ArcelorMittal

6 October 2020

Standing Committee on Finance (National Assembly)
Committee Secretaries, Mr Allen Wicomb and Ms Teboho Sepanya

By eMail: awicomb@parliament.gov.za; tsepanya@parliament.gov.za

Dear Sir/Madam

COMMENTS ON THE DRAFT TAXATION LAWS AMENDMENT BILL 2020 (draft TLAB):
PROPOSED INTRODUCTION OF EXPORT TAXES ON SCRAP METALS (FERROUS)

ArcelorMittal South Africa ("ArcelorMittal") is fully committed to and supportive of government's intentions to stimulate growth, employment and development across the ferrous scrap and steel value chains in South Africa. As this is of national importance, the viability of the ferrous scrap and steel sectors should be maintained, by providing a framework that enables private sector participants to maximise their potential. However, ArcelorMittal believes that government interventions and policy considerations in these sectors need to be carefully evaluated, given the significant impact which such policies could have in times to come.

ArcelorMittal disagrees in principle with, and does not support, the proposal of an export tax on ferrous scrap metal ("Proposed Tax") as proposed in the TLAB.

In summary ArcelorMittal is of the view that the Proposed Tax should not be introduced for the following reasons:

- There is more than adequate supply available to meet local demand and such a tax would only dampen domestic prices, the benefits of which will not flow to the broader economy in general but rather accrue to the direct users of the resource, the electric steel makers.
- A decrease in local scrap price would dampen the incentive for collection this would negatively impact the informal sector in particular.
- The Proposed Tax would therefore not be beneficial to the downstream scrap suppliers who should be the beneficiaries of such intervention.
- Even though ArcelorMittal would enjoy some benefit directly from lower scrap prices, it will have a disproportionate effect on steel producers using iron ore (like ArcelorMittal) and believe that the longer-term impact on the steel industry would be negative.

This is explained further below. Our concern is that the export tax will have adverse long-term effects and is ultimately prejudicial to economic growth, and ArcelorMittal firmly believes that

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its implementation will do significant harm to the manufacturing sector in South Africa, as explained in the four topical areas highlighted below.

- **Domestic availability of scrap metal: there is no shortage of scrap**

There is not a lack of quality scrap metal in South Africa. With industrial-scale steel production since 1934 South Africa has accumulated a scrap pool that can be reasonably estimated at circa. 140 million tonnes. This scrap pool is increasing at a nett rate of roughly 2 million tonnes per year: additions of ca. 4.5 million tonnes of steel (domestic and imports) and subtractions of ca. 2.5 million tonnes for steel-making and exports.

South Africa has some of the lowest scrap prices in the world, on average 75 to 80 US dollars per tonnes below the South East Asian scrap price. That there are complaints of a lack of scrap in the country is an indication that the scrap prices are too low to motivate scrap merchants to collect and sort enough scrap. If at present levels, pricing is insufficient to incentivise scrap collection then the answer cannot be an export tax which will only reduce domestic scrap prices further and thereby dis-incentivise collection even more.

It should also be noted that 2018 was a profitable year for the steel industry globally with significant spread between long products prices and the scrap price. As such the reported difficulties of electric steelmakers in South Africa to be profitable during this period seems more likely to be linked to the structural overcapacity of steel-making in the country rather than to the price paid for scrap.

As a final point on scrap availability, the highest quality scrap comes from the manufacturing sector; the off-cuts remaining at the end of the manufacturing process. This scrap is the highest quality because it is coming from fresh steel and is promptly recycled. The volume of prompt scrap available therefore depends on the level of activity in the manufacturing sector. To have more prompt scrap South Africa needs more manufacturing activity and to generate this, given that neither the economy nor demand are growing, requires government to protect downstream industries pro-actively from imports of finished goods.

- **Support to small business/informal sector**

The informal scrap collection sector who are the main source of “brown” scrap will be paid less for the material they bring to the scrap merchants, resulting in a reduction of what is already a small take-home income. Also, with lower realised prices and lower volumes being processed, the scale and efficiency of scrap collection will be lost, so this part of the economy will shrink.

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- **Output and pricing: the Proposed Tax will be equivalent to a significant and disproportionate direct subsidy to electric steel-makers having a distortive effect on the market**

While it is clear that electric steel mills will benefit from lower scrap pricing, given that there is a structural over-capacity of steel-making in the country, South Africa will suffer disproportionately.

- The subsidy by way of an export tax (proposed as 1000R/t) given to the mini-mills may allow increased production in the near term, but the longer term more serious implication will be the reduction of collection of scrap and a distortive effect in the market which may result in the further closure of plants due to the impact of what could be seen as a government subsidy. For example, South Africa could lose the capacity to beneficiate up to 3 million tonnes of iron ore
- South Africa could lose the ability to make high-end, high-quality steels which can only be made directly from iron ore. These steels are crucial inputs to the automotive sector (e.g. springs, hubs, forgings), the mining sector (e.g. high strength rock-bolts) and to high added-value exports. Without domestic production, companies dependent on these products will be forced to down-size or close.
- Wire producers who depend on wire-rod from ArcelorMittal will be forced to either reduce significantly or close their businesses.

As a result of the distortive effect of the Proposed Tax as explained above, it is also likely that it could affect investment decisions regarding upstream iron-ore based production and lead to job losses.

With regards to the level of the Proposed Tax, it has also been stated that the Proposed Tax is intended as a replacement of the Preferential Pricing System (PPS). However, at 1000R/t it would have a significantly larger impact than the PPS ever had (45R/t).

- On an annual basis, the average gap between Domestic scrap prices and export prices has ranged between +200 R/t and -200 R/t
- Prior to PPS, the average monthly Domestic scrap price was 84R/t more expensive than the export price. Under PPS, the average monthly Domestic scrap price was 39R/t more expensive than the export price. So, the nett effect of the PPS can be estimated as a 45R/t impact on the domestic scrap price
- Also, stating that the 1000R/t duty is based on an ad valorem rate of 20% would imply an expectation that scrap prices would be 5000R/t, which is a level not seen since prior to 2012. Our experience is that the present domestic pricing is significantly below this amount (by more than 30%).

Consequently, in the event that our main recommendation, to not introduce the tax, is not acceptable, then at least the imposition of the export tax should be based on realistic calculations as explained above. This would indicate a maximum value of R50/t. At a level of R1000/t, as proposed currently, the export tax is excessive.

- **Conclusion**

For the above reasons, we respectfully submit that the Proposed Tax would be a significant mistake which would cause irreparable harm to the South African manufacturing sector.

None of the above takes away the fact that the steel sector is in significant difficulties, due to structural over-capacity. As explained previously, the Proposed Tax will provide a disproportionate direct subsidy to electric steel-makers, to the detriment of the integrated steel-making route based on iron ore, and thereby have a distortive effect on the steel market. If such a subsidy on the raw-materials of electric steelmakers is implemented, similar support (i.e. an export tax) should be provided to the raw materials flow for the integrated steel route, namely on iron ore and coking coal. Our understanding is that such reasoning (i.e. support via an export tax) is being contemplated for application to ferrochrome ore exports, and thus would be consistent with a broader ore beneficiation policy.

ArcelorMittal would appreciate the opportunity to make a submission at the public hearings on Wednesday, 7 October 2020.

Yours sincerely,

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