UK Steel

4th February 2019

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Implications of a No-Deal Brexit for UK Steel Companies

Key Impacts Summary:

- UK steel exports to the EU would almost certainly be restricted by the new EU steel safeguards. This combined with US steel tariffs, responsive safeguard actions elsewhere, and loss of access to EU FTAs would mean trade restrictions in virtually all our export markets accounting for 97% of our current exports.

- The export of some 2.6 million tonnes of UK produced steel to the EU each year would be severely disrupted by additional administration, costs and border delays. We estimate 4-5% would be added to the cost of a tonne of steel – estimated at £70 million/year for the sector. Delays and complications would also encourage many EU customers to seek alternative steel providers.

- The EU would introduce a range of tariffs on imports of steel containing products (such as 10% on cars) from the UK, reducing export and production of these products and ultimately demand for steel in the UK.

- Loss of access to a range of EU free trade agreements (FTAs) would result in the imposition of tariffs to other important markets for steel, most significantly Turkey (15% average tariff impact) which the UK exports 300,000 tonnes to each year.

- No detail exists on how the UK will replicate the EU's recently introduced steel safeguards, introduced in response to the US Section 232 tariffs. Here the devil is in the detail, poorly implemented measures could be as ineffective as no measures at all, leaving the UK open to trade diversion and import surges.

- Concerns remain about the UK's immediate readiness to investigate and introduce new trade remedies measures in a timely manner, particularly those already in train in the EU. This could leave the UK further at risk to trade diversion and dumping.

- UK steel would no longer count as of EU origin for the purposes of rules of origin within the EU FTAs – EU demand for UK steel could weaken as a result.

- UK Government policy is to ensure that EU steel qualifies as UK origin for the purposes of replicating our existing FTAs – eliminating any possibility of any strengthening of UK manufacturing supply chains after Brexit.

- UK Steel companies would lose access to the €1.6 billion Research Fund for Coal and Steel – essential to the sector's ability to collaborate across the EU on vital innovation projects.

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Introduction:

1. In August 2018 UK Steel set out in a policy note the severe implications for steel companies if the UK were to leave the EU without a deal. Since then the government has negotiated its Withdrawal Agreement, which has in turn been rejected by Parliament. In the light of this rejection, the government has at the time of writing explicitly refused to rule out a "no deal" Brexit. It therefore remains the default position, and increasingly likely that:

    - The UK will leave the EU and all related agreements and bodies at 11pm on 29th March 2019.
    - There will be no transition (or "implementation") period.
    - No preferential tariffs will be in place for UK exports to anywhere in the world.
    - The UK will obtain complete control over its trade policy, including Free Trade Agreements (FTAs) and trade remedies.

2. Whilst huge levels of uncertainty remain even in the event a/the Withdrawal Agreement is ultimately approved by Parliament – many of the impacts outlined in this paper could be minimised or even removed through an orderly and well-planned exit from the EU. One of the principal advantages of the draft Withdrawal Agreement is that it provides a transition or implementation period lasting at least 21 months, during which the UK would for all effective purposes remain a member of the EU (albeit as a rule-taker). This would provide certainty for steel companies in the short term and time to prepare for the changes to come in 2021. We cannot overstate the importance to the future of the UK steel sector of achieving this outcome, as a minimum, in the coming months.

3. However, it goes without saying that there are still negative implications of leaving with a deal – particularly one that takes the UK out of the Customs Union. Some of the steel industry's concerns over a "no deal" Brexit would apply in any Brexit Scenario (even in a 'Norway' type deal). Given the chronic uncertainty over the country's future destiny, this paper also highlights these issues here where relevant.

Movement of Goods:

4. The biggest immediate concern for steel producers resulting from a no-deal Brexit would be the additional cost and complexity of moving their goods from the UK to the EU. UK steel producers exported 2.6 million tonnes of steel to the EU in 2017, around a third of its total production. With such huge volumes of steel moving across the border, (including an estimated 1400 trucks and six trains each week) any delay and additional checks/administration would have a major impact on the sector. Estimates on the cost of this could be in the region of an additional 4-5% on total costs for each tonne that crosses the channel – an estimated £70 million cost to the industry each year.[1]

5. Adapting to a "no deal" scenario will have a significant impact on steel companies' competitiveness and ability to service their customers – the UK is severely limited in its ability to minimise costs and disruption on the other side of the Channel (i.e. with respect to UK exports to the EU) – other than by investing in infrastructure to assist with the flow of good across the Channel. The government must however do all it can to simplify and streamline import procedures on this side of the Channel should we no longer be in the EU on 29th March. This would at least help to minimise some of the expected additional costs for steel companies.

