



**THE SENATE ECONOMIC REFERENCE COMMITTEE
INQUIRY TO THE FUTURE OF AUSTRALIA'S STEEL
INDUSTRY**

Submission from the South Australian Government

February 2017

Introduction

South Australia is the birthplace of the nation's iron and steel industry and the South Australian Government steadfastly supports the continued commercial operation of steelmaking in this country as a strategic industry.

The South Australian Government notes the vulnerability of the Australian steel industry is well documented in the Senate's Economic References Committee's Interim Report into the Future of Australia's Steel Industry.

It is accepted that the Australian steel industry is under pressure from a global oversupply of steel that has led to a combination of unfair competition from imports and a downturn in steel and iron ore prices.

To support the steel industry, the South Australian Government has already taken several measures to ensure Australian Standards are upheld in government procurement and to financially assist steel fabricators to be appropriately accredited.

The South Australian Government acknowledges measures adopted by the Commonwealth to strengthen the operations and investigative powers of the Anti-Dumping Commission so as to minimise the economic damage inflicted on Australian industries by the dumping of imported steel products. These measures include a more active, risk-based approach to address proven circumvention activities by steel importers.

The South Australian Government also acknowledges a number of amendments to the Commonwealth Procurement Rules that will come into effect from 1 March 2017 that require tenders to demonstrate the capability to meet the Australian Standards and a requirement that contracts must contain evidence of the applicable standards.

The decision in April 2016 by Arrium's previous management to enter voluntary administration has created additional challenges to the steel industry both in South Australia and elsewhere. Studies attempting to quantify the adverse social and economic impact on Whyalla that would be triggered by the closure of the steelworks and associated mining and infrastructure highlight the magnitude of the adverse social and economic consequences for that community. An environmental liability could also crystallise from a closure of the Whyalla operations.

The South Australian Government acknowledges the best outcome of the administration is a successful conclusion of the Arrium sale process that includes the continued commercial operation of the Whyalla steelworks and its associated mining and infrastructure. To encourage potential bidders for Arrium, the South Australian Government committed \$50 million in the 2016-17 State Budget for co-investment with the new owners on projects that will support the long-term, commercial viability of Arrium's Whyalla operations.

The South Australian Government is pleased to contribute its views on the Interim Report and provide new and updated data on matters relating to Arrium and the Whyalla community. In doing so, the Government highlights the strategic importance of steel to both the Australian and South Australian economies and comments on issues such as:

- Economic Impact and Community Support for Whyalla;
- Arrium Bidder Interactions;
- Sovereign Steelmaking Capability;
- National Steelmaking Road Map;
- Global Competitiveness & Anti-dumping;
- Steel Economic Participation Policy;
- Shipping Regulatory Issues; and
- Low Carbon Economy

INTERIM REPORT

The South Australian Government endorses those recommendations presented in the Interim Report that call for additional policy measures and legislative reforms to protect the Australian steel industry with a focus on securing the future of Arrium Whyalla operations in South Australia:

Recommendation 1

2.63 The committee notes commitments made by the Australian and South Australian Governments to secure the sale of Arrium and recommends that this funding be deployed as a matter of urgency to assist with the sale process, in accordance with advice from the company administrators.

Recommendation 3

2.65 The committee recommends that additional policy and legislative reforms, particularly in the areas of anti-dumping and countervailing measures, government procurement, and standards, should be addressed in detail as part of the committee's deliberations and final report.

Economic Impact and Community Support for Whyalla

The capability and critical mass created by the Whyalla Steelworks underpins the potential to develop an industrial infrastructure hub for the Upper Spencer Gulf region of South Australia.

In the absence of Whyalla Steelworks, labour and skills go elsewhere and this contraction of the industrial hub leads to inefficiency and investment barriers for replacement industries.

Whyalla's geographical location and heavy reliance on Arrium and its suppliers as the major employers of the local population mean that there is little opportunity and scale to substitute alternative industries that can support a regional centre in the immediate term.

With regard to the Interim Report Recommendation 2-2.64, the South Australian Government established the Steel Task Force prior to Arrium entering voluntary administration with the objective of securing steelmaking's future in South Australia with an allocation of \$2.7 million over 4 years.

Following Arrium entering into voluntary administration the Department of State Development established the Whyalla Response Office in May 2016 as a one-stop shop for community and business to access financial and other services.

