspective. You do need to look at retailers as well. They have a role to play in facilitating greater supplies coming into the domestic market via some contractual arrangements. At this point in time we have not seen that. That is why it cannot always be addressing things from a production end through a reservation policy when there are a number of market players through the supply chain that could collectively help arrive at a market outcome for the betterment of the state.

Mr W.J. JOHNSTON: How would that work?

Mr Nicolaou: If the challenge is so great and the concerns around future gas supplies are so great, retailers and users have a role to play in helping facilitate new production coming on stream.

Mr W.J. JOHNSTON: So how would that work?

Mr Nicolaou: Through normal contractual negotiations.

Mr W.J. JOHNSTON: Give me an example of how it would occur.

Mr Nicolaou: An example could be a demand aggregation whereby a number of end consumers come together to help facilitate a potential project coming on stream, in the same way that the North West Shelf venture, for example, underpinned its development through long-term contracts overseas. A similar analogy could be drawn here.

Mr W.J. JOHNSTON: The North West Shelf joint venture's initial financial viability was because of a 30-year take-or-pay contract from the state government. Are you suggesting that the state government should step in and do that again?

Mr Nicolaou: Not at all. I think the state government-owned public utilities have a role to play, but the state government in itself does not need to play a role in it. You would expect that those utilities could arrive at those sorts of outcomes themselves.

Mr W.J. JOHNSTON: If you had been advising Sir Charles Court, would you have suggested to him that he go ahead with that take-or-pay contract?

Mr Nicolaou: I cannot —

The CHAIRMAN: How old were you when that happened?

Mr W.J. JOHNSTON: I was not around either.

The CHAIRMAN: I was!

Mr W.J. JOHNSTON: It is always amusing to me that there should be a market-based mechanism when the dominant gas supply that was created in the late 1970s was created because a Premier was prepared to not listen to that type of advice. Do you see the point that I am getting to?

Mr Nicolaou: I am not really in a position to provide an eloquent response, but it is an example in which a long-term contract was struck that helped underpin that development. I cannot say with clarity whether or not that was a success, but it certainly helped underpin the state's economy for many years.

The CHAIRMAN: Let us explore this. In order to ensure domestic supply—let us put aside what you mean by “ensure”—one area is to have a reservation policy and we say that the projects have to supply a certain portion of their total production. Our reservation policy is up to negotiation; it is flexible, as far as I understand. The second thing is that you give the state, through production-sharing contracts, a volume of your off-take and they do with it whatever they wish—either sell it overseas or domestic. A third would be an aggregator, whether it is government backed—you would think it would have to be government backed, given that this is associated with it—going out and signing a contract with the North West Shelf or somebody else and maybe even building a processing plant and a pipeline and saying, “We assign a very large long-term take-or-pay contract with one of them.” Those are the options.

[1.10 pm]

Mr Nicolaou: The third option certainly is a viable option. It brings together two parties to arrive at a mutually beneficial solution. There are no regulatory barriers to prevent that from occurring. It is about all market participants coming together to arrive at that outcome rather than seeking out government intervention to resolve the problem from a particular perspective.

The CHAIRMAN: The latter two options—forget the production share; that is not how we do things—they are almost the same thing. One is that you say that the joint venture partner is to build the pipeline and processing unit and sell the gas, for whatever price, and the other one is that the third party does the infrastructure. The real question is: why is it needed? There is some perception about market failure in terms of providing contestability to the domestic market. That is the essential issue we have here. Once they build the facility, I think we can be comfortable that they will use it, given it costs millions and millions of dollars. The real question is whether they will make the physical linkages to the market. It is a strategic security of supply issue more than a price issue.

Mr Nicolaou: Yes.

The CHAIRMAN: That is the call we have to make.

Mr Nicolaou: Understood.

The CHAIRMAN: You can see that. Whatever way you come at it—whether you force them to do it or somebody else does it as an aggregator—that needs to happen. The evidence we have to date is that I do not think some of these projects would have actually made that physical connection. The

North West Shelf is different. It is much different from the new ones. Going forward, most have not come forward saying they will build a domestic link by themselves and the state does not need to have a reservation policy. We also see the reservation policy so far, as applied, not killing off or distorting state domestic-focussed projects like Macedon because the economics of those is totally different—short term, low volume, no LNG.

Mr Nicolaou: And I would add too that for these larger projects there is commerciality attached to them; that is, supplying to the domestic market. What does that mean?

The CHAIRMAN: That is an area that is completely unexplored.

Mr Nicolaou: Absolutely. I think that the risk for the smaller projects is lower than it would be.

The CHAIRMAN: Except once they build a processing plant of a certain capacity, which is in line, I think, with their reservation, they can pump it. What is meant by “commerciality”?

