Committee Secretary,
Senate Economics Reference Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Inquiry into the Future of Australia's Steel Industry

1. **Introduction:**

We are writing in response to the Senate Economics Reference Committee's inquiry into the future of the Australian Steel Industry.

Key points of this submission are:

- Consideration of the future of the Australian Steel Industry benefits from an understanding of its past.
- Whilst the Australian Steel Industry is often associated with raw steel production, the vast majority of Australian steel related jobs are in downstream manufacturing and value adding.
- The future viability and international competitiveness of Australia's steel industry is best served by Government policy that does not seek to `pick winners' but rather provides a competitive framework that fosters critical mass in thin market sectors, productivity, innovation and investment.

2. **Background**

At the turn of the twentieth century the demand for steel increased as railways and manufacturing industries expanded, and Australia's first modern blast furnace went into production at Eskbank near Lithgow, NSW. In 1915 BHP opened a steelworks in Newcastle, fuelled by coke from local coal and processing iron ore mined in South Australia. Other steelworks opened at Port Kembla, New South Wales, in 1921 and Whyalla, South Australia, in 1938.

After World War II, there was further requirement for steel and steady growth was seen in Australian steel production, from 4.6 million tonnes in 1963 to 10 million tonnes in 1981. During this period sheet steel was in demand as a material for manufacturing motor vehicles and domestic appliances. Steel pipes were required for infrastructure projects and for agricultural applications such as cattle panels and Australia's building industry used steel products as structural components and roofing materials.

By the 1980s an excess of production of steel around the world forced changes in the Australian steel production[i].

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As the volumes of iron and steel produced in Australia fell, the steel producers embarked on an ambitious program to increase productivity in Australian mills.

From the mid 1980s Australian steel producers introduced significant changes in the industry's structure. They rationalised their operations by closing inefficient production sites and adopted innovative practices and technologies to ensure that the local steel product remained competitive in terms of both quality and price.

2.1: Button Plan 1983

The Industry Assistance Commission reported in May 1983 that the industry had lost competiveness because of wage increases and declining productivity, with both raw steel production and BHP's steel workforce falling by around 25 per cent in a year. The IAC commissioners were divided over remedies, the majority recommending an end to temporary assistance and a continued phasing out of tariffs, while the minority argued for volume-based tariff quotas for 10 years. Hawke's Industry Minister Senator John Button persuaded Cabinet to endorse a steel development plan which would provide bounties for five years to retain between 80 and 90 per cent of the domestic market for local producers. In return, the unions gave undertakings on work practices and improved productivity, and BHP committed in principle to $800 million of new investment. Button also made a general submission on industry policy to Cabinet in September 1983. He identified long-standing structural weaknesses in Australian manufacturing, including inefficiently small and scattered plants, entrenched union and management attitudes, high wage costs and inadequate investment in training and research.[ii]

The assistance provided by the Button Steel Plan was utilised for capital investment in industry reform and modernisation including the full conversion to `continuous slab casting' which brought BHP Steel in line with world best practice.

2.2 BHP Steel Spin Offs Early 2000s / Strategy

2.2.1 Bluescope Steel

BlueScope is a flat product steel producer that was demerged from BHP Billiton on 22 July 2002 as BHP Steel and renamed BlueScope Steel on 17 November 2003

Bluescope Steel has operations in Australia, Asia, New Zealand, North America and Pacific Islands.

Key Differences between Bluescope Steel and Arrium are:

Bluescope Steel continued to pursue the key tenets of the `BHP Steel Blueprint for the 21st Century.

Key planks of this strategy included:

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2.2.1.1 Multi- Domestic Strategy

Bluescope Steel's Multi-Domestic Strategy (MDS) involves the seeding of markets on a country by country basis by capital investment in downstream manufacturing capability.

Expansion is achieved by upstream vertical integration, where critically, capital investment is underpinned by the achievement of economic scale.