6. Any form of Brexit will raise complications of this nature, but at least a withdrawal agreement and transition period will allow 21 further months for steel companies, and the UK as a whole, to prepare.

EU Tariffs:

7. Fortunately, there is little to no risk that the EU, or indeed the UK, would impose tariffs on **most**[2] steel products or steelmaking raw materials under any scenario. Since 1994, developed countries, through the WTO, have agreed to eliminate all customs tariffs on these products and it is inconceivable that this will change as a result of Brexit.

8. However, a no deal Brexit does throw up major concerns for the use of steel by other manufacturers. For example, we would see a 10% tariff on UK-produced cars imported into the EU, reducing demand for UK cars on the continent and thus demand for automotive steel in the UK. Given the complexity of pan-European automotive supply chains (and indeed those of many other steel-intensive manufacturing industries), there are similar implications for intermediate component manufacturers. Overall, the UK will become a less attractive location to manufacture goods destined for sale in the EU, with major knock-on implications for steel producers. Some 20%[3] of UK produced steel is supplied to the UK manufacturing sector – any trade restrictions on these sectors will immediately impact their steel producers.

9. These EU/UK tariff related concerns would naturally be addressed by the Withdrawal Agreement, which aims for tariff free trade following the transition period.

Free Trade Agreements & Non-EU Tariffs:

10. The EU is by far our biggest export market for steel, accounting 2.6 million of the 3.6 million tonnes UK producers exported in 2017. However, with a quarter of our exports going to markets outside of the EU there are major concerns about how Brexit will impact on this trade.

11. Under a "no deal" Brexit, the UK would immediately lose tariff-free access to the 70+ countries with which the EU has FTAs, the vast majority of which do not apply the WTO agreement on zero steel tariffs noted in paragraph 7 above. Loss of FTAs with these countries would therefore result in the imposition of tariffs on steel imported from the UK. While it is the government's avowed intention to renegotiate replacement FTAs, it is inconceivable that this can be achieved by 29th March. Indeed, it is evident that the only deals likely to be in place at this point are with Switzerland and a handful of minor trading partners. There would therefore inevitably be a prolonged period under which the competitiveness of steel, and of steel-containing goods, would be damaged in these markets.

12. One specific concern regards Turkey. Products covered by the former European Coal and Steel Community[4] are excluded from the EU/Turkey Customs Union. Instead they are covered by a separate FTA. Government officials have informed UK Steel that for a number of reasons, both political and WTO agreement related, there is no possibility of replicating our current preferential trading arrangements with Turkey. Not least, Turkey's customs union with the EU makes discussions on any FTA a complex and long term affair, intricately bound up with the UK's future relationship with the EU.

13. This means that while Turkish steel producers will continue to enjoy tariff-free access to the UK market, UK steel companies will have to pay tariffs of up to 40% (average impact 15%) on any sales to Turkey. Turkey has a large and commercially aggressive steel industry, exporting 580,000 tonnes of steel (6% of total demand) to the UK in 2017. Turkey is the UK steel industry's third largest export market, after the EU and the US, with sales of over 300,000 tonnes, worth £130 million, in 2017.

14. Importantly, it must be stressed that the loss of access to these FTAs could not come at a worse time. Protectionist sentiment is on the rise across the globe, most relevantly in the form of steel tariffs of

25% in the US. This has resulted in other markets, including the EU and Canada, introducing safeguards on a broad range of steel products. As such, a no-deal exit from the EU at the end of March would mean the UK steel industry would face some form of trade restrictions in nearly all export markets, accounting for 97% of its steel trade[5], severely curtailing its ability to search out new export opportunities and adapt to developing market conditions. As late as June last year 96% of the UK's steel exports faced no trade restrictions.

Export Market	**UK Steel Exports 2017 (tonnes)**	**Trade Restriction**
EU	2.6 million	EU Steel Safeguards in the form of tariff rate quotas would almost certainly include the UK in a no-deal Brexit (see para 28 below).
US	0.3 million	Section 232 tariffs of 25% remain in place.
Turkey	0.3 million	UK withdrawal from EU/Turkey FTA on steel sees introduction of tariffs up to 40% - estimated average impact of 15%.
Canada	0.09 million	Canada is in the process of introducing steel safeguards in reaction to US steel tariffs, these would include the UK in coverage.

