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THE RESTRUCTURING PROCESS OF THE EUROPEAN STEEL INDUSTRY - A CASE STUDY

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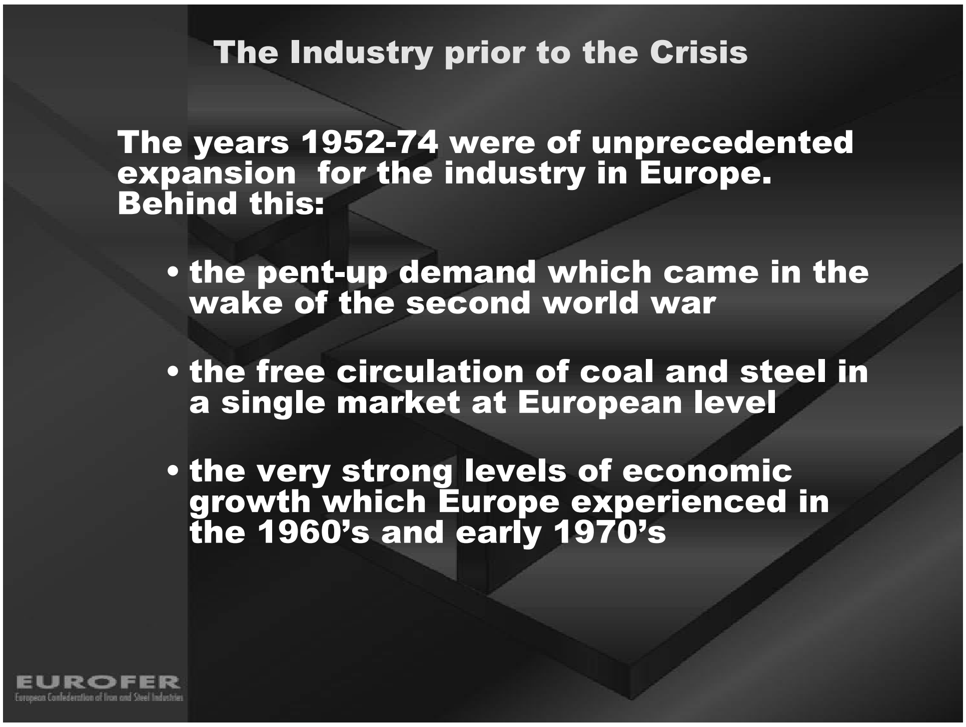
THE RESTRUCTURING PROCESS OF THE EUROPEAN STEEL INDUSTRY

1. The globalisation of the steel market requires from companies particular efforts to strengthen their competitiveness and to adapt to fast changing conditions of competition. On a technical level, expenditure for research must be increased with a view to a further development of process and product technology and the opening of new fields of application for steel. With regard to industrial management, the joining of forces, the utilisation of all synergy potentials and the development of economy of scale have to be addressed. Keywords are restructuring and consolidation.

2. Everybody agrees on this principle. However, when looking at the present structure of the world steel industry, it has to be noted that the degree of consolidation varies strongly region by region. In some, the consolidation process is well underway with encouraging results, whereas elsewhere this process has even not yet begun. Therefore, a discussion on the conditions for consolidation has also to deal with the question how the economic, political and legal framework can support this process.

3. The structure of the European steel industry today is largely the result of the restructuring which has taken place over the past 30 years.

4. This process represents a unique case-study of the use of industrial policy instruments to drive forward structural change in an industrial sector beset by a structural crisis. The experience in Europe, including the errors made, could provide useful lessons for the future.



The Industry prior to the Crisis

5. The years 1952-74 were a period of unprecedented expansion for the industry in Europe. Behind this:

- the pent-up demand which came in the wake of the second world war;
- the creation of a single Europe-wide market for steel with the elimination of all trade barriers between nation states;
- the very strong levels of economic growth which Europe experienced in the 1960's and early 1970's.

6. In the European Union, of then only 9 member states, the peak in terms of steel was reached in 1974 with:

- crude steel capacity of 179 Mio t
- crude steel production of 156 Mio t
- sales in the EU market of 102 Mio t
- a direct work force of 870,000

The Crisis

7. Significant structural imbalances in the steel sector in Europe and internationally were triggered by the first oil shock of 1974 and worsened by the second later that decade.

