

CHAPTER 2

Economic Impact

The macroeconomic impact

2.1 The Varanus Island incident caused significant disruption to economic activity in Western Australia causing interruption to both gas and electricity supplies. As the explosion occurred in June, and gas supplies are expected to be fully restored in December, the impact would have been concentrated in the June and September quarters of 2008, with a smaller effect on the level of output in the December quarter. The impact on economic growth in the year 2008-09 will depend on the extent to which the impact on output is only temporary. (Firms who responded by bringing forward maintenance and annual leave may have higher output in late 2008 and early 2009 than if the incident had not occurred.) The Western Australian Treasury is optimistic on this, telling the committee:

...the second half of 2008-09, we would expect economic growth to be probably a little bit faster than it would have been because things will bounce back.¹

2.2 The macroeconomic impact will never be precisely known. The simultaneous impact of the global financial crisis makes it harder to attribute any economic slowdown observed in WA to the impact of the explosion. The committee has seen a number of estimates of how much the explosions weakened economic activity.

2.3 At the hearing in Perth in early October, the Western Australian Treasury told the committee they stood by their estimates from August.² These were as follows:

The June 2008 disruption in gas supplies...is expected to cost the Western Australian economy around \$2 billion in Gross State Product (GSP) terms, with roughly half of this impact in each of the June and September quarters of 2008. This translates to approximately a 0.5 percentage point reduction in estimated GSP growth in 2007-08, from 7.5% at budget-time to 7.0%.

Forecast growth in GSP in 2008-09 remains unchanged at 6.25%, although this growth will occur off a lower base as a result of the gas supply disruption (the level of economic activity for 2008-09 will be 0.2% lower than forecast at budget-time). Importantly, the impact of the disruption is expected to be temporary, evidenced by the recent return of a third of the lost production, with forecast growth in 2009-10 revised upwards to 6.25%

1 Mr Bruce Layman, Assistant Director, Economic Policy, Western Australian Department of Treasury and Finance, *Proof Committee Hansard*, 2 October 2008, p. 121.

2 Mr Michael Court, Acting Executive Director, Economic, Western Australian Department of Treasury and Finance, *Proof Committee Hansard*, 2 October 2008, p. 111.

(from 5.75% at budget-time) to account for the expected rebound from the domestic gas supply disruption.³

2.4 The then Western Australian Treasurer felt in July that 'while there is no doubt that the incident at Varanus has caused significant disruptions to particular firms, the overall health of the economy is expected to come through this disruption well.'⁴

2.5 The Reserve Bank of Australia estimated that:

Overall, the disruption is expected to result in a temporary reduction in national GDP growth of around ¼ percentage point, spread across the June and September quarters.⁵

2.6 As GDP is around a trillion dollars, a ¼ percentage point represents about \$2½ billion, so the Reserve Bank estimate is broadly consistent with that of the Western Australian Treasury.

2.7 The Chamber of Commerce and Industry of Western Australia (CCIWA) also gave estimates of the impact:

A CCI survey of WA industry estimated the gas crisis has cost business and industry \$2.4 billion in lost turnover during June and July alone...and it is likely that the flow-on effects will continue to impact the economy for some time... Some 16.6 percent of respondents indicated that their business had been directly affected by the outage, while a further 33.2 percent had been indirectly affected. Of those businesses impacted by the gas outage, their production declined by an average 30.6 percent.⁶

2.8 A much smaller impact is estimated by the Australian Attorney-General's Department and Geoscience Australia using the Critical Infrastructure Protection Modelling and Analysis Program (CIPMA) and a general equilibrium model from Monash University known as 'TERM ('The Enormous Regional Model'). They concluded:

...the impact on the Western Australian gross state product is approximately just over \$120 million in the period 2008-12. At the national level, the GDP loss from the incident is almost \$300 million or 0.03% of GDP in this period... The effects of the event appear to 'wash out' of the economy within the two years. The key message from this CIPMA analysis

3 Western Australian Department of Treasury and Finance, *2008-09 Pre-Election Financial Projections Statement, August 2008*, p. 23.

4 Hon Eric Ripper MLA, Treasurer of Western Australia, 'Economic growth expected to stabilise after gas disruption', Media Statement, 24 July 2008.

