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NZ ETS Review Consultation
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To Whom It May Concern

New Zealand Steel submission on the ETS Review 2016

Thank you for the opportunity to share New Zealand Steel's view on the important issues involved in reviewing the New Zealand ETS.

We look forward to working with Government to achieve a sustainable and economically viable future for the South Auckland region and the wider New Zealand economy.

This is a submission on the priority issues relating to the ETS transitional measures as outlined in the discussion document.

Submission summary

New Zealand Steel is very exposed to the ETS. There are three factors specific to steel making in New Zealand that must be considered in a review of the transitional measures.

1. **New Zealand Steel is globally trade exposed.** We compete with other countries in import and export markets, where our competitors do not place mandatory carbon costs on their steel industries. Competition in a solely domestic market is largely unaffected by the ETS because all manufacturers face the same impost. This is not the case for New Zealand Steel, which faces global market competition.

2. **Our emissions are not by choice.** The majority of emissions are a physical result of the chemical reactions required when manufacturing steel products. Similar to methane emissions in the agriculture sector, it is simply not a choice whereby we can switch to a lower carbon emitting product or supplier. Carbon is an intrinsic requirement of the steelmaking process.

3. **The global steel industry is in downturn.** Since 2014 world steel prices halved. Commodity price decreases and shifting patterns in financial markets means New Zealand Steel's trading conditions are far worse than faced during the GFC. The business is currently significantly loss making.

These three factors mean that the sustainability of competing in the world market, where steel prices continue significantly below production cost, is already in question for steelmaking in New Zealand.

An increased cost from the ETS in the current international trading environment would have a significant financial impact on New Zealand Steel.

This could trigger the closure of iron and steel manufacture in New Zealand, with a combined direct and indirect loss of up to 6500 jobs in the South Auckland region. New Zealand would then become an importer of CO_2 in steel products rather than an emitter. This would likely have a negative impact on the international objective of reducing emissions, due to increased emissions of shipping steel to New Zealand from overseas rather than producing locally. Furthermore, there would be negative effects in terms of employment and economic activity in New Zealand.

The current ETS excludes agriculture for good reason. There are parallels with the current situation facing agriculture for the steel industry; in particular, exposure to international competitors who are not carbon constrained and the lack of viable technologies to materially reduce emissions.

On the same principles that agriculture is exempted, New Zealand Steel advocates that steel manufacture is exempted from the ETS. Failing that, New Zealand Steel must secure the mechanisms to off-set the full costs of the ETS.

Introduction to New Zealand Steel

New Zealand Steel has contributed to the New Zealand economy for 50 years. We operate a fully integrated steel mill in Glenbrook, South Auckland, manufacturing a large range of steel products from locally sourced materials for use in the building, construction, manufacturing and agricultural sectors.

New Zealand Steel contributes around 1 per cent of New Zealand's GDP and employs around 1500 people and indirectly creates employment for a further 5000 people.

We are part of a wider metals industry, which contributes over 7 per cent to annual New Zealand GDP. Furthermore, direct metals-based product manufacturing employs over 26,000 people.

New Zealand Steel is supportive of climate improvement initiatives. Examples of this include: Lanzatech bio-ethanol pilot plant; ownership and management of the Taharoa forestry complex; Biomass coke sources (CarbonScape); cogeneration of 60 per cent of the site electricity requirement and a number of energy conservation projects.

Response to specific discussion document questions

Context and drivers for the review

1. Do you agree with the drivers for the review?

New Zealand Steel has no issue with the drivers, but urges the government to consider the following during its review.

1. The development of policy that is adaptable and responsive to the global reaction to the climate change challenge and the assumptions that underpin individual jurisdiction responses to the Paris Agreement.

2. Climate change is not a subject that can be considered in isolation. It is connected implicitly to all facets of New Zealand's economic activities and consideration must be given to its interactions with other policy so as not to irreparably damage New Zealand's economic performance.

2. What other factors should the Government be considering in this NZ ETS review?

The Government should consider the three scenarios specific to steel manufacture in New Zealand.

1. **New Zealand Steel is globally trade exposed**
   New Zealand Steel is an Energy Intensive Trade Exposed Entity (EITE). It is crucial that the ETS review looks at the specific competitive environment faced by steel businesses around the world. Directly or indirectly we are all competing in the world market and consideration must be given to whether there is an ETS or carbon tax structure is in place and in particular how this impacts steel manufacturers on a country-by-country basis. Steel manufacturing in New Zealand should not face costs additional to those in overseas jurisdictions.

   The majority of New Zealand Steel's international competitors do not currently face mandatory carbon costs. Less than 20 per cent of global steel production is currently taking place in countries that have mandatory national emissions trading schemes. Almost 100 per cent of steel imported to New Zealand (competing with New Zealand Steel) comes from countries that do not impose such costs or exempt their steel industries from the direct costs of their schemes. In addition, 100 per cent of New Zealand Steel's exports go to countries without such costs.

   Moreover, New Zealand is a very small contributor to global emissions from the steel industry. There is now about 1.8 billion tonnes of steel production capacity in the world. By far the largest country producer is China, which now has over 1.1 billion tonnes of capacity. New Zealand Steel's production capacity of approximately 600,000 tonnes constitutes only 0.03% of global capacity.

   The imposition of a material carbon price on New Zealand Steel ahead of our international competitors threatens the viability of the Glenbrook plant for no net environmental benefit and at considerable cost to jobs and economic activity.
   The global market context also means that access to global emissions units is critical to finding the lowest cost form of abatement. The scheme will require a mechanism that allows access to, and the ability to trade in, global carbon units.

