Summary Report of the Intra-Departmental Task Team on Iron and Steel (IDTT) by the Department of Trade and Industry

Portfolio Committee on Trade and Industry
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1 Background

2 Iscor / Kumba Resources Unbundling

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4 Implementation Progress
1. Background

- South Africa has the largest mineral resources in the world, excluding oil, with an estimated value of $2.5 trillion;

- Despite this no competitive advantage accrues or is passed on to domestic manufacturing;

- Historical competitive advantages, especially low electricity prices no longer apply;

- An Import Parity Pricing (IPP) policy is practiced by producers who enjoy market dominance for key inputs into manufacturing – steel and plastics and polymers.
1. Background

- Kumba Iron Ore (KIO) accounts for 80% of domestic production and is the world's leading supplier of lump ore.
- Global demand and an increase in the price from $80 in 2007 to > $160 from 2010 resulted in exports of ‘unbeneficiated’ ore to > 70% of total production.
- AMSA accounts for 75% of domestic steel production. Until March 2010 it derived a massive cost advantage under cost plus 3% supply arrangement, not passed on as a ‘developmental steel price’.
- Domestic steel prices consistently in highest quartile in world.
- Arcelor Mittal enjoys market dominance and their pricing strategy has not been in support of downstream manufacturing. Have experienced plant shut downs, most recent at Vanderbijl Plant. (Saturday 09.02.13) Long term maintenance and capital investment arrangements a concern.
- Simultaneous and interlocking court processes involving government AMSA, KIO and other parties have retarded progress.
1. Background

• High international prices have fuelled a massive unimpeded expansion of scrap metals exports. Some countries have a total ban on export of scrap metal and others impose an export tax;

• This has negatively impacted upon supply to domestic scrap processing industries (including mini-mills; foundries)

• The unimpeded export of scrap is associated with wide-spread cable and metal theft and masking of illegal export of scrap metals
1. Background
1. Background

2. The establishment of the Inter-Departmental Task Team

3. Final Instruments Approved by Cabinet in December 2012

4. Implementation Progress
## 2. The IDTT on iron ore and steel value chain

### EVENTS LEADING TO THE ESTABLISHMENT OF THE IDTT

<table>
<thead>
<tr>
<th>Event</th>
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| AMSA / SIOC dispute       | Apr. 2009 | • AMSA’s old order mining rights lapses  
                            | Feb. 2010 | • Kumba cancels the cost + 3% supply agreement of 6.25 million tonnes per annum of lump iron ore, triggered by AMSA’s failure to convert its old order mining right (21.4%) as was apparently required in terms of MPRDA  
                            | Mar. 2010 | • Kumba and AMSA begin negotiations on an interim pricing agreement for iron ore, pending the court case on the Sishen mining right and arbitration process to decide on the validity of the iron ore supply agreement;  
                            |          | IDTT established                                                                                                                           |
|                           | Apr. 2010 | • An Intra-Departmental Task Team (IDTT) is established (*the dti*, DPE, EDD and DMR) to develop a set of inter-related policy instruments to ensure the long term viability of the iron ore and steel value chain in support of increased levels of value addition to create a competitive advantage for the South African manufacturing industry  
                            | Jul. 2010 | • *The dti*, EDD and DMR initiate a mediation process with the two companies to bring about a settlement to the dispute that would avoid retrenchments and cuts in production in the short term in the national interest - industrial development and job creation;  
                            |          | • The mediation process is overtaken by the decision by the two companies to unilaterally reach an interim pricing agreement  

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1 Business Assistance Agreement concluded in 2002 between Iscor Steel and LNM Holdings
2. The IDTT on iron ore and steel value chain

EVENTS LEADING TO THE UNBUNDLING OF ISCOR INTO KUMBA RESOURCES AND ISCOR STEEL (NOW ARCELOR-MITTAL SOUTH AFRICA) (Cont…)