Mr Nicolaou: Yes.

The CHAIRMAN: The market is fine, but in this market structure you would not bet your house on them doing it, would you?

Mr Nicolaou: That is a fair point. I cannot comment any further than that, unfortunately.

Mr W.J. JOHNSTON: Can I explore a new issue? We have read in the papers et cetera that the gas price in the east coast of Australia is under \$4. Is that your understanding? Part of our terms of reference is the relationship to the east coast gas price.

Mr Richards: It is difficult for us to make calls on pricing. We are probably in the dark as much as the committee and other industry players in terms of how our prices compare with those on the east coast. Broadly, our understanding is that the gas prices in the east coast are lower than the gas prices in Western Australia.

Mr W.J. JOHNSTON: Do you see any consequences in the long term for Western Australia if our gas price is significantly above the east coast gas price?

Mr Nicolaou: There are risks attached to that. I hope that those price signals are strong enough that that would help underpin future developments and inevitably help drive down the prices further. There may be some short-term pain that comes with that. I am not defining “short term”; it is very unclear how long that is. If the markets were operating efficiently, I would expect that those price signals would be strong enough to underpin new developments.

The CHAIRMAN: One of the issues is that people have provided evidence of the very rapid increase in the costs of production in the north west. In fact, the argument is that Western Australia is higher than most offshore oil places. It is very much a global market. Do you have any views on that? Do you have measurements? The CCI has commented on the rising cost of construction and labour in other areas. Do you have any comments on that area?

Mr Nicolaou: Probably one of the most significant issues facing the state is addressing the challenge of a growing economy with a capacity constraint imposed on it. We are going to run into problems over time if we do not address those capacity issues that the state faces, primarily in the form of labour shortages and the associated wage costs. I think that is the most important challenge facing the state going forward, and is one that if we do not do something about it at a state government and federal government level, will have long-term consequences and may mean that very important projects do not get off the ground because the construction costs are so high.

The CHAIRMAN: Are they rising? They were very high in 2007–08 and they cooled down a bit. Are they sharply on the rise again?

Mr Nicolaou: All the anecdotal evidence, survey figures and official numbers suggest that costs are rising—in the form of wage costs primarily. I think it will accelerate through 2010–11, particularly as construction starts to ramp up on major projects in the state. It is a challenge that requires

solutions today, both at a federal and state government level, if we are to ensure that the issues of the two-speed economy do not become pervasive and crowd out other valuable, social sectors of the economy.

The CHAIRMAN: Is there trouble with bringing in 457 visa workers or workers on temporary permits? Is that getting more difficult even in the gas and oil industry?

Mr Nicolaou: Certainly that is the feedback we are getting. In the past few years we have seen a tightening of the 457 visa program in response to some demonstrated issues associated with the visa program, primarily in relation to the education sector and the issues with chefs and hairdressers et cetera. The problem is that it has gone too far. The feedback we are getting now is that it has become inflexible and unresponsive. In a period when things will ramp up very quickly, you need the supply to be able to respond as quickly as the demand will be moving. That is certainly a key policy that we continue to push at a federal government level. We need an answer now to the 457 visa program, putting to one side the permanent immigration program. The 457 visa program is about smoothing out those peaks and troughs in the economic cycle, and we are on the way towards a peak rather than a trough.

The CHAIRMAN: Slowness in Europe and North America should mean you should be able to get English-speaking tradesmen. I think the problem with the 457 visa was the concern about English language competence.

Mr Nicolaou: That certainly was a key barrier. We have articulated the issues related to the visa program in a recent report to the state government. We did that in conjunction with the Chamber of Minerals and Energy. An issue that acts as a barrier to settlement in this state in particular is the cost of living pressures that come with unaffordable housing, rent and other necessities of living that make it a real disincentive to move to Perth rather than other parts of this country.

The CHAIRMAN: Is net interstate migration picking up?

Mr Nicolaou: It is averaging around 1 000 per quarter. It is minimal. Around seven per cent of our total migration intake is people from interstate. While we continue to encourage interstate migration to resolve our labour shortage issues, it will not be the answer. We need to look at overseas migration.

The CHAIRMAN: Any questions?

Mr W.J. JOHNSTON: Can I confirm that you will get those two answers you said you would take on notice for me?

Mr Richards: Yes, the examples of domestic reservation of LNG globally.

The CHAIRMAN: Thank you for your evidence today. A transcript of this hearing will be forwarded to you for the correction of minor errors. Please make these corrections and return the transcript within 10 working days of the covering letter. If the transcript is not returned, it will be assumed to be correct. Do not make any corrections or alter your evidence. If you do, provide a supplementary submission with your transcript. Thank you very much.

Hearing concluded at 1.20 pm