15. A withdrawal agreement and transition period would not provide access to the EU's existing FTAs, but it would provide a 2-4 year transition period to replicate them at a UK level. Moreover, it would ensure the UK was not subject to EU safeguards until 2021 at the earliest (see para 28), by which time US steel tariffs may well have been withdrawn and with them the need for safeguard measures in the EU and elsewhere.

Rules of Origin

16. Rules of origin are used to determine the origin of a product for customs and other purposes. Examples of important uses include:
    - Establishing the correct level of import duty to charge; or
    - Determining whether a product has EU origin in order to benefit from preferential treatment under one of the EU's free trade agreements. For example, CETA[6] states that cars must contain 50% by value of EU products to be exported to Canada tariff free.

17. A "no deal" Brexit will see UK steel or UK manufactured components no-longer considered of EU origin for the purposes of this calculation. Thus EU manufacturers who currently buy UK steel or UK components and who aim to export to countries with which the EU has an FTA will have an incentive to stop buying from the UK, or risk becoming uncompetitive in those export markets. One result of this

will therefore be a loss in UK Steel companies' sales (and of UK steel-containing components) to the EU. Total sales from UK producers to other EU countries are worth £1.8 billion a year. The proportion of this business that will be lost as a result of this effect specifically cannot be estimated, but it will sit alongside the multitude of other Brexit impacts that will reduce our ability to competitively supply steel into the EU.

18. An additional adverse effect is as a related to UK Government policy. The government has decided that in replicating the existing EU FTAs it will attempt to secure partner countries' acceptance that EU produced goods will qualify as "UK" origin when assembled in a UK plant, for the purposes of attaining tariff free access. This might work for OEMs such as the car assembly plants, but will not work for steel and component suppliers. This is because it is inconceivable that in any Brexit scenario the EU would grant reciprocal arrangements for UK producers, i.e. by renegotiating all of its FTAs to stipulate that UK produced goods counted as EU-origin goods for the purposes of the rules of origin.

19. The effect will therefore be that while UK OEMs will be able to buy EU-origin steel and components without losing tariff-free access under the UK's eventual FTAs, EU OEMs buying UK-origin steel or components will risk losing their tariff-free access under the EU's FTAs (as explained in paragraph 17).

20. A negotiated exit from the EU where we remained in the EU Customs Union, could conceivably avoid these concerns but it is still far from certain. There is no precedent for a non-EU country being part of the EU Customs Unions, and it is not clear whether it would still be necessary for the EU to renegotiate all its existing FTAs to have UK products counted as EU-origin and, subsequently for the UK to replicate all of these FTAs.

Trade Remedies:

21. The steel sector has more measures in place than any other sector in the EU, accounting for 31 of the 92 currently in place; 15 of these are relevant to UK producers. This high volume of measures is driven by a range of factors including: overcapacity in the global sector, continued widespread state support for steel producers in many countries, the high level of international trade in the sector (30-40% of all steel produced crosses borders), and the zero tariffs for steel WTO-agreement. These factors combine to mean steel sectors in developed countries are particularly at risk from the import of under-priced and subsidised products and therefore rely, more than any other sector, on a robust and reactive regime to provide a level playing field in trade.

22. Any gap in the coverage of necessary measures would very quickly be taken advantage of by foreign exporters and would undermine the UK steel sector at a critical time in its recovery. The UK Government has said that in the event of no-deal Brexit, arrangements will be in place to ensure all necessary trade remedies measures are transitioned over. The steel industry is confident that this is the case, but the Government must finalise the process immediately with definitive confirmation of precisely which measures are to be carried over.

23. Serious concerns however remain about the UK's readiness to investigate and introduce new trade remedies measures following a no-deal Brexit. While the steel sector is confident in the ability of government to have the UK's regime, including a staffed and trained Trade Remedies Authority (TRA), fully operational by December 2020, there are worries about the possibility of doing this by 29th March. As things stand, the TRA does not legally exist, still has a large number of vacancies[7]; and most staff still require considerable time for training and to acquire the specialist knowledge necessary to perform in their roles. Furthermore, all the flesh still needs to be put on the legislative bones in the form of

voluminous secondary legislation. It is unrealistic to assume that the TRA will be ready to conduct full scale investigations by March.

