Merchantec research

Value Added Steel Industry

Recommendations

Ferrous Metals Downstream Sector

March 2016

the dti
Department:
Trade and Industry
REPUBLIC OF SOUTH AFRICA

IDC
Industrial Development Corporation
Your partner in development finance

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1. Executive Summary

The steel and engineering sector contributed R335 billion to the South African economy in 2013 and employed on average 291 700 people. 48% of this production is for the local market with a value of around R150 billion. The rest of the products are exported and hence contribute to South Africa's balance of payments and foreign currency earnings.

The entire steel industry (from iron ore mining through primary steel manufacturing to value added steel manufacturing) is under significant pressure as a result of decreasing demand, increasing input costs and unfair competitive behaviour by some of South Africa's trading partners.

For this reason it is essential for the stakeholders of the industry (private sector, labour and government) to understand the challenges facing the industry as well as the possible remedies available to strengthen internal demand, decrease imports and increase exports.

This research assignment provides recommendations to the stakeholders of the industry based on extensive industry, labour and government consultation through primary research.

The recommendations can broadly be categorised as short, medium and long-term interventions and each recommendation has concrete action steps associated with it in order to achieve the desired result of increased local manufacturing, job creation, skills development and poverty eradication. This in turn will have many positive effects for government as tax revenue increases and unemployment is addressed.

Improved internal and external communication between the stakeholders is a key aspect highlighted in this report as there is continued mistrust between the role-players in this industry. Through positive interaction the relationship can be restored and this will result in vibrant economic growth that will benefit the entire country.

The recommendations in this report are also aimed at all stakeholders. Government has a lot to do in order to create an environment conducive for fair trade. Private sector needs to implement various changes in order to effectively communicate with government. Labour has to understand how they can contribute in a fair manner in revitalising this crucial manufacturing sector. This report should be seen as an enabler of this growth relationship

South Africa has positioned itself as a leader on the African continent and has strong political relationships with the BRICS formation. Unfortunately South African manufacturers are not yet reaping the benefits of these relationships and more needs to be done to encourage our political partners to trade with us in a fair and sustainable manner.

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2. Background to the Project

The IDC and **the dti** commissioned a study to profile the South African value adding steel industry in order to understand the supply, demand, challenges and opportunities and trade in this diverse industry. Merchantec delivered a number of reports to the stakeholders of this project that includes government, industry associations, companies and labour.

This report is the last in the current series on the downstream value adding steel industry in South Africa. In this report the major findings of the project are discussed and specific interventions proposed to ensure that this industry that employs over 200 000 people is protected from a possible demise.

The dti has done extensive research on specific parts of the industry in the past and a number of interventions have already been made that have had a positive impact on certain parts of the market. In this report we look at the areas where no interventions have been made and provide specific recommendations.

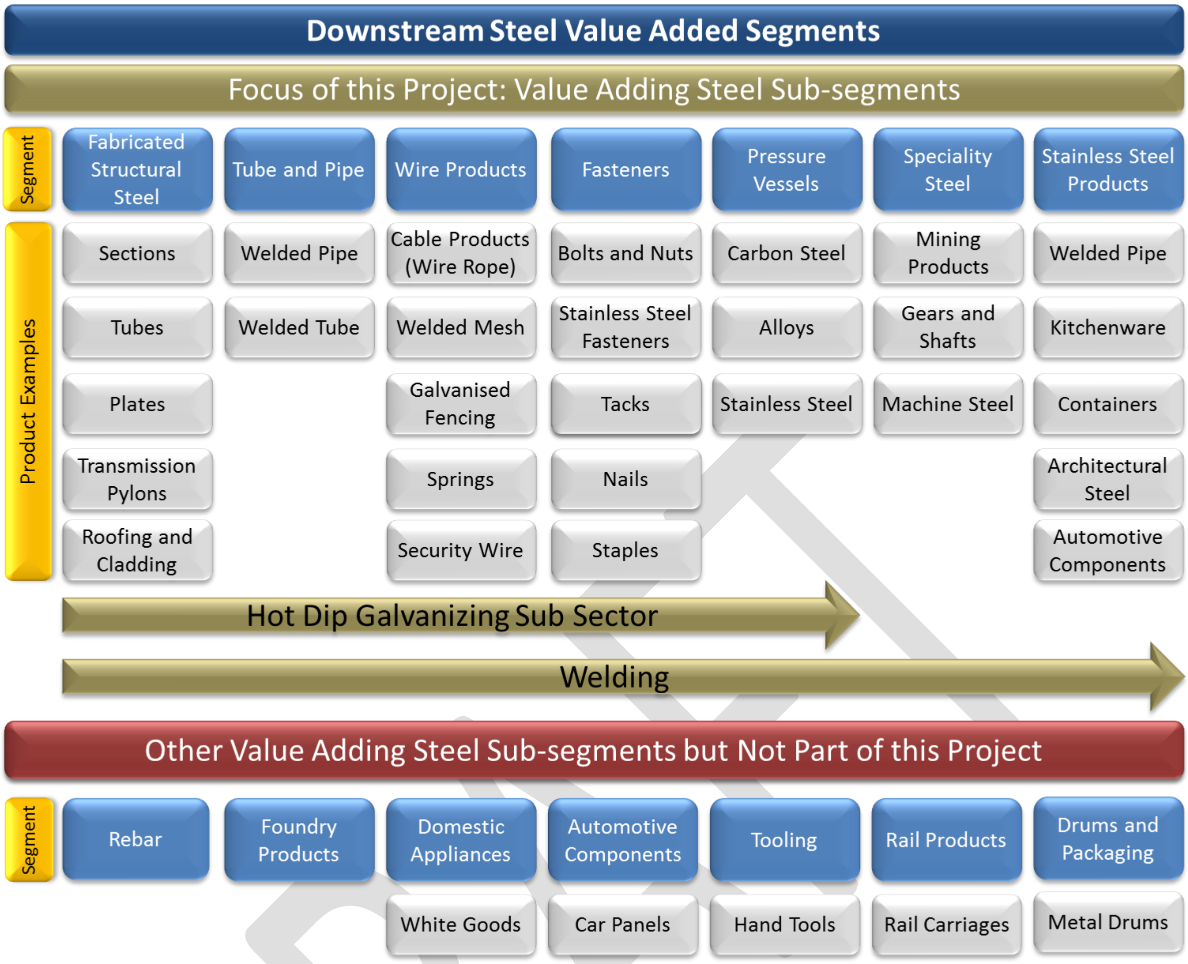
We specifically look at the segments that require more attention and support, provide specific action programmes to be implemented in the short, medium and long term, identify specific government intervention programmes and provide resource estimates in order to achieve this.

