

Steel Crisis Plan Demands

2015

Compiled by:

Joint Steel Task Team

1 Steelmaking: a strategic industry for South Africa

Steelmaking is a key strategic industry for South Africa, representing 1.5% of the country's GDP and accounting for some 190,000 jobs. It multiplies the economic value of South African iron ore by a factor of four, and is core to two of the country's industrial ecosystems.

In addition to the direct economic benefit of South Africa's steel industry, it also underpins several other key industries – the top five of which contribute 15% of GDP and employ 8 million people. It is no accident that all of South Africa peer countries have well-established steel industries; a domestic industry provides security of supply of this critical commodity.

Were South Africa's steel industry to dissolve, it would take over 10 years to re-establish. Yet as the economy grows, its steel intensity will increase. Indeed, many of the key growth drivers laid out in the National Development Plan (NDP) depend on steel; if this steel were imported, it would increase South Africa's trade deficit by around 1% of GDP.

1.1 The economic value add of South Africa's steel industry

Steelmaking contributes 1.1% directly to South Africa's GDP, and a further 0.4% indirectly. Over 190 000 jobs are attributed to primary steelmaking and the immediately downstream industries, while an additional 100 000 jobs are created and induced through suppliers such as transportation of raw materials and steel.

Moreover, the steel industry plays a critical role in mineral beneficiation, given South Africa's abundant iron ore reserves: steel quadruples the economic value of South Africa's iron ore, adding some R26 billion in value.

At a local level, the steel industry is a core employer in three of South Africa's key industrial ecosystems, Vanderbijlpark (Gauteng), Saldanha (Northern Cape) and Newcastle (KwaZulu Natal). Two thirds of the households in Vanderbijlpark and Newcastle and one quarter of those in Saldanha are dependent on the local steel industry for their livelihood. Local suppliers of the steel industry in these communities would not survive without it; if the steel plants were to close, 66% of the labour force in Vanderbijlpark and Newcastle, and 25% of the labour force in Saldanha would be unemployed.

1.2 Steel: enabler of South Africa's key industries

Steel is a key enabler of every part of the South African economy – including the automotive, mining, construction, energy, and infrastructure sectors (all of which have been identified as major growth drivers by the NDP). The top five steel consuming industries together contribute some R600 billion to South Africa's GDP (15% of the total) and employ more than 8 million people (Exhibit 1). In particular:

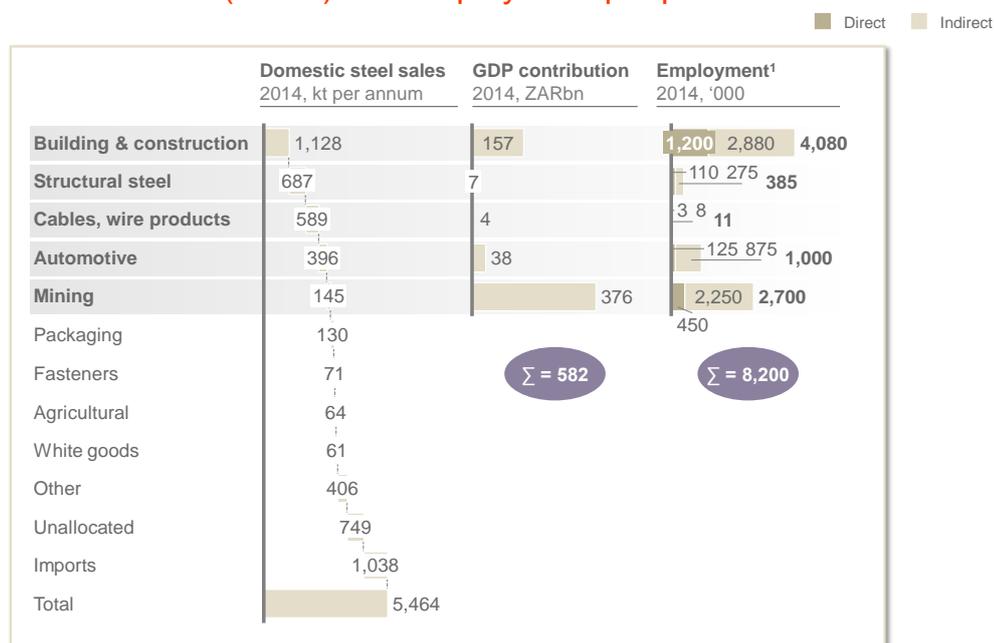
- **Building and construction** contributes R157 billion to GDP and employs more than 4 million people directly and indirectly, and is highly dependent on steel. For example, Medupi power station will consume 120 000 tonnes of steel – more than the world's tallest building, the Burj Khalifa in Dubai.
- **Structural steel** contributes R7 billion to GDP and employs 385,000 people directly and indirectly. Structural steel is South Africa's largest primary steel export, worth over R6bn in 2014.
- **Cables and wire products** contribute R4 billion to GDP and employs 11,000 people directly and indirectly. By way of illustration of the importance of this sector, Kusile power station will have 5,300 km of cabling installed, double the length of South Africa's

coastline.