24. This is a particularly urgent concern in relation to those measures already under investigation in the EU – such as measures due to be introduced in April on steel hollow sections (produced at mills in Hartlepool and Corby). The TRA should already be investigating such cases in parallel to ensure UK measures do not lag behind the EU, but it looks increasingly unlikely the UK will even be ready to take on this case in March, six months behind the EU timeline. As such, if the EU introduces measures in a few months' time the UK would become the dumping ground of choice for exports from Russia and Turkey.

25. All such concerns would disappear if the UK had a sufficiently long transition period in which to prepare, or if it remained in the Customs Union.

Safeguards:

26. The EU Commission, with the full support of the UK Government, has introduced safeguard measures on a wide range of steel products in response to US Section 232 steel tariffs. Definitive measures[8] will now be in place until July 2021, unless it is deemed they are no longer required. The question of how such measures would be transitioned over to the UK post-Brexit has been discussed with DIT, but with the risk of "no deal" looming this question becomes all the more urgent.

27. The UK Government, in-line with its policy on all existing trade remedies measures, has provided assurances that EU safeguard measures will be transitioned to the UK in time for 29th March. However, we are still lacking the necessary detail on how this will be done. It is critical that before measures are introduced they are modified in a number of ways to ensure they are effective at a UK, rather than an EU, level. Most obviously quotas will need reducing by an average of 75 to 80% in reflect the UK market; unless/until these modifications happen the UK measures would be completely useless to providing protection. We need clarity on the UK Government's approach here quickly.

28. A further no-deal concern, is the likelihood that EU safeguard restrictions will be imposed on UK steel, and likewise our safeguards will be imposed on EU imports into the UK. UK Steel has strongly stated the need to avoid this situation – but it is looking extremely difficult under WTO-rules and would be open to challenge. This situation is particularly concerning for those companies operating plants both in the UK and the EU-27, frequently transferring products between the two. It is yet another factor that will frustrate the continued operation of UK steel companies, reliant on frictionless movement of goods to the EU.

29. These safeguard concerns could be easily be addressed via a withdrawal agreement and transition period. The UK would remain part of the EU own safeguards during the transition period; should UK safeguards be required after this the UK would have time to adequately prepare. Moreover, as part of negotiations on the future UK/EU relationship discussions could be held over exemptions for each party from the other's safeguard measures – as has been provided to Norway on the basis of its close economic integration with the EU.

Research and Development:

30. The UK steel industry currently benefits from EU wide collaboration on vital R&D projects via the Research Fund for Coal and Steel (RFCS). The RFCS, administered by the EU, is funded by the interest

receipts (circa €40 million/year) from the significant financial reserves (€1.6 billion) that were accumulated by the former European Coal and Steel Community (ECSC) prior to its expiry in 2002. UK steel companies are likely to lose access to this fund in both a no-deal scenario and in the event the Withdrawal Agreement is approved – Article 145 of which states that the EU will return to the UK its share of the ECSC assets.

31. Losing access to this fund will have a number of adverse impacts:

- Most obviously, UK steel companies and research institutes will lose access to a vital funding stream for innovation, critical for the future success of the industry.

- It would severely curtail our ability to collaborate with partners across the EU. One of the major benefits of the RFCS is the collaborative aspect allowing participating parties to multiply the impact of their own investment several fold. Even if the UK were to create a UK version of the RFCS, the outputs would only be a fraction of what is possible through an EU wide fund.

- Importantly the RFCS is not subject to state aid rules as the money has been provided from levies on industry rather than public funding. This means typical projects are provided with 60% funding – under state aid rules they would only be awarded 25% funding.[9]

- HMT's commitment[10] to underwrite any EU research funds for UK participants secured before 2020 could therefore still result in a significant loss of funding unless a way could be found round state aid guidelines in this regard.[11]

32. UK Steel's first preference remains for the UK to continue to access these funds and collaborate on R&D after Brexit. Clarity is still being sought from the UK Government on whether some form of 'associate' membership of the fund could be sought during transition period negotiations, but this is far from certain.