The South African value adding downstream steel industry can broadly be categorised into a number of subsectors that supply semi-finished or finished products into the South African economy and also play an important part in export revenue generation for the country. Although a large number of these segments are classified as being part of the downstream value adding segment, the focus of this research report focusses on a particular part of the industry that does not benefit greatly from other **dti** incentive and support programmes. The 7 main product segments are: 1) structural steel, 2) tube and pipe, 3) wire and wire products, 4) fasteners, 5) pressure vessels, 6) speciality steel products and 7) stainless steel products.

Products such as primary steel products, rail products, machinery, tooling, domestic appliances, automotive components and foundry products fall outside the scope of this research service as these products all have segment specific support and investment programmes in place.

The focus of this document will therefore be on the first group of product manufacturers.

Figure 1: Downstream Steel Value Added Segments



Source: Merchantec

3. Explaining the Various Intervention Levels

The main aim of this document is to ensure the downstream value adding steel industry remains viable in the short term and becomes a growth driver in the medium term. In order to achieve sustainable growth there are three levels of intervention required. These are:

1) Increasing Local Demand

The first important area of focus is the increase in local demand. This requires end-users of value adding steel products to operate in an environment where they require more products and very importantly buy more local content.

2) Increasing Exports

The second focus area is for downstream value adding companies to increase their exports. This can be done by becoming more efficient and by identifying and successfully exploring more opportunity in SA’s traditional trading partners as well as regions where SA has not traditionally done much business.

3) Reduce Imports

Lastly, the reduction of imports is an important focus area. Imports can be decreased through a more cost efficient local industry, trade protectionist measures and also by convincing government and private sector to buy local.

Figure 2: Aim of the Recommendations of this Report

Source: Merchantec Capital

The various steps required to strengthen the industry is further segmented according to the duration required to have a positive impact on the local value added steel industry. The interventions can be summarised as shown below.

Figure 3: Value Added Steel Industry Recommendations Summary

Intervention	Difficulty Level (1-5)	Duration	Expected Cost	Main Lead
Short Term Interventions				
Financial Support Interventions	3	Ongoing	Minimal as measures will pay for themselves	IDC
Business Support Measures	2	Ongoing	R50 – R100 million per annum	**The dti**
Knowledge Sharing and Education	2	Ongoing	Minimal	Industry Associations, **the dti**, treasury,

				Competition Commission etc.
Policy Support Measures	4	6-18 Months	Minimal	**The dti**, ITAC
Medium Term Interventions				
Stakeholder Relationship Management	3	Ongoing	Minimal	Organised labour, employer associations and **the dti**
Government Implementation Programmes	4	Ongoing	Significant investment required as per the SIP project team planning	SIP Implementation team
Skills Alignment	3	6-18 Months	Minimal	SETA's Industry Associations
Export Incentives Programme	3	12 months (ongoing)	Self funding	**The dti**
A China Plan	3	12 months	R1 – R2 million	**The dti**
Long Term Interventions				
Cost of Doing Business in South Africa	5	Ongoing	NA	National Government
Economic Policy	4	Ongoing	NA	National Government

4. Short Term Interventions

Short term interventions are action measures that can be implemented in a relatively short space of time but may need to be sustained for a long period in order to remain relevant. The interventions have been grouped according to the various themes identified through the primary research process.

4.1. Financial Support Interventions

4.1.1. Cost of Capital

The current cost of capital is in many cases higher than the return on onvestment for many companies in the value adding steel manufacturing sector. The implementation of low cost loans to companies who are able to expand their export activities should be encouraged. This would be for manufacturing expansion as well as for bridge finance to fund working capital when it comes to products that have a long lead time between the initial order and the final payment. At present a number of such facilities are available to exporters through government support. However, very few companies are aware of the potential support mechanisms available to them. Many of the available incentive and support mechanisms are also very administratively burdensome and as a result do not always have the intended required impact.

4.1.2. Export Finance Support

The primary steel manufacturing industry (and AMSA in particular) is at present one of the only segments actively trying to support downstream value added steel exports through the COSM fund. Despite the contribution in supporting water borne exports, it seems that the impact of the fund is marginal and does not have a significant effect on boosting local manufacturing. The aim of the fund is to reduce the geographical disadvantage that South Africa has to major steel consuming areas such as Europe, Asia and the USA. What is required is an export incentive on all exports.

Much can be learnt from government's very successful (albeit controversial) support of the automotive industry through the Automotive Production and Development Programme (APDP). The programme is relatively simple in that it enforces high import duties on parts and completed vehicles and uses the funds generated as a production incentive to OEM's. The benefit to the manufacturers has definitely made the difference between manufacturing in South Africa versus producing in low cost manufacturing destinations. Exported automotive products add significantly to South Africa's trade balance and also continue to support a wide range of local component manufacturers. The down side of this programme is that South African consumers pay at least 20% more for new vehicles in the country. Some analysts believe the programme is a burden on the South African consumer, but most economists agree that the impact of job creation outweighs the negative impact of higher prices.

Further consideration should be given to the creation of a similar programme to help reduce imports and increase exports.

4.1.3. Export Finance Support

A key challenge faced by any company is having sufficient working capital in order to grow. This is particularly true for companies that have long sales cycles and that are involved in long-term export agreements. In many cases it takes months to receive payments for exported goods and this places a significant challenge on the company to continue operations. Smaller companies can for this reason also not benefit from large export opportunities.