The principles of the MDS are salient in the context that given the appreciation of the Australian dollar and the resultant impact on the international competiveness of Bluescope Steel exports, a managed reversal of the MDS may serve as a template to address the challenges of reconfiguring the Australian upstream Australian steel sector to address sub-scale domestic operations.

As an analogy, the lower economies of scale of auto assembly relative to full metal stamping and assembly is presumably the rationale for Punch Corporation's interest in GM Holden's Adelaide assembly plant[iii].

Similarly economic critical mass was initially achieved in the Asian auto industry via the establishment of vehicle assembly plants[iv].

2.2.2.2 Vertical integration into downstream (competition with customers)

The BHP Steel Blueprint for the 21st Century flagged continuing involvement and investment in relevant downstream investments of a significant scale[v].

Downstream businesses such as `Lysaght' (roofing) have been supplemented with a range of additional businesses including:

- Fielders (Roofing)
- Ranbuild (Sheds)
- Charlwood (Home Improvements)
- Impact Steel (Distribution)
- Orrcon (Pipe and Tube)

Whilst these downstream businesses offer pull through volume for the raw steel production they, critically, create a position of market dominance as Bluescope Steel directly competes with its' independent customer base.

The requirements of Australia's independent steel manufacturers needs to be an integral part of any policy affecting the future of the Australian steel industry.

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2.2.2.3 Export of excess Australian capacity

The third component of Bluescope Steel's strategy had been the exporting of the excess Port Kembla / Westernport steel capacity.

Exports from Australia constituted up to half of the volume from the Port Kembla steelworks.

In 2011, driven by the rapidly rising Australian dollar and high material costs associated with the mining boom, coupled with low international steel prices in the post GFC period, Bluescope announced an exit from export markets[vi].

Whilst not due to factors within the Australian steel industry, the exit from export markets necessitated a major restructure of steel-making capacity resulting in the closure of the No 6 Blast Furnace and the Westernport Hot Strip Mill.

The important consideration from independent Australian steel intensive manufacturers is that the excess capacity previously directed to export, now needs to find an outlet domestically.

This has exacerbated competition issues in the Australian market particularly when coupled with an overt protectionist policy platform[vii] that constrains Australian steel manufacturers access to alternate feed material inputs.

Whilst the challenge of determining a sustainable manufacturing platform at Port Kembla is likely to be on an ongoing challenge,[viii] it is critical that policy initiatives are at not at the expense of the competitiveness of Australia's independent downstream manufacturing sector.

2.2.3 One Steel

On the 23rd October 2000, BHP divested the steel businesses comprising the newly created `OneSteel' by way of a Spin-out.

OneSteel is an Australian based steel company involved in the manufacture and distribution of a wide range of products including structural, rail, rod, bar, wire, pipe and tube products[ix].

Included as part of the Onesteel spinout were the iron ore resources from the Middleback Ranges in South Australia. Presumably a consideration around the inclusion of the SA Middleback Ranges iron ore was the fact that:

- Iron ore prices were at the long term trend of $12USD per metric tonne (well below today's `depressed' benchmarks).
- The relative remoteness of the Middleback ranges compared to the Pilbara and the iron ore markets of Asia.

