

EXECUTIVE SUMMARY

Arrium welcomes the Senate Economics Committee's inquiry into the future sustainability of the Australian steel industry, and we thank the committee for the opportunity to provide a submission in this regard.

The Australian steel industry is facing substantial challenges due to what is essentially a global market failure, primarily caused by the significant oversupply of steel. While a market could reasonably be expected to respond to such an oversupply by correcting itself through natural attrition, this has not occurred. This is principally due to the fact that the majority of this oversupply rests with China, which is continuing to run loss-making facilities through subsidies and other government support and relying on export markets to accept marginally-costed products.

The Australian industry is not alone in facing these challenges. Governments around the world are acting to support their steel industries, in acknowledgement of this market failure and in the belief that domestic industries offer vital economic and strategic benefits.

In our submission, Arrium will seek to outline the domestic steel industry and its importance to Australia on a number of levels. We will also examine the global steel market and its impact on Australia's industry, and what Australia without a domestic steel industry might look like. We will explore options for government action, in the context of the global activities currently taking place.

Finally, we will outline the benefits of a healthy steel industry, and the vital role it can, and is, playing in supporting innovation in Australia.

It is Arrium's view that the current and future sustainability of the Australian steel industry is in doubt and must be secured. The comments and proposals we are putting forward in this submission are based on our experiences as an Australian steelmaker with a 100-year history and an active participant in major construction and infrastructure projects around the country.

THE AUSTRALIAN STEEL INDUSTRY

OUTLINE

Steel is a key ingredient in almost all construction and infrastructure. It is vital for nation-building and essential for economic growth. The Australian industry ensures a secure, flexible and high-quality supply of steel for everything from roads and bridges to skyscrapers and units. Generally speaking, Arrium produces in line with domestic demand and does not contribute to the current global oversupply of steel.

In recent times, however, the significant global oversupply has resulted in an increasing amount of marginally costed/priced imported steel being used in Australian projects. In turn, these low-priced imports have pushed Australian prices to unsustainable lows. While Arrium and other Australian

steelmakers have taken significant steps to reduce their cost to make and sell to respond to Asian steel prices, the current situation is not sustainable and must be addressed to secure the future of our domestic industry.

The Australian industry employs approximately 90,000 people and generated \$11b in revenue in 2014-15. While these numbers may seem significant out of context, in truth annual revenue for the industry has fallen by an annualised rate of 7.5 per cent in the last five years.¹ Equally, the sales margins and return on funds from Arrium's steel business have both been negative for the past five years². Australia's share of world steel production has also fallen, from 0.8 per cent in 2000 to 0.3 per cent in 2014³. Arrium's share of the domestic market, however, is approximately 75 per cent, demonstrating the value of Arrium's quality product and service offer to the construction market.

The Australian industry is large and complex, with several broad components and many participants. The major domestic participants are BlueScope Steel and Arrium Steel, which were originally part of BHP Steel. In 2000 Arrium Steel (then known as OneSteel) was "spun out" of BHP and in 2002 the remaining businesses in BHP Steel were spun out as BlueScope Steel.

BlueScope Steel and Arrium are the only domestic producers of crude steel; that is, they are the only producers of molten steel which is then subsequently processed into steel products. Apart from the production of crude steel, the other major parts of the Australian steel industry are steel products manufacturers, steel distributors and steel recyclers: both BlueScope Steel and Arrium Steel participate in either some or all of these other parts of the Australian steel industry.

Arrium generates approximately 14,000 jobs through its activities, employs nearly 7,000 people directly, and spends nearly \$4b in goods, services and taxes each year. We produce approximately 44 per cent of the total amount of crude steel made in Australia each year, with a total steelmaking capacity of 2.6 million tonnes per annum (MTPA).

As a key player in the Australian domestic steel and construction industry, Arrium has significant concerns about the industry's future sustainability. Virtually all developed and developing countries recognise the importance of a domestic steel industry, with only Iceland, Ireland, Denmark and Estonia not producing any crude steel. It is important to note, however, that these are small countries that have access to other local, secure supply chains, primarily through the EU.

THE IMPORTANCE OF A DOMESTIC INDUSTRY

The generally recognised core reasons for maintaining a domestic industry are economic development, preservation of employment, national security and, increasingly, environmental protection. A domestic industry also provides an important mechanism for value adding to domestic mineral resources such as iron ore and coking coal, reduces the dependency on imports

¹ Deloitte Access Economics, 'Economic contribution of Arrium and steel manufacturing to Whyalla and Australia', October 2015, p 6

² Arrium Annual Report 2015, at p.31 (See: <http://www.arrium.com/~media/Arrium%20Mining%20and%20Materials/Files/ASX%20Announcements/FY2015/2015%20Annual%20Report.pdf>)

³ Deloitte Access Economics, 'Economic contribution of Arrium and steel manufacturing to Whyalla and Australia', October 2015, p 6

for the nation's infrastructure and construction needs, and develops manufacturing and innovation skills to support industrial and economic development.

It has been estimated that every dollar of steel production generates an additional gross output of \$2.30 across the wider economy.⁴

Many steelmaking facilities are located in regional centres, and form the basis for the area's economy. One example of this is Arrium's Whyalla Steelworks in South Australia, which provides jobs to 25 per cent of Whyalla's workforce and makes up 35 per cent of the town's economy⁵. These figures do not include the flow-on jobs in sectors such as education, health and hospitality, which rely on the Steelworks maintaining a core presence in the community.

A domestic industry means constructors have security in knowing the products they need will be available through a flexible, short, secure and high-quality supply chain that cannot be matched by imports, which in turn leads to lower project costs. Equally, the lack of a robust domestic industry will lessen any price pressure on imports, likely resulting in higher prices.

Issues of compliance have also been raised in relation to imported steel. An inquiry currently being undertaken into non-conforming building products by this committee has received multiple submissions outlining concerns in this area. In particular, the Australian Steel Institute's submission outlines significant examples of non-conforming or non-compliant imported products:

Observable defects such as substandard welding that needed to be ground out and replaced, laminations in plate that could cause catastrophic failure, substandard corrosion protection affecting the life of an asset and generally poor workmanship were found unfortunately to be commonplace on imported structural steelwork. There also is a price depressing effect from these imports that affects a sector of local fabricators that are forced to chase price at the expense of maintaining their quality systems and procedures. The knock-on effect is that currently many fabricators and steelwork manufacturing SMEs are unable to maintain a reasonable profit that would allow them to reinvest in their businesses.