2. **Our emissions are not by choice**
   In reviewing the impact of ETS on the steel industry the Government must consider the fact that emissions from the steel manufacturing process are unavoidable. Carbon dioxide released from coal is an essential part of the reaction that enables the manufacture of steel products. Coal is used primarily as a chemical reductant in the iron and steel making process. Despite on-going research around the world, there are currently no proven and commercially viable technologies to replace coal in this process. Our modern way of life requires steel and the reality is that in order to have steel, it is necessary to use coal.

3. **The global steel industry is in downturn**
   The ETS transitional provisions were retained in 2011 to moderate the impacts of the NZ ETS during the recovery phase from the worldwide economic downturn (GFC).

A number of areas of the NZ economy have largely recovered from this down-turn. The steel industry has not. The last 24 months has seen world steel prices halve. For New Zealand Steel the business conditions are considerably worse than during the GFC. The business has been significantly loss making since the start of 2015. Steel businesses around the world are impacted by similar challenges.

Moving to full surrender obligations

3. Should the NZ ETS move to a full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors?

No. This would have a significant financial implication for New Zealand Steel and indirectly the New Zealand economy.

Any additional costs above that already factored in under the current ETS would likely create a non-viable business position for steel manufacturing within New Zealand and lead to carbon leakage.

The reasons to exclude the agriculture sector from the scheme as set out in section 1.2 on page 4 of the NZ ETS scheme review document apply equally to steel manufacturing. As explained, New Zealand Steel is globally trade exposed and our emissions are not by choice. Despite ongoing international research it is likely to be some decades before alternative technologies are commercially available. Unlike a number of other businesses, changes in behaviour/ energy sources or raw materials are not possible at this point in time. This is consistent with the agriculture sector, whereby steel manufacturers cannot significantly reduce their carbon emissions footprint.

On this basis, a good case exists for the steel industry in New Zealand to be treated like agriculture and exempted from the ETS. Alternatively mechanisms need to be in place to off-set the full costs of the scheme.

4. What impact will moving to full surrender obligations have on you or your business?

a) Increased carbon prices, including actions to reduce emissions and future investment decisions. Please comment on effects that may occur at carbon prices ranging from \$5 to \$50, including any evidence of actions taken previously when carbon prices were higher.

The external pressures on the business currently mean any increased cost threatens the survival of iron and steel making in New Zealand. Implicitly any reduction in emissions-intensive trade-exposed (EITE) allocation and/or increase in carbon prices will have a negative impact on the business.

The removal of the current 2 for 1 provision would have a direct impact on our business of between \$0.6M (@\$5 NZU) and \$6M (@\$50 NZU). If the current allocations were to be reviewed, the ongoing impact would escalate significantly from this base. As outlined previously the majority of our carbon emissions are generated as a direct result of the steel making chemical reaction, not from choices on types of carbon, intensive energy sources or other inputs.

b) Any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.

From a New Zealand Steel perspective, the operation and functionality of the current ETS works well and without a requirement for a disproportionate administrative load on the business.

5. If full surrender obligations are applied, when should this be implemented?

a) 2016
b) 2017
c) 2018
d) other – please specify

Outline the reasons for your answer, and include any comments on the pros and cons of applying an increased surrender obligation to a partial or a full NZ ETS reporting year.

Given the international steel market conditions outlined previously and the prospect of this negatively impacting the business for the foreseeable future, we oppose any move to full surrender obligations so no timeframe is appropriate.

If full surrender obligations were applied the only option as we see it, would be to increase the free allocation to New Zealand Steel to 100 per cent.

Any move to full surrender obligations for New Zealand Steel and the imposition of further carbon costs should only occur once major international competitors have introduced comparable costs.

Managing the costs of moving to full surrender obligations

6. If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?

Yes, subject to a mechanism that is transparent and transitional, dependent on any movements in the international environment and is inclusive of comparable cost imposts in competing trading sectors.

7. If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?

a) maintain the fixed price option at $25
b) lower the fixed price option
c) gradually move to full surrender obligation
d) other methods.

Please explain your answer

It is untenable for our business to absorb further cost until global competitors bear the same costs and/or technology finds alternate means of producing steel with reduced release of CO_2 to the atmosphere. If there is a move to full surrender obligations, the only option as we see it would be to provide 100 per cent free allocation to New Zealand Steel.

Any move to full surrender obligations for New Zealand Steel and the imposition of further carbon costs should only occur once major international competitors have introduced comparable costs.

However, maintaining of the current cap at $25 could be reasonable subject to:

1) increasing the current levels of free allocations to 100 per cent
2) not moving to full surrender obligations; and
3) the scheme permits access to globally traded units to allow access to the lowest cost abatement.

8. If the $25 fixed price surrender option value should change, what should it change to and why?

As outlined above there is no need to change the cap. However, if the full surrender obligations are implemented the price cap should halve. This would allow the scheme to be more aggressive up to the cap but still manage the maximum exposure of businesses to the current level.

Conclusion

New Zealand Steel appreciates the opportunity to share its view on the NZ ETS review.

New Zealand Steel wants steel making exempted from the ETS for the same reasons that the Government exempts agriculture. Failing that, New Zealand Steel wants continued mechanisms in place to off-set the full costs of the ETS.

If, however, there was a move to full surrender obligations, the only options as we see it, would be to increase the free allocations to New Zealand Steel, to 100 per cent.

We are available to discuss this matter further should Ministry for the Environment officials wish.

Yours sincerely

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Margaret Gracie
Vice President People & External Affairs