There are a number of privately owned bridging finance companies operating in South Africa, but their services comes a high cost eroding profit margins and decreasing the overall impact of exports. The IDC is an important player in supplying export bridging finance but companies have indicated that they find it difficult to actually access capital when required. It is therefore recommended that the industry associations help to facilitate the process of gaining access to capital by working closely with the IDC and its members in order to decrease red tape and speed up capital flows.

Implementation Plan for Financial Support Interventions

The interventions listed above should be regulated by the IDC that already has a number of similar initiatives in place. Creating sufficient awareness of the financial support initiatives is however lacking with many manufacturers unaware of the financing support mechanisms provided by government. The overall difficulty in implementing these initiatives is relatively low since most of the mechanisms required are already in place for other industries.

4.2. Business Support Measures

4.2.1. Marketing

The value added steel industry is increasingly competing with manufacturers from the Far East (in particular) increasingly competing for African markets. Many companies interviewed indicated that they would be interested in selling into Africa, but that they either did not have a budget to drive their marketing campaigns into Africa, or that they were unsure on how to enter into African (and other) markets.

It would be prudent to also identify companies that could potentially be exporting (but who are not) and to visit them with an aim of supporting them in expanding their markets. These companies could be identified by the industry associations.

One of the many incentives that **the dti** provides is marketing assistance to companies trying to expand their export footprint. This includes covering costs to attend trade shows, supporting companies during their foreign marketing campaigns as well as providing market research (Export Marketing & Investment Assistance Scheme). In addition Brand South Africa is a government led marketing agency that promotes South Africa as an investment and trade partner.

However, many of the companies in the steel industry indicated that they do not understand how they can benefit from these services and that they have never been engaged by **the dti** for such support. The industry forum where the Industry Associations and **the dti** meet on a regular basis should form the basis of information sharing with industry in order to create better access to the already available services from government.

A suggestion from the value added steel industry was that there should be a dedicated desk (information point) at **the dti** where value added steel companies can learn more about the potential export opportunities as well as the requirements in order to take advantage of the various opportunities. Such an export desk already exists at **the dti** but awareness of the opportunities and services of **the dti** is low at company level and hence the Industry Associations should be doing more to get individual companies to connect with the resources available at **the dti**.

4.2.2. Proudly South African for Private Sector

A core reality of the South African constitution is that government cannot force private companies to procure locally. Only when dealing with government can they implement specific localisation targets. However, more needs to be done in order to promote buying local. The benefits of doing this are obvious and will result in a significant manufacturing boom in South Africa. One senior industry expert put it like this: "At present we are sitting with a dangerous and highly complex situation. The primary steel manufacturers are bleeding because the value adding industry is importing their base materials. However they too are struggling against cheap imports and as a result the entire industry is at risk of collapsing. And that is exactly what the Chinese manufacturers are trying to achieve. Once the local industry has collapsed they will increase prices and once an industry is lost it is almost impossible to revive it again."

More needs to be done to promote local product to local procurement suppliers. There is a need to develop a local database of services and products that are updated in real time and allows companies to procure their products from local manufacturers.

Government has helped to create a culture of private companies procuring from BEE suppliers in order to improve its own BEE rating, but more weight should be placed on local procurement. Government could consider tax breaks as an incentive for more local procurement.

It is recommended that more research is done in this space to quantify the potential costs as this is a large and potentially significant area.

The stainless steel industry indicated that they are able to maintain market share with public and private sector by focussing on quality and meeting health standards. Products mentioned include catering equipment for kitchens prisons, hospitals, schools, etc. This may include cooking appliances, tables, trolleys, wall cladding, implements such as spatulas, pizza shovels and other products. By focussing on quality they have been able to maintain market share.

The key reason for increased imports is that foreign manufactured products are in many cases cheaper than locally manufactured products. Some of this has to do with a lack of economies of scale and also a lack of country willingness to support local industry. Since economic times are hard it is clear that procurement specialists are instructed to obtain products at the lowest cost rather than consider the positive knock-on effect of supporting local industry. There have been various "Buy Local" campaigns run by various institutions including **the dti** but buying local should be a theme supported by government on every platform and forum where it interacts with private sector.

In Brazil very aggressive tariff structures are used as a method to get local companies to procure locally. This has been effective for stimulating internal demand, but not in stimulating exports as local prices is higher than international prices. In China the use of subsidies have been widely criticised as unfair business practice and hence is also not sustainable. In Russia government has used rhetoric to encourage Russians to purchase from national suppliers. The downside of this strategy is that external product suppliers are painted in a negative political manner and this does not help to build international relations.

In order to convince local companies to purchase from local suppliers more focus should be placed on the quality of South African manufacturing as well as the availability of after sales. Price alone should not be the distinguishing factor. This message needs to be regularly voiced by government, the industry associations and private industry participants.

4.2.3. Export Challenges into Africa

Various value adding companies raised concerns about exporting into Africa, raising issues of non-payment, logistical nightmares, language challenges, non-tariff barriers and a challenging sales environment.

Many of these challenges can be circumvented by a more informed private sector. Government has a great opportunity to create a competitive edge over other countries through an efficient and pro-active African Investment desk. This information service must proactively identify large infrastructure projects in Africa, form strategic relationships with other government departments and communicate with industry through e-enabled platforms. Market intelligence remains one of the most important tools available to industry to grow. By focussing heavily on trade relations with Africa, South Africa can in fact increase its exports to the region and thus grow more South African industry. For many years industry has been complaining about distance to market and shrinking exports to developed countries. With the continued growth experienced on the continent South Africa should be far more proactive in building strong relationships with countries such as Nigeria, Mozambique, Uganda, Tanzania, Kenya, Ghana, the DRC, Senegal, Ethiopia and all of the other rapidly expanding economies on the continent. From the discussions with private sector it is clear that the influence of China and India is growing on the continent and if South Africa wants to remain the major economy of the region it must improve its relationships with the growth economies.