Testing by the steel industry has also identified metallic coated and pre-painted steels that do not meet Australian Standards and regulations. Examples include substandard metallic coating and paint thicknesses and non-conforming levels of lead in paint.

The non-compliances are not limited to poor quality and bad workmanship but extend to deliberate fraudulent behaviour with examples such as falsified test certificates, welds made with silicone rubber and then painted, attachment of bolt heads with silicon rather than a through bolt and water filled tube to compensate for underweight steelwork with fraudulent claims that their products meet particular Australian Standards.⁶

⁴ BIS Shrapnel, 'The benefits of a local procurement policy for local steel in government construction', September 2015, p 11

⁵ Deloitte Access Economics, 'Economic contribution of Arrium and steel manufacturing to Whyalla and Australia', October 2015, p 16

⁶ Australian Steel Institute, *Submission to Senate Economics References Inquiry into non-conforming building products*, p 6

THE GLOBAL STEEL MARKET

OUTLINE

Many of the challenges Australian steelmakers are facing can be attributed to the current status of the global steel market. In the simplest terms, there is too much capacity and facilities are being run far below economic levels. This situation is pushing prices and margins to ten-year lows.⁷

The amount of overcapacity in the global steel market has nearly doubled since the GFC to 700mtpa. Approximately a third of this amount rests with China, due largely to Chinese Government policies that have continued to encourage increases in production even as the country's domestic demand slowed. In the last ten years, China has moved from being a net importer to a net exporter of steel, and last year its exports rose by 51 per cent to reach a total of 93.8 million tonnes. These exports total nearly as much as the entire production of Japan, the world's second biggest producer. China, as the biggest producer, accounts for over 50 per cent of the world's supply of steel.⁸

This oversupply is not being met with the expected market response – that is, a reduction in supply. It is estimated that approximately 300 to 400mtpa needs to be removed from the market to return it to its optimal utilisation rate of 85 per cent (the current rate is approximately 70 per cent). The Chinese Iron and Steel Association has estimated it will take at least ten years for this overcapacity to correct.

It is expected the most effective reduction in overcapacity will come from the closure of facilities. Although there have already been significant closures outside China (including in the US, France and UK), this has not yet resulted in meaningful reductions.

As noted by EY in their 2015-16 global steel report, while there have been commitments from the Chinese Government to reduce capacity, this is unlikely to have an impact in the short term:

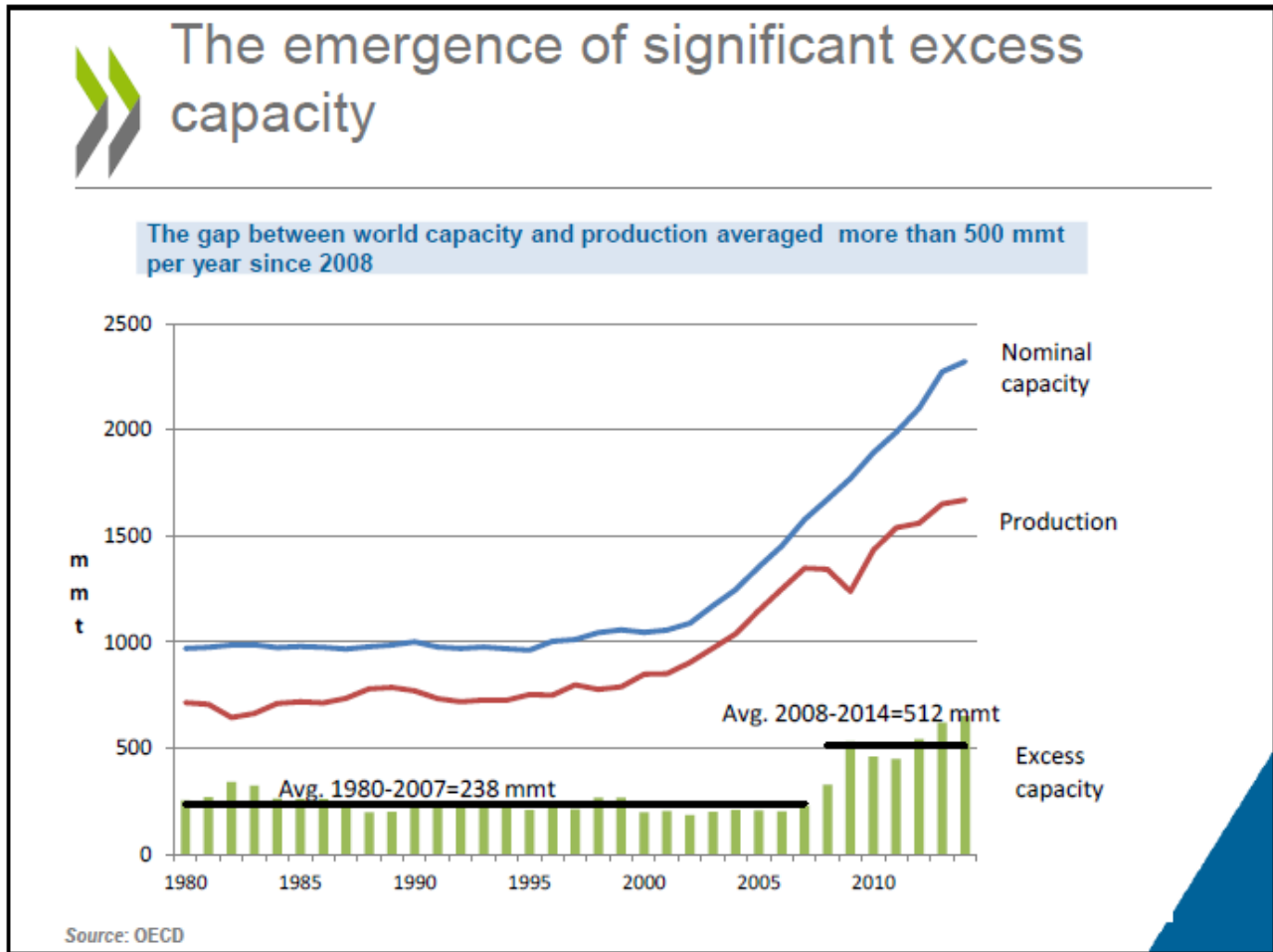
While the Chinese Government states that peak steel demand has been reached, it is our view that there is too much capacity to remove over two years to meet utilization targets. In addition, the policy gives Chinese steelmakers more time to consolidate the domestic sector with targets to achieve 60% of market share in the top 10 mega steel companies delayed to 2025. So while some capacity will be removed, it is likely that steel production will continue to increase, although perhaps not to the full extent forecast by major iron ore producers. The major iron ore producers are forecasting peak steel production at more than 1 billion tonnes in the mid-2020s and a plateau through to 2030.⁹

