DONALD MACKAY: Export tax on scrap metal shows perils of unintended consequences

The scope has crept beyond the sector to the mills that manufacture steel from the metal

BL PREMIUM

18 JULY 2024 - 05:00

by DONALD MACKAY

Picture: DOROTHY KGOSI

Imagine that you were taxed 20% on your revenue, and 27% more on any profit you make. Would it encourage you to invest?

This is what happens now with the export tax on scrap metal, only the scope has crept beyond the scrap metal sector to the mills that manufacture steel from scrap metal. Policy wonks call it an unintended consequence.

The foundries and mini-mills buy scrap steel, melt it down and convert it into all sorts of steel products. The government supports these businesses through a programme known as the price preference system (PPS).

This policy, with friendly financing from the Industrial Development Corporation, has caused a big rise in the number of mini-mills and foundries. But as PPS is tough to administer, the International Trade Administration Commission (Itac) recommended it be discontinued and replaced by an export tax. The recommendation was strongly supported by most businesses in the industry.

In 2021, a working group composed largely of mini-mills and some government officials, lobbied for export duties to be imposed in addition to PPS, rather than instead of. It has never been clear why they thought this was a good idea, as it is impossible to export scrap metal unless there are no local offers at the discounted PPS price.

The export duty is thus paid on products domestic consumers have no interest in. On August 1 2022, the export duties were duly imposed. From August 2022 to May 2024, R1.7bn was collected in export duties.

The cost of these duties is borne primarily by state-owned enterprises (SOEs) and SA's manufacturing sector, which ended up recovering less for their scrap metal to accommodate the export duty. The export duties were not intended to apply to products manufactured by the downstream industry, which includes the mini-mills and foundries. In fact, the very opposite.

Sars collection

The government's industrial policy has been focused on developing this sector and certainly the sector has grown, but the export tax has nothing to do with this growth. And now this tax poses an existential risk to the very industry that lobbied for its creation.

Enter SA Revenue Service (Sars) customs and those scary unintended consequences. Sars doesn't play a role in the creation of trade and industrial policy, but when the implementation of those policies happens through a border tax such as the export duty, Sars is responsible to make sure it is collected.

Here is where things start to go off the rails. When goods are traded across borders this needs to be classified into a tariff code, which determines the duty rate payable on the product. But tariff classification is a complicated business.

In SA we have about 7,500 tariff codes, but an infinite variety of products need to fit into those 7,500 codes. It can get complicated.

Tariff disputes are the most common disputes Sars customs has to deal with, but export duties are very new, so tariff disputes on export duties have never occurred before.

Sars lacks the legal discretion to infer what the intention of the duty was. Its job is simply to ensure the duty is collected (and the correct tariff code used) before the goods leave the country.

For decades these products have been cleared under the tariff codes for billets and other manufactured items but — awkwardly — Sars believes the goods coming out of the mini-mills are technically in the wrong tariff code and should be cleared as remelting ingots.

And just like that we have a 20% tax on the turnover of these mini-mills and foundries. It is the ultimate unintended consequence.

The Customs & Excise Act allows Sars to recover underpaid duties going back two years, which means these companies now face a tax equal to 20% of their turnover for the past two years, excluding penalties and interest.

This is an existential crisis for the entire industry and the thousands of people employed in it. I believe Sars is wrong in its interpretation, and no doubt this case will be fought tooth and nail, but in the short term companies can’t get their stock out of the country without first paying Sars its pound of flesh.

Given that PPS is still here and was recently extended to 2027, the export tax should not exist. If it is not removed, versions of this problem will keep recurring. PPS provides all the protection the mini-mills require. The export tax must go.

• *MacKay is CEO of XA Global Trade Advisors.*