- **Automotive** contributes R38 billion to GDP and employs some 1,000,000 people directly and indirectly. South Africa's automotive and assembly industry boasts many firsts: for example, Rosslyn, built in 1968, was BMW's first plant established outside of Germany.
- **Mining** contributes R376 billion to GDP and employs some 2,700,000 people directly and indirectly. South Africa has nearly 90% of the platinum metals, 80% of the manganese, 73% of the chrome, and 41% of the gold reserves globally; steel is a core component of mining operations for all these metals.

EXHIBIT 1

Top 5 steel consuming industries contribute ~R600bn to South Africa's GDP (~15%) and employ ~8m people



¹ Indirect jobs estimated using industry multipliers

Source: SAISI, Steel insight – cost comparison, OECD stats, StatsSA, AMSA, DMR, Eskom, BMW plant.co.za, South Africa.info

In addition, the South African steel industry supports key innovative sectors of the economy such as renewable energy. For example, the industry is able to offer tailored products to meet specific requirements for wind towers and solar installations. As a result, wind towers are now locally constructed, and South African technology has been developed which has led to a 16% saving on solar installations.

It is worth emphasising how critical South Africa's steel industry is to support the NDP's goals of increasing GDP growth to 5.4% per annum and reducing unemployment. Increasing transport, rail and electricity infrastructure all require steel, and provide employment. Additionally, the potential to triple advanced manufacturing exports will be lost if the local steel industry is not supported. The automotive industry in particular will have tremendous export potential, but it will not be possible to realise this potential without a thriving local steel industry.

1.3 Why a domestic steel industry matters

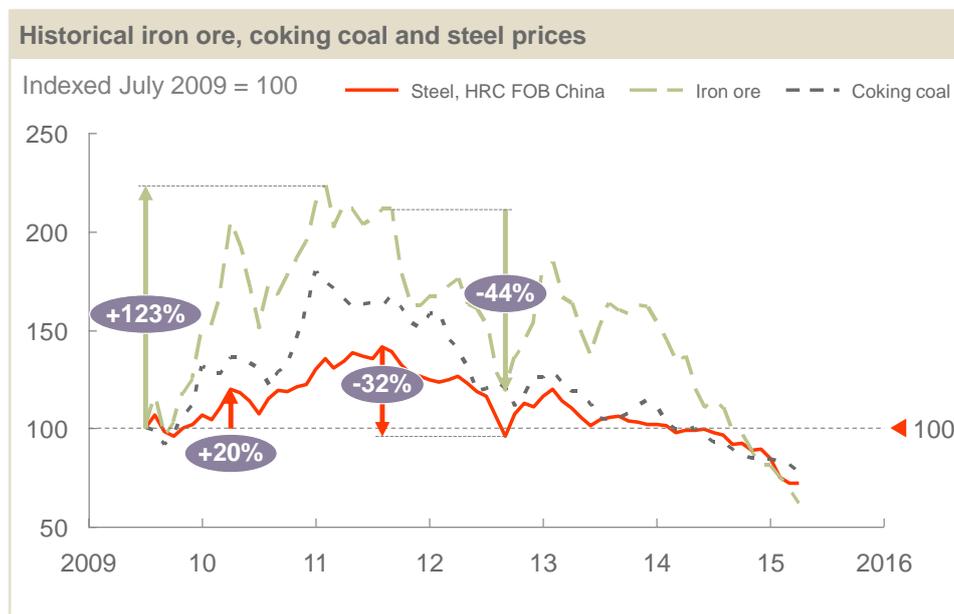
Some 65 countries around the world have a domestic steel industry, including all of South Africa's peer nations, all the BRICS countries, and other fast-growing developing economies. Indeed, there is a positive correlation between GDP and steel intensity for developing countries; countries such as India and China have moved up the steel intensity curve throughout their development. Likewise, South African steel demand is likely to increase with the growth in the economy; local steel demand is forecast to recover from the current slump and attain a 2% annual growth rate, with demand estimated to increase to 5.8mtpa by 2020 and potential 13mtpa by 2030.