⁷ Deloitte Access Economics, 'Economic contribution of Arrium and steel manufacturing to Whyalla and Australia', October 2015, p 2

⁸ Deloitte Access Economics, 'Economic contribution of Arrium and steel manufacturing to Whyalla and Australia', October 2015, p 9

⁹ EY, 'Global steel 2015-2016', p 14. Available online: <http://www.ey.com/GL/en/Industries/Mining---Metals/EY-global-steel-2015-2016>

Recent data from the OECD Steel Committee also shows the emergence of excess capacity in the global market significantly exceeding the average from 2008:¹⁰



The result of this overcapacity has been an increase in exports as countries, particularly China, seek to offload steel into export markets, more often at marginal pricing. Their target markets are those with the least trade protection against such activities.

THE IMPACT OF OVERSUPPLY

The most direct impact of the current global oversupply of steel on the Australian market has been to reduce domestic margins and prices as Australian steelmakers work to compete with imported products.

¹⁰ OECD Steel Committee, 'Capacity Developments in the World Steel Industry', December 2015

One of the most common ways to deal with surplus supply is to export product that cannot be sold domestically or into traditional export markets. Typically, these new export markets are penetrated by marginally pricing the exported goods. Such marginal pricing or sales at marginal cost (that is, at a cost less than the full absorbed cost to make and sell the goods in their domestic market) is, in effect, dumping.

It is important to understand that 'marginal pricing' and dumping will not necessarily be resolved when global economic conditions improve. This is because of disparity between regional economic conditions: so long as the export economy has surplus supply and capacity, then the strategy of 'marginal pricing' will continue. The spiral of 'marginal pricing' and dumping will only end when the domestic (and traditional export) markets of the export source have restored demand and supply equilibrium, and the exporter is again motivated to return to a strategy of full cost-absorption and profit. Only then will markets previously subjected to 'marginally priced' or dumped goods be abandoned.

This is consistent with the Australian steel market's experiences as the world attempts to deal with the significant oversupply from China. Unless and until the Chinese Government deals with this oversupply, presumably by significantly reducing their capacity through facility closures, this cycle will continue.

The excess global capacity in steel and resulting increase in exports has led to a significant increase in anti-dumping and other trade measures actions since 2010, as governments around the world seek to support their domestic industries. A recent presentation from the OECD Steel Committee noted that:

- There has been a significant escalation of trade actions recently;
- Governments are increasingly resorting to trade measures in response to the crisis in the steel industry;
- Trade remedy measures have increased to historically high levels this year;
- There are many "new users" of trade remedies;
- There are a large number of safeguard cases;
- Tariff increases have also been observed recently; and
- The use of several other types of measures (localisation and trade finance measures) has become apparent.¹¹

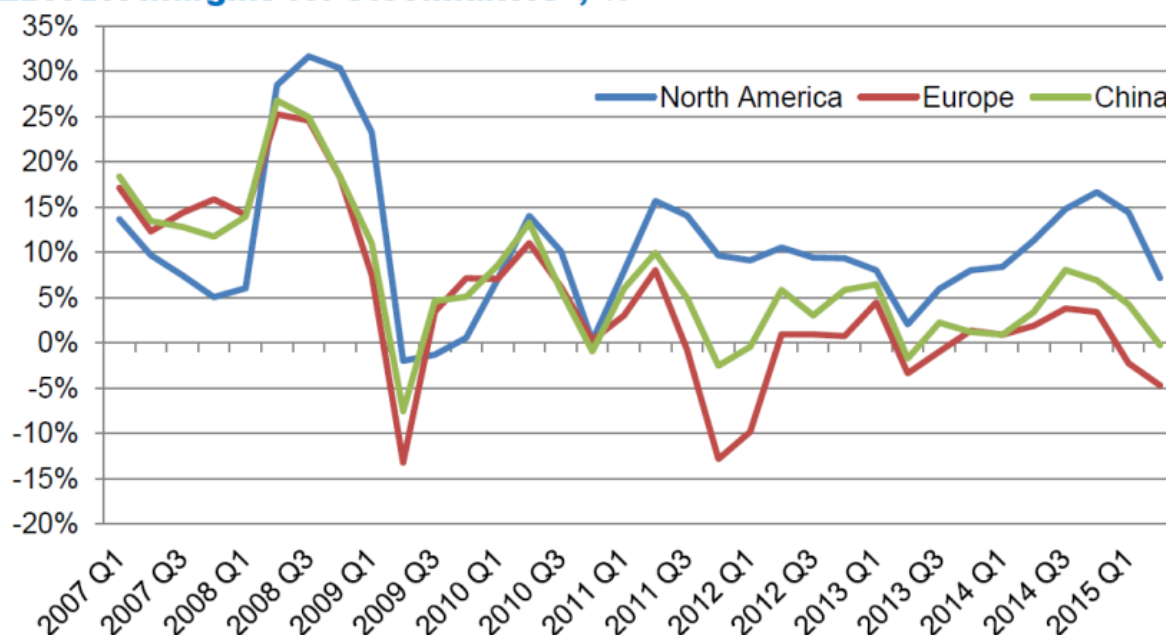
The presentation concluded that addressing the root causes of trade actions is now a priority.¹²

This oversupply has also forced steelmakers' margins to significant lows. In turn, this is impacting on profitability as steelmakers attempt to compete against marginally priced goods. The minimum global average margin required for long-term sustainability is estimated at 17 per cent, but steelmakers' EBITDA margins are currently in the range of -5 per cent to +7.5 per cent.

