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DIRECTORATE FOR SCIENCE, TECHNOLOGY AND INDUSTRY

## OECD Special Meeting at High-Level on Steel Issues

### INDUSTRY PROSPECTS

Statement by Mr. John Surma, United States Steel Corp

*The Outlook for Steel Conference, organised by the OECD in co-operation with the IISI on 12-13 January 2005 at the OECD Headquarters in Paris.*

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## STATEMENT OF JOHN P. SURMA

### OECD High-Level Meeting on Steel Issues: Panel on Industry Prospects

Paris, January 12-13, 2005

It is a pleasure to be here today and to participate on this distinguished panel. I am sure we will have a lively discussion to follow on some very weighty topics — as set out on the agenda - so I will try to keep my remarks brief and focused on just a few larger issues.

#### Industry Consolidation and Restructuring

There has been much written and talked about with regard to the consolidation and restructuring that has occurred, and is still transpiring, in the steel industry worldwide. To be sure, there were significant transactions in the industry in the years prior to the most recent flurry of activity, but the breadth and scope of the transformation we have seen in the last two years - and continuing even today - is truly astonishing.

A number of factors have undoubtedly helped foster this result. Certainly, the disposition of assets in bankruptcy court, the concurrent elimination or reduction of some legacy costs, and new labor agreements have been important - particularly in the United States. But clearly this is not the whole story. In fact, we are seeing major consolidations among profitable companies, transactions that are plainly not driven by distress but by financial and market opportunities - the same type of opportunities that have resulted in large-scale consolidations and transactions in similar industries, but have only rarely been evident in steel.

One point that is critical to recognize is the role not just of improved market conditions, but also of the greater stability and predictability that we have seen, in creating the conditions where significant restructuring can occur. During the depths of the steel crisis, companies were often restrained in their ability to pursue projects that otherwise would have made economic sense and created value - due to extraordinary volatility in the market, the lack of capital, and the difficulty of justifying any acquisition in the context of wholly unsustainable market conditions. Undoubtedly, a number of the transactions we have witnessed in the last two years reflect the “pent up” demand for market-driven and financially-justified projects and investments that simply could not be undertaken when market conditions were at their worst.

In the United States, industry participants made clear that we wanted the chance to restructure, rationalize and take advantage of market opportunities. And that is exactly what we have done. Not so long ago, U.S. Steel’s annual capacity of 12 million tons placed us among the larger steel producers in the world. Now, thanks to our expansion into Slovakia and Serbia, as well as our purchase of National Steel, our capacity has more than doubled to some 27 million tons. We have achieved enormous cost savings and synergies (more than \$400 million) from the National transaction, and worked with our major union to create an innovative new labor agreement - which has dramatically enhanced productivity, efficiency and cost-competitiveness, while providing incentive-based programs that allow all our employees to share in our company’s success.

Throughout the industry, billions have been invested, work rules and practices have been modernized, and consolidation has resulted in large-scale synergies – as assets benefit from new fiscal and managerial resources, access to a larger customer base, and greater economies of scale. The success of these efforts is

reflected in a return to profitability, much improved share price performance, better access to capital markets, and a somewhat more favorable outlook from credit agencies. It is imperative to see that these are all very positive developments not just for the industry — but for our economy and our consumers, as the long-term productivity and cost-competitiveness of the industry is enhanced and a more stable outlook can be foreseen.

I should add that from the standpoint of our company, our acquisitions abroad -specifically in central Europe - have been remarkably successful as well. Building on initial investments and joint ventures that allowed us to understand, the markets and operations involved, as well as the people and their cultures, our acquisitions in Slovakia and Serbia have been a “win-win” for us and for the communities where these facilities are located. There have been major challenges - requiring U.S. Steel managers to be effective diplomats, dealing with different languages, different legal systems, and different cultural attitudes toward business. We had to engage with workers who were not familiar with Western-style capitalism, and with governments who were deeply concerned about whether we were really committed to their countries for the long term. But in the end, the application of market principles and sound business practices -along with a commitment to the communities and countries involved - has proven a very successful formula in the context of acquiring and operating these previously government-owned facilities.

### **The Need for Market Outcomes**

These are better days for the industry, to be sure. And that invites a question that is a focus here - *namely what is the outlook and what can we do to keep this momentum going?*

My answer is perhaps not particularly profound or new, but is no less important for being apparent. With a stronger market and improved economic conditions, we are now seeing a world supply and demand in relatively good balance. That means reasonable profits for the industry, a chance to recover from past losses, and an opportunity to pursue investments and capital spending that is long overdue. That is exactly what you would expect during an upturn in the context of a cyclical industry and a functioning market. The paramount danger for this industry and for our governments is that we fail to learn the lessons of the past, and that we once again allow non-market forces to disrupt market outcomes.