5 Reserve Bank of Australia, *Statement on Monetary Policy*, August 2008, p. 26.

6 Chamber of Commerce and Industry Western Australia, *Submission 16*, p. 2. Note that the CCI figure for lost *turnover* cannot be compared with the estimates of lost *gross state product*, which as a 'value-added' concept will necessarily be smaller.

is that the fast response and injection of investment funds rapidly returns the economy in all regions to the business as usual path.⁷

2.9 As well as methodological differences, the CIPMA team explain their smaller estimate by the fact that they are using more recent data and the economy has recovered more quickly than earlier expected.⁸

2.10 Real household consumption expenditure in Western Australia slowed significantly in the June quarter. But given that it still increased slightly in WA, whereas it fell in New South Wales, Victoria and the Australian Capital Territory, it is hard to say how much of the slowing in consumption was due to the Varanus island incident rather than national (or global) factors.⁹ September quarter data will not be available until 3 December. The monthly trend increases in nominal retail sales in WA held up quite well in the September quarter,¹⁰ which augers well for an increase in real consumption.

2.11 Real private sector gross fixed capital expenditure (i.e. investment) was very strong in Western Australia in the June quarter. On the other hand, there was a fall in imports. While weaker imports would often be interpreted as a sign of weaker domestic demand, it is implausible that the gas disruption starting in early June could have affected imports this quickly. Export volumes also fell in WA in the June quarter. As with consumption, the picture will become clearer once the September quarter data are released on 3 December.¹¹

2.12 There is no sign of a large impact on employment in Western Australia, which grew in June, July and August after a flat period in the early months of 2008. Employment in WA fell slightly in September but then grew again in October, to reach 4 per cent higher than in May. The unemployment rate declined from 3.6 per cent in May to 2.7 per cent in August and 2.2 per cent in October. This is consistent with the view expressed by business to the committee:

The skills shortage meant that most industries have been reluctant to lay off staff during the period of the gas shortages...¹²

I think the loss of employment was relatively low.¹³

7 Attorney-General's Department and Geoscience Australia, *Varanus Island Incident: Economy Wide Impact and Supply Chain Analysis*, November 2008, pp 4–5.

8 Attorney-General's Department and Geoscience Australia, *Varanus Island Incident: Economy Wide Impact and Supply Chain Analysis*, November 2008, p. 5.

9 Data from Australian Bureau of Statistics, *Australian National Accounts: National Income, Expenditure and Production*, June 2008, Cat. no. 5206.0.

10 Australian Bureau of Statistics, *Retail Trade Trends*, September 2008, Cat. no. 8501.0

11 Data in this paragraph from Australian Bureau of Statistics, *Australian National Accounts: National Income, Expenditure and Production*, June 2008, Cat. no. 5206.0. Exports and imports data only refer to international trade, not exports to and imports from other states in Australia.

12 Bunbury Wellington Economic Alliance, *Submission 2*, p. 1.

We certainly surveyed the membership to find evidence of people being stood down...and there really was not any evidence to suggest that was happening...¹⁴

2.13 However, while few workers have lost their jobs, it was reported that some have been stood down or required to take annual leave at times not to their convenience.¹⁵ It was suggested that around 2 000 workers may have been affected in the Bunbury region.¹⁶

The economic impact on industries

2.14 A model used by the Western Australian Treasury suggested:

The industries that were worst affected were the energy intensive mineral processing industries—alumina, nickel, mineral sands; those kinds of industries...Some of the tourism industries were badly affected; food, drink and tobacco, and also wood and paper products...Even though it [the model] takes into account second and third round impacts, it really is that big first round impact that dominates.¹⁷

Manufacturing

2.15 The CCIWA suggested that 'businesses operating in the manufacturing industry were hit hardest...'¹⁸

2.16 Chemical production, such as ammonium nitrate, was particularly affected, with some plants forced to close. A major food manufacturer, Vesco Foods, closed for a week.¹⁹ It was reported that brick kilns were closed down for a period, with a flow-on to construction.²⁰ Bottling operations were disrupted by a shortage of CO₂. It was reported that some Western Australian businesses with national operations replaced local product with product from the eastern states.²¹

13 Mr David Lock, Food Industry Association of Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 95.

14 Mr Reginald Howard-Smith, Chamber of Minerals and Energy of Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 106.

15 Chamber of Commerce and Industry Western Australia, *Submission 16*, p. 3.

16 Bunbury Wellington Economic Alliance, *Submission 2*, p. 2.

17 Mr Bruce Layman, Assistant Director, Economic Policy, Western Australian Department of Treasury and Finance, *Proof Committee Hansard*, 2 October 2008, p. 122.