¹¹ OECD Steel Committee, 'Monitoring report on trade policies', December 2015

¹² Ibid

EBITDA margins for steelmakers*, %



Data: CRU Steel Costs Review. *Note: CRU estimate. Analysis based on the modelling of 4 mills in the US Midwest, 3 mills in Europe and 3 mills in China. EBITDA margin is based on mills selling 50% of their material to contract buyers and 50% on the spot market.

ARRIUM'S EFFORTS TO ADDRESS THE GLOBAL CHALLENGES

In spite of this global situation, Arrium has continued to supply reliable, quality-conforming products to the Australian industry, with a focus on providing the right product at the right place at the right time. Arrium has worked to maintain competitive pricing, even though this is marked against products that are likely dumped. To achieve this, since 2009 we have reduced our total delivered cost of steel per tonne by 24 per cent after inflation, as well as improving productivity and reducing margins wherever possible.

Overall, Arrium achieved an annualised cost base reduction of \$40m in 2014-15.¹³ Over the last five years, Arrium's steel business has been radically restructuring to improve efficiency, and has done so while producing a greater amount of steel than we produced five years ago. This can be seen from the following key indicators¹⁴:

¹³ Deloitte Access Economics, 'Economic contribution of Arrium and steel manufacturing to Whyalla and Australia', October 2015, p 11

¹⁴ Arrium Annual Report 2015, at p.31 (See: <http://www.arrium.com/~media/Arrium%20Mining%20and%20Materials/Files/ASX%20Announcements/FY2015/2015%20Annual%20Report.pdf>)

Arrium Limited
ABN 63 004 410 833

Level 40, 259 George St, Sydney NSW 2000
GPO Box 536, Sydney NSW 2000, Australia

P +61 2 9239 6666
F +61 2 9251-3042



	FY11	FY15
Employees	6,922	4,880
Steel produced	1.92MT	2.00MT

Equally, Arrium's mix of Electric Arc Furnaces (EAFs) in NSW and Victoria and the blast furnace at Whyalla means that we can balance production, increasing or reducing the use of the EAFs to compensate for the fact that the blast furnace must continually run at close to total capacity.¹⁵

Further, Arrium has identified a cost reduction and efficiency target of \$100m for our Whyalla operations for the 2016 financial year. To date, approximately \$100m of this has been identified, and unfortunately has included approximately 200 job losses, with an additional 50 losses likely from contractors. The continued deterioration of the market, however, has now increased the required target to \$160m.

Despite these significant efforts, Arrium cannot continue with the status quo. Similar pressures have been felt by BlueScope, Australia's other primary steelmaker, who last year raised the likelihood of closure for their Pt Kembla steelworks without Government assistance.

In short, Australia's domestic industry – like steel industries around the world – is under significant pressure due to a global situation that has been created largely by non-market forces and is accordingly beyond our control.

A FAILED MARKET

Many of the current challenges facing the global steel industry are the result of a failure of market forces. In short, it would be reasonable to expect that the significant overcapacity would be addressed through a natural reduction in supply as steel prices drop. Instead, the Chinese industry has become almost 'too big to fail', and government subsidies and other payments mean facilities stay open and continue to produce. The excess steel that is not used domestically then makes its way into export markets, as discussed above.

It is important to note the distinctions between Australia (and the domestic industries of many other countries) and China in this regard, particularly in relation to the impact of any government involvement.

Arrium's production, and Australia's production generally, is closely linked to domestic demand. Arrium does not export any material amounts of steel, and does not contribute to the global oversupply. As such, Australian Government involvement would occur with the aim of supporting the domestic industry through the current period, and would not work against the need to reduce global supply. Australia also produces, in total, approximately 5mtpa, compared to China, whose exports alone total approximately 94mtpa, making us only a small part of the global picture.

¹⁵ The structure of a blast furnace, which burns coke or other fuel to smelt iron ore, means that it must run at full capacity once started, often operating for 20 years. EAFs, on the other hand, use electric current to melt scrap, and can be ramped up or down as required.

It is this failure of the market to correct itself that makes the steel industry worthy of special consideration. Market responses to this situation have been, to date, largely ineffective and governments are now taking a more interventionist approach.

IF NOT STEEL, THEN WHAT?

OUTLINE

As has already been outlined in this submission, the Australian steel industry is a significant economic contributor to Australia, both directly and through facilitating infrastructure and construction projects, which bring their own economic benefits.

It is Arrium's view that the future sustainability of the Australian industry is under threat. It is therefore reasonable to consider what Australia without a steel industry might look like, and what impacts that might have.

The risks to the economy from not having a domestic steel industry are great, given the criticality of steel to domestic growth, and in particular construction and infrastructure. The case that imports are or could be a permanent alternative to a domestic steel industry is misconceived; in truth, they complement each other and the absence of either would be to the great detriment of Australia's national interests. Potential risks from not having a domestic steel industry include:

- The closure of large manufacturing facilities;
- The replacement of the domestic supply option with longer, and riskier (and potentially more costly) supply chains;
- A distorted allocation of Australian productive capacity and potential;
- Lost economic development opportunities;
- Serious and irreplaceable loss of generally well paid and highly productive jobs;
- Heightened risks and costs for infrastructure and construction activity; and
- A disproportionate structural and economic impact on regional Australia if the steel industry exits.

ECONOMIC IMPACTS

The continuation of the status quo will, from Arrium's point of view, almost certainly result in the closure of steelmaking facilities in Australia. It is simply not sustainable, given the current low margins and prices and the ongoing pressure from cheap imports, for Australian steelmakers to continue to operate as they are.

The most immediate impact will be on both jobs and the domestic supply chain. A complete shutdown scenario, where Australia makes no steel at all domestically, would result in the loss of

5m tonnes of steel production and up to 10,000 jobs. In turn, \$10b would be lost from real GDP, along with a reduction in taxation revenue to state and federal governments.¹⁶

REGIONAL IMPACTS

The impact on regional areas would also require significant government expenditure on bailout packages.¹⁷ As noted earlier in this submission, Arrium's Steelworks in Whyalla, South Australia, employs 25 per cent of the town's workforce and makes up 35 per cent of its economy. The presence of the Steelworks also provides indirect benefits: other sectors, such as education, health, hospitality and tourism rely on the population base the Steelworks provides.¹⁸ This base also ensures access to a level of services from governments (including schools and healthcare) that generally do not exist in nearby, lower-population towns.

