



Premier must consider possibility Whyalla closure is in public interest

PAUL KERIN



Last Wednesday, South Australian Premier Jay Weatherill announced \$50 million of support for Arrium's Whyalla steelworks on condition the federal government commits \$100m. Questioning such support is no way to be popular in South Australia, but I have to be honest: he's jumping the gun and risks wasting taxpayer dollars.

While Arrium has other operations, the SA government's concerns focus on Whyalla, where the company is a major employer. SA Treasurer Tom Koutsantonis said last Monday: "If it's not about saving Whyalla, I am out — no taxpayers' money".

However, government support would be justified only if the steelworks is not commercially viable and, if not, closure would generate net social costs exceeding the cost of government support required

to prevent it. We actually don't know yet if the steelworks is viable. Arrium went into administration laden with debt. That doesn't mean its operations aren't viable. The ultimate test of viability is whether the competitive sale process — due to start next month — generates positive bids for the steelworks, unencumbered by debt.

Without the \$150m (which must be spent on steelworks infrastructure), Weatherill says, "steelmaking in Whyalla is unlikely to continue", but that sum "should be adequate to enable a new owner to build an ongoing sustainable steelmaking business". If so, the

steelworks' commercial value (without support) must be between negative \$150m and zero.

But as any investment banker knows, it's impossible to predict bid prices for large operations within such a narrow range of accuracy — and governments have atrocious track records in assessing commercial viability. In any case, Arrium administrator Mark Mentha claims to have cut costs substantially and both Koutsantonis and Mentha have stated that many potential buyers have already expressed interest in the Whyalla operations.

If the steelworks would have received a positive bid anyway, a \$150m commitment will be wasted. It will simply increase buyers' bid prices. Effectively, taxpayers will just be handing creditors \$150m. If the commercial value of the operations is (say) negative \$50m, a \$150m commitment will succeed in eliciting a positive bid; however, as it's triple the required amount, \$100m of taxpayer dollars will be wasted.

If they believe steelwork's closure would generate net social costs, the SA and federal governments are in a difficult situation. They don't yet know whether positive bids will be received, nor the cost of government support required, but they shouldn't waste taxpayer dollars either.

There's one way to solve this problem: agree with the administrator that negative bids may be submitted. A bid of negative \$100m would mean a bidder requires \$100m of government assistance to take over the operations. If the best bid is positive, no taxpayer dollars are necessary. If not, the best negative bid will reveal the minimum assistance required. Governments can then decide whether meeting that bid is worth the net social

costs avoided. This approach uses the competitive bidding process to ensure taxpayer dollars aren't wasted and that operations continue if in the public interest.

But governments should also critically assess whether the steelworks' closure, should it prove non-viable, would generate net social costs — or benefits. Proponents of government assistance often overstate the gross social costs of closing non-viable businesses and ignore the considerable social benefits. Master Builders SA CEO Ian Markos has denied claims the steelworks' closure would cause Australia's construction industry to collapse in weeks, saying the industry has other domestic steel providers and "won't collapse or be devastated".

A recent report by the Australian Industrial Transformation Institute (AITI) claims that closing the Whyalla operations would cause between 4762 and 5363 job losses in SA (including 3545 to 3939 in Whyalla). However, that report uses the input-output (I-O) "multiplier" approach that has long been discredited by leading authorities as inappropriate for such a purpose.

In 2012, the Australian Bureau of Statistics wrote at length about

the "inherent shortcomings" of multipliers that make them "inappropriate for economic impact analysis", as they are "likely to significantly overstate" impacts. Indeed, the ABS stopped publishing multipliers in 2002 due to concerns about their frequent misuse in seeking government assistance.

The Productivity Commission has long sounded similar warnings. As long ago as 1989, its predecessor said this approach "often overstate effects" of industry assistance. The reasons I-O analyses overstate impacts are well-known. The Productivity Commission recently stated that they "fail to con-



14 Jun 2016
The Australian, Australia

Author: Paul Kerin • Section: Business News • Article type : News Item
Classification : National • Audience : 101,980 • Page: 29 • Printed Size: 371.00cm²
Market: National • Country: Australia • ASR: AUD 7,497 • Words: 982
Item ID: 610055814

esentia.mediaportal

Licensed by Copyright Agency. You may only copy or communicate this work with a licence.



Page 2 of 2

 back

sider the cost of that assistance to taxpayers and the alternative uses of resources in other industries in the economy (which themselves have flow-on effects)". They also ignore that our economy is dynamic and contains adjustment mechanisms.

Indeed, a user manual for the "RISE" I-O model that the AITI report uses states some of these limitations. Yet AITI's report acknowledges none of this and gives no justifications for the assumptions that totally drive its results.

In any case, AITI's numbers should be put in context. Even if its worse-case numbers were true,

total SA employment would fall by 0.7 per cent and total Australian employment by 0.05 per cent.

In a typical year, about 3 per cent of all Australian jobs disappear and 6 per cent of all businesses close. Yet total employment rises because even more jobs are created. Society gains from "creative destruction" — value-destroying businesses closing and labour and other resources moving to value-creating businesses. Rather than propping up non-viable businesses, governments should assist affected workers adjust to change.

Now, SA and federal governments should agree that negative bids may be submitted and critically assess whether closure, if the steelworks proves non-viable, would generate net social costs or benefits. They should then wait for the competitive bidding process to yield hard evidence of the amount of assistance, if any, needed to avert closure. They will then be best positioned to decide if supporting the steelworks is both necessary and in the public interest.

Professor Paul Kerin is head of the School of Economics at the University of Adelaide.