In order to successfully implement such a desk a senior research specialist with a strong background in the steel industry and African infrastructure should be sourced with a team of 3-5 analysts that exclusively track infrastructure projects, build relationships with trade organisations and link local companies with export opportunities. The role of the industry associations will be crucial here to ensure the trade desk is aware of industry capability.

An example of a well-functioning trade desk for a specific industry is within the department of Agriculture, Forestry and Fisheries that develops relationships on a global basis including a sub directorate focussing exclusively on African trade development.

Implementation Plan for Business Support Measures

All of the interventions mentioned above fall within the realm of **the dti.** The overall cost of these implementations is relatively low and mostly will involve salary expenses.

4.3. Knowledge Sharing and Education

4.3.1. Importance of Cluster Development and Lobbying

Government (through the state owned enterprises and various departments) has indicated that there is a significant lack of knowledge sharing between government and private sector. As a result government often attempts to help an industry only to find the plan is not feasible since a specific challenge will impede implementation. As a result the role of the industry associations will have to be elevated in order for these organisations to become real centres of information and co-ordinate lobbying in a far more assertive and meaningful manner.

A large part of what is required is creating awareness of private sector's capability, product types and a better explanation of what the impact of any particular market condition is on that industry. An example is that of the valves industry where lobbying parties were hugely successful in getting valves designated across all product categories. During the investigation process industry indicated they are capable of manufacturing the majority of products required. However, **the dti** has experienced a significant inflow of requests for import as many products are not manufactured locally. Better communication between government and industry associations is required to drive industry progress.

The industry associations should be responsible for creating a portfolio of the products and services within each value adding segment. Specific information around utilisation, product design capability and output capacity is required. This will assist government (and specifically state owned enterprises) to plan and implement realistic localisation programmes.

Government has also indicated that the industry associations need to be far more vocal in bringing sectoral issues to government's attention. Following the right channels and building the right relationships will go a long way in helping government build plans and policies that have a real positive impact. Just inviting government to official meetings is not sufficient effort to create awareness. At the same time government should create sufficient capacity in order to make communication easier and create modern platforms to share information. This includes e-market place and industry challenges forums.

In order to grow the industry associations there should be stronger focus on funding these institutions and this can be achieved through government funding, increased private sector participation, consultation services, commission on trade facilitation, events (conferences) or training activities. The funding of the associations has been a challenge in the past and the private sector is at present struggling and hence there is more pressure on the associations to play their important role properly.

Although the challenges facing the steel industry are relatively similar to each value adding segment it is important that each value adding sector develop a developmental roadmap for its industry in terms of export led growth, creating economies of scale, quality improvement and cost reduction strategies. It is proposed that such a strategy be developed through the industry associations and that government becomes a planning partner in the development of each subsector. The plan should include required tariff changes, quick acting dumping strategies and information sharing that will help to improve competitiveness.

In order to drive these changes it is essential to establish a Steel Industry Crisis Committee that will urgently address the challenges facing the industry and should involve the captains of industry and government (Director General Level or even ministerial involvement). At present the EDD is used for the main channel of communication between industry and government and although this is valuable the level of participation is too low. The CEO's of the major manufacturers needs to be directly involved as well as the most senior government officials from **the dti** and economic development.

Substitute material use is an ongoing concern and in recent years many steel products have been replaced with alternative materials such as aluminium in the packaging industry and plastic for water pipes. In order to expand industry it is proposed that all industry associations set up an R&D department that co-ordinates research into product development and commercialisation between private sector, tertiary institutions and other research institutions. These institutions should on a regular basis do global technology scans in order to identify new products and trends in the steel industry and hence empower local companies with bleeding edge knowledge. More innovation is required for steel industry products.

A further function of the Associations could be a central desk to help plan material demand from its members. This could in turn assist the primary steel industry with regards to better planning for material production and help to increase order sizes to warrant producing certain speciality steel materials not commonly produced in South Africa.

4.3.2. The Impact of the Competition Commission

The South African competition commission plays an important role as the watchdog against uncompetitive behaviour in the local market. This includes practices such as price fixing and an agreement not to compete against one another in a particular geographic region. The impact of such practices is inflated prices to end-users and inefficiency in the economy. As a result the Competition Commission has advised industry associations to stop collecting information from their members on sales, volume and geographic focus in order to ensure collusion is weeded out.

An unintentional impact of this restriction on data sharing is a reduction in the ability of local manufacturers to benefit from export opportunities. The Competition Commission is only really interested in national partnerships with unfair behaviour but as a result companies now also do not discuss external opportunities.

Much can be learnt from industry associations where the bulk of the product is exported such as the South African Table Grape Association (as an example). This institution collects detailed information on export opportunities, is involved in industry training and continuously funds research that is of benefit to the entire industry.

More should be done by the established industry associations to support the local manufacturing industry through the collection of industry data that will assist with planning and expansion especially aimed at the export market. The current Downstream Development Committee plays an important role in guiding the overall industry but more should be done to not only solve industry challenges but also help to create export opportunities through a dedicated desk (person) collecting information on projects and procurement in Africa and elsewhere.

Closer ties should be developed between the various industry associations and the Competition Commission. The commission should be invited to industry events and gatherings so that is can better understand the challenges facing the industry and help support the flow of information without compromising competitiveness.

Most of the downstream value added steel industry indicated that the very strong rules created by the competition commission were having a detrimental impact on their ability to increase competitiveness. Industry associations are no longer able to collect industry data making market research extremely difficult. It also impacts negatively on companies' ability to plan and work collectively to identify and capitalise large export opportunities.

4.3.3. The Education of Government Departments

A theme that was raised on a number of occasions both from **the dti** and industry associations was that of a unified localisation procurement approach. Often designation and localisation is viewed as **dti** initiatives where in fact the benefit of such programmes is to the greater good of the entire country. More should therefore be done to create awareness of the positive impact of designation and localisation programmes across departments. Both senior and junior state employees stand to benefit by understanding the positive impact of localisation better. Proudly South Africa should be a total government approach and this could well trigger more private sector local procurement as well.