As we know from this industry, when the balance of supply and demand is altered by other than normally occurring commercial forces, the consequences can be felt for decades. And with all the emphasis and effort spent on trying to craft a new steel subsidy agreement, I must say that we are even now seeing a very dangerous trend toward *new* subsidies and *new* capacity built with government assistance. I expect that we can all intellectually admit that this is *exactly* the wrong medicine for the industry and its future health, but we need to find the will to act on that realization. The fact is that no government program, however well-conceived, can match the subtlety and wisdom of a properly-functioning market - but such programs certainly can defeat it, as has been demonstrated time and time again.

So what should we do? First, get governments out of the steel business. North American producers have supported, and I am confident will continue to support, a real steel subsidy agreement — one that applies across-the-board, bans all non-closure-related aid, and avoids loopholes and exemptions that undermine its effectiveness. At this point, we have not seen a willingness on the part of all participants to accept this type of agreement, and in fact a number have sought to use the negotiation to effectively greenlight new subsidized projects. Obviously, we could and should never agree to that.

We have an expression in the United States - called NIMBY - for situations where someone does not want an undesirable business or facility located near his or her own residence or business. It stands for “Not in My Backyard.” Hearing some of the debate that has surrounded the steel subsidy talks, in which a multitude of countries have sought to exempt their own pet subsidy projects, it sounds a little more like JIMBY - Just in My Backyard. If we are ever going to see a successful conclusion to these talks, it is going

to require a realization that everyone has to play by the same set of rules.

While governments continue to look for a consensus on new steel subsidy disciplines, we should be using the tools we already have available to combat non-market behavior. Governments should be acting to counteract new subsidies and taking advantage of settings like this to exchange information and to highlight the need to refrain from new forms of government assistance. One reason we strongly support the efforts of the OECD steel committee and a proactive agenda going forward is to provide governments a setting to share information and engage in a dialogue - hopefully heading off problems and disputes before they develop.

Second, we need to preserve and enhance fair trade rules. These disciplines may not be perfect, but they are by far the most effective means we have to meaningfully address and deter non-market behavior. No company, no matter how efficient, can compete with the resources of a government treasury or a producer that is not constrained by the need to earn a profit. Anti-subsidy and anti-dumping rules are market-correcting, not market-distorting, and fill an absolutely vital need if we are to deter the type of behavior that has led to the vicious cycles of the past. The fact is that one of the greatest threats to legitimate free trade is the abuse of it. We should be working together to strengthen and preserve fair trade rules, not undermine them.

Finally, we need to crack down on the type of collusion, closed markets and anti-competitive practices that have too often found their way into steel markets around the world. These practices are in many cases the root cause of the dumping and predatory trade that has pervaded the industry. Again, governments should be working together to identify and discourage this type of conduct.

So the message is simple. If we want a healthy industry, a reasonable return on investment, and sustainable conditions, let the market work. The era of government planning has passed, because government planning has failed. It failed workers, it failed consumers, and it failed the industry. It's time to move in a different direction.

### **Current Market Conditions**

Let me conclude with a comment on current market conditions. There has been a lot of talk of late about higher steel prices and their impact on consuming industries and economies around the world.

Let me be clear. Prices in world markets are being determined by market forces of supply and demand, which for the first time in a long time are in relative balance. The strong demand for steel products is evidence of what a great value they are - providing strength, formability and consistency for an extraordinary range of applications. Steel is the material of choice among competing products because of the value it represents.

There is no question that prices have recovered substantially - particularly when measured against the historic and unsustainable lows seen in 2001. Strong demand, especially in China, and the high cost of raw materials have played a role in this price recovery. But when you take a look at the movement in steel prices - compared to competing products - over the past 10-20 years, it is evident that existing market-driven steel prices are fully in line with other materials, and continue to represent a superb value.

And while this industry has turned the corner on profitability, we are only beginning to make up for past losses, optimize our processes, and pursue needed investments. Improved and sustained profitability is critical to the transformation we are seeing in this critical industry, and to the investment that remains essential if it is to maintain the strength and vitality to serve our economies in the future.

I will conclude with that and look forward to the discussion period.