33. If this is not possible, the government must commit to using the funds returned to it by the EU to establish a similar research fund in the UK. Importantly, this must be state aid exempt, ensuring that the same levels of grant funding are provided as under the RFCS. There can be no entertainment of the notion that such returned funds would simply be absorbed into the public purse. The ECSC's financial resources came principally from a production levy imposed on coal and steel producers[12], as well as a down payment from UK Government upon accession in 1972[13]. The levies were paid directly by the companies to the ECSC: they did not pass through the national administrations. The uses to which the funds could be put were severely limited, and were exclusively related to supporting the coal and steel industries and their workers. The principal uses were the funding of collaborative R&D by the two industries; and support to redundant coal and steel workers. It can therefore be seen that the levy was not a tax as such: rather, it was a mechanism to ensure the coal and steel industries helped themselves in adjusting to market conditions and investing in their long term future. The levy was wound up in 1998, four years before the ECSC's expiry.

34. On the ECSC's expiry in 2002 its funds were passed to the EU with the condition that they should be used exclusively to finance coal and steel research. This was supported by the UK government of the day. It was seen as a pragmatic way of ensuring that the original intentions of the ECSC's founding fathers with respect to the levy were honoured. It is therefore beyond doubt that these EU assets must continue to be used entirely for the benefit of the coal and steel sectors – and this should continue to be the case if/when the UK proportion of these assets are returned after Brexit. UK Steel stands ready to discuss with the government a mechanism for achieving this.

35. In the event of a no-deal scenario in which UK ECSC assets were not returned, for example where relations soured to the point that UK Government elected not to pay its £39 billion settlement, it would still be contingent on the government to establish an equivalent fund for the UK steel sector. As outlined above, the UK steel sector is already set to be significantly harmed by many unavoidable consequences of Brexit, it would be unacceptable if it were also to lose access to vital innovation funds that it has paid for itself.

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Notes:

[1] 4% additional costs on steel exports of £1.8 billion to the EU in 2017.
[2] The exceptions are certain types of pig iron and ferro-alloys; cast iron tubes; tube fittings; and steel castings & forgings.
[3] BEIS (2017) Future Capacities and Capabilities of the UK Steel Industry. 1.6 million tonnes of UK steel/year is sold to UK manufacturing sectors: automotive, machinery & engineering, yellow goods, packaging, and 'others' (radiators, home appliances, shipbuilding, shelving, cabinets, catering equipment, pressure vessels, metal furniture, boilers, rail cars.)
[4] ECSC products include most steelmaking raw materials, semi-finished steel, all hot rolled steel products and cold rolled and/or coated steel sheet.
[5] 97% of all exports of steel from the UK. 75% newly restricted through EU safeguards, 9% newly restricted through loss of access to EU FTAs, 8% newly restricted through US 232 tariffs and related safeguards, 4% remain restricted and represent no change to status quo. 3% remain completely unrestricted – Australia, Hong Kong, Japan, New Zealand, Norway, Singapore, South Korea, Switzerland, Taiwan.
[6] CETA = the Comprehensive Economic and Trade Agreement between the EU and Canada.
[7] TRA's Chief Executive's evidence to the International Trade Committee on 16 January 2019 noted 90 out of 129 posts had been filled – 69%.
[8] The EU Committee on Safeguards voted in favour of the introduction of Definitive Measures on 16 July 2019.
[9] Nearly all RFCS steel projects would be classified as 'experimental development' under state aid rules which allows for only 25% funding.
[10] https://www.gov.uk/government/news/funding-from-eu-programmes-guaranteed-until-the-end-of-2020
[11] The Government has made clear that even under a no-deal scenario it would follow EU state aid rules, at least for the time being: "*The EU state aid rules will be transposed into UK domestic legislation under the European Union (Withdrawal) Act. This will apply to all sectors; and will mirror existing block exemptions as allowed under the current rules"* https://www.gov.uk/government/publications/state-aid-if-theres-no-brexit-deal/state-aid-if-theres-no-brexit-deal
[12] The only other income source of any importance was "fines" imposed on coal and steel producers. In the case of the UK steel industry, such "fines" derived mainly from production by the then British Steel Corporation in excess of its Article 58 production quotas during the 1980s, which were incurred with the active encouragement of the UK government.
[13] 1972 Treat 'concerning the ascension of the Kingdom of Denmark, Ireland, the Kingdom of Norway, and the United Kingdom of Great Britain and Northern Ireland to the European Economic Community and to the European Atomic Energy Community'. Protocol No 24 details a contribution from the UK of 57 million ua (accounting units – later converted into euros on a 1:1 basis) to the RFCS upon accession.