It is important that such a programme not only target procurement specialists but also their superiors (right up to ministerial level) as these are the individuals that will ultimately drive local procurement.

Implementation Plan:

The dti should develop a number of cases studies to show the positive impact of local procurement across sectors and do a roadshow to all major ministries.

Expected Cost

The cost of such a plan is limited and only involves time spent collecting information, developing an attractive presentation and the cost of the roadshow. This solution can have a long term beneficial impact with minimal cost.

4.3.4. Improved Ministerial Co-ordination

According to various industry specialists interviewed for this assignment there is often a gap between the goals and strategies of various departments. Although the foundry industry is not part of this analysis there is an example that explains the principle well. The Department of Environmental Affairs is mandated to reduce pollution. As a result officials from the department visited a local foundry and served notice that the foundry is exceeding emission levels and hence has to close. The impact of this closure would have been hundreds of manufacturing jobs with a knock on effect on other companies and industries.

The goals of the department of environmental affairs are in no way inferior to that of **the dti** (i.e. job creation and economic growth), but both can be achieved through better co-operation. Industry should be innovative and improve their emissions but at the same time jobs ought to be protected. Setting realistic targets in place and assisting companies to achieve these targets will improve the relationship between government and private sector.

The cost of implementing such an initiative is not high and only requires more planning and communication before execution. To achieve better co-operation will require the goodwill of stakeholders at the highest levels of government.

4.3.5. Solving the Steel Price Dispute

There has been significant conflict between the stakeholders of the industry on the management of the South African steel price. However, in recent months there has been positive movement between the parties and it seems that government and steel producers are closer to finding a solution to this challenge.

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 and are prepared to change from import parity pricing (IPP). It is now required that this price be debated between the primary manufacturers, government and labour and the most appropriate form would be at the Steel Crisis Committee. It is further proposed that the working group on steel pricing also drives the implementation of a ban on scrap steel exports.

4.3.6. Education Programme on Incentives

During the research process it was revealed that private industry is highly uneducated on the available government incentives and that when they are aware they perceive these incentives to be very administratively intensive and full of red tape.

The industry associations should develop more awareness of the incentives that are already in place and work closer with the dti in order to explain the benefits available and how companies can reduce the administrative burden of claiming. It is not the responsibility of government to ensure that each company is completely educated on available incentives. However, if these incentives do not impact positively on the intended industries then more should be done in order to help companies access the relevant information. In this regard better communication between the IDC and the DDC could result in increased utilisation of government incentives within the downstream value adding steel industry.

Implementation Plan for Knowledge Sharing and Education Initiatives

In order to implement the above mentioned intervention will require the participation of all stakeholders. The cost of implementing the various measures is low as it requires people to meet in an ongoing way and commit to the process of resolving the challenges facing the industry.

4.4. Policy Support Measures

4.4.1. Tariff Levels for Value Added Products

A massive and ongoing concern is trade protection. There are global efforts to reduce trade barriers and to make trade easier across the globe. However, many governments subsidise their exporters and hence products can often not be compared on a price basis alone. Research conducted on value added steel exports from China has found as much as a 41% subsidy on exported China steel products. As a result some protection is required for industries under unfair trade threat and also for nascent new industries. Once the threat has disappeared or the industry is settled, the protectionist measures should also be reviewed.

Local value adding steel companies differ in opinion regarding the increase of tariffs. The problem is that almost all local manufacturers also import either material or complementary products and that it is impossible to please all parties regarding tariff increases. As a result there will be a negative impact on some manufacturers while others will benefit if tariffs were to be increased. Some participants in the industry have requested that tariffs on all steel products should be increased to a minimum of 10%. Products where higher tariffs apply should not be changed and should in fact also be increased to the bound rate. Such an implementation will force local buyers to try and source more material and product locally and will have a long term beneficial impact on the industry.

South Africa is not allowed to implement trade barriers to a single country (i.e. an import tariff against Chinese products). However, in many cases China has an 80% or more market share in imports in a particular market and hence a tariff could effectively reduce imports from a dominant exporter.

The earlier Trade Analysis document identified a number of products where tariffs are not on the bound rate and could be considered. The following tariff and bound rates apply:

Category	HS code	Average Applied Duty	Minimum AV Duty	Maximum AV Duty	Duty Free TL (%)	Bound Rate (%)
Wire and Wire Products	7312	1.3	0	5	75.0	15
	7313	5.0	5	5	0.0	15
	7315	3.1	0	10	68.8	15
	7320	5.0	5	5	0	30
	7326	3.0	0	15	77.1	30

Tube and Pipe	7303	0.0	0	0	100.0	15
	7304	8.5	0	15	30.8	15
	7305	7.9	0	10	21.4	15
	7306	10.0	10	10	0.0	15
	7307	6.2	0	10	37.8	30
Fasteners	7317	10.8	0	15	16.7	15
	7318	2.8	0	20	76.3	30
Structures	7308	10.5	0	15	30.0	15
Other Value Added Products	7301	7.5	5	10	0.0	10
	7309	0.0	0	0	100.0	15
	7310	2.5	0	15	83.3	15
	7311	7.5	0	15	50.0	15
	7314	4.6	0	5	8.3	15
	7316	0.0	0	0	100.0	15
	7319	0.0	0	0	100.0	30
	7322	15.0	15	15	0.0	30
	7323	20.8	20	30	0.0	30
	7324	21.3	10	30	0.0	30

Source: World Trade Organisation

Importers also label their products incorrectly to be presented as products with lower tariffs and hence a tariff increase in many products will be useful but not a solution in isolation.

An important aspect of fair trade is ensuring dumping is prevented and it is recommended that the associations continue their efforts to prevent dumping in order to promote fair trade. Government should also act more decisively on dumping applications in order to decrease the probability of dumping. This includes making dumping prevention applications easier and also setting a maximum time in which such requests are dealt with. In order to prevent industry from wasting government time there should be a penalty should it be found that dumping is not taking place in order to avoid private sector behaving in an uncompetitive manner.