8. The effect was a dramatic and immediate fall in demand for steel in Europe and worldwide.

9. Production of steel in the Community of 9 fell from 156 Mio in 1974 to 126 Mio t in 1975, a drop of 30 Mio t, 19 %.

10. This in itself would have been dramatic enough – a reduction in demand of this scale would have had catastrophic effects on any sector, even now. The effects at the time however were exacerbated by a number of other factors:

11. The continued introduction of new capacities. Even as demand shrunk by 20 % new capacities resulting from ambitious investment projects decided on the basis of demand projections made prior to 1974 were coming on stream.

Technological advances

12. Reduction in the specific consumption of steel due to advances in product technology and quality meant that in tonnage terms the consumption of steel began to move down anyway.

13. The introduction of new production techniques worldwide such as continuous casting further increased production capacities but also required European producers to invest in these techniques in order to maintain technological competitiveness.

New capacities in Developing Countries

14. Worldwide new capacities were coming on-line in newly-industrialised countries simultaneously increasing the global demand-supply balance and reducing opportunities for European producers on third country markets.

Structure of the industry intensified the difficulties faced

The industry in the 1970's and 80's:

- largely state-controlled. With only a few exceptions, all major integrated producers were state-owned;

concentrated in certain regions;

- huge employer – 870,000 direct employees, possibly 2 Mio indirect with in consequence massive political upheaval and economic and social disruption if the industries were allowed to fail;

- The industries were seen as national, with few if any cross-border mergers.

15. In consequence from 1975 onwards there were increasingly massive financial interventions by national authorities to conserve their industries.

State Intervention

16. This was the key element which served to exacerbate the crisis:

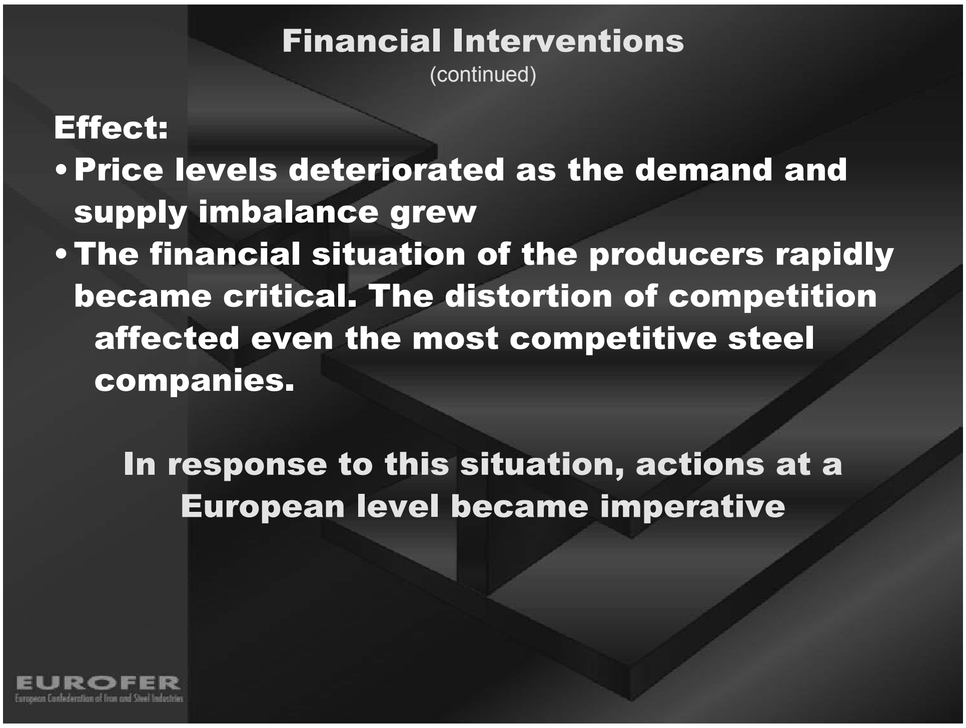
- public funds were used to complete investments in new capacities with no closure of obsolete plants.