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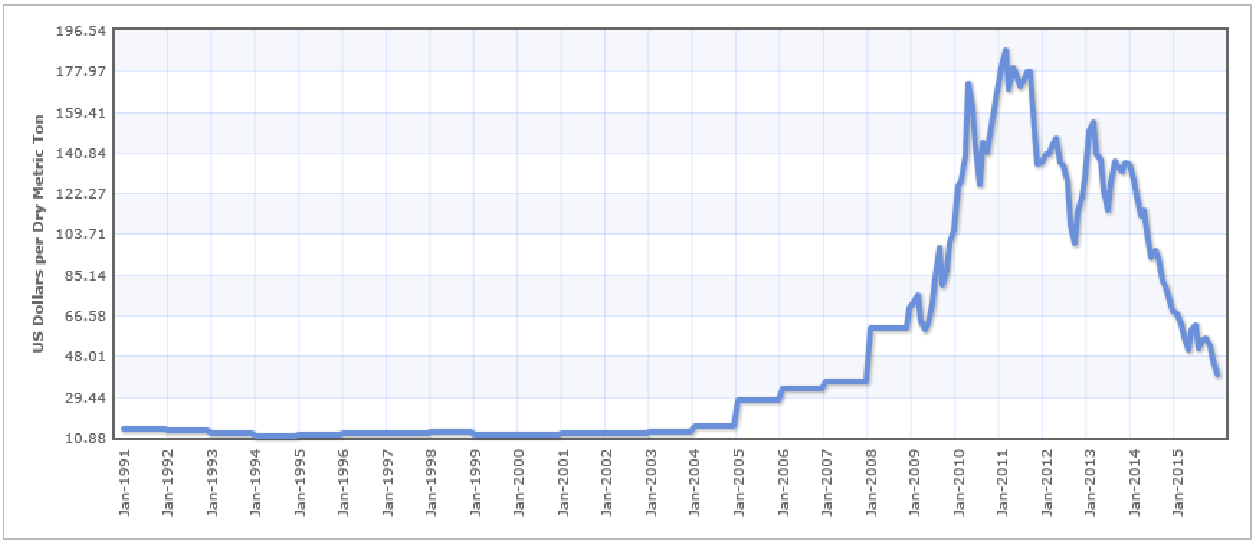
- That the Middleback ranges ore is predominantly `Magnetite' that contains lower purity iron and needs further beneficiation prior to use. Accordingly magnetite, in its raw form, sells at a discount to the higher quality `Hematite' ore.



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In contrast to Bluescope Steel, Onesteel's strategy departed from that of the `BHP Steel Blueprint for the 21st Century'.

Buoyed by rising iron ore prices in the lead up to the GFC, Onesteel pursued a diversification strategy that focused on transitioning from a steel business to an iron ore play.

In 2005 Onesteel decided to diversify into the resources sector through Project Magnet which would convert the Whyalla Steelworks to magnetite iron ore feed, creating a new revenue stream for the company by making hematite iron ore reserves available for export sales.

In 2012 Onesteel renamed the business `Arrium'

"*to reflect the significant change in the nature of its business over recent years. OneSteel is now a mining, mining consumables and steel business with an increasingly global orientation, rather than a domestic focused steel company.*

A defining moment in OneSteel's history occurred in 2005 when the Board decided the company would enter the export iron ore market through Project Magnet. The company has continued its growth focus on mining and mining consumables with further significant investments, including becoming the largest producer globally of grinding media to the resources sector, and announcing last year that it would double the size of its port capacity at Whyalla, South Australia to 12 million tonnes per annum and increase iron ore sales to a run rate of approximately 11 million tonnes per annum by around the middle of 2013.

The name Arrium provides a better association with the company's current mining and materials businesses, as well as better accommodating its strategic growth focus on mining and mining consumables[x]".

The consequences of this strategy are:

- In pursuing iron ore exports, the Whyalla steelmaking facilities, that were previously considered likely to remain “under intense competitive pressure,[xi]” were modified via a $325 million project to operate with higher input cost magnetite ore.

  In our opinion this, along with limited capital investment in the steel business[xii], contributed to sacrificing the international competitiveness of the Onesteel Australian steel operations.

- The high cost iron ore export business “is sucking cash and has limited scope to further lower its cost base. For the three months ending December 31, Arrium Mining reported an average total cash cost of $57.60 a tonne and sales at just $51 per tonne[xiii]”.

- The other component of the Arrium, the Molycop grinding media business is presently for sale with the proceeds required to reduce debt.

3 Current Situation / Observations:

Different stakeholders of the Australian steel industry offer different perspectives.