In January 2017, the Whyalla Response Office reported the following impacts on the community as a result of continuing administration of the Arrium Whyalla operations:

- The rate of closures of small business has escalated with more than half of the 700 small businesses in Whyalla closed since Arrium entered administration.
- Drug abuse and domestic violence remain major issues compounded by limited provision of services with one Drug and Alcohol Services South Australia (DASSA) position assigned to the Upper Spencer Gulf region.
- There are approximately 800 properties either for sale or vacant rentals which are adversely impacting house prices and owner options.
- There has been a loss of capacity in Whyalla with significant workforce reductions and subsequent skill loss.
- Apprenticeships have almost stopped and the businesses still operating remain primarily focused on Arrium.
- Sporting clubs are failing due to the inability of the community to cover fees and costs and the impact of a reduced available population.

Further, the State Budget 2016-17 included nearly \$70 million to support steelmaking, businesses and the community in Whyalla comprising:

- \$50 million State Government Grant Facility,
- \$9.6 million Whyalla Small Business Loan Scheme,
- \$8.5 million Mental Health Funding, and
- \$0.3 million Foodbank Whyalla.

The \$9.6 million Small Business Loan Scheme implemented in May 2016 supports small businesses suffering from cash flow implication as a result of the Arrium's administration. As at December 2016, 16 businesses had applied for and received loans totalling \$5.3 million. The program continues to be available to qualifying suppliers.

Loan recipients included sectors covering:

- Heavy transport;
- Plant Hire;
- Mining services companies;
- Equipment providers;
- Specialist trade providers.

South Australian Government Support for the Arrium Sale

Arrium entered into external administration in April 2016 and is now subject to a Deed of Company Arrangement, with KordaMentha appointed as Deed Administrators. The Administrators are working towards completing the sale of the Australian operations (Whyalla operations and the east coast businesses) as a single going concern, with a view to maximising returns to creditors, by 31 March 2017.

As at 1 February 2017, active bidders remain in the sale process. Bidder proposals differ greatly from each other.

The South Australian Government has committed to a \$50 million grant facility to a new owner of Arrium Whyalla operations for capital investment. In addition, the South Australian Government will also negotiate with a new owner on indemnity provisions for historical environmental contamination. It is expected that bidders will require further support from governments.

In addition to the support package, the South Australian Government is working closely with the Commonwealth Government to support the sale of Arrium:

- Holds weekly meetings to ensure a collaborative and coordinated approach to bidder enquiries and to discuss matters relating to the Administrator and the Arrium sale process.
- Meets with interested bidders to discuss their vision, and ultimately to understand their business plans and to inform them of matters related to inform their bids such as the Foreign Investment Review Board guidelines, Department of Defence approvals, environmental regulatory requirements and support available through the Export Finance and Insurance Corporation and the Clean Energy Finance Corporation.
- Is jointly briefed by Arrium's Whyalla management team, the Administrator KordaMentha and its sales adviser, Morgan Stanley on the Whyalla operations and the sale process. This includes site visits.

STRATEGIC MATTERS

Sovereign Steelmaking Capability

The South Australian Government supports the views put forward in submissions received from the Australian Workers Union, the Australian Constructors Association and others that:

- “maintaining the domestic industry is important to ensure a supply of steel during times of international conflict”; and
- “maintaining a domestic steel industry is important both for the economic performance of other industries in the supply chain and the overall economy”.

The fundamental question for the Australian and all State and Territory Governments’ “should Australia retain its sovereign steelmaking capability”?

The South Australian Government’s view is that the answer to this question is a resounding ‘yes’ for a number of reasons:

- Steel is a technologically-complex product having strong forward and backward linkages in terms of material flows and income generation. It adds value to Australia’s iron ore output and provides significant input to many manufacturing industries, all of which make a contribution to the national economy. Its integration into the manufacturing and construction industry is indicative of steelmaking its strategic importance. Local steel industry capability undoubtedly underpins the continued industrial development in a number of sectors of the Australian economy.
- A loss of steel manufacturing capabilities, particularly in structural steel, could mean the loss of skills, knowledge and industry know-how which may not be quickly recoverable should the need to produce steel arise again in the future. These capability losses could also impact on the growth and support for other sector opportunities.
- Local steel production benefits Australia’s trade balance and ensures a competitive market based on Australian Standards that are important to protecting the interests of Australian consumers.