  Existing capacity remained in place regardless of profitability despite forecasts of further reduction in demand;

- productivity remained low due to the reluctance of national authorities to force redundancies;

- the guarantee of state support had the effect of stultifying competitivity.

Result



17. Price levels deteriorated as the demand and supply imbalance grew. The political failure in Europe to cut back production and capacity in line with the structurally changed market situation meant that the financial situation of producers rapidly became critical.

18. The distortion of competition due to the provision of state aid meant that even the most competitive steel companies were unable to cope with the dramatically low prices.

19. Member states were effectively competing against each other providing increasingly enormous sums to ensure the survival of their industries. This became financially untenable and the massive subsidy flows were a direct breach of the absolute ban on state aid which was supposed to be in effect but was being completely ignored by national authorities.

20. In response to this situation, actions at a European level became imperative.

The Measures Imposed

21. The ECSC Treaty, the first and founding treaty of the EU, provided the European Commission with wide-ranging powers to regulate the market in the event of a manifest crisis. This manifest crisis was declared in October 1980 and a range of compulsory measures came into force. These covered 3 main areas:

1. Measures to regulate the market

22. These measures in particular must be seen in the context of the '70s and '80s. The authorities basically took over the market – it is inconceivable that this type of measure would be taken today even if the power existed which it no longer does.

- *Imposition of production quotas* on each EU producer and delivery quotas for each market, together with a system of fines for breaches.

- Imposition of mandatory minimum prices

- *Bilateral Agreements* with the main steel exporting countries to the EU to voluntarily restrain their deliveries to the EU. These measures stayed in force throughout the crisis and maintained imports at around 10 % of apparent consumption.

2. Ending of State Aid

23. The State Aid Code was introduced banning all state aid by member states apart from that authorised by the Commission limited only to research and development, environmental protection and to restructuring under the condition of a cut of capacities. This was aimed at restoring the viability of the industry by forcing companies to stand alone financially.

24. This still exists – in fact Europe is the only region in the world where at present there is a clear ban on subsidies with only limited exceptions.

3. Measures to address the social impact of restructuring

25. The immediate impact of any restructuring process is most keenly felt in two areas – jobs and money. The loss of jobs is painful and can have major political consequences. There is only one solution – money – and the development of proper programmes to direct that money to the creation of new businesses, regional redevelopment, and retraining and retirement.

26. What was the cost in Europe – we cannot say exactly but certainly hundreds if not thousands, of millions of euros.

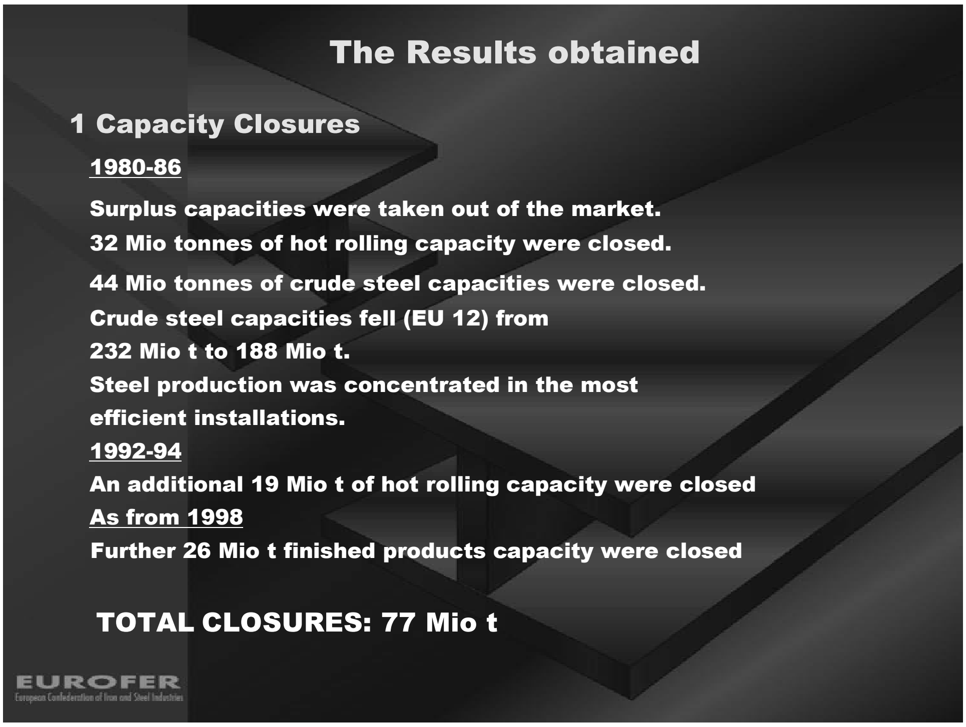
The programmes developed were:

i) **Loans** to provide risk capital for small businesses and the development of enterprise and innovation centres for new business

ii) **Regional Development Fund,** evelopment of programmes for the reconversion of regions affected by the crisis

iii) **Social Funds**; These were used for:

- training and education
- assistance for mobility
- aid for early retirement and redundancy.



The Results Obtained

Capacity Closures

- Between 1980-86, significant surplus capacities were taken out of the market.
- 32 Mio tonnes of hot rolling capacity were closed. 44 Mio tonnes of crude steel capacities were closed. Crude steel capacities fell (EU 12) from 232 Mio t to 188 Mio t.
- Steel production was concentrated in the most efficient installations.

- Between 1992-94, an additional 19 Mio t of hot rolling capacity were closed, partly with the assistance of state aid for closure but largely through voluntary closures by the private sector and funded by the companies themselves.

- Further 26 Mio t capacity of finished products have been closed since 1998.

- Over the whole of the period, total closures amount to 77 Mio t.

Employment

27. Employment declined from 672 000 in 1980 to 409 000 in 1988, a reduction of almost 40 % (and a reduction of more than 50 % compared to 1975).

28. By the year 2005 the workforce in EU15 had fallen to 250,000. Since 1975 therefore when employment was 870,000 the industry has shed close to more than 70 % of its workforce.

29. Production per worker in 1975 was 158 t/year. In 2005 it was 660 t/year, a 4-fold improvement.

1989-2005: strong market orientation and further structural changes

30. As from the end of the 1980s, European steel policy became radically market-oriented:

- All steel production or capacity control by the EU authorities was abolished;

- The very restrictive state aid rules introduced in 1986 were applied rigorously. The last derogations allowed were in 1993, however under the condition of capacity closures.

- EU steel import policy was radically liberalised. From the 1990s onwards the EU became the most open steel market in the world.

31. As a further consequence of this strong market-oriented policy for steel, the structure of the European steel industry has undergone some more fundamental changes.

32. First, the European steel industry was privatised on a massive scale. Whereas in the 1980s about 60-70 % of the European steel industry was under state control, virtually all steel undertakings in Europe are now privatised.

33. Secondly, an unprecedented consolidation took place in the European steel industry. The German steel producers Thyssen and Krupp/Hoesch merged into ThyssenKrupp after the prior absorption of some smaller companies. British Steel and Hoogovens of the Netherlands merged into Corus, and France's Usinor – after taking over Cockerill-Sambre from Belgium - , Arbed of Luxemburg and Spain's Aceralia – which was already the result of the consolidation in Spain – merged into Arcelor. The five biggest European steel undertakings account for more than 60 % of steel production in Europe, compared with

approximately 25 % in 1993. In flat products the consolidation is even more impressive. Five companies account for 85 % of the deliveries to the EU market.

34. The third fundamental change is Europe's growing participation in the globalisation of the steel industry. This is illustrated by the increasing share of Mittal Steel in European steel production and the takeover of Slovakia's VSZ by U.S. Steel. In the opposite direction, European steelmakers already active in some countries outside Europe, are extending their presence.

35. Last but not least, steel prices in Europe have become more stable thanks to both the consolidation process and the creation of a single currency in eleven of the 25 member states of the EU.

36. Today the European steel sector (EU15) is among the best, worldwide, in terms of manufacturing skills, equipment performance, product quality, distribution and service activities and innovation capacity. With 165 Mio t of crude steel last year it represents 15 % of world production.

37. In the light of the above, the following **conclusion** can be drawn: after much trial and error, finally the European steel industry achieved a structure allowing it to compete internationally. Even a massive use of public funds and state intervention have not succeeded to maintain uneconomic capacities – market forces have proved to be stronger.