3.1 Bluescope Steel

- Bluescope Steel has recently agreed to an immediate continuation of raw steel making at Port Kembla.
- Integration of recent acquisitions into downstream businesses (Fielders, Orrcon, OneSteel Sheet & Coil Distribution) progressing well[xiv]

3.2 Onesteel

Onesteel (Arrium) have, in our opinion, adopted a protectionist stance evidenced by:

- `Trade Measures’ being a core strategic focus of the business[xv]
- Almost 75% of Onesteel’s business being subject to anti-dumping applications[xvi].

3.3 Independent Steel Sector

For those independent Australian businesses, the outlook is more challenging.

What is often not appreciated in discussions about the Australian steel industry is the structure of the industry and the fact that the vast majority of Australian jobs are engaged in independent downstream steel intensive businesses.

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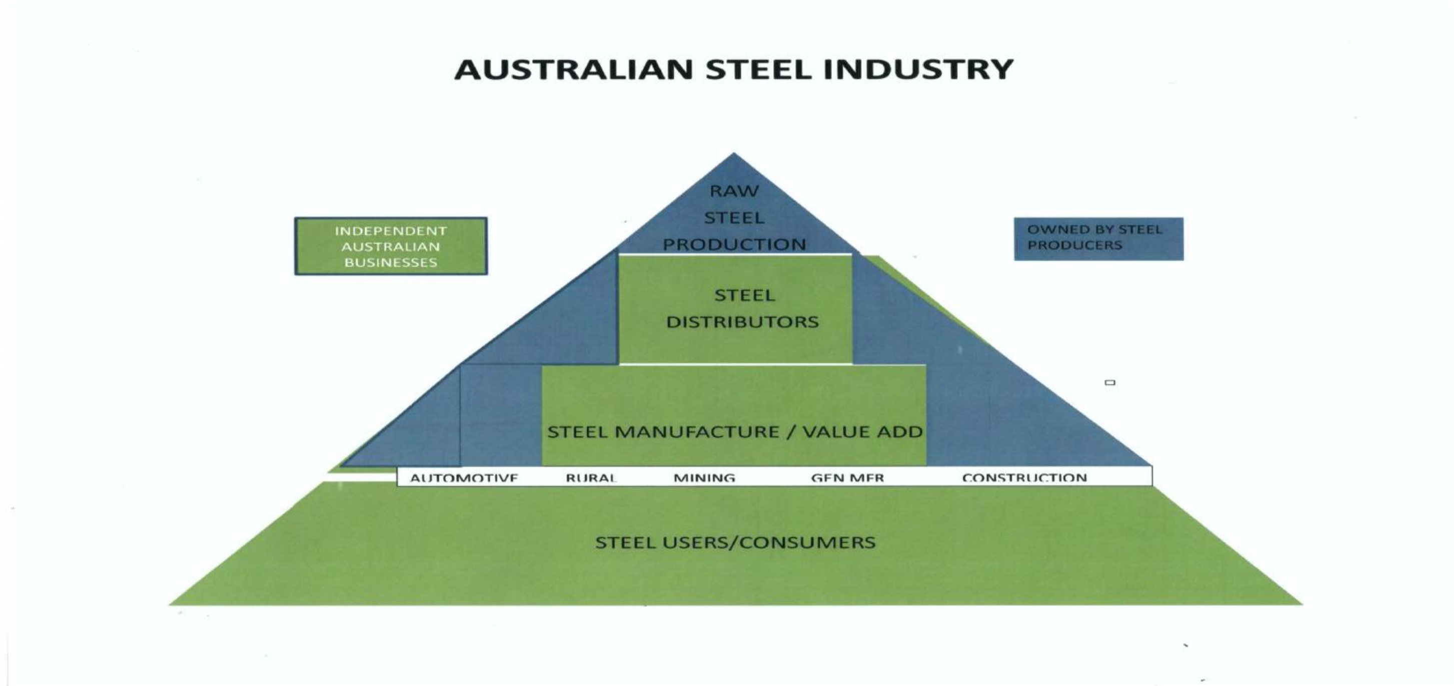

It has been cited that 500,000[xvii] direct and indirect Australian jobs are affected by the fortunes of the Australian steel industry.