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<thead>
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<th>Event</th>
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<td>IDTT established</td>
<td>Nov. 2010</td>
<td>• Cabinet approves a set of policy instruments for further development namely (a) deployment and amendment of the MPRDA, (b) Amendments to the Competition Act, (c) Amendments of shareholder compacts with SOEs, (d) Introduction of export taxes on iron ore and steel, where appropriate, (e) Promotion of new steel investments</td>
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<tr>
<td>AMSA / SIOC Interim Supply Agreement</td>
<td>Jul. 2011</td>
<td>• The first interim supply agreement (IPA1), valid for 1 year, between AMSA and SIOC, expires;</td>
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<td>• The second interim supply agreement (IPA2) valid for 1 year is signed. IPA1 is used as a base to create IPA2 so as to avoid the onerous and protracted exercise of seeking a new agreement;</td>
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<td>Jul. 2012 • AMSA notifies the dti of agreement expiry and subsequent deadlock in terms of the new interim agreement. AMSA’s notification implies production cuts and job losses;</td>
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<td>The dti’s mediation process</td>
<td>Aug. 2012</td>
<td>• the dti appoints a mediator to facilitate a short term interim iron ore pricing and supply agreement in line with Government’s long term objectives to ensure access to iron ore resources at developmental prices to promote competitive steel-making and downstream beneficiation industries;</td>
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1 Business Assistance Agreement concluded in 2002 between Iscor Steel and LNM Holdings
## 2. Iscor / Kumba Resources Unbundling

### Events Leading to the Unbundling of Iscor into Kumba Resources and Iscor Steel (Now Arcelor-Mittal South Africa) (Cont…)

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| The dti’s mediation process | Dec. 2012 | • AMSA and SIOC reach an agreement on the terms and conditions on which SIOC will continue to supply iron ore to AMSA after 31 December 2012;  
• The dti noted with concern that the parties failed to agree on the developmental intent and outcomes. Agreement does not ensure a discounted iron ore price will be passed on as a developmental steel price to the local manufacturing sector;  
• Failure strongly underlines Cabinet’s conviction on the need for a set of policy interventions to secure a competitive advantage for the domestic manufacturing sector and its decision to expedite the deployment of those policy instruments proposed by IDTT;  
• Cabinet approves IDTT’s final policy instruments namely  
  (a) A fast-track legislative process led by DMR to amend the MRPDA,  
  (b) A process led by EDD to utilise the International Trade Administration Act to safeguard the supply of affordable scrap metal to domestic industries  
  (c) A process to amend the Competition Act led by EDD,  
  (d) IDC led process to fast-track new steel investments to strengthen competition in the steel sector; |

1 Business Assistance Agreement concluded in 2002 between Iscor Steel and LNM Holdings
1 Background

2 Iscor / Kumba Resources Unbundling

3 Final Instruments Approved by Cabinet in December 2012

4 Implementation Progress

In December 2012, Cabinet approved the following set of policy instruments that seek to ensure the long term viability of the iron ore and steel value chains in support of increased levels of value addition to create a competitive advantage for the South African manufacturing sector:

1. A fast-track legislative process led by the Department of Mineral Resources to amend the Mineral Resources and Petroleum Development Act to secure a competitive advantage for the manufacturing sector, which arises from South Africa’s enormous resource endowment;

2. A process led by EDD to utilise the International Trade Administration Act to safeguard the supply of affordable scrap metal to domestic mills and curtail the abuse of scrap metal, including associated cable and metal theft;

3. A process to amend the Competition Act led by the Department of Economic Development to ensure that iron ore price concessions are passed onto the downstream industry;

4. Industrial Development Corporation led process to fast-track new steel investments to strengthen competition in the steel sector;

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2 A study on the effects of the introduction of export duties on iron ore and primary steel products, using a Computable General Equilibrium (CGE) model, has been concluded. Introduction of an export tax would be similar in effect to the introduction of Section 26 as per the amended MPRDA with economic growth, employment and welfare impacts;
Background

Iscor / Kumba Resources Unbundling

Final Instruments Approved by Cabinet in December 2012

Implementation Progress
Instrument 1 of 4 (Amendment of MRPDA, led by DMR)

MPRDA Draft Amendment Bill 2012
Approved by Cabinet – 28 Nov 2012
Published in Government Gazette – 27 Dec 2012
To be Tabled in Parliament

Section 26 – amended to enhance provisions and align with national priorities related to access to minerals for local beneficiation
Section 26 MPRDA Amendments

Provides specific powers to the Minister of DMR to:

- Determine the percentage per mineral commodity and the price in respect of such percentage, in a production cycle, as may be required for local beneficiation.

- Impose that every producer shall offer to local beneficiators a certain percentage as prescribed. This will apply to iron ore being auctioned to more than one steel producer on condition that the developmental price is passed on as a developmental steel price.