South Africa's distance from the nearest steelmaking nations increases the risk to supply and poses challenges for importing due to long lead times and transport costs. A domestic steel industry lessens these risks and offers protection against raw material market volatility, which has been higher than that of the steel price in recent years (Exhibit 2). From 2009 to 2010, for example, iron ore prices rose by 123%, compared to steel at 20%. Similarly for 2011 to 2013, iron ore fell by 44%, while steel prices fell 32%.

Finally, it is worth emphasising that South Africa has Sub-Saharan Africa's only primary steelmaking capability. This represents an opportunity for South Africa to supply steel to neighbouring economies, many of which are growing in excess of 5% per annum.

EXHIBIT 2

A domestic steel industry partially protects against raw material market volatility



Source: SARS, World Bank pink sheet, SARB statistics

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1.4 What if... South Africa lost its steel industry?

The domestic steel industry took a long time to build – beginning with Vereeniging in the

1910's and Pretoria in the 1930's; establishing and expanding Vanderbijlpark in the 1940s and 1950s; building Newcastle in the 1960s and 1970s; and establishing Saldanha in the 1990s. All these major steelworks took at least 5 years to build and their capacity was gradually increased. Vanderbijlpark remains unique in the industry for the variety of products it can produce.

Rebuilding this industry would be costly and time-consuming: should the current local industry dissolve, it would take at least 10 years to re-establish. South Africa would have to compete globally for investment; furnaces would have to be rebuilt to bring plants back to current production capacity, drawing on scarce local skills; and the environmental impact assessments for this would take up to 3 years. Moreover, logistics networks for transporting iron ore and coal would need to be re-established. Downstream demand for steel products would have disappeared due to imports and with it the value chain of merchants and processors. Skilled labour for the industry would have moved to other industries and countries, and it would take massive investment and time to re-build skills to the current level.

2 An industry under threat

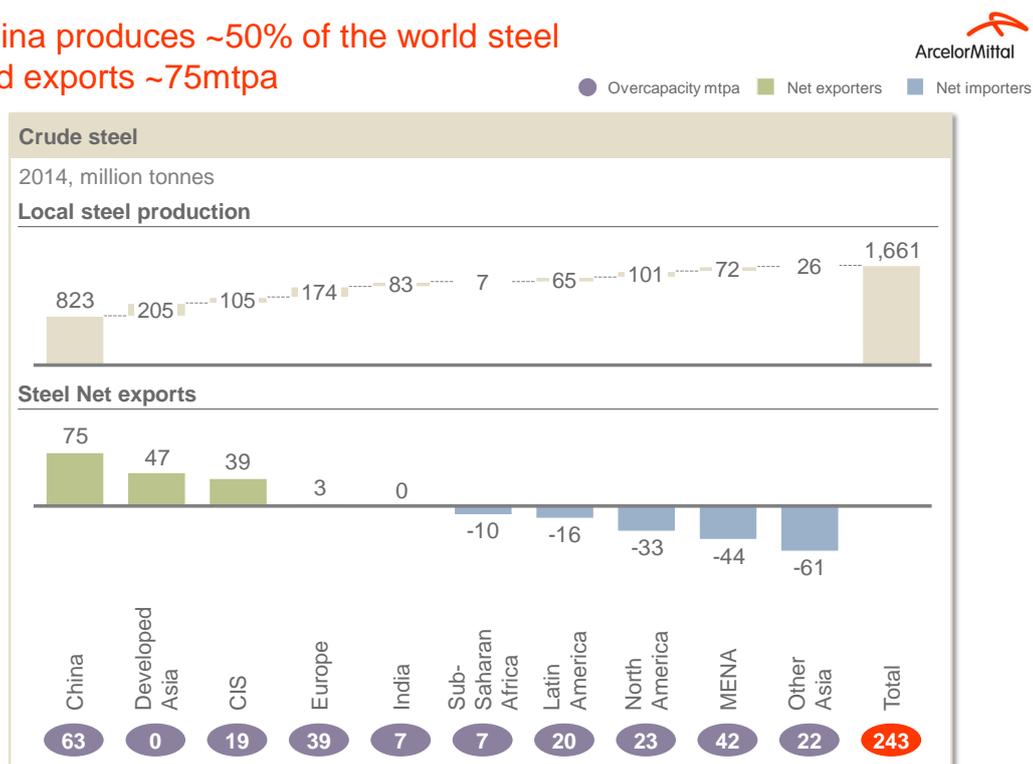
As the previous section makes clear, South Africa’s steel industry is of critical strategic importance. Yet the industry is currently under serious threat from imports. This threat is driven by the current global overcapacity of the steel industry – amounting to some 240 Mt per annum, driven largely by Chinese producers. China prices its products below both South Africa’s – and below its own production costs. This is possible due to a high level of government support for the Chinese steel industry, amounting to more than \$50 billion per annum.