4.4.2. Tariff Code "Other"

Both government and industry associations have expressed their frustration with the increasing volumes of products classified as "other", "unspecified origin" and blanket import codes for large infrastructure projects.

It is recommended that SARS do more to provide descriptions for products categorised as "other" in conjunction with the industry associations. SARS has indicated they appreciate ongoing involvement of the industry associations in training, making custom officials aware of the products and their physical dimensions. Ongoing education is required to make sure importers do not abuse tariff codes in order to avoid paying taxes. ITAC should also be involved in this process.

SARS in general should not accept the registered codes on face value and employ more trained staff to correctly categorise products according to their true purpose. The industry associations should also be more involved in supporting SARS staff to identify and intercept products that are labelled incorrectly.

4.4.3. Designation

Designation is one of the key tools government has to enable spending on locally manufactured goods. Government as a customer is crucial for most industries and specifically so for the downstream value added steel industry as a significant amount of steel is procured for local infrastructure projects as well as by state owned enterprises.

There are a number of products within the value added steel industry that have already been designated such as certain water pipes, electricity pylons and valves.

Specific products that would benefit local producers include:

1. **Wire and Wire Products:**

Products that could benefit from designation are:

- Wire rope/strand(7312)
- Chains(7315) and
- Gabions(7326).

Specific products that were identified include:

- ACSR (Staywire) (used by Eskom), and
- GP ropes (used by PetroSA).

SAWA indicated that it is very difficult to designate other products as these products will typically form part of a larger project (such as fencing for a school) and that this is typically sourced by the contractor from the local hardware supplier that may or may not have imported the product.

The industry association has indicated that a more effective method of awareness has been to lobby for buying local through the promotion of a clause in the PPPFA Act that suggests that all tenders should include use of SA manufactured products.

2. **Tube and Pipe Products:**

The tube and pipe industry indicated that they do not have any specific products that they want to have designated as the industry as a whole cannot agree on the specific products they want to have designated. The Association has indicated that individual companies are currently applying for designation. It further indicated that tubes and pipes are often part of larger systems (such as a complete water reticulation system with all ancillary equipment) and as such are difficult to designate. Promoting the use of local products through the PPPFA act is more likely to result in demand from state owned companies. At present tube and pipe spiral products exceeding 3000 mm and larger are designated.

3. **Structural Steel:**

There are a large number of structural steel products that has benefitted from designation and increased local content rules. The products include:

- Steel power pylons
- Monopole pylons
- Powerline hardware
- Street lighting steel poles
- Steel lattice towers and masts
- Steel substation structures (this still needs to be designated)

The dti is currently reviewing structural steel products for designation and has made significant progress in identifying the best products for local designation.

Under the harmonisation system it includes:

- H730890: Structures and parts of structures iron/steel (including steel powerline hardware)
- H730820: Towers and lattice masts (including monopole pylons and street lighting poles)
- H761090: Aluminium structures and parts for construction (including aluminium powerlines hardware)

4. Fasteners:

SAFMA has indicated that nuts and bolts are very difficult to designate as they are part of putting something together and are not very easily identifiable as opposed to say a pump, generator or pylon. The industry believes designation is valuable and should continue and that the industry will benefit from the designation of systems rather than individual products.

According to the industry, action on dumping duties or an increase in general duties in the past has been ineffective in curbing imports and hence no further tariff support has been requested.

5. Stainless Steel:

Within the stainless steel market a number of products have been identified that would benefit greatly from designation. These include:

- Wastewater treatment plants – new as well as the upgrading and rehabilitation of existing plants. This would include pipe and tube and pipe and tube fittings including forged and plate flanges for water and waste water conveyance as well as sewage plants - grit separators, clarifiers, tanks etc., and dams - outlet pipes, tunnel lining, dam wall gates.
- Sanitary equipment for prisons, hospitals, schools, etc. This category includes stainless steel toilets, urinals and sinks.
- Roofing and cladding for any government/SOE building.
- Prisons, hospitals, schools and government buildings - sun screens, security products such as doors (including fire doors) and access gates, bollards, electrical boxes, cable racking, BA mirrors, signage, solar geysers, security screens (perforated sheet), body stretchers, post mortem tables, operating tables, door/floor and wall corner protectors, waste incinerators, masonry fixings, lift cladding etc.
- Platform access systems for all of the above. Walkways and hand railing. Product standardisation across government.
- Catering equipment manufacturers (who supply industrial kitchens) feel that designation is not necessary as government procures from them anyway, and only imports the high tech equipment that is not made locally. Also they are somewhat protected by safety regulations, in that the cheap imports generally do not comply.

Implementation Plan for Policy Support Measures

The proposed interventions listed above should be driven by **the dti** and Industry Associations. The cost of the mentioned interventions is not high, although the red tape involved in getting policy changed is significant. It is proposed that the Industry Crisis Committee participate in the implementation of the above mentioned interventions.

5. Medium Term Interventions

Medium term interventions are measures that are urgently required by the industry, but require significant co-ordination, planning and budgeting. The measures further include relationship aspects that require longer term interventions to reduce distrust and increase co-operation.

5.1. Stakeholder Relationship Management

5.1.1. Labour Disruptions

A regular topic of feedback from the value added downstream steel industry was the significant disruptions in manufacturing output during periods of strikes. Most companies mentioned that they have a relatively good relationship with their employees, but that the collective bargaining system results in manufacturing disruptions.

It is unlikely that collective bargaining and the trade union system will be scrapped any time soon and hence alternative forms of solutions are required. Merchantec is of the opinion that the relationship between SEIFSA and NUMSA in particular requires intervention. It is most likely not an intervention that can be facilitated by government. Although there are relatively regular interactions between the trade union and the employers' organisation it is clear that there is little trust between the parties and this leads to conflict and labour disruptions during wage negotiations. More transparency about financial results is required by employers while employees need to be realistic about the challenges facing the industry and do their part to improve efficiency and productivity in line with above inflation increases.