18 Chamber of Commerce and Industry Western Australia, *Submission 16*, p. 4.

19 Food Industry Association of Western Australia, *Submission 24*, p. 2.

20 *West Australian*, 9 June 2008, p. 1; *Manjimup-Bridgetown Times*, 18 June 2008.

21 Food Industry Association of Western Australia, *Submission 24*, p. 2.

Tourism

2.17 Hotels reported that they faced difficulty getting clean linen as commercial laundries had their supply of gas cut.²² Responses included cutting back on use of linen (e.g. tablecloths) and using guest laundries within hotels to wash sheets. As gas started to become available, prices charged by commercial laundries were temporarily higher than usual. During this period hotels generally absorbed these costs rather than attempting to pass them on.²³

2.18 Some swimming pools and saunas were forced to lower temperatures, or in some cases close, and a fifth of local governments reported reducing casual staff in recreational facilities.²⁴ Tap beer was affected by CO₂ shortages.

2.19 The impact on hotels became an especially crucial issue due to the Australian Tourism Exchange being held in Perth from 14 to 20 June 2008 with over 2 000 international delegates. This raised concerns over reputational risk. However, in the event, the delegates seemed understanding of the need for some restrictions and there were no complaints.²⁵

2.20 The Australian Hotels Association (Western Australia) is particularly concerned about 'the long term effect of customer dissatisfaction, lost business and revenue opportunities and damaged business reputations'.²⁶ However, while they came close, no hotels turned away customers as a result of the gas shortage and there appear to have been no job losses at hotels or restaurants.²⁷ The majority of hotels responding to a survey said that 'customers were satisfied that the hotels were doing the best that they could'.²⁸

22 Lighthouse Beach Resort, *Submission 3*, p. 1; Western Australia Chamber of Commerce and Industry, *Submission 16*, p. 3; Tourism Western Australia, *Submission 22*, p. 1.

23 Ms Jennifer Duffecy, Tourism Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 6.

24 Mr Ian Duncan, Western Australian Local Government Association, *Proof Committee Hansard*, 2 October 2008, p. 74; Australian Hotels Association (Western Australia), *Submission 21*, p. 1.

25 Ms Jennifer Duffecy, Tourism Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 3.

26 Australian Hotels Association (Western Australia), *Submission 21*, p. 3. They reported that 68 per cent of hotels had received complaints, of which 40 per cent were blaming the hotel and its staff.

27 Ms Jennifer Duffecy, Tourism Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 9; Mr Brockschlager, Australian Hotels Association, *Proof Committee Hansard*, 2 October 2008, p. 18.

28 Ms Jennifer Duffecy, Tourism Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 5.

2.21 By the time of the committee's hearings in early October, the situation in the tourism industry was back to normal.²⁹ One benefit that arose from the shortage was that some hotels realised that there were cost savings and environmental benefits in using less linen where possible.

Mining

2.22 Some mines had to cut production due to lack of power.³⁰ According to CCIWA:

Almost 19 percent of mining sector respondents have been directly affected by the gas crisis, while a further 41 percent have been indirectly affected. On average, production among these affected businesses has declined by 26 percent.³¹

2.23 It was reported that other mining operations were disrupted by a shortage of sulphuric acid used to clean ore, or a shortage of explosives³² and the some producers brought forward maintenance.

Insurance

2.24 The Insurance Council of Australia told the committee that the impact on the insurance industry had been relatively modest:

At the present time [late October]—and I should stress that claims will continue to come in for some time—the aggregate of claims made to the general insurance industry is \$75 million. That is perhaps a smaller figure than the media have led others to believe...Seventy-five million dollars as an aggregate loss is very small if you compare this to, for example, the Longford gas disruption in Victoria some years ago.³³

2.25 The relatively small impact reflected most companies choosing not to take out business disruption insurance and in some cases policies only allowing a claim if gas supply was totally cut off rather than just reduced or subject to high deductibles.³⁴

Rural industries

2.26 Farmers were affected as fertiliser became scarce or more expensive.³⁵ It was reported that abattoirs were affected by a shortage of liquid CO₂ used for killing

29 Ms Jennifer Duffecy, Tourism Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 8.

30 Newcrest Mining, *Submission 14*, p. 1.

31 Chamber of Commerce and Industry Western Australia, *Submission 16*, p. 2.

32 *Manjimup-Bridgetown Times*, 18 June 2008.