2.1 Global overcapacity driven by China’s low-cost exports

Between 2004 and 2008 steel supply and demand were closely matched. Since then, however, there has been a steady increase in global oversupply of steel production capacity. This is largely driven by China, which produces 50% of world steel and has the capacity to increase further. China is also the largest exporter of steel, exporting 75mt per annum. In 2005, steel exports were widely distributed across the globe. By 2014, however, steel exports were almost exclusively from China and developed Asia (Exhibit 3).

EXHIBIT 3

China produces ~50% of the world steel and exports ~75mtpa

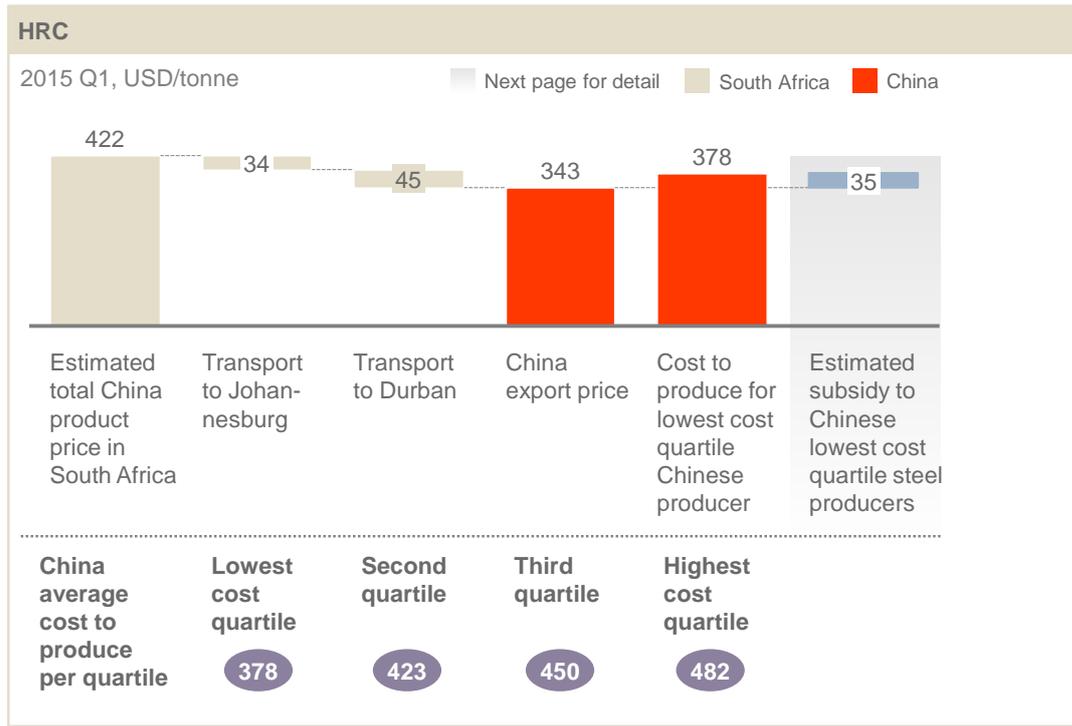


Chinese exports are priced significantly below South Africa’s cost of production. The landed price of Chinese steel is \$66 per tonne below the cost of South African production; this is more than 12% cheaper than what South Africa can produce at. Not only is the Chinese export price lower than the cost of SA production, it is also lower than the Chinese cost of production (Exhibit 4). Even a lowest cost quartile producer in China would currently make a loss of \$35 per tonne. The Chinese price (excluding transportation) is roughly 10% less than the Chinese

production cost for a lowest cost quartile producer. Chinese producers require assistance in order to maintain this price level. The input costs of Chinese products are highly subsidised, thus giving Chinese products a strong cost advantage – the estimated Chinese assistance and subsidies are close to \$122 per tonne of product.