- Provide consent for the export of designated minerals subject to conditions the Minister may determine.
### MAXIMISE LINKAGES

<table>
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<tr>
<td>• Feedstocks supplied at competitive or</td>
<td>• Local Content</td>
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<td>developmental prices (for strategic minerals) for domestic industries and power generation</td>
<td>• Maximise local inputs into mining (capital goods, services, consumables) through local content milestones</td>
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<td>• Minimum local spend on critical Science, Technology, Engineering &amp; Mathematics skills and technology development</td>
<td>• Provision of mining infrastructure at non-discriminatory tariffs for other economic activities</td>
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Instrument 2 of 4 (Use of ITAC to safeguard the domestic supply of affordable scrap, led by EDD)

Background

- Use the International Trade Administration (ITA) Act to safeguard the supply of affordable scrap metal to domestic mills, foundries and smelters by introducing a price preference system to strengthen existing export control measures;
- In terms of such a system, exporters will not be considered for an export permit until they have offered domestic users first option to purchase scrap metal at a price lower than the international price;
- Export permit applications will only be considered if accompanied by:
  - A metallurgical certificate confirming the type, grade and quality of metal to be exported; and
  - A certificate indicating that the metal is not stolen and that the exporter has complied with the Second Hand Goods Act, as administered by the SAPS
The Minister of Economic Development’s draft scrap metal policy directive to ITAC and ITAC’s draft guidelines for scrap metal export permits were published in the Government Gazette on 25 January 2013 for public comment. Comment open for 4 weeks;

The draft directive sets out the policy, including a price preference system, the Minister proposes ITAC implement to further regulate scrap exports. It proposes scrap metal should not be exported unless it has first been offered to domestic users at a price discount determined by ITAC;

ITAC’s draft guidelines set out the proposed conditions exporters would have to satisfy to qualify for a permit to export scrap metal, including offering the scrap to be exported to local users at a price discount, and also requests comments on the level of the price discount;

Target date for implementation is 1 April 2013;

Discussions are also underway between EDD, ITAC and SAPS on introducing regulations, by the Minister of Police in terms of the Second Hand Goods Act, to establish task teams to inspect scrap metal consignments. Such inspections would have to certify the scrap has not been stolen before ITAC can grant an export permit.
Instrument 3 of 4 (Amendment of the Competition Act, led by EDD)

Background

• EDD is leading the process to make amendments to the Competition Act, including, in the case of the iron ore and steel value chain, to ensure that iron ore price concessions accruing to the primary steel industry are passed onto the downstream users;

• This includes work to determine appropriate powers to determine pricing methodologies, monitor compliance and sanction non-compliance;

• This may be achieved through powers given to the competition authorities or other bodies including regulators, where appropriate, given the nature of such strategic industries;

• The actual amendments will be finalized by June 2013;
An IDC led pre-feasibility study on new steel investments has concluded:

- That a new steel production facility can be established, which can effect a 10% reduction in the price of steel (for a broad range of flat and long products);
- International investors are ready to enter into a Joint Venture to establish such a facility;
- It would utilise low cost iron ore fines / tailings (not iron ore lump used by AMSA);
- New capacity would be optimally located (logistic costs are the single largest component in the cost of steel)
- Technologies used would eliminate the need for expensive imported coking coal (the second largest component in the cost of steel using blast furnace technology);
- Strong conditionalities must guarantee government control, avoid the shortcomings of the Iscor unbundling and ensure developmental objectives;
1. **Original Masorini Project**
   - Original concept consisted of long and flat steel production capacity, development of marketing and distribution channels to provide an alternative domestic steel supply from AMSA;
   - The inability to meet the required product range contributed to:
     - High capital costs;
     - Reduced efficiencies;
     - Added complexity;

2. **Impact of IDC’s Acquisition of Scaw**
   - IDC’s acquisition of Scaw brought about the Masorini “Scaw” option which entails separating the long and flat product production facilities, addresses market penetration, approaches implementation in a phased manner, reduces technical risk and enables the benefits of the learning curve to be applied to the long product portion of the project;
   - Accelerated delivery of additional steel capacity and leveraging off a brownfield project;
   - Facilitates international operating partners to develop local comfort and expertise prior to implementing the larger flat product project;
3. Progress-to-date:
   • Prefeasibility study for the Masorini 2.5 mtpa fully integrated steel project completed in 2012;
   • The Masorini Project Internal Rate of Return (IRR) (dollar geared) as a flat product project is acceptable;
   • Their interest is in operating both Scaw and Masorini as a combined operation, ensuring access to Scaw’s distribution network;
   • Access to Scaw’s information resulted in some delays in the due diligence process, however, this is not anticipated to impact the overall schedule;
   • Based on responses from the PIM, full access to the data room has been provided to the potential investors;
   • Selection of partner and negotiation of the participation agreement anticipated Q2 2013;
   • Detailed Feasibility Study (±R350 million) forecast to commence early 2013 and anticipated to take 18 months;
   • The Detailed Feasibility Study (DFS) and Environmental Impact Assessment (EIA) processes to be done concurrently;
Thank You