

# O-I New Zealand: Response to Productivity Commission 'Low Emissions Economy' Inquiry – Draft Report

8 JUNE 2018

## Headline Responses

- As at 2018, no countries where O-I's key competitors are located impose effective carbon pricing mechanisms. It is unlikely that such mechanisms will be imposed in the short-to-medium term.
- It is important not to conflate free allocation of emissions units to emissions-intensive, trade exposed (*EITE*) firms with 'assistance' or a 'subsidy' to New Zealand emitters.
- Until genuinely comparable overseas carbon management schemes are in place, any withdrawal of free allocation will only serve to undermine the ability of O-I (and other *EITE* firms) to compete, and result in carbon leakage.
- In the case of emissions reduction policies, impacts on the viability of domestic industries are the result of policy settings, which are under the Government's control, rather than external market forces.
- The wider impacts on the New Zealand economy of any carbon-reduction policy measures need to be subjected to comprehensive assessment and testing before any such measures can be properly assessed.
- O-I (and similar firms) plays an important role in ensuring that New Zealand can operate as a more 'circular' economy, where waste is able to be repurposed and reused using domestic facilities.
- O-I would like to see a hypothecated fund set up for the purpose of investment in carbon-reducing technologies.

## INTRODUCTION

O-I New Zealand (*O-I*) wishes to provide feedback on a number of findings in the draft report on the Productivity Commission's 'Low Emissions Economy' inquiry (*Inquiry, Draft Report*).

O-I's history, and its importance to New Zealand's waste management system, are outlined in more detail in O-I's original submission on the Inquiry.<sup>1</sup> Where necessary, this response builds on the points made in O-I's original submission.

Specific findings, and O-I's responses, are set out below:

## WITHDRAWAL OF FREE ALLOCATION

**Finding F4.3: "[...] The case is strong to withdraw the free allocation of units to EITE firms over time as competing firms in other countries also face emissions pricing"**

### Response

O-I is a 'moderately' EITE firm, and currently receives a free allocation to cover 60% of its ETS liability. O-I faces considerable overseas competition, particularly from glass manufacturers in the Middle East and South-East Asia.

As at 2018, no countries within those regions impose effective carbon pricing mechanisms.<sup>2</sup>

O-I therefore relies on the free allocation regime to remain competitive with manufacturers in such regions. In light of the Draft Report's finding F4.3, O-I wishes to make the following points clear:

### **Free allocation is not 'assistance'**

O-I considers that it is important not to conflate free allocation of emissions units to EITE firms with 'assistance' or a 'subsidy' to these emitters.

Instead, the free allocation regime within the ETS ensures that the competitiveness of New Zealand producers is not undermined by Government-imposed costs that offshore firms do not have to meet.

In this sense, free allocation should be more accurately considered as a **balancing mechanism**, designed to ensure fairness and consistency between comparable manufacturers in different jurisdictions. Such a 'level playing field' is all that O-I is seeking – not 'assistance'.

### **Overseas regimes need to be genuinely comparable to the NZ ETS**

O-I acknowledges that overseas jurisdictions are increasingly moving to impose some form of pricing on carbon emissions. However, these efforts are still a long way off providing genuine parity in terms of liability for emissions.

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<sup>1</sup> Submission 085.

<sup>2</sup> *State and Trends of Carbon Pricing 2017* (World Bank, November 2017).

To illustrate, O-I notes that (as at 2018):<sup>3</sup>

- No jurisdictions in the Middle East are contemplating carbon pricing mechanisms. In South East Asia, only Thailand and Vietnam have carbon pricing under consideration; and
- Even where such mechanisms are being contemplated, the relevant jurisdictions are still some way off imposing an effective cost on carbon in practice.

In addition, before overseas carbon pricing schemes can be assessed as 'comparable' to the NZ ETS, the actual competitive position under such schemes must be analysed against the following factors:

- Lead-in periods, free allocations, and how soon overseas emitters will face **full liability** for their emissions;
- Actual dollar costs faced by overseas emitters to comply with the applicable scheme;
- Any subsidies available to offshore emitters;
- Quality, provenance and credibility of any equivalent units that may be accepted in the relevant overseas scheme; and
- Whether overseas schemes are adequately enforced.

Until genuinely comparable overseas carbon management schemes are in place, O-I considers that any withdrawal of free allocation will only serve to undermine the ability of O-I (and other EITE firms) to compete.

***If overseas schemes are not comparable, carbon leakage and potential global increases in emissions are likely***

If O-I and other domestic EITE firms cannot remain competitive, the likely outcome is carbon leakage as production shifts offshore.

In the specific case of glass, there is also a risk of a net increase in global emissions if carbon leakage occurs. O-I's operations are already relatively efficient as a result of considerable investment in its processes and equipment. Further, O-I is continually seeking ways to reduce energy use and emissions.

By contrast, if glass demand shifts offshore, it will likely be picked up by less efficient producers. These firms may ultimately use more energy than O-I, and generate more emissions, for the same output.