EXHIBIT 4

China prices its products below its own cost of production



Source: MEPS international steel review, International Trade solutions China report, AMSA

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The information flow from China is limited. However, it is known that in 2013 alone the Chinese government provided more than \$50 billion in assistance to its steel industry through various means. Known forms of assistance include:

- **Government infusions of equity and debt-to-equity swaps.** For example, the non-performing commercial loans of Shanghai Baosteel were taken over by Chinese state owned bank asset management companies, then converted into shares in the steel company, substantially lowering the debt burden of Shanghai Baosteel.
- **Government sponsored preferential loans and directed credit.** Preferential loans and loan guarantees have been given to Chinese Steel companies by the Government of China for satisfying certain export criteria.
- **An undervalued currency.** The Chinese currency, the renminbi, is considered a fixed exchange rate currency. This has caused the Chinese currency to be undervalued by 5-27% of its real value, according to the IMF. This has been exacerbated by the latest two rounds

of devaluations this week.

- **Land use discounts.** These are awarded to local steel companies for setting up manufacturing facilities. Many of the China's previously state-owned land assets were donated to local steel companies.
- **Mergers.** Privately owned steel operators have merged with government owned companies.
- **Preferential tax programmes, energy subsidies and reduced VAT.** These forms of assistance include electricity subsidies, which have increased by 25% since 2008.

2.2 The threat to the South African steel industry

The South African steel industry cannot sustain operations at current prices, and several steel plants have already closed (see example below). The second largest producer, Evraz Highveld Steel, has closed down and Scaw Metals, Cape Gate, Macsteel, Aveng Steel have retrenched workers. Given that global steel oversupply is likely to continue for at least the next 5 years, this may cause the closure of the steel industry in South Africa unless decisive intervention is taken.

Case Study 1: Cape Town Iron and Steel Works (Cisco)

Cisco operated in the Western Cape, producing billets and bar products. There was an influx of competing products into South Africa, priced at levels below Cisco's domestic price. Additionally, scrap metal products, a key input for Cisco, rose substantially in price and limited the company's domestic supply. In 2010, Cisco decided to shut down production as a consequence of this challenging operating environment. At the time, Cisco employed close to 300 people and produced 0,3 mtpa of billet and bars. DHT planned to expand and upgrade the Cisco facility in 2013; to date, however, this has not been realised.

Case Study 2: Evraz Highveld Steel

Highveld Steel operated in the Witbank area and was the largest large structural steel plant of its kind in South Africa. Due to the high volume of structural steel imports, lack of infrastructure project roll-outs and energy cost drivers Highveld closed down in 2016. 2200 workers lost their jobs directly and another 1300 jobs were affected in the supply and customer chain.

The industry has suffered significant losses over the last 5 years and this is expected to continue under the current pricing regime; these losses are unsustainable under current conditions. AMSA, which represents 80% of South Africa's flat steel production and 50% of the country's long steel production, has seen its cash flow steadily worsened over the past 7 years – from over R3.7 billion in positive cash flows in 2008, to a loss of nearly R2.9 billion in 2014. Moreover, AMSA's debt levels have increased by close to 2000% between 2008 and 2014, and are set to increase much further if current conditions continue. This is an industry –wide phenomenon. The result is that debt servicing levels have become unsustainable.

Against this backdrop, there is every possibility of further plant shutdowns across the steel industry. Indeed, discussions are already underway on the closure of the Vereeniging plant, and several other plants are in distress as previously noted. Unless remedies are put in place, the

unsustainable economic environment is likely to force South Africa's steel industry to restructure drastically – or shut down completely.

3 The South African steel industry needs immediate support – the steel industry demands

Given the global steel industry environment discussed above, the South Africa steel industry has suffered significant losses during the last 5 years – losses which are expected continue under the current pricing regime. In short, the industry's position is unsustainable, and it needs immediate support as outlined below.

3.1 Trade remedies for steel

Almost all countries have either introduced or increased trade remedies for steel, and South Africa should do the same. In the short term, *South Africa should urgently implement trade duties across all imported products up to the World Trade Organisation bound rates of 10%*, as these provide fast and effective relief. At the same time, *South Africa should launch an urgent investigation into anti-dumping measures*, however, these typically take 2-3 years to investigate and implement.