The impact of a closure on a region such as Whyalla will be significant. It is highly unlikely steelmaking jobs would be replaced with a similar number of high-value jobs in an equivalent industry. This would result in higher levels of unemployment and a significant population drop, leading to poorer socio-economic outcomes that would properly need to be addressed by governments.

INDUSTRY IMPACTS

Further, even a partial shut-down scenario in the industry will have significant impacts on the domestic supply chain, as both governments and private enterprise will be forced to import products. This will mean a longer, lower quality and less flexible supply chain, increasing overall project costs and timelines. There will also be heightened risks for infrastructure and construction activity, making them less attractive forms of investment which, in turn, will mean Australia will miss out on the economic and social benefits such projects provide.

It is highly unlikely a similar sector would evolve to replace the loss of 10,000 plus jobs in the steel industry that would result from a closure of the domestic industry, potentially leaving thousands of people subject to long-term unemployment. It should be noted that the areas of current investment, including technology, start-ups and the service industry, are unlikely to be able to provide employment for retrenched steelworkers.

Arrium is not advocating for an unchanged steel industry and a continuation of the status quo. We believe a healthy steel industry can, with proper planning and investment, make significant contributions in terms of innovation and technology.

¹⁶ BIS Shrapnel, 'The benefits of a local procurement policy for local steel in government construction', September 2015, p ii

¹⁷ BIS Shrapnel, 'The benefits of a local procurement policy for local steel in government construction', September 2015, p ii

¹⁸ CRU, 'Review of national steel industry support mechanisms', October 2015, p 29

THE ROLE OF GOVERNMENTS

OUTLINE

Governments around the world, many of whom face fewer structural and supply risks than Australia, are taking action to protect their domestic industries against the current global situation. Generally, these measures are either trade measures (such as anti-dumping and countervailing duties on imports) or direct policy measures (such as local content and procurement policies). Other governments are offering direct support, often through measures such as subsidies for energy costs (such as in the United Kingdom) or payroll tax relief (NSW Government).

TRADE MEASURES

Anti-dumping duties are one of the most common measures, and the number of cases being brought forward is at an all-time high. Around the world, there have been 20 new trade measures implemented each year in recent years, most of which are anti-dumping measures.¹⁹

Since 2008, China has been the main target of implemented trade steel measures introduced by many countries. Of the 135 measures implemented by countries other than Australia, 74 are related to Chinese products and 31 target China exclusively. Australia has also placed itself at a significant disadvantage to other countries by recognising China as a market economy – one of only three developed countries to do so²⁰. Countries that recognise China as a non-market economy can generally apply higher anti-dumping tariffs under WTO rules. The possible removal of China's non-market status by the WTO in 2016 has raised significant concerns from member countries.²¹

Since 2010 there has been an increase in global anti-dumping activity which has been reflected in an increase in Australian cases. The increase in anti-dumping activity has largely been caused by slowing rates of global economic growth, resulting in supply exceeding demand.

The WTO does not prohibit dumping, but allows member countries to establish anti-dumping measures against exporters if goods have been found to have been dumped. These usually take the form of duties on imports, but countries may also establish safeguard measures if there has been a surge in imports that is causing serious harm to domestic industry.

The key aspects for successful trade measures are generally considered to be speed, duration, whether China is considered a market economy, and whether multiple support measures are used. As outlined below, Australia's anti-dumping and countervailing measures are generally among the shortest in the world, with some of the lowest margin rates. This makes Australia's measures less

¹⁹ CRU, 'Review of national steel industry support mechanisms', October 2015, p 3

²⁰ The three developed countries that recognise China as a market economy are Australia, New Zealand and Switzerland.

²¹ Ibid

supportive of the domestic industry relative to other countries, and places the steel industry at a disadvantage.

Table 2.1: Summary Table for Antidumping and Countervailing Duties Measures¹⁰

Implementing jurisdiction	Number of measures	Duration (years)	Speed of implementation (months)	Anti Dumping margin rates	Countervailing duty margin rates
USA	28	14.8	1.26	44.83 - 71.6	44.37 - 210.89
EU	17	5.3	5.16	27.01 - 35.91	1.51 - 18.07
Canada	7	6.8	2	28.12 - 58.17	
Australia	6	1.4	4.64	8.37 - 17.79	19.55 - 54.8
Brazil US\$/TON	11	2.0	6.75	378.04 - 616.83	
Thailand	9	8.2	7	12.19 - 29.99	
Malaysia	2	2.0	4	5.99 - 28.58	
India	5	4.3	5.76	23.67 - 40	
Indonesia	9	4.2	NA	9.85 - 21.72	
Turkey US\$/TON	4	6.5	NA	374.75 - 400	
China	2	2.0	5	11.38 - 14	

Data: CRU

It is worth noting that steelmakers in the United States have relatively high margins compared to the rest of the world, and these have not been eroded by imports. They also face a relatively small amount of imports from China. It is likely the healthier margins in the US are because domestic steelmakers there have been successful in getting anti-dumping measures in place.²² The US also has some of the highest anti-dumping and countervailing rates, as well as the shortest average time period for implementation. All of these factors work together in supporting US domestic producers.

Successive Australian Governments have maintained a policy of absolute free trade, in the belief that the benefits of such a policy would outweigh any costs to local industry. The Australian Government's position of aiming to be beyond reproach within the WTO has put our domestic steel industry at a disadvantage to those in other countries, where governments take a more flexible approach to implementing trade measures.

Countries are also seeking to apply safeguard measures in increasing numbers. Safeguard measures are generally considered to be emergency actions, and allow a country to restrict imports to protect a specific domestic industry if those imports are causing, or threatening to cause, serious injury.

Over the last four and half years, 35 per cent of all safeguard measures worldwide have been in the 'metals and metal products' sector. In our own region, ASEAN countries with safeguard provisions in place for steel products include Thailand, Indonesia, Malaysia and the Philippines.