Additionally, the loss of O-I as a domestic glass recycler/producer would increase the need to export cullet (crushed glass) for recycling (assuming a suitable export market can be found). Additionally, New Zealand consumers would need to import finished glass products from overseas, in contrast to the current situation where 70-80% of O-I's sales are within 20km of its Penrose plant. This increased need for imports/exports would result in a corresponding increase in transport emissions.

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<sup>3</sup> Ibid.

## FINANCIAL ASSISTANCE

**Finding F9.7: "Providing financial assistance to firms facing closure or decline as a result of policy change would be risky, encourage unproductive lobbying and raise questions of fairness"**

### Response

O-I notes that the Draft Report refers to the "futility" of trying to retain struggling firms through providing assistance.<sup>4</sup> O-I urges caution when assessing policy settings that may result in closure or decline of New Zealand firms and industries. This viewpoint is particularly pertinent in the context of the Inquiry not yet having the benefit of any economic modelling.

In the case of emissions reduction policies, impacts on the viability of domestic industries are the result of **policy settings**, which are under the Government's control, rather than external market forces.

In O-I's view, what qualifies as 'financial assistance' to New Zealand firms needs to be more carefully distinguished from policies, such as free allocation, which are not strictly 'assistance' to New Zealand firms.

### ***Wider economic impacts need to be tested***

O-I notes that economic modelling in support of the Draft Report has not yet been completed. Consequently, the findings and recommendations of the Draft Report have not been supported by comprehensive economic assessment. O-I encourages robust economic assessment and modelling to support any findings in the Productivity Commission's final report.

O-I considers that any modelling undertaken should be subject to peer review. At the very least, O-I considers that modelling should be made publicly available, so affected parties can ascertain how they have been treated by the model, and test any key inputs, outputs and assumptions.

Further, O-I considers that the modelling already underway is a good start, but is not fulsome enough. In O-I's view, the wider impacts on the New Zealand economy of any carbon-reduction policy measures need to be subjected to comprehensive assessment and testing before any such measures are committed to.

In particular, any modelling needs to follow through the entire supply chain, to ensure all 'flow-on' impacts are captured. If certain manufacturers or industries are no longer able to operate in New Zealand, the impacts are unlikely to be confined to a single industry.

For example, as a glass producer, O-I is a crucial component of the supply chain for key New Zealand industries (including the wine industry, which had a total export value of \$1.66 billion in 2017, and employs over 7,000 people).

The loss of a domestic producer of containers may increase costs for such industries, who would need to secure imported containers. These producers are already very cost-sensitive, meaning even small increases in cost may have considerable flow-on effects. Wine producers also face existing constraints on access to overseas consumers (eg in the form of restrictions on container weight, which essentially operate as a 'de facto' tariff).

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<sup>4</sup> Draft Report, page 233.

In addition, the ability of New Zealand producers to access locally-sourced, high-quality recycled packaging is becoming an important part of their own 'brand building' efforts. Overseas consumers are increasingly conscious of the source and production processes of the goods they purchase. O-I's product is therefore an increasingly important component of high-end food and beverage export goods, whose markets are particularly sensitive to environmental and ethical considerations.<sup>5</sup>

### ***Waste management and the circular economy***

While O-I is a significant industrial operator, it also occupies an important niche in New Zealand's waste management system as the only on-shore recycler of glass products.

Glass is infinitely recyclable, and O-I currently receives used glass from local authorities across New Zealand, which is processed and turned into new products. In this sense, O-I plays an important role in ensuring that New Zealand can operate as a more 'circular' economy, where waste is able to be repurposed and reused using domestic facilities.

If O-I is forced to cease operations in New Zealand, a significant component of the waste management system will effectively 'go offline', and require central and local government to find export markets for used glass products (which totalled 127,000 tonnes in 2017). Used glass is a very low-value commodity, with the most valuable available use being domestic recovery and processing into new products (which has the added benefit of creating a positive 'loop' in terms of production and consumption).

If domestic recycling is not an option, finding a suitable market to accept glass waste cannot be taken as a given. Specifically, for exports of cullet to be viable:

- Overseas glass producers must be able to purchase cullet at a lower price than the equivalent virgin raw materials (which may be challenging once transport costs are factored in); and
- Overseas waste policies must also accommodate imports of low-grade waste. As an illustration, China's recent 'National Sword' programme has substantially curtailed New Zealand's (and other countries') ability to export waste to China for processing, which is already having an impact on New Zealand's waste management systems.

Assuming a viable export market cannot be found for used glass, increased amounts of recyclable waste will end up in landfill.

In O-I's submission, these (more subtle) potential 'ripple' impacts from the loss of domestic manufacturers should also inform the Productivity Commission's findings on the treatment of New Zealand firms and industries facing closure or decline.

### ***New Zealand's wider sustainability commitments***

O-I wishes to make a broader point about New Zealand's industries and the UN's 'sustainable development goals', adopted in 2015. In O-I's submission, these goals, and their application to New Zealand industries, should inform the Productivity Commission's final set of findings and recommendations, particularly concerning the ongoing viability of domestic firms.