An increasing number of countries are introducing trade remedies for steel. Between 2003 and 2015, roughly 110 new trade remedies introduced around the world, with a marked increase in trade investigations, anti-dumping investigations and raised import duties. Selected examples include:

- **Brazil** imposed anti-dumping duties on Chinese line-pipe in 2013, ranging from \$779 to \$835 per tonne. At the same time it imposed anti-dumping duty of \$211 on Chinese steel plates
- **Turkey** increased duties in 2013, on wired rod, rebar and bars imported from China. Carbon steel duties were increased to 30-40%, and those on wire rod to a similar level
- **Colombia** imposed a provisional anti-dumping duty on imports of galvanized steel wires from China at 20% of the FOB price, in 2013
- The **USA** imposed anti-dumping duty of over 100% on Chinese wired rod in 2014
- The **European Union** imposed duties of around 25% on stainless steel on targeted Chinese firms in 2015, as well as anti-dumping duties of 90.6% on welded pipe for Chinese producers
- **India**, the most recent (Brics) country to do so in 2015, imposed anti-dumping duties on Chinese stainless steel at \$180-316 per tonne; and increased import tax and duties on carbon steel to 7.5-10%

3.2 Designation of steel for local Government infrastructure spend

Local content and public procurement are additional measures that prove effective where trade remedies fall short. These measures, which encourage the use of locally produced and manufactured steel (as opposed to imported steel), can spur domestic demand and help ensure that steel producers have the volumes required to operate efficiently.

3.3 Fair pricing for steel versus Import Price Parity (IPP)

As the key proposed mechanism for support to the South African steel industry, a “fair price”

should be used. A fair price is a measure that decision-makers can use to understand the level of support the steel industry needs – it does however constitute or advocate to some extent a regulated steel price. A fair price would allow the steel industry to operate profitably and at the same time would incentivise greater efficiency. The fair price is defined as the price level which covers the industry's operating costs, allows for asset replacements and enables a sustainable return; all primary steel producers support this mechanism. This arrangement is now in place at ArcelorMittal through an agreement with the Dti.

3.4 Monitoring of Imports

Currently “non-disclosure” laws exist as to the information available on imports. Should the import tariffs be implemented as requested then *SARS Customs should be instructed to make information available regarding imports of steel products. In addition, customs officials should be trained by steel industry experts already in place to identify and categorise imports accurately.* The precedent of monitoring tyre imports in conjunction with the rubber industry should be followed for steel as well. The industry stands ready to work with Customs under oath of confidentiality to assist in this endeavour.

3.5 Urgent advancement of Government's beneficiation strategy

50% of the steel industry's costs are raw materials. In addition, certain of its key inputs are electricity and natural gas with a large percentage of Eskom's costs dependent on coal. The metals and engineering sector is essentially asking support for it to continue the beneficiation already taking place in the iron and steel value chain.

Ensuring that the minerals and resources are used in a manner that contributes most effectively to the South African economy through the determination of certain raw materials as strategic is a critical issue that needs to be addressed urgently.

3.6 Banning of steel scrap exports

Scrap steel is also an important input for the steel industry. Measures implemented by Government to control the escalating prices of local steel scrap have largely been frustrated and rendered ineffective. Time is running out and urgent action needed. . *The export of local steel scrap needs to be banned immediately.*

3.7 Carbon Tax

The introduction of Carbon Tax as currently proposed is inappropriate as it does not allow for an appropriate balance between the intervention to be implemented and the need for a sustainable steel industry. There is currently no alternative technology that can be used to produce steel and reduce emissions to the extent required, so the effect of the tax would be punitive and not be an incentive to change behaviour.

In addition, the projected tax burden would be significant and would threaten the viability of the steel industry and the South African economy. The ability to pass on the tax to customers, particularly exports, is limited given the stress in the entire economy.

The introduction of a Carbon Tax for the steel industry should be delayed indefinitely.

3.8 Urgent rollout of Government's infrastructure programmes

Huge numbers are quoted regarding money allocated to infrastructure projects, but the activity trends and company results in the sectors that should have benefited do not show the desired

impact, as envisaged. The *proposed Government's Strategic Infrastructure Projects (SIPs)*, which by their nature have a large steel content *need to be urgently rolled out*. The current impasse brought about by distrust between Government and the private sector needs to be set aside and *Government needs to involve the private sector urgently* to expedite and execute the SIPs

3.9 Transparency of current SOE capital programmes

It is a fact that the current SOE capital programmes do not prescribe any local content for steel. This needs to be rectified immediately and *we urge that the SOE's become transparent as to where their steel is being purchased from and be instructed to change to local steel at a negotiated price*.

The industry is ready to assist in any way possible to work with SOE's to enhance the domestic industry's response to their realistic procurement needs. It is also ready to assist in monitoring the effective implementation of such programmes.