ITAC

International Trade Administration Commission of South Africa

Report No. 121

Review of the duty structure for iron and steel products classifiable under Chapter 72

enabling FAIR TRADE

The Commission herewith presents Report No. 121: **REVIEW OF THE DUTY STRUCTURE FOR IRON AND STEEL PRODUCTS CLASSIFIABLE UNDER CHAPTER 72**, with a recommendation.

Mr Itumeleng Masege
DEPUTY CHIEF COMMISSIONER

PRETORIA

05 /07/ **2005**

REPUBLIC OF SOUTH AFRICA

INTERNATIONAL TRADE ADMINISTRATION COMMISSION

REPORT NO. 121

REVIEW OF THE DUTY STRUCTURE FOR IRON AND STEEL PRODUCTS CLASSIFIABLE UNDER CHAPTER 72

Synopsis

The Commission decided to launch the investigation against the background of several ad-hoc applications for a reduction in the duty on tariff subheadings classifiable under Chapter 72. These mounting applications prompted the Commission to publish the whole Chapter 72 for a review of the duty structure of all primary steel products. The Commission took this decision in light of the national debate about the pricing of primary steel and the effect that this has on the downstream industries. The objective of the review was to look at the possibility of reducing the duties to reduce costs for downstream and domestic value addition, given the perceived international competitiveness of the industry.

The Commission found that: The primary steel industry was performing well in terms of economic criteria; it is globally competitive; it is very much export oriented and enjoys the bulk of the market share in the Southern African Customs Union (SACU). In light of the restructuring and consolidation of the primary steel industry globally, Mittal Steel became the major shareholder of Mittal Steel South Africa and Acerinox became the major shareholder of Columbus Stainless (Pty) Ltd. This has led to enhanced efficiencies, improved international competitiveness, growth in production, the pursuit of economies of scale and significantly increased exports.

The primary steel industry uses an import parity pricing system, also factoring the 5% duty into the equation. This protects the industry against foreign competitors and the geographical isolation of SACU gives it an advantage. These circumstances have rendered the 5% duty superfluous.

The Commission also found that SACU is endowed with the major raw materials used in the manufacture of primary steel, giving the carbon steel and

stainless steel industries a substantive competitive advantage against foreign competitors.

In terms of the SA/EU Trade Agreement, the import duties on the primary steel products classifiable under Chapter 72 were already reduced to zero from 1 January 2005. Imports from the EU represent a major share in relation to imports from other countries, resulting in a relatively open steel industry.

The Commission found that a reduction in the duty on steel products could assist in lowering the cost of production for downstream manufacturing of secondary iron and steel products.

A reduction in the duty will also render a number of rebate provisions redundant and will therefore simplify the tariff structure and lead to less administration. The Commission therefore recommended that the duties of 5% ad valorem on iron and steel products classifiable under Chapter 72 be reduced to free of duty, and that all the rebate provisions applicable to these products be withdrawn.

Introduction

1. The Commission decided to launch the investigation against the background of several ad-hoc applications for a reduction in the duty on tariff subheadings classifiable under Chapter 72. These mounting applications prompted the Commission to publish the whole Chapter 72 for a review of the duty structure of all primary steel products. The application was published in the Gazette of 1 October 2004 for comment. The Commission took this decision in light of the current national debate about the pricing of primary steel and the effect that this has on the downstream industries. The objective of the review was to look at the possibility of reducing costs for downstream and domestic value addition, given the perceived international competitiveness of the industry.

The application and tariff position

2. The review of the whole duty structure of iron and steel products classifiable under Chapter 72 covers in total 17 tariff headings (72.08; 72.09; 72.10; 72.11; 72.12; 72.13; 72.14; 72.15; 72.16; 72.17; 72.19; 72.20; 72.25; 72.26; 72.27; 72.28; 72.29) and 109 tariff subheadings that carry duties of 5% ad valorem. The steel and stainless steel products involved are flat-rolled products, bars and rods hot-rolled, bars and rods of other alloys, angles, shapes, sections and wire.

The industry and market

3. The industry constitutes five carbon steel producers and one stainless steel producer. The producers are listed below with an indication of major shareholding.

- Cape Gate (Pty) Ltd – privately owned
- Cape Town Iron and Steel Works (Pty) Ltd (Cisco) – wholly owned subsidiary of Murray and Roberts
- Columbus Stainless (Pty) Ltd – 64% shareholding by Acerinox of Spain, 12% by Highveld Steel, 12% by Samancor and 12% by the IDC
- Highveld Steel and Vanadium Corporation Ltd – 2/3 shareholding by Anglo American
- Mittal Steel South Africa – 51% shareholding by Mittal Steel Group
- Scaw Metals, a Division of Anglo Operations Ltd – Wholly owned by Anglo American plc.