Of particular relevance to the treatment of New Zealand's industrial operators are the following goals:

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<sup>5</sup> See <http://recycleglass.co.nz/the-infinite-bottle/> for an example of collaboration between O-I, Unitec and the New Zealand Beverage Council on this matter.

- Goal 8 – ‘decent work and economic growth’
- Goal 9 – ‘industry, innovation and infrastructure’
- Goal 11 – ‘sustainable cities and communities’
- Goal 12 – ‘responsible consumption and production’

In line with the above goals, O-I:

- Is the country’s only domestic supplier/recycler of glass, ensuring New Zealand retains viable on-shore glass recycling capability;
- Is an important supporter of other New Zealand industries, contributing to wider economic wellbeing;
- Continually invests in improving its processes, and pursues innovation in reducing its environmental footprint; and
- Commits to high standards in working conditions, remuneration, and employee wellbeing (particularly in comparison to competitor firms). O-I’s parent company implements these standards across all of its operations worldwide.

## **ABSORPTIVE CAPACITY**

**Finding F5.12: “‘Absorptive capacity’ is the capacity of firms to learn by using knowledge from their external environment. It appears to be a key driver of a firm’s ability to accumulate knowledge assets and raise its productivity. Absorptive capacity is also likely to be important for learning about, and investing in, clean technologies. This suggests a double benefit from better absorptive capacity – reduced emissions and improved productivity”**

### **Response**

O-I supports the recognition of the concept of absorptive capacity in the Draft Report, and of the importance of absorptive capacity in transitioning to a low emissions economy.

O-I considers that it meets all of the ‘markers’ associated with high levels of absorptive capacity, as identified in the Draft Report:<sup>6</sup>

- *Firms having overseas interests and links* – O-I New Zealand is part of a global organisation, with 78 plants in 23 countries worldwide. O-I’s New Zealand operation therefore draws on considerable global glass manufacturing knowledge and experience;
- *Firms that undertake R&D* – In New Zealand, O-I is continually investing in improving its operations. In 2010, O-I invested \$125 million in a new furnace and 2 new machine lines. In 2016, O-I invested \$30 million in furnace upgrades. Globally, O-I’s parent company operates a R&D laboratory at its head office in Perrysburg, Ohio. This R&D covers new innovations across all glass manufacturing activities, including: processes to melt glass; new ways to form glass; more efficient colour change methods; and methods to improve training globally to share best practice processes and procedures. Replication of successful projects is also assessed at the R&D centre;

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<sup>6</sup> Draft Report, page 130.

- *Firms that innovate* – O-I is continually seeking to improve its operations. O-I understands what world-class glass manufacturing looks like, and seeks to harness key advances in productivity, efficiency and environmental impacts, through replication of successful projects through its plants worldwide. To achieve these outcomes, O-I’s parent has developed a set of **global manufacturing fundamentals**, which are implemented across the organisation’s global operations. O-I and related companies use these ‘fundamentals’ to leverage its global knowledge to drive continuous improvement.

O-I’s parent has also developed a series of principles for managing costs, referred to as **total system cost**. Total system cost seeks to integrate the organisation’s global systems and operations, to reduce waste and improve both environmental and financial sustainability outcomes;

- *Larger firms* – O-I carries out the majority of glass recycling that occurs in New Zealand, and is one of New Zealand’s largest recycling companies overall. O-I is also a major supplier to the food and beverage industry; and
- *Firms employing greater relative numbers of professionals, managers and technicians* – O-I employs 272 people at its Penrose manufacturing plant. These jobs are primarily professional or skilled in nature.

In line with O-I’s comments above, O-I considers that any policy decisions that may impact the viability of firms with high absorptive capacity should be informed by detailed analysis of the flow-on impacts if such capacity within New Zealand is lost.

## **RISING EMISSIONS PRICES**

**Finding F13.5: “Rising emissions prices will be central to driving emissions-reducing investments in industrial heat processes”**

### **Response**

O-I wishes to emphasise that methods other than pricing, such as research and development (potentially with Government assistance) also have the potential to assist in reducing emissions.

As noted, O-I is continually seeking innovations and improvements in its emissions performance. O-I recognises that its future viability will depend on carbon-reducing technologies being available, and is therefore actively pursuing these developments regardless of carbon prices.

In particular, O-I would like to see a **hypothecated fund** set up for the purpose of investment in carbon-reducing technologies, drawn from revenues from auctioning of NZUs. O-I notes that the Draft Report finds that the policy case for hypothecating such revenues towards assistance for *households* is not strong (Finding F9.10). The rationale for this finding is that the link between the taxed activity and subsequent expenditure is not strong.

O-I notes that the Draft Report does not make a direct comment on the justification for a hypothecated fund for businesses. O-I considers that (in potential contrast to hypothecation for households) the case for hypothecating NZU revenue for businesses engaged in research and development to reduce emissions is stronger. There is a more direct connection between revenue raised from auctioned emissions units, and Government funding towards projects and research and development that lead to emissions reductions.