Higher tax to replace Russia’s metal export duty

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Temporary export duties collected from ‘too profitable’ metals firms will be exchanged for more sustained taxes

Export duties on a range of metal products came into effect on August 1, lasting until year-end. Officials are trying to correct high domestic prices which they see as unjustified, and to claw back what they regard as excessive profits earned by metals companies.

What next

The authorities plan to replace export duties with more permanent fiscal arrangements next year, most likely linked to global metal prices. In the medium term, an increased tax burden could discourage investment, delaying modernisation and undermining competitiveness, particularly in the EU where high-carbon items will be penalised.

Subsidiary Impacts

• Export duties could exert upward pressure on global prices of steel, nickel and aluminium.

• Exports to the Eurasian Economic Union are exempt, so the government will need a failsafe system to prevent re-exports to third countries.

• The export duties will reduce the corporate income tax earned by metal-producing regions.

Analysis

Export duties on aluminium, copper and nickel plus some steel products came into effect on August 1 after being announced on June 24 (see RUSSIA: Metals firms hit by temporary export levy - July 1, 2021).

The excise system uses 15% as a base rate, with specific minimum rates for different metals USD254 per tonne charged for aluminium, USD1,226 per tonne for copper and USD2,321 per tonne for nickel. Ferrous metals and processed steel will be subject to minimum levies of between USD54 and USD133 per tonne, and USD150 per tonne for stainless steel and ferroalloy.

The Economic Development Ministry forecasts that the government will receive an extra RUB110-115bn from ferrous metals and RUB50bn from non-ferrous metals over the five months the tax is in effect.

Restraining prices

The official argument is that as metal prices rise globally, Russian firms have responded in an unjustifiable manner by raising prices for domestic customers -- the increase has been calculated as a 60-100% year-on-year increase from June last year. Meanwhile, their input costs in Russia increased only moderately; some even fell due to ruble devaluation. Approximately 80% of metals companies’ costs are ruble denominated, whereas revenues are denominated in or pegged to the dollar, according to the Russian credit rating agency ACRA.

The government said it acted to stabilise the domestic market because spiralling metals prices were increasing costs for key state programmes -- defence procurement and civilian infrastructure -- and for other industries including construction, car manufacturing and machine building. Cancellations of state procurement contracts for 2022-24 have risen.
Higher metal prices pushed up general inflation, feeding into broader concerns which have prompted several central bank rate rises this year. The government has imposed controls on certain grain exports and is monitoring food prices (see RUSSIA: Central bank intent on controlling inflation - July 26, 2021) and (see RUSSIA: Policy toolkit mixes rate rises and price caps - July 20, 2021).

Penalising profits
The government had another reason for taxing metals: a perception that metals companies were earning excessive profits.

Industry profits in the first quarter stood at RUB570bn, a 250% increase in the average of the same quarters of 2017, 2018 and 2019. The Economic Development Ministry forecasts they could reach RUB2.1-2.3tn rubles in 2021.

The government is concerned that profits distributed to shareholders as dividends will be transferred offshore rather than invested in sector modernisation. ACRA estimates that the average annual dividends of the four largest steel companies -- Severstal, NLMK, MMK and Evraz -- could together amount to USD5.2bn in 2020-23, far more than their joint capital expenditure, an estimated USD3.8bn per year over that period.

Not a new idea
The government decided on a sector-wide measure after initial action -- a large rise in export tax on ferrous metal scrap effective in January-July -- failed to bring down domestic prices, and discussions with company representatives on containing price growth yielded no results (see RUSSIA: Metals firms pressed into state service - June 2, 2021).

The desirability of reclaiming 'excess' profits from the metals sector is a recurring theme. It was proposed in 2018 by Andrey Belousov, then economic advisor to the president and now deputy prime minister, but was rejected at the time. This year it received unanimous support from the economic development, trade and finance ministries.

Officials have argued for higher taxes before
Belousov rejoined the debate this year, accusing metals companies of "cheating" the state in a May 31 interview.
Industry impact

Metal companies raised objections, arguing that because their business is cyclical, it is unfair to penalise them during a period when they are doing well.

Aluminium giant Rusal warned that it might have to shut down production at some plants as it would be unable to pass on the cost to foreign customers, for contractual reasons (see RUSSIA: Rusal warns on export tax, adapts to EU rules - July 23, 2021). However, initial rises in international contract prices after the tax was announced in June indicated an expectation that Rusal would pass on some of the costs to the global market, where it accounted for 6% in 2020.

Steelmaker NLMK told S&P Global Platts that the decision was discriminatory and purely fiscal, and included products for which there is no market in Russia. The Russian Steel Association calculates that the duties will reduce steel companies' profits by RUB150bn-180bn this year, depending on market conditions.

However, the Fitch rating agency said that high prices for ferrous and non-ferrous metals would mitigate the tax's impact on Russian companies and on global prices.

Fitch's calculations indicate that the short-term effect will be moderate with a maximum impact on EBITDA (earnings before interest, taxes, depreciation and amortisation) of less than 15% in 2021.

Fitch says Rusal's EBITDA will be affected the most since it exports only aluminium, whereas Norilsk Nickel will be less hard-hit as precious metals accounted for 60% of its revenue in 2020 and are not subject to the excise duty. The most affected steelmakers are NLMK and EVRAZ, which export about 50% of their output.
Others, including hydrocarbon firms, see the metals sector’s tax burden as inordinately light. Total payments made to government by metals companies, including social security contributions, amounted to 5% of their corporate revenues in 2020, compared with 48% in the oil and gas industry, according to the Federal Tax Service.

Tax structure reform

The government plans to replace its temporary export duties with permanent new tax arrangements. Details are likely to be released in September when the finance ministry submits its draft budget for 2022-24.

A lasting tax change is in the offing

The Vedomosti newspaper quotes an unnamed government official as saying the change will involve an increase in mineral extraction tax (MET), with rates linked to commodity prices. This would mean a further rise in MET on top of the increase introduced in October 2020 (from 4.8% to 16.8% for ferrous ores and from 8.0% to 28.0% for most non-ferrous metals) (see RUSSIA: Government eyes mining firms as new tax source - September 24, 2020).

Another option is to raise corporate income tax. In that case, regional budgets would be the main beneficiaries, especially if a plan to shift tax revenue allocations towards producing regions goes ahead (see RUSSIA: Cautious reforms for regional governance - July 27, 2021).

Risks to investment

Russian metals have been kept competitive by a moderate fiscal burden and low energy prices.

Insufficient domestic demand and overcapacity in the global steel market has restricted new investment and modernisation has proceeded slowly. The share of obsolete physical stock stood at 40% in 2019, down from 54% in 2000 and 46% in 1998.

A higher tax burden will dampen profits and could undermine investment plans, at a time when exporters need modernisation more than ever to reduce their carbon footprint and minimise payments under the new EU Carbon Border Adjustment Mechanism, expected to be fully effective from 2026 (see INTERNATIONAL: Carbon border taxes raise dispute risks - May 18, 2021) and (see RUSSIA: Moscow will contest and adapt to EU carbon tax - October 12, 2020).
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**EU: Imports of Russian non-ferrous metals (EURbn)**

- **2017**: 12 EURbn
- **2018**: 15 EURbn
- **2019**: 12 EURbn
- **2020**: 9 EURbn

Source: European Commission