Challenges facing the steel intensive manufacturing sector include:

3.3.1 Competition from the Australian steel producer suppliers who compete against them

As indicated, the vertical integration of both steel producers results in them competing against their customers in the downstream market.

This results in Australian steel distributors and steel manufacturers needing to develop independent supply inputs for their survival. Aside from the monopoly Australian steel producers, these Australian manufacturing inputs can only be served by imports of semi- finished steel products.

Australian downstream manufacturers are frustrated in these endeavours by a myriad of techniques that impede their ability to compete.

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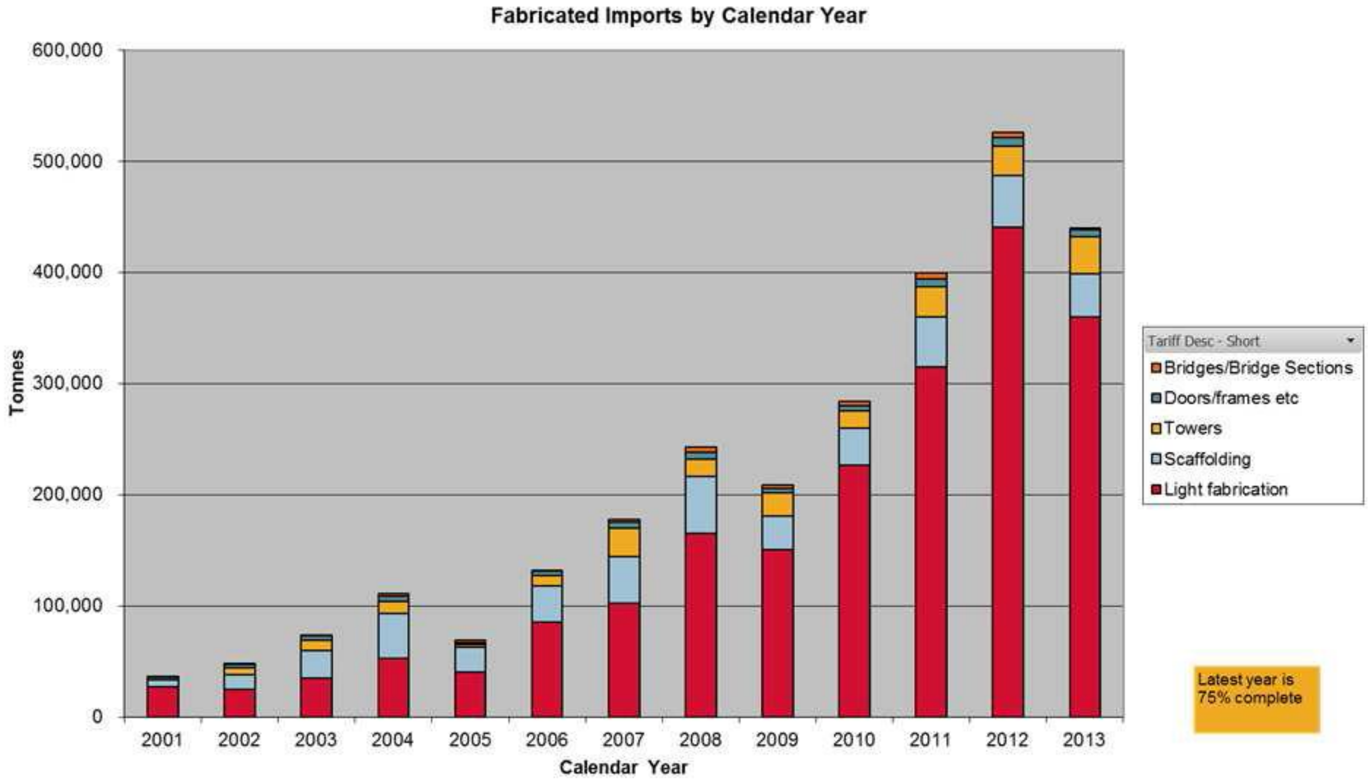
3.3.2 Competition from fully manufactured goods

In a globalised market economy, on Asia's doorstep, Australian steel intensive manufacturers must be able to compete on an equal playing field.



