Opinion Piece Topic: South Africa's Scrap Metal Policy: Quo Vadis?

Focus: Contextualizing the State's Intervention Measures in the Scrap Metal Sector.

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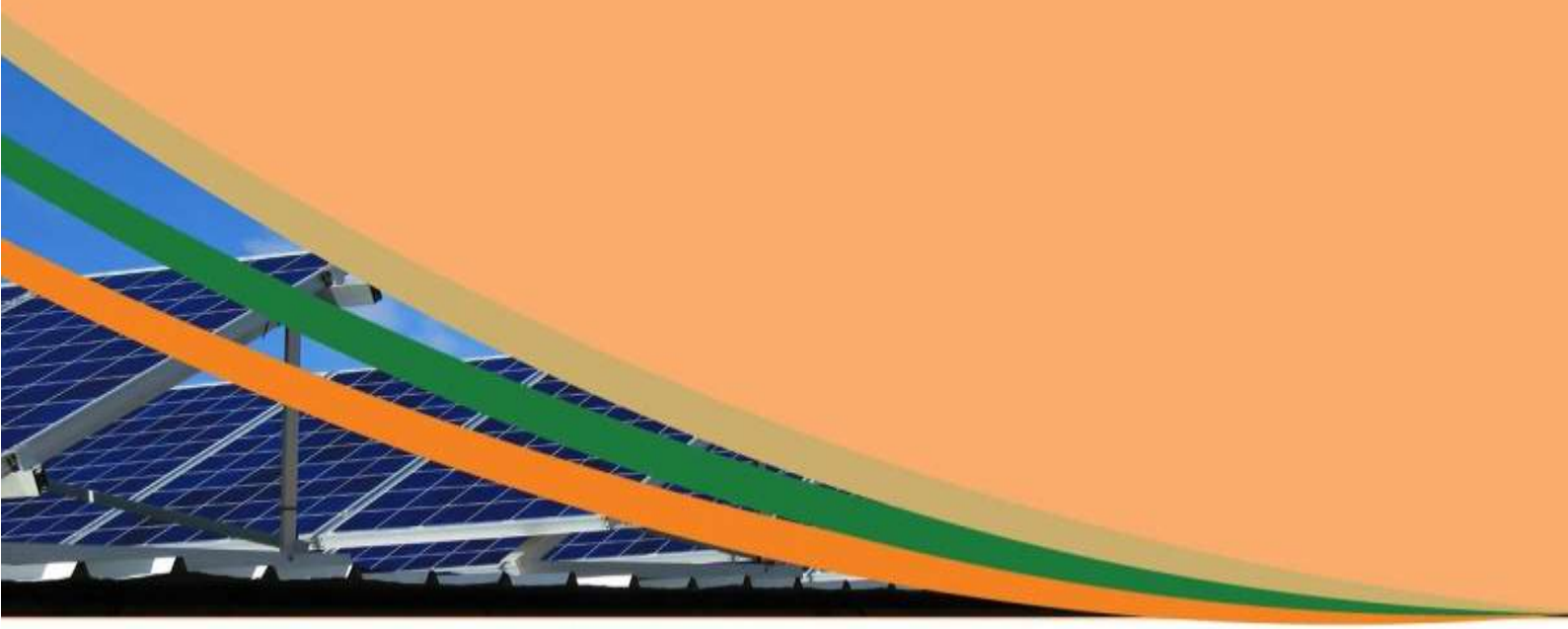

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SA's Scrap Metal Policy: Quo Vadis?

The debate on trade and industrial policy has moved from whether government should pursue the policy to how it should be strategically implemented. Given the level of uneven economic development globally, it is now generally accepted that it is the responsibility of government, especially in developing countries[1], to not only support the profitability and competitiveness of domestic firms, but also to influence their behaviour to promote social welfare and protect the interests of citizens in general.

This is informed by government's objective to shift profits from foreign to domestic firms as well as other positive externalities, such as higher revenue from taxes, to support more social spending and profits that can benefit workers in terms of wages. Methods used are taxes and subsidies, research and development incentives, export or import quotas, and voluntary export restraints (VERs). Given the fiscal position in many developing countries, the choice of sectors or activities to support becomes critical. Even leading economists such as Joseph Stiglitz, Dani Rodrik and Justin Lin, as well as international organisations such as the World Bank and Organisation for Economic Cooperation and Development (OECD) are acknowledging the need for well-designed and selective sectoral interventions, making industrial policy en vogue.

The success of any policy intervention and targeted sector approach depends in the early stages on engagement with the private sector, through structured dialogue and knowledge-sharing platforms with policymakers. This requires an institutionalised mechanism with greater emphasis on coordinating implementation and ensuring accountability.

With steel the material of choice for many elements of manufacturing, mining, construction, transportation and consumer products, the current thinking on industrial policy is what informs the government stance on a targeted approach towards promoting and addressing critical constraints within the steel industry value chain, in particular the foundries and mills. In 2021, South Africa was the 32nd largest crude steel producer in the world, using either a basic oxygen furnace (BOF) with a maximum of 30% of recycled steel (scrap) or an electric arc furnace (EAF) with a maximum of 100% of scrap to produce 1 000kg of crude steel. The BOF process is done by ArcelorMittal South Africa, while the EAF is led by mini mills and foundries. Figures from Statistics South Africa show that the steel value chain employs about 200 000 people and contributes 4% to the country's gross domestic product (GDP). This makes steel a strategic industry for South Africa.