4. To be successful in the steel industry, smaller players have to become part of larger multi-national companies in the world in order to compete globally. The industry has seen domestic and global consolidation in enhancing efficiencies, improving international competitiveness and fostering growth in production. Multi-national companies trade their products worldwide and are increasingly dominating the global industry. Mittal Steel, a major shareholder in Mittal Steel South Africa, is now set to be the largest producer in the world and Acerinox, also a major shareholder in Columbus Stainless (Pty) Ltd is the third largest producer of stainless steel globally. To be competitive globall, these companies are forced to continuously reduce costs by rationalising production lines, getting larger economies of scale, improving efficiencies and moving up the value chain and investing in value adding capital projects.

5. Together with this huge drive towards optimisation, there has also been a drive towards regionalisation. This is clearly evident through the creation of regional trade arrangements, hence the South African steel industry's focus on the African continent. It should, however, be noted that the African market is fragmented and is growing from a very low base compared to other developing regions in the world.

6. The geographical location of SACU in relation to foreign competitors serves as natural protection for the locally manufactured products as imported products have to be transported over a long distance to compete in the SACU market. However, according to the South African Iron and Steel Industry (SAISI), the same is also true for their export costs.

7. Only low-cost producers will survive in the global steel market. The primary steel producers have demonstrated that it is possible for South African companies to attain world benchmarks. Some producers have progressed further than others.

8. Notwithstanding the steel industry's continuous improvement efforts, the global steel industry is facing increasing cost pressures in respect of steel making, raw materials, freight costs and uncertainty about energy costs and mounting environmental pressures. A price-cost squeeze of more than 2% per annum has prevailed for the last 25 years in the global steel industry.

9. With regard to the rising costs of raw materials, it should be noted that whilst prices of the raw material inputs are rising globally, SACU is endowed with raw materials that are available at reasonable costs. However, it should be noted that a proportion of the material inputs for the manufacture of carbon steel, like coking coal, are imported. For the manufacture of stainless steel, raw materials like nickel, chrome, manganese, molybdenum, titanium scrap and steel scrap are used. Although the prices of nickel and chrome increased drastically, the products are locally sourced and represent approximately 70% of total production costs. Of the raw materials used, molybdenum is imported from Chile and represents approximately 4% of total production costs.

10. The production capacities of the producers in the SACU region are reflected in the table below.

Approximate Crude Steel Capacity – million tons - 2005	
Cape Gate	0.485
Cisco	0.250
Columbus Stainless	0.650
Highveld Steel	1.000
Mittal Steel South Africa	7.251
Scaw Metals	0.561
Total	10.197

Source: SAISI

As reflected in the table, total carbon steel production capacity is 9,55 million tons compared to a stainless steel capacity of about 0,65 million tons.

11. With regard to crude steel production, the lowest figure for the ten-year period as from 1995 was 6.830 million tons during 1999, with the highest figure at 9.384 million tons during 2003. There seems to be an upward trend in the South African crude steel production as from 2000. Local production is set to increase by as much as 2 million tons over the next few years as Mittal Steel South Africa has recently indicated its intention to raise production of crude steel to be in a position to fully exploit installed rolling capacity.

12. Regarding primary carbon steel sales of profile products and flat products, the lowest figure for the ten-year period as from 1995 was 3.407 million tons during 1999, with the highest figure at 4.516 million tons during 2002. The figure for 2004 was 3.882 million tons.

13. Regarding Columbus Stainless (Pty) Ltd, the production of stainless steel products increased from 516 000 tons in 2001 to 718 000 tons in 2004 and to an estimated figure of 1 000 000 tons in 2007. Domestic sales remained nearly constant since 2001 at approximately 100 000 tons per year.

14. The exports of primary carbon steel products by Mittal Steel South Africa represent approximately 64% of total sales in 2004. About 82% of the primary production of stainless steel of Columbus Stainless (Pty) Ltd is exported to world markets. The export of both these products showed an upward trend over the last 3 years due to plant expansion, high efficiencies and increased global demand. The figures decreased somewhat in 2004 as a result of the relatively strong rand.

15. As the domestic market for steel and stainless steel increased steadily since 1999, imports also show an upward trend. Imports from the EU countries represent approximately 40% of total imports in 2004. Imports from the non-EU countries increased from 17% in 2003 to approximately 28% in 2004. The

imports from the ten biggest countries increased from 277 749 tons in 2003 to 335 420 tons in 2004.

16. Capital expenditure in the primary steel industry increased significantly. From the year 2000, capital invested increased gradually from R1.7 billion to R3 billion in 2004. Regarding the stainless steel industry, new investment of R 2.1 billion has taken place over the past 4 years.

17. Employment in the primary steel industry decreased from 1980 to 2003. The reduction in employees in the industry led to an escalation in crude steel production per employee from 200 tons in 1970 to 600 tons in 2002. This phenomenon reflects the concerted and ongoing actions of the steel producers to restructure and consolidate their business to be globally competitive. On the other hand, employment in the downstream metals industries and fabricated metal products has increased.

The competitive position

18. Mittal Steel South Africa is price-competitive on the domestic market. It prices its products in accordance with a notional landed cost of similar imported steel products.
19. The profitability of the major domestic role players in the steel and stainless steel industries is excellent.