National Steelmaking Road Map

A National Steelmaking Road Map is proposed by the South Australian Government to support the long term future for the Australian steel industry through identification of key strategies to ensure steel makers and supply chain participants remain globally competitive by adopting world-best practice. Other Road Maps developed by the South Australian Government that have been successfully applied include “ICT Roadmap for Minerals and Energy Resources” and “Road Map for Unconventional Gas (SA)”.

Development of the Road Map would consider research and development activities, the uptake of and commercialisation of new technology and innovation, development of new materials and applications, improving supply chain efficiencies and encourage collaboration to capture greater share of domestic and global markets.

There are significant opportunities for the Australian steel industry with appropriate investment to expand its capabilities. Many steel products including head-hardened rail for mining infrastructure are currently imported and should be domestically sourced. Defence grade steel projects are another opportunity.

Global Competitiveness and Anti-dumping

A globally competitive steel industry will improve Australia's potential to increase exports and to compete against imported products

The South Australian Government supports free trade as beneficial for our industries and consumers. However, dumping and circumvention that injures our local industries undermine the community's confidence in our free trade policies.

The South Australian Government supports access to appropriate trade remedies for the State's industrial and trade-exposed sectors, including steelmaking, particularly if the industry in question is facing, or about to face, material injury (usually in the form of price suppression, declining sales and falling employment).

Trade remedies should be temporary, allow for structural adjustment and be consistent with the rules of the World Trade Organisation (WTO). There is no inconsistency with the South Australian Government's general position on supporting free trade.

The South Australian Government supports the Productivity Commission's recommendation following its inquiry into Australia's dumping system in 2010 that an effective anti-dumping and countervailing framework is necessary for manufacturers to make longer term, capital-intensive investments.

The South Australian Government notes Arrium has benefited from the imposition of anti-dumping measures in recent years for steel and steel products and that were it not for these measures, Arrium may have suffered an even more material injury to its business. The South Australian Government concurs with Arrium that additional (albeit temporary) dumping and countervailing measures may be required to allow the company under its new ownership to restructure. Once it has done so, the dumping margins can be gradually phased down.

Furthermore, given the complexities of the current trading environment the steel industry faces, including global supply chains and retail dominance in certain sectors, Australia's anti-dumping system needs to be beyond reproach in terms of procedural application. The framework also needs to be seen to accord equity to all parties. Streamlined investigation procedures and strengthening of the material injury test would greatly assist in this regard.

To maintain and strengthen Australia's anti-dumping and countervailing system, the South Australian Government requests that the Commonwealth Government establish a formal legislative review through the Department of Industry, Innovation and Science to report to Cabinet, with appropriate legislative amendments.

Government Procurement of Steel and Steelwork

The South Australian Steel Economic Participation Policy ("the Steel Policy") mandates that reinforcing and structural steel for projects funded by the South Australian Government must fully meet the requirements of the relevant Australian Standards. Steelwork procured for public projects must be supplied by independently-verified fabricators who are capable of meeting required standards to ensure its quality and safety.

The Steel Policy applies in conjunction with the South Australian Industry Participation Policy (SAIPP). The SAIPP requires tenderers to commit, through an Industry Participation Plan, to the level of economic benefit the State can expect to receive from packages of work under the contract. Other procurement policy measures such as lifting the economic benefit weighting in procurements involving steel or in particular zones also help support the steel industry.

The South Australian Government was encouraged by amendments to the Commonwealth Procurement Rules to take effect from March 2017 that require greater evidence of compliance with Australian Standards in the Commonwealth's procurement activities and recognise economic benefit as a legitimate purchasing requirement of governments.

For government procurement to most effectively support the steel industry in Australia, the South Australian Government encourages all states, territories and local governments to adopt procurement requirements in line with that of South Australia and the Commonwealth.

Shipping Regulatory Issues

Coastal shipping services provide critical linkages for Arrium and its domestic bulk suppliers. Products are moved by sea from South Australia (eg limestone) and New South Wales (coking coal).

Coking coal has previously been identified by Arrium as a significant input cost to its production, which is in part, driven by the higher cost structure of domestic shipping compared to international shipping.