[1] Due to the fact that developed countries were already wealthier through protectionist policies, incentivisation of domestic industries and other measures when the World Trade Organisation was established in 1995 to promote trade liberalisation

The challenge of climate change has also brought new rationale for state intervention in sustainable industrial development. Since the mid-1800s, the Earth's average surface temperature has risen by 0.07°C every decade, which ironically is the same period (the dawn of industrial age) in which countries ramped up their use of fossils fuel such as coal, oil and natural gas to achieve rapid economic growth. The Industrial Revolution, fuelled by sources of energy, resulted in higher concentrations of greenhouse gases, which has now propelled governments working with affected stakeholders to develop measures to limit global warming to below 2°C to prevent the potential catastrophic effects of climate change.

Given its high recyclability (85% to 90% of steel products can be reused) and continuous critical role throughout the manufacturing value chain, including for building and infrastructure, the steel sector has been targeted to reduce industry emissions and resource consumption, and to contribute to the circular economy. One of the measures proposed by the European Union (EU) to contribute towards the circular economy, for example, is to restrict the export of scrap metal to only non-OECD countries that adhere to EU environmental and sustainability standards. The intended purpose of the proposed legislation is to avoid the dumping of EU waste in other countries, however, it would also make scrap metal available to EU steel users at a lower price than the baseline.

Furthermore, steel production from recycled metals uses about 75% less energy than steel production from virgin ores, thus substantially reducing input costs and greenhouse gas emissions. This has massively increased global demand for scrap metals, making it the 'new gold'. As a result, there has been significant growth in ferrous and non-ferrous metal scrap exports over the last decade, which has attracted new export traders and led to domestic processors finding it difficult to access quality and affordable scrap metal. In addition, a new phenomenon emerged where export permits were tampered with and the volumes applied for through section 26 of the International Trade and Administration Commission (ITAC) were less than the volumes exported. This affected production and employment in a large number of mills and foundries.

The abovementioned benefits of downstream industrialisation and environmental impact, and the associated challenge of low scrap volume show that it is in the interest of government to put in place appropriate policy measures for a competitive and sustainable domestic metals recycling industry across the value chain, and to ensure local end-users are not negatively affected by increasing prices and supply shortages. This is important to avoid a decline in mills and foundries, which would have a major impact on industrialisation and infrastructure development, and lead to job losses and the destruction of industrial capacity.

Measures introduced by government with support and input from the sector include the price preference system (PPS) in 2013, which allowed for the exportation of scrap metal only after it had first been offered for sale for domestic beneficiation to the domestic consuming industry, for a period and at a price discount or other formula determined by the ITAC. This was followed by the an export tax on scrap metal in August 2021 to ensure the supply of affordable scrap metal to the domestic consuming industry and address some of the gaps identified in the PPS, which included serious circumvention of the PPS and tampering of export permits. In turn, this would result in the mills and foundries becoming more cost competitive and attract investment, creating employment and supporting industrialisation. In addition, it would ease the pressure brought about by unfair trade practices within the domestic metals industry.

Global demand for metals has continued unabated mainly due to the industrialisation of China and, most recently, the supply chain disruptions brought about by the COVID-19 pandemic and Russia/Ukraine war. As a consequence, South Africa has seen an increase in illegal scrap metal exports and theft of metal, and the associated impairment and destruction of critical public and private-sector infrastructure. Recent research by TIPS and Genesis puts the annual economic cost in 2020/21 at more than R50 billion, with serious disruptions to social and health services, and dampened business and investment confidence.

Part of the new thinking on industrial policy, as articulated in the South African Steel and Metal Fabrication Master Plan, requires collaboration with steel industry stakeholders to explore measures over and above export tax on scrap metal. The new trading regime for scrap metal will ensure the promotion of scrap beneficiation through access to higher quality scrap metals. The proposed measures include security and enforcement of a comprehensive industrial policy intervention for a reliable and sustainable domestic recycling industry. In many countries scrap metal is used for light manufacturing specifically in micro and small industrial clusters and although there are challenges relating to formalisation, access to funding etc., the element of job creation and employment during turbulent economic periods supersedes such issues. Thus in addition to promotion of beneficiation the new trade regime will also need to consider increasing the technical skills and easing access to finance of micro and small enterprises (downstream industries) in metal and scrap fabrication in specific light industries

While the WTO does not allow the prohibition or restriction of trade between member countries, there are conditions that need to be met for any country to undertake such measures, including addressing critical shortages of essential products. Furthermore, a country can implement trade restriction purely on security and health considerations. For example, the EU recently introduced new phytosanitary requirements for the import of citrus fruit. As one of the largest global exporters of citrus fruit, and with Europe accounting for more

than 40% of South Africa's total exports in 2020, the Citrus Growers Association reported that the country spent about R4 billion to comply with the previous phytosanitary measures (citrus black spot and false codling moth) imposed by the EU in 2020. Despite not being WTO compatible, the EU went ahead and imposed restrictions on the country's citrus fruit, directly benefitting Spain, which accounts for 60% of all EU citrus production. This shows that countries are willing to introduce measures to safeguard their economies and strategic interests amid rules prohibiting such measures.

Should the South African government not intervene in the scrap metal industry, the country will suffer enormous costs to the economy and risk losing comparative advantage in the steel sector across the entire value chain due to high costs associated with maintenance (security) and repairs to critical public and private infrastructure as a result of damage; interruptions to the supply of energy, rail and communication services; and import taxes imposed by trading partners and reduced demand for carbon-intensive exports.

Thus, the current ongoing scenario in the scrap metal industry is a classic economic example of market failure and warrants government intervention.