Source : Onesteel

Considering product conformance as an example, one SME steel fabricator cited an average of between 7.6% and 11% of additional project costs to maintain conformance on a structural steel fabrication project[xviii].

This is not to suggest that product conformance is not critical.

Rather, what is suggested is that if the altruistic intent of compliant, fit for purpose product is impeded by an unduly high cost regime, the resultant cost burden contributes to Australian steel fabricators and manufacturers being at a competitive disadvantage against fully manufactured imports.

Another family owned Australian fabricator, employing 340 people, lashed out at the perceived protectionist regime indicating that "duties could kill his business[xix]"

A separate Australian fabricator has claimed that his business has incurred costs of $100,000 due to his business' duty exemption application being stifled despite the product no longer being produced in Australia.

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Ensuring policy settings enable Australia's steel fabricators and steel intensive manufacturers to operate against the real competition of manufactured imports should be central to any consideration of the future of the Australian steel industry.

Present thinking is reflective of policy that considers the Australian steel industry almost exclusively through the lens of raw steel tonnes produced. A review of any `media grab' or reporting reflects this[xx]

Better policy settings would consider a triple bottom line for the Australian economy of:

- tonnes of raw steel produced
- the number of Australian jobs employed at each level of the industry and
- the dollar value added through the different levels.

Such an analysis would affirm that much of the economic value of the industry resides in the downstream value adding processes that, apart from expected peer competition, have the additional challenge of competing against their local raw steel producers and against fully manufactured imports.

Consideration of the needs of this key sector of the Australian steel industry would enable a broader informed view for policy formulation.

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4 Where to from here?

Australia's steel industry does have inherent competitive advantage by virtue of:

- Natural Resources in steel making materials (iron ore and coal)
- Cost advantage given that steel inputs from Asia have incurred shipping costs (of iron ore/ coal) from Australia and shipping costs of semi – finished steel inputs back to Australia.

Inefficiency of Australian raw steel production results in challenges to Australia's value adding steel intensive manufacturers and fabricators due to high input costs, coupled with competing with their local raw steel suppliers and achieving innovation and productivity improvements in order to compete with fully manufactured imports.

Policy challenges that confront the Australian steel industry as a whole are:

- facilitation of Australia's upstream steel production at a sustainable level of value adding be that at raw steel production, slab or hot rolled coil.
- balancing requests for protectionism without terminally damaging those Australian jobs reliant on competitive inputs such as steel fabricators who provide the majority of the 43,800 plus jobs through this sector of the industry.[xxi].

  "Even tariff protection in the order of 5-10 per cent can equate to the entire selling margin on some steel products[xxii]". With FTA's being agreed with Australia's major regional partners, imposing (dumping) duties on the inputs to Australia's downstream steel intensive manufacturers simply has the effect of transferring competitive strain to the sector of the Australian steel industry most under pressure.

- Ensuring competition regulation recommendations are progressed to provides the oxygen for Australia's fabricators and manufacturers to operate.

5 Recommendations:

5.1 Raw Steel Producers

We respect the role of the two steel producers to advocate policy that centres on assisting the transition of to an economically sustainable platform of production.

To this end, the Australian Steel Association supports many of the micro-economic previously advocated by the steel producers[xxiii] such as:

- tax reform
- workplace relations
- skills & training
- reduction in regulatory burdens and importantly
- increased infrastructure spending.

Additionally, temporarily facilitating non profitable Arrium iron ore exports into competitive inputs for Bluescope's Port Kembla steelworks may be an example of a short term measure.

It is, in our opinion however, poor policy for the Australian tax payer to underwrite individual businesses.