Globally much work has been done in the area of conflict management between employers and trade unions and it is suggested that **the dti** in conjunction with the department of labour develop a balanced training programme to empower both employees and employers to the reality of each other's situation. Such a programme should be aimed at individuals across the companies and should help to build trust between the various parties.

5.1.2. Lack of Industry Transformation

A key concern raised by government has been the slow pace of transformation within the value adding steel industry. In many cases companies have been owned by white families for many years and no equity stakes are available for sale. These companies are already penalised when trying to do business with government in segments where there are companies that have transformed more as government has very strong BBEEE requirements and will typically choose more empowered companies.

There is not much government can do other than what is already being implemented, but any support programmes should be based on the criteria that companies that have transformed more should qualify for better support mechanisms.

Companies in the value added steel industry have in turn indicated they find it hard to transform as equity is being invested in sectors with higher profit margins and hence there is little funding available or interest to buy into this sector.

The dti in conjunction with the IDC should consider creating a fund that will enable black investors to invest in value added steel manufacturing companies at a subsidised market price.

5.2. Government Implementation Programmes

5.2.1. Delay in Local Projects

The delay in local projects is widely viewed as a major cause for the decline of the steel industry in South Africa. Despite the large number of infrastructure projects under planning the actual implementation thereof is lacking. At the same time there are major delays in the projects that are being implemented (such as the Medupi and Kusile projects) resulting in deferred demand and hence lower local sales. Private sector has also not invested in new capacity or infrastructure and hence demand from this segment has also decreased.

It should be noted that government should be commended for the way it has handled the renewable energy rollout as the various bidding rounds have been hugely successful and a number of these projects has been successfully connected to the energy grid.

The following infrastructure projects should all include local steel namely:

- Power generation
  - DoE’s renewable energy projects (Solar PV, Wind and Concentrated solar)
  - Coal 3
  - Gas to power projects (3 000MW expected)
  - Nuclear
  - Power transmission projects
- Rail
  - Locomotives
  - Wagons (all the components to freight wagons should be designated)
  - Rail networks and towers
- ICT
  - Meerkat project
- Water and Sanitation
- Oil and gas pipelines (public)
- Oil and gas refineries
  - Project Mthombo
- Social buildings
  - Housing
  - Education
  - Healthcare

There is an urgent requirement to commence the projects that have been announced.

5.3. Skills Alignment

The shortage of relevant skills in the South African steel industry has been discussed in more detail under the industry challenges section. The main cause for skill misalignment is a growing divide between what is taught at technical institutions and what is required in private sector.

The solution to the problem is better communication through the industry associations to training institutions. The associations have indicated that they no longer try and influence training programmes as their efforts have been in vain.

It is recommended that government subsidies to the training institutions should be dependent on written agreement from the industry associations with approved training content.

For instance all training provided at colleges in welding should be accredited by The South African Institute for Welding. If a training programme fails to achieve the accreditation then the related certificate or degree should not be awarded and the training institution should not receive any subsidies.

To ensure industry associations do not abuse their power the industry association needs to prove they represent the majority of employers in a sector before they are appointed as training programme approvers.

It is proposed that a skills Indaba be organised where all relevant training and private sector organisations come together to develop a practical way to implement this intervention. Government should be the facilitator of this engagement and use its financial contribution to training institutions as leverage for compliance.

Implementation Plan

The practicality of this arrangement should be determined in 2016 with all relevant training institutions and industry associations.

Implementation Cost

The cost of this implementation is limited to the indaba which is expected to cost less than R1 million. In fact the conference could be without cost if industry is willing to sponsor the event.

5.4. Export Incentives Programme

The dti has implemented a very successful scheme to promote automotive manufacturing in South Africa. The steel industry in general has benefitted from this scheme. However, some of the principles used to boost local manufacturing should also be implemented for steel products.

The principle of tariff generated subsidies should be implemented. In other words, the steel manufacturing industry in South Africa should identify the core products where South Africa wants to have a competitive advantage and then raise tariffs for those products. The revenue earned from imports can then be used to subsidise exported products and help give South African exporters a competitive advantage.

The cost of implementing such a programme is marginal as tariff revenue generated from imports is used in order to stimulate local manufacturing. **The dti** should plan and implement the programme.

5.5. A China Plan

China as a market player in the steel and value added steel industry has become significantly more complex over the last 15 years. There is a significant amount of data that points to unfair market practices from this region. Globally there are efforts underway to understand the Chinese support model better and to indicate where unfair advantages are being created.

From the research conducted by Merchantec it is clear that there is a large amount of misconception on what is really happening in China and the recommendation is that a commission should be set up to probe the real impact of China on the South African value added steel industry, to better understand their cost structures and to clearly define the support mechanisms offered by the Chinese government. Until more clarity is provided on this situation it is unlikely that South Africa will be able to take proper and definitive action to protect the local manufacturers' interest in a fair and sustainable manner.

What is clear is that governments across the globe are taking protective action against imported steel products from China based on the evidence supplied regarding unfair support mechanisms used.

The cost of such an assignment is estimated at between R1 and R2 million. The dti should be the project lead on the assignment, but the Industry Crisis Committee should have a strong input into the direction of the research.

6. Long Term Interventions

Long term interventions require significant structural and policy change at the highest level. These are implementation projects that require the involvement of various ministries and departments and often require new policy decisions to be made. However, the required measures could have a significant impact on the competitiveness of local companies as well as the entire economy.

6.1. Cost of Doing Business in South Africa

During this research project more than 200 interviews were completed with stakeholders within the supply side, the demand side, labour, government and industry associations. A key theme that was repeated on a number of occasions was the high cost of doing business in South Africa. It is beyond the scope of this assignment to address each of the contributing factors in great detail but the main hurdles were:

6.1.1. Electricity

The cost of electricity has risen sharply over the last 5 years as Eskom has invested in new power generation infrastructure. Although there is very little government can do in order to alleviate the burden of energy costs it should be considered to provide electricity directly from Eskom to manufacturers rather than through municipal suppliers who charge a premium to their customers and cross subsidise other municipal services. Electricity sales are crucial to the financial stability of municipalities and hence careful consideration should be taken before any changes are made.