33 Mr Karl Sullivan, *Proof Committee Hansard*, 28 October 2008, pp 2–3.

34 Mr Karl Sullivan, *Proof Committee Hansard*, 28 October 2008, pp 4–6.

pigs.³⁶ Vineyards were affected by a shortage of CO₂ for their bottling runs.³⁷ Logging operations, and associated transport companies, were disrupted as mills were forced to close.³⁸

Construction

2.27 Construction and maintenance activities were impeded by a shortage of asphalt.³⁹

Retailers

2.28 Food retailers normally selling to workers in some of the above industries who had been stood down, were indirectly affected.⁴⁰ Some shopping malls shut lifts and turned off lights to conserve energy.

Research

2.29 Research into carbon capture at Curtin University was disrupted by a shortage of dry ice, which could jeopardise its ongoing funding.⁴¹

The regional impact

2.30 Views differed about which regions of Western Australia were the most affected, although the majority view seems to be the south west:

...the failure of the marketplace to provide adequate supplies for industry was stark and caused great expense and dislocation to the south west business community and industry in particular.⁴²

Disruption was caused across the state...If there was a section of the state most severely impacted up, and it is all relative, it would be the south west.⁴³

35 Manjimup Chamber of Commerce and Industry, *Submission 4*, p. 1; Mr Kim Marino, *Submission 13*, p. 1.

36 *Farm Weekly*, 19 June 2008, pp 3–4.

37 Manjimup Chamber of Commerce and Industry, *Submission 4*, p. 1.

38 Plantation Logging Co., *Submission 7*, p. 1; Premin Holdings, *Submission 9*; M & T Cutts Haulage, *Submission 19*, p. 2.

39 Mr Ian Duncan, Western Australian Local Government Association, *Proof Committee Hansard*, 2 October 2008, p. 74.

40 Capel Takeaway, *Submission 11*, p. 1.

41 Professor Robert Amin, *Submission 1*, p. 1.

42 Mr Allan Birrell, Bunbury Chamber of Commerce and Industries, *Proof Committee Hansard*, 3 October 2008, p. 23.

43 Mr Reg Howard-Smith, Chamber of Minerals and Energy of Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 99.

...the goldfields would have been more impacted, proportionately, than the south west.⁴⁴

...impacts from the crisis were felt from the Pilbara down to the south west. I acknowledge that there were particular impacts in the south west...probably because some of the gas consumers there were significant employers and were hard-hit. Also, there were a number of companies in the Pilbara, for example, which basically shut down and, in at least one case that I am aware of, are still shut down.⁴⁵

From the local government perspective directly, I do not think that you can pick out any particular area.⁴⁶

Larger residential and light industry distribution [most affected by the crisis] includes the Bunbury, Busselton, Geraldton and Perth regions...⁴⁷

2.31 A model used by the Western Australian Treasury suggested that given which industries were most affected:

... you really look at which regions have got those industries, and the south west has the biggest share, with alumina and mineral sands. That was the worst affected area. Other than that, the incident itself had a fairly large economic impact on the Pilbara. There were also businesses in the goldfields, and obviously a lot in the Perth statistical area. There are bananas up north... It was fairly widely distributed, but the south west was quite a fair way in front in terms of regional impacts.⁴⁸

2.32 The Insurance Council, when asked the source of most claims, replied:

...predominantly from a mixture of businesses and commercial operations in the south west part of the state and around Perth. There are a reasonable proportion of claims in there from mining operations and manufacturing operations.⁴⁹

44 Mr Stuart Hohnen, DomGas Alliance, *Proof Committee Hansard*, 2 October 2008, p. 27.

45 Mr James Pearson, Chamber of Commerce and Industry of Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 46.

46 Mr Ian Duncan, Western Australian Local Government Association, *Proof Committee Hansard*, 2 October 2008, p. 80.

47 Attorney-General's Department and Geoscience Australia, *Varanus Island Incident: Economy Wide Impact and Supply Chain Analysis*, November 2008, p. 6.

48 Mr Bruce Layman, Assistant Director, Economic Policy, Western Australian Department of Treasury and Finance, *Proof Committee Hansard*, 2 October 2008, p. 122.

49 Mr Karl Sullivan, Insurance Council of Australia, *Proof Committee Hansard*, 28 October 2008, p. 2.