Given the competitive, international nature of coking coal commodity markets, there is a danger that unless the cost differential of shipping is addressed in some form, it may ultimately be more cost effective for Arrium to lower the total cost of shipping by sourcing coal from overseas. Whilst this may increase Arrium's short-term costs (in making necessary adjustments to blast furnaces and operations) it may lead to a sustainable long-term reduction in costs.

There are a number of national benefits of a strong coastal shipping policy, including:

- A strong domestic shipping industry can assist in the alleviation of land transport bottlenecks, infrastructure constraints and environmental impacts;
- The industry has potential to provide economic benefits derived from the creation of local employment and the growth of maritime services; and
- Australian defence, maritime safety and security also benefit from the coastal shipping sector.

While there may be some limited scope for Arrium to reduce its costs by renegotiating shipping arrangements with its domestic suppliers, there is considerable merit in closely examining the impacts of the current regulatory coastal shipping regime and its upstream and downstream cost impacts.

The South Australian Government recommends the Commonwealth Government actively collaborate with the Steel Task Force to work with Arrium to identify and pilot regulatory and infrastructure solutions to address shipping regulatory issues.

Low Carbon Economy

The transition to a low-carbon energy supply consistent with the Commonwealth Government's commitment to an economy-wide 26-28 per cent reduction in carbon emissions provides significant opportunities for productivity improving investment by industry that will reduce emissions from steel production, such as harnessing significant waste heat to generate power.

These investments can have significant external benefits to the national energy market as they not only reduce primary fuel consumption, such as gas, but can provide energy that lowers electricity costs and supports other advanced manufacturing opportunities.

Accordingly, there is a key role for the Commonwealth to invest in these through agencies such as the Australian Renewable Energy Agency and the Clean Energy Finance Corporation to assist in both achieving Australia's climate change commitments and supporting key manufacturing capability.

Conclusion

Australia's national interest is served by maintaining a domestic steel production capacity. Strategic capabilities, a skilled work force and ensuring Australian Standards for consumers are just some of the benefits of a local steel industry.

To support the Australian steel industry to remain globally competitive, companies need access to appropriate and timely trade remedies with time and government support to adjust and restructure operations in response to the challenges created by the current global oversupply of production. To advance this objective, the South Australian Government has already announced a significant package of support to the steel industry in South Australia.

While a recent upturn in steel and iron ore prices have reduced the immediate danger to the local industry, exchange rates and commodity markets remain volatile in a market place that remains uncertain about the future of international trade and the pace of economic growth.

To mitigate these challenges, Australian, State and Territory Governments need to implement policies that encourage the steel industry to invest, restructure and innovate in a manner that improves efficiency and also reduces CO₂ emissions in line with Australia's obligations under the Paris Agreement.

Without these policies, it is highly likely that Australia's sovereign steelmaking capability will be diluted over time, increasing the nation's dependency on other countries to supply to Australia. In an increasingly uncertain international climate, the national interest is not served by a reliance on imports to supply a strategic product that is vital to the manufacturing, construction and defence industries.

The South Australian Government recommendations to the Inquiry are to:

- Encourage all states, territories and local governments to adopt procurement and accreditation requirements in line with South Australian Industry Participation Policy (SAIPP) and Steel Policy as well as the Commonwealth procurement guidelines that take effect 1 March 2017.
- Request the Commonwealth Government to actively collaborate with the South Australian Government's Steel Task Force to work with Arrium to identify and pilot regulatory and infrastructure solutions to address shipping and other supply chain regulatory issues.
- Support the development of a National Steelmaking Road Map to facilitate the long term future for the Australian steel industry through identification of key strategies to ensure steel makers and supply chain participants remain globally competitive by adopting world-best practice.
- Request the Commonwealth Government to maintain and strengthen Australia's anti-dumping and countervailing system.

- Note the opportunity to assist the steel industry to transition to a low-carbon energy supply consistent with the Commonwealth Government's commitment under the Paris Agreement to an economy-wide 26-28 per cent reduction in carbon emissions.
- Note that the challenge of supporting a new owner to restructure the Whyalla operations in the future is too large for the South Australian Government alone. The Commonwealth Government's further support is critical.

Together, these recommendations should allow the local steel industry to prosper and provide jobs and future opportunities to Australians, especially in regional communities such as Whyalla. Securing a future for the Whyalla Steelworks will return confidence to the Whyalla community and reduce the need for expensive and lengthy structural adjustment programs to limit the economic and social damage to the Upper Spencer Gulf region.