

Striking a deal for cheaper power last hope for smelter

With just a short amount of time remaining for the government and the management of the New Zealand Aluminium Smelter (NZAS) to come to an agreement regarding the smelter's future, it's timely to point out some little-known facts and debunk some widely-held myths about the Southland-based employer.

And if readers in Otago and other parts of New Zealand think this doesn't affect them, they're mistaken. The outcome of the decision has massive implications not only for Southland, but the entire country.

But first, here are a few facts about the smelter. Located on Tiwai Peninsula, south of Invercargill, it employs nearly 770 full-time employees and provides work for 225 full time contractors, which means that over one thousand people make their living directly from the smelter. Indirectly it is estimated that another 1,600 Southlanders depend on the smelter for their living. It spends \$422 million per annum on goods and services, and its total annual economic contribution to New Zealand, including salaries, is estimated to be nearly \$600 million.

NZAS converts alumina into aluminium using renewable hydroelectricity. It has the highest environmental certification for responsibly produced aluminium and has won business awards for innovation, safety and sustainability initiatives. The result is one of the lowest carbon footprints for an aluminium smelter in the world. Approximately 90% of what it produces is exported.

The determining factor in the current discussion around the smelter's future is the price it pays for electricity. This raises the spectre of the most widely circulated myth: the idea that the smelter's substantial electricity consumption is subsidised.

This perception is incorrect, as a quick review of the smelter's history proves.

The smelter was built in the 1970s after the government committed to build the Manapouri power station. New Zealand was suffering the effects of a nosedive in the farm-based exports to the United Kingdom on which it had historically relied, and was looking to create jobs and diversify its export industries.

Aluminium smelters require vast quantities of electricity and constant supply, and the only way in which the smelter was viable was with the construction of the hydroelectrical generation plant at Manapouri, a relatively short distance from Tiwai Point. To attract the smelter the government agreed to an electricity price based on the actual cost of generation and transmission plus a 10% margin which was effectively profit that went to the Crown. However, in 1977 the government reneged on the offer and imposed a price increase of more than 300%. It also linked the price to the average price index, which in those high inflationary times meant continuously skyrocketing costs.

This was a massive blow to the international competitiveness of the smelter – and it's a testament to its ongoing improvements in productivity and efficiency that it has remained operating thus far. But more importantly, it makes a mockery of anyone who claims the smelter receives any electricity subsidy. In fact, a former NZAS CEO estimates that the smelter was paying the full cost of the Manapouri power scheme and all other smelter-linked electricity assets every 14 months.

Even hamstrung in its electricity costs, NZAS has been remarkably productive, but unless a new supply agreement with a realistic electricity price is negotiated in the next few weeks the smelter will close in August 2021. This will cost not only the 1000 jobs at the smelter, but also another 1600

jobs which the smelter supports indirectly. It's not difficult to imagine how this would be an economic disaster for Southland, particularly in our post-Covid economy. But a longer timeframe will give Southlanders time to develop alternative employment options.

Still, some argue the electricity could be better used by other industries such as Fonterra, but the reality is Fonterra, particularly in its current financial position, would not be able to afford the price NZAS currently pays. Fonterra has admitted that electrifying its South Island milk processing plants is currently not economically viable.

The reality is there is no other current viable demand for the electricity as there is insufficient infrastructure in place to transport the power further afield. The total cost of network upgrades to get Manapouri power to Auckland, for example, is estimated to be \$600m. Undertaking this work would undoubtedly impact New Zealand electricity consumers as the costs would be passed on.

Further, any such infrastructure project would take five to eight years to complete, during which time Meridian would have to spill water, dump surplus electricity and settle for lower prices. This would mean a drop in revenue and share price for Meridian. This too would impact New Zealand electricity consumers, whose power prices would inevitably increase to make up the shortfall, as well as the (now heavily indebted) New Zealand government, which would see a fall in revenue.

Finally, from a global environmental viewpoint, NZAS makes sense. Because it uses hydroelectricity it is far more environmentally friendly than the majority of aluminium smelters around the world. Its carbon footprint is much lower when compared with coal-powered smelters in China, for example.

Any way you look at it, it makes sense to retain the smelter at Tiwai Point for a longer time frame. This means the government must agree to a fairer power price for the smelter. Any electricity consumer – be they private individual or business, large or small – who doesn't want a hike in their electricity bills should agree.

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