²² CRU, 'Review of national steel industry support mechanisms', October 2015, p 39

CHINA AS A MARKET ECONOMY

The designation of China as a market economy by the WTO, which is part of China's accession to the WTO and is due to occur in December 2016, has become highly controversial for steelmaking countries. As discussed above, how a country designates China has significant impacts for its anti-dumping and other trade measures.

The most significant outcome from such a designation would be that investigators would no longer be able to use market economy prices (such as those of the US or EU) to determine whether China is dumping. Instead, they would be required to accept Chinese prices, which may be unreliable. In Australia, we have seen this designation lead to anti-dumping duties that are lower and of a shorter designation than those applied in countries where duties are based on US or EU pricing.

The upcoming decision has become so contentious that it has led to large-scale protests from steelmaking countries. Most recently, industries in the European Union mobilised 4,500 people for a protest march in Brussels with the aim of influencing EU policymakers to reject the move. The main concern for steelmakers and other industries is the impact the change in designation will have on anti-dumping policies, with manufacturers such as Thyssen Krupp and Arcelor Mittal expressing their concern.²³

A report into the potential impacts was commissioned by six steel industry groups (the American Iron and Steel Institute; the Steel Manufacturers Association; the Specialty Steel Industry of North America; the Committee on Pipe and Tube Imports; the Canadian Steel Producers Association; and Mexican Iron and Steel Producers' Association) and authored by economists from Capital Trade, Washington; the Centre for Spatial Economics, Milton, Ontario; and the Mexican Institute for Competitiveness, Mexico City.

The report found that the impact on the US could be a decline in steel output of approximately US\$21.1 billion and a contraction of US\$40.2 to US\$46.5 billion in economic welfare. It also found that Canadian gross domestic product could permanently reduce by C\$8 billion across a range of sectors.²⁴

Further, these declines could lead to 400,000 to 600,000 fewer jobs in the USA and the loss of up to 60,000 highly skilled jobs in Canada.²⁵

Australia formally recognised China as a market economy in 2005. It is likely Australia's designation of China impacts on our ability to establish more material anti-dumping duties, and disadvantages Australian industry when compared to other countries in the WTO.

²³ Steams, Jonathan 'China trade threat prompts EU protest', *Australian Financial Review*, 17 February 2016, p 13

²⁴ Steel First, 'Market economy status for China will devastate US steel sector', 12 November 2015

²⁵ Ibid

LOCAL CONTENT AND PROCUREMENT

Governments are also taking a role in supporting domestic industries through the implementation of local content and/or procurement policies. The United States has measures in this area in place since 1933 (The Buy American Act), which includes a specific, stricter requirement for Defence purchases (Berry Amendment). Canada also has the Agreement on Internal Trade, which relates to trade between different provinces. It provides for preference for Canadian goods either through favourable weighting criteria or through limiting tender to Canadian suppliers.²⁶

Australia also has two excellent examples of local content and procurement policies in practice, in South Australia and Victoria.

The South Australian Government, for example, has a specific Industry Participation Policy that applies to all expenditure over \$22,000. In these cases, the Government must determine whether there is a business in the state or region that can deliver the product or service, and that there is a minimum of one business in the state or region quoting for the work.²⁷ The South Australian Government also recently announced that all SA Government projects will be required to use steel that meets Australian Standards and certification.²⁸

The Victorian Government similarly has had the Victorian Industry Participation Policy (VIPP) in place since 2003. The VIPP applies to contracts valued at \$1m or more in regional Victoria, and \$3m or more for metropolitan Melbourne or state-wide activities, and requires consideration of local suppliers when fulfilling contracts.

The VIPP also identifies Strategic Projects (those valued at \$50m or more). Bidders for these projects are encouraged to seek out goods and services from local suppliers.²⁹

THE NEED FOR AUSTRALIAN GOVERNMENT INVOLVEMENT

OUTLINE

It is Arrium's view that Australian governments at all levels must work together to ensure the immediate future of Australia's domestic steel industry. There are a number of measures we believe governments can implement, but most important in our view is the need for an overarching steel industry policy at the federal level.

²⁶ BIS Shrapnel, 'The benefits of a local procurement policy for local steel in government construction', September 2015, p 18

²⁷ South Australian Industry Participation Policy, available online: <http://www.industryadvocate.sa.gov.au/industry-participation-policy>

²⁸ Treasurer Tom Koutsantonis Media Release, 25 November 2015, available online: http://www.premier.sa.gov.au/images/news_releases/2015/15_11Nov/steeltaskforce.pdf

²⁹ Victorian Industry Participation Policy, available online: <http://dsdbi.vic.gov.au/our-department/strategies-and-initiatives/victorian-industry-participation-policy>

THE NEED FOR POLICY

One of the greatest challenges facing the steel industry in Australia is a lack of clarity regarding the Federal Government's position on whether it believes the domestic industry should continue. Arrium understands and acknowledges the Coalition Government's policy in relation to direct subsidies for corporations, but there are a number of measures the Government can implement to put the Australian industry on a level playing field with other countries.

It is Arrium's view that a clear and public statement of intention from the Federal Government about their position in relation to the steel industry is vital. This statement of intention should then form the basis for policy and decision-making in a number of areas, including trade measures, procurement, workplace relations, taxation and environmental law. It should also drive the formation of short term initiatives to secure the immediate future of the steel industry, as well as medium to long term structural adjustment measures to maintain a healthy, growing industry.

Such a clear, comprehensive approach to the challenges facing the Australian steel industry will also help in the decision-making process for steelmakers; if we clearly understand the Government's intention, we can better undertake planning for the future.

TRADE MEASURES

In Australia, the issue of trade measures rests with the Federal Government, primarily through the Department of Industry and the Anti-Dumping Commission. Arrium acknowledges the significant changes that have occurred in the anti-dumping system over the last several years, which have been driven by successive governments and have led to marked improvements. There are, however, further ways to ensure Australia has a world-leading anti-dumping system.

In Australia, the two key factors for the Anti-Dumping Commission to consider whether goods have been dumped are: firstly, whether they are being sold at below the price in their domestic market and, secondly, whether material harm has been caused to Australian manufacturers by these imports.