Government can use the opportunity to drive its goals through this by for instance requiring a company to meet minimum BEE levels before qualifying for reduced electricity costs.

However, the issue around electricity supply to the manufacturing industry in general is a sensitive topic that needs further exploration as a separate research assignment.

6.1.2. Transportation

Similarly, the efficiency of South Africa's rail transportation is well published. South Africa's manufactured goods are transported via road resulting in congestion, accidents and life loss, damage to road surfaces and increased carbon emissions as compared to rail.

Transnet in conjunction with the Department of Transport is currently working on plans to improve rail access and reliability.

6.1.3. Labour

Conflict between employers and employees remains a serious issue in South Africa and the current system is developed in such a manner that parties are able to negotiate at an industry level on wages, productivity and other issues. Unfortunately South African labour relations are not in a healthy state and compare particularly poorly when compared to other countries (if a recent report by the World Economic Forum is to be believed). To fix labour relations issues is beyond the scope of this assignment but this is an area that should receive more attention at a central level. Working together for the best interest of companies AND employees should be the mutual goal.

6.1.4. Pricing of Steel

The price of steel in South Africa has been a contentious matter since the sale of ISCOR to ArcellorMittal some years ago. The use of import parity pricing has had a detrimental impact on the downstream industry in some cases – but in many cases the value of the input steel is relatively low when compared to the output prices and hence a reduction in the steel price may not solve internal demand issues. In fact, the primary steel industry in South Africa is under tremendous pressure and recent tariff increase approvals on primary steel is a clear indication of an industry under stress. However, this issue remains a contentious one and more should be done to bring the various stakeholders closer. The issues around steel prices are beyond the realm of this report but this does pose a significant question to both supply and demand.

6.1.5. Other Costs

There are other costs that also make South Africa less competitive. This includes the high cost of skilled labour (and administration staff), red tape and general inefficiency. These challenges are crucial to the manufacturing industry but falls outside the scope of this assignment.

6.2. Economic Policy

6.2.1. Currency Fluctuations

The majority of investment in South Africa is in the form of short term and highly liquid investment in the Johannesburg Stock Exchange. Foreign investors are allowed to invest in South African companies but at the same time they are also allowed to disinvest at any time. The result is that capital flows into the country when other markets are down but that capital outflows are often severe when fears for growth in the developing market develop. As a result the rand is often under pressure from large outflows that has nothing to do with the real economy. Manufacturing companies delivering on export orders are as impacted by these moves as the financial services industry and while a weaker rand may be good for exports in the short run, in the long run it results in higher inflation and thus higher input costs. A more stable currency would be more beneficial to both financial services and the export industry.

The volatility of the rand has been identified as having a major impact on the profitability of exporters. It is especially longer term contracts that are in danger as it is virtually impossible to determine the value of the currency days or months in advance. Since many of the supply contracts run over many months it creates significant risk for exporters limiting the opportunities they are willing to explore. Since margins on products are extremely low any fluctuation in currency can result in a loss.

Exporters have to have access to better and cheaper hedging instruments in order to protect them from an appreciating currency. Government should consider making more trade finance available in the form of hedging instruments that can be accessed through easy-to-access portals. The aim of such hedging instruments should not be to generate funding for the state but rather to protect long term exporters from the volatility of the rand.

However, such a plan would require further detailed feasibility analysis that falls outside the scope of this assignment.

6.2.2. Interest Rate Differential

Investors view South Africa as a developing nation with inherent larger business risk as compared to the mature markets of the USA and Europe. As a result they require a higher return on investment to validate their investment and as such South Africa's repo rate is on average between 5%-6% higher than developed economies.

Value added steel manufacturers indicated that in many cases their profit margin is around 5%-7% making borrowing for plant improvement unattractive. As a result companies fall behind on the technology curve and ultimately lose their market share in both the local and export markets. Access to affordable credit remains a high priority for investment in local companies.

The dti and the IDC have a variety of schemes and preferential rates in place to support local manufacturers. In many cases these manufacturers do not know of the proposed benefits or find the red tape in accessing services to cumbersome.

The value added steel industry should be supported through low cost loans, bridging export finance and hedging products. Access to such finance should be verified by industry experts and could well be managed and channelled through industry associations such as Seifsa that is already administrating the COSM fund.

Project Conclusions

The South African value added steel industry makes an important contribution to employment, GDP contribution and skills development. However, the industry is under severe pressure as a result of economic conditions, increasing production costs and unfair competition from producers in Asia.

The recommendations of this report stems out of the extensive research completed into the state of the value added steel industry in South Africa over a period of more than 18 months. The research findings are based on the valuable contribution by the manufacturers, labour, industry associations, government departments, end-users of steel products and industry experts.

The recommendations can broadly be classified in three segments according to the difficulty and duration before implementation can occur.

The short term interventions focus on the immediate needs of the industry namely to increase access to finance, business support, the use of traffic to level the playing field and lastly rebuilding the trust relationship between government, industry and labour. It also focuses the attention on the various policy measures available that could assist the industry. Although the cost of implementing these measures is not significant it will take the active participation of all stakeholders in order to improve the outlook for this sector.

The medium term interventions will take more effort to implement and focus measures to drive internal demand, skills alignment, export support and the development of a plan to counter the aggressive trade tactics used by China. These interventions will require strong political will to implement and will require a strong relationship foundation which will be developed through the implementation of the short term interventions.

The long term interventions are aspects that are having an overall detrimental impact on the South African economy and not only the value adding manufacturing industry. To solve these challenges will require the involvement and political will of all levels of government and will require extensive participation from private sector. Although these measures are hardest to implement they are also the most important to the overall competitiveness of the country and the long term survival of the employment intensive industries in South Africa.