Comments on the Publication

20. The South African Iron and Steel Institute (SAISI) objected to the application. According to SAISI, the steel industry is afforded much lower protection than many of its counterparts in other countries, in particular developing countries, and for that reason the duty should therefore be maintained.

21. With regards to stainless steel products, Columbus Stainless (Pty) Ltd as well as the Southern African Stainless Steel Development Association (SASSDA) objected to the application. According to them, extreme care should be taken

not to compromise the viability of the primary producers, which are highly capital-intensive operations and a key cornerstone of the industry. In this regard there is no evidence that a reduction in the duty would have the desired positive effect on the downstream industries. It should also be recalled that other significant stainless steel exporting countries like Brazil and India have much higher duties in place to protect their own primary producers.

22. The Capital Equipment Export Council that includes mining, agriculture, building and construction, processing and the utilities sub-sector, supported the application. The Council stated that, although preferential pricing arrangements are made by the steel industry with large customers, little is being done for SMMEs and BEEs that are trying to find a footing in manufacturing. It is well documented that few jobs are created at the large company level. However, when the barriers of competitiveness are so heightened by high prices at the beginning of the value chain, according to the Council, this constrains the small steel fabricators and converters to survive and grow into globally competitive companies. According to the Council, this is where jobs are created, yet very little cognisance seems to be taken regarding supporting this sub-sector of the economy. The primary steel and stainless steel industry also make use of the import parity pricing system resulting in higher prices to the downstream industries. A reduction in the duty should reduce costs to the downstream industries.

23. Similar comments to those of the Export Council were also received from Steelbank Merchants (Pty) Ltd. The company is a steel service center and steel stockist involved with a variety of steel users such as automotive, white goods, building, electrical, baking, wholesaling and retailing.

Findings

24. Information at the Commission's disposal indicates that the primary steel and stainless steel industries have undergone significant consolidation and restructuring. This includes the rationalisation of product lines and steel grades produced, improvement in efficiencies throughout all operations and raising

the level of customer satisfaction. This has placed the primary steel industry in an internationally competitive situation. The industry has committed itself to substantial capital investment to remain globally competitive. The recent economic performance of the primary steel industry is impressive.

25. The Commission found that the primary steel and stainless steel manufacturers enjoy the bulk of the market share in SACU and also export a large percentage of their local production. Imports are relatively small and contribute a minor percentage of the domestic market. Most of the raw materials are available locally at reasonable prices.

26. By making use of the import parity pricing system, the industry is subsidising its lower export prices with the higher domestic prices. Together with the competitive advantage of lower raw material prices, the primary steel and stainless steel industries are in a position to export their products at world competitive prices resulting in good profit margins. Unfortunately, the price benefits that the primary industries enjoy are not fully passed on to the downstream industries. South Africa's geographic isolation and the lack of regional competition mean that the secondary industries are indeed prejudiced by import parity pricing. The primary industry cannot have protective duties and practice import parity pricing at the same time. Further, smaller merchants in the distribution channel increase prices to the downstream industries and contribute to the problem of price escalation.

27. The Commission also found that, notwithstanding the lower custom duties that the industry enjoys compared to its counterparts in other countries, it competes well against imports. The primary steel industries could experience price competition in future against imports from the Far East when the cycle turns. The multi-national companies are, however, well positioned to combat such competition. In terms of the SA/EU Trade Agreement, the import duties on the primary steel products classifiable under Chapter 72 were reduced to zero from 1 January 2005 resulting in a relatively open steel industry.

28. The Commission is of the view that the downstream sector should be

promoted, as more jobs and value-added products need to be created. By reducing input costs through tariff reduction, the end products could become more competitive, resulting in more sales, more exports, growth and a better utilisation of production capacity.

29. The Commission is also of the view that a reduction in the duties on the products classifiable under Chapter 72 to free, will render a number of rebate provisions redundant and would lead to further important tariff simplification, and reduced administration. The recommendation is that these rebate provisions should be withdrawn.

Recommendation

30. In the light of the foregoing, the Commission recommends that:
    (a) Iron and steel products classifiable under tariff headings 72.08; 72.09; 72.10; 72.11; 72.12; 72.13; 72.14; 72.15; 72.16; 72.17; 72.25; 72.26; 72.27; 72.28; 72.29 and stainless steel products classifiable under tariff headings 72.19 and 72.20, be reduced from 5% ad valorem to free of duty.
    (b) Rebate items 315.04/7213.9/01.05; 315.08/72.11/01.04; 15.08/7226.92/01.06; 315.10/72.19/01.00; 316.01/72.12/01.00; 316.01/72.28/01.00; 316.09/7212.20/01.06; 317.06/72.28/01.04; 317.13/7226.99/01.06; 317.13/7228.70/01.06 of Schedule 3 and rebate items 460.15/72.19/01.00; 460.15/72.19/02.00; 460.15/72.20/01.00 and 460.15/72.20/02.00 of Schedule 4 to the Customs and Excise Act, 1964, be withdrawn.

[T5/2/15/2/1 (34/2004)]