It is important to understand the context in which Australian producers and manufacturers operate. Australian markets are among the most open, and therefore the most competitive in the world. There are minimal to no tariffs on imported goods, which makes it a very attractive market for exporters. Australian manufacturers and producers need to be able to compete with these imports on price, even though the cost bases may be significantly different. Australian companies, for example, are subject to certain costs including workplace relations and environmental laws, as well as payroll tax, to which many importers are not.³⁰

If left unchecked, dumped and subsidised goods are a threat to the sustainability of Australian domestic markets in the medium to long term.

³⁰ The Australian annual weighted median of other consumer price measures have remained below 3% since the period year-ending September 2011 (Source: ABS Cat No 6401.0)

In the medium term, the sustained price undercutting that results from dumping, as domestic producers attempt to compete with dumped imports, impacts on the market in the following ways:

- Exporters dealing in non-dumped and non-subsidised goods exit the market in favour of other, more profitable options;
- Importers of non-dumped and non-subsidised goods begin to reduce their investment in the current market, and do not look to increase or improve supply chains; and
- Local Australian producers suffer financial injury from the dumping, which means they lose the capacity to invest in improvements, expansion, productivity and associated developments.

In the longer term, the above factors become more entrenched and lead to further negative outcomes:

- Exporters dealing in non-dumped and non-subsidised goods do not enter or invest in the domestic market due to risk of damage by dumped products;
- Importers of non-dumped, non-subsidised goods exit the market as they lose return on their investment and the capacity for improvement or expansion;
- Local Australian producers exit because of financial injury and the inability to attract or retain capital due to low returns on investment, resulting in significant job losses and poorer economic outcomes;
- The loss of future investment in rebuilding domestic production due to the risk of recurrent dumping; and
- The loss of competition in the market, usually resulting in higher prices and poorer outcomes for consumers.

In essence, any short-term benefits in terms of lower prices are lost in the medium to longer term if the issues are not addressed.

Dumped goods also impact on investment in areas such as distribution networks (including infrastructure that supports local, flexible supply chains), quality assurance, innovation, compliance, and safety and liability issues.

Importers of dumped and/or subsidised goods engage in 'rent seeking' behaviour, in that they benefit from market infrastructure without having to bear the costs of maintenance or investment. As such, dumping and subsidised goods cause harm on a number of levels, and must be addressed to ensure the fair and efficient operation of Australian markets.

There have been significant improvements to Australia's anti-dumping system over the past several years, and it is now a generally fair system. There are, however, further reforms that would continue to support the creation of competitive and sustainable markets in Australia.

Arrium has identified the following areas for development:

- Form of measures.
 - In the case of high fixed cost commodity products (such as those produced by the global steel industry), the “ad valorem” measure is not the most effective measure, as the exporter has the ability and incentive to absorb the dumping margin, lower prices and continue to cause material injury to the Australian Industry.
- Anti-circumvention framework – opportunities to strengthen the system.
 - The language of the anti-circumvention provisions is being literally interpreted with unintended limitations being place on their powers to remedy circumvention activities.
- Rationalising ‘exemption to measures’ processes.
 - Arrium notes that exemption applications under the Dumping Duty Act are growing in number and statistically is the Commission’s fastest growing form of inquiry. This is absorbing both the Commission’s and industries’ resources that should otherwise be deployed in higher risk areas for domestic industries, such as investigation and compliance monitoring.
- Whole of government approach to anti-dumping system – improving compliance with tariff classification and Dumping and Countervailing Duty Notices.
 - Our experience following our request for a like goods inquiry is that Border Protection is disengaged from the dumping compliance framework.
- If Lesser Duty Rule applied, then level of profit should be based on a sustainable rate of return for industry reinvestment.
 - A reduction in the dumping duty rate by any amount less than the full rate of dumping continues to impact both the Australian industry and legitimate exporters of undumped goods.
- Retrospective measures for importers who frequently import dumped goods.
 - Importers have no disincentive to country hop and move to new sources of dumped exports. Our experience is that the same importers are subject to subsequent investigations concerning different countries for goods subject to measures.
- Ability to impose measures on different models (Pan Asia).
 - Practice of the Commission to calculate a single product margin following the PanAsia decision is diluting the weighted average duty rates.

Arrium submits that Australia’s anti-dumping system is worthy of ongoing whole-of-Government support and improvement, as it has the capacity to sustain both broader economic, and microeconomic market objectives.

LOCAL CONTENT AND PROCUREMENT

Local content and procurement policies are generally the purview of the states and territories in Australia, with South Australia and Victoria leading the way in this regard. Involvement from other states and leadership from the Federal Government would be of significant benefit to Australian steelmakers. In particular, Arrium notes that the significant federal funding provided to state infrastructure projects provides an ideal avenue for Federal Government involvement and leadership in this issue.

BIS Shrapnel has estimated that a 90 per cent local steel content plan would add a cumulative \$1.3b to real GDP over the next five years, and only cost an average of \$61 to \$80m annually, or an extra 0.2 per cent of total construction costs for public projects.³¹

Arrium understands the concerns on the part of the Federal Government regarding potential breaches of the WTO rulings in relation to local content. It is worth noting, however, the existing schemes in the US and Canada, among others, which manage to work within this context. Indeed, the *Australian Jobs Act 2013* already requires the preparation of Australian Industry Participation plans (AIPs) for major projects (defined as projects with an expenditure greater than \$500m). It is Arrium's view that the Federal Government could take a more active auditing role in ensuring the formation and compliance with AIPs for major projects. The application of this legislation could also be broadened to include a wide range of projects. There is also the capacity for the Federal Government to take on a leadership role with the states in encouraging the formation and use of local content and procurement policies.

Ultimately, all levels of government in Australia need to work together to secure the future of the Australian steel industry. While improvement in the areas of trade measures and local content and procurement are important and will assist in strengthening the industry, without an overarching policy statement from the Federal Government the current patchwork approach will continue, with potentially negative results.

THE CASE FOR ACTION

OUTLINE

Arrium's aim in providing a submission to this inquiry is two-fold: to secure the immediate future of the Australian industry, and to make the argument for its longer term future.

Arrium is concerned that there is a view that steelmaking is an 'old-fashioned', 'low-tech', 'mature' or 'dirty' industry. This is very far from the truth.