Overtly protectionist positions ultimately serve to negatively impact on the competitiveness of Australia's SME, steel intensive manufacturers and has to date stifled significant investment in the Australian steel industry.

5.2 Independent Steel Sector

The Productivity Commission recently stated that "the biggest challenge for Australian industry is getting access to fragmenting global supply chains"[xxiv]

It is critical that whilst policy may assist the two steel producer's to become internationally competitive, that policy for the future of Australia's steel industry also embrace our geographic proximity to Asia both for competitive inputs to our steel manufacturing and as prospective markets for Australian made steel products.

Pivotal to a sustainable future is policy that is geared toward a steel industry environment that engenders competition and investment. Policy considerations should include:

Recommendation 1:

- Competition Policy reform including the implementing the Harper Review recommendation of an `effects test'.

Recommendation 2:

- Introduction of a `public interest' test in investigations in accordance with the key recommendation of the Productivity Commission inquiry into Australia's anti-dumping system.[xxv].

Recommendation 3:

- Policy development based on an improved understanding of the full Australian steel industry with particular emphasis on the independent downstream steel sector.

Recommendation 4:

- Micro-economic reforms that facilitate productivity improvements & innovation to counter competition from fully manufactured steel goods.

Recommendation 5:

- Considered removal of impediments to competitive inputs via access to global supply chains including ready adoption of internationally aligned standards and cautious, cost focused adoption of an internationally competitive conformance regime.

Without an internationally competitive steel intensive manufacturing basis, there will simply be no demand for Australian produced steel.

A balanced policy framework that considers the requests of the steel producers, along with the needs of Australia's steel intensive downstream manufacturers, should enable the Australian steel industry to find a middle way to achieve its potential on a more sustainable, internationally competitive footing.

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ENDNOTES:

[i] Steelforce : The History of Steel Manufacturing in Australia
[ii] Australian Government National Archives of Australia
[iii] Australian Financial Review 22nd January 2016; page 9
[iv] Konosuke Odaka: The Motor Vehicle Industry in Asia; Singapore University Press
[v] BHP Steel Blueprint for the 21st Century (refer Appendix 1)
[vi] Bluescope Steel ASX Media Release 22nd August 2011
[vii] Appendix 2: Anti-Dumping as an anti-competitive tool.
[viii] Sandon Capital Investor Presentation June 2015
[ix] www.onesteel.com: `The Spin Out Proposal at a Glance'
[x] Onesteel ASX Release 3 April 2012; Change of name to Arrium Limited
[xi] BHP Steel Blueprint for the 21st Century (refer Appendix 1)
[xii] Onesteel J.P Morgan Conference Presentation October 2009 ; page 18
[xiii] Red Lights Flashing at Arrium; Australian Financial Review 8 February 2016
[xiv] Bluescope Annual Report 2014/15; page 14
[xv] Arrium Steel and Recycling Presentations 19 October 2015; page 8
[xvi] Arrium Anti- Dumping Update January 12, 2016
[xvii] `New Steel Plan Our Vision for Australian Steel in the 21st Century' AWU
[xviii] Australian Industry Group: The quest for a level playing field; page 25.
[xix] `Best Bar steel for fight with Arrium over dumping claims'; Australian Financial Review, 2 March 2015
[xx] `Does Australia's Steel Industry have a Future; AFR June 19 2015
[xxi] IBIS World.com.au: Iron Smelting, Steel Manufacturing and structural steel fabricating in Australia: Market Research Report- Report Snapshot.
[xxii] `New Steel Plan Our Vision for Australian Steel in the 21st Century' AWU
[xxiii] Inquiry into the State of Australia's manufactured export and import competing base now and beyond the resources boom; Submission 39; Bluescope Steel ; pages 18 and 19
[xxiv] Expert slams Tony Abbott's growth centre's policy and trade deals';Australian Financial Review June 24, 2015
[xxv] Australia's Anti-dumping and countervailing system: Productivity Commission Inquiry Report No 48; 18 December 2009, page 56