³¹ BIS Shrapnel, 'The benefits of a local procurement policy for local steel in government construction', September 2015, p i

THE BACKBONE OF INNOVATION

In reality, steel is the backbone of every innovative and modern economy in the world. The reasons for this are subtle but nonetheless compelling, and need to be clearly understood.

The world is now more open and competitive than ever before. Innovation is critical, but innovation can take many forms. While completely new products (and services) are obviously one form of innovation, making existing products (and services) better, quicker or cheaper is also key, and perhaps the most important in a globalised world. Steel is, directly or indirectly, a vital building block for every manufactured product.

Innovations in the supply of steel are therefore a comparative advantage for the economy that develops them, and a disadvantage for the economy that doesn't. Of course, without a domestic steel industry there will be no opportunity for innovation in the supply of steel, and so innovation at its most essential level will be permanently stifled. Some areas of interest for further innovation include:

- Supply chain innovation for steel products, such as "just in time" inventory management, can dramatically improve the working capital profile of manufacturers that either make or use steel products, which in turn reduces their costs and improves their ability to compete on price.
- Subtle, innovative changes in the chemistry of steel made in Australia can lead to significant improvements in the performance of downstream steel products.
- Process innovation can dramatically improve the use of energy, water and recycled materials, thereby improving both the sustainability and viability not only of the steel industry, but of associated industries.
- Product design innovation, which increases speed and reduces cost of construction activity. One example is BAMTEC, which has developed the use of 'carpets' of reinforcing bar, which can be rolled out to speed up construction.

Steel, and particularly steel long products, are also vital building blocks for construction. Without a domestic industry, building the schools of the future, environmentally friendly high-rises, medical research centres, solar farms and high-speed rail will become more costly and complex.

STEEL-SUPPORTED INNOVATION

It is a fact that steelmaking must constantly evolve. To this end, Arrium has formed significant partnerships with universities and other research centres, and collaborates on a number of research projects, education programs, academic articles and information-sharing events.

A particular focus for many of these collaborations is energy efficiency and reducing reliance on fossil fuels. One example, between the University of New South Wales (UNSW) and Arrium OneSteel (OneSteel), considered the use of alternate carbon sources in Electric Arc Furnaces to reduce emissions and consumption of traditional fuels such as coke and natural gas. This project considered whether end-of-life rubber tyres and post-consumer plastics could be an acceptable substitute, as they are not only a good source of carbon but their use in steelmaking provides a possible solution to the environmental challenge of disposing of these waste materials.

In close co-operation with the UNSW, OneSteel developed and commercialised Polymer Injection Technology (PIT), which enables EAFs to inject a blend of coke and rubber in place of pure coke, resulting in improved furnace efficiency. OneSteel has been using PIT as a standard practice since 2008 at its Sydney Steel Mill and Laverton Steel Mill in more than 84,000 heats, consuming over 2.4 million recycled tyres in the process. PIT has been granted patent protection in most major industrial countries.

It is also an example of leading edge steelmaking technology being exported to the world. Since 2011, the technology has been licensed, and implemented, in steel plants in Thailand, UK, South Korea and Norway, and OneSteel is in negotiations to license the technology in many other plants in Europe, the Americas, the Middle East and Asia. The technology provides a significant market for used tyres, with many countries listing stockpiles of end of life tyres as a significant environmental issue. It also provides cost reductions and environmental benefits to the world steel industry.

Essentially, this project has provided innovative technology that reduces electrical energy consumption, reduces CO2 emissions, and replaces conventional fossil fuels with recycled materials diverted from landfill.

It is most important to note, however, that the existence of a domestic steel industry was a key factor in developing this technology. While UNSW was able to conduct laboratory testing and research, the collaboration with OneSteel allowed for industrial testing and eventual commercialisation. Without a domestic steel industry, the progression of UNSW research would have proved far more complicated, and Australia would not have received the initial benefit.

This project is only one of many in which Arrium is participating. While many of these focus on efficiency and environmental outcomes, others also consider social benefits.

Arrium is also the Steel Industry Partner in the Australian Research Council Training Centre for Advanced Manufacturing of Prefabricated Housing, based at the University of Melbourne. The Centre aims to unlock the potential for growth of Australia's prefabricated building industry, and has been established to create a \$15 billion prefabricated housing sector in Australia within five years. The potential economic, employment and social outcomes from this venture are considerable, and again facilitated by the presence of a domestic steel industry in Australia.

These are only two of the many projects on which Arrium is collaborating. Despite the challenges facing the domestic industry, we recognise the need to push for new and innovative outcomes so that steelmaking in Australia can continue to transform. While the domestic industry has not stagnated from a technology point of view, its further contraction or even absence will certainly limit research, development and innovation in these areas.

AUSTRALIAN STEEL INTO THE FUTURE

Securing the future of the steel industry will not only have economic benefits for Australia, but will also enable Australian steelmakers to continue to improve and evolve. The Coalition Government has been very clear about its intention to make Australia an 'innovation nation', and a healthy domestic industry can both facilitate and participate in this bright future.

The lack of a domestic industry will have very real implications for Australia's research and development capacity. While there may no longer be a place for the stereotypical 'old-fashioned' steel industry, we are continually evolving to ensure we keep pace with Australia's, and the world's, development.

CONCLUSION

A domestic steel industry is vital to Australia on a number of levels. It delivers significant economic and strategic benefits, and supports a flexible supply chain providing high-quality products for major infrastructure and construction projects.

Further, a healthy domestic industry will continue to play a vital role in collaborating on innovative projects that have significant economic, environmental and social benefits. The presence of a domestic industry is an important factor in developing commercial and industrial outcomes from these projects, as has already been demonstrated.

Ultimately, without a domestic steel industry there is a lot for Australia to lose, and very little to gain. Australia must take urgent and significant steps to support the steel industry in the current challenging environment, to secure its future sustainability and the benefits that will continue to bring.

ⁱ "Fundamentally China lacks natural advantages for steelmaking" - see Warrian, "The importance of steel manufacturing to Canada - A research study" (May 2010), http://canadiansteel.ca/media/supporting_documentation/Warrian_Report_Final_Version.pdf, at p.88 (and also at p.11).