

Unclassified

CCNM/NIS/DSTI(99)56



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

OLIS : 27-Oct-1999
Dist. : 28-Oct-1999

PARIS

CENTRE FOR CO-OPERATION WITH NON-MEMBERS
DIRECTORATE FOR SCIENCE, TECHNOLOGY AND INDUSTRY

Or. Eng.

CCNM/NIS/DSTI(99)56
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WORKSHOP ON THE SITUATION IN THE STEEL INDUSTRY IN THE NIS

U.S. GOVERNMENT (USG) ASSISTANCE TO THE RUSSIAN AND UKRAINIAN STEEL INDUSTRIES

Paper presented by the United States government

The Workshop will be held in Paris on 2-3 November 1999.

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U.S. GOVERNMENT ASSISTANCE TO THE RUSSIAN AND UKRAINIAN STEEL INDUSTRIES

Background

The problems of the steel industries in Ukraine and Russia are rooted in these countries' overall economic difficulties. Many of these difficulties are the legacy of over 70 years of the Communist centralized economic system, resulting in lack of market institutions and poor economic performance, combined with the effect of external shocks and incomplete economic reforms on already weak economies.

The results of the Communist centralized system are well known. The system emphasized production over profits and quantity over quality. The result was weak financial controls, little sense of the true costs of production and poor quality controls. Centralization and a bias in favor of goods production led to excessive investment in large-scale enterprises and heavy industry and the underdevelopment of small business, consumer industries and services, especially financial services. The centralized distribution system divorced producers from consumers and prevented enterprise managers from developing marketing skills.

External shocks have exacerbated these structural problems. The 1998 financial crisis in Russia impacted not only its own economy, but also that of neighboring countries including Ukraine. In 1998, Russia's official GDP fell by 4.6 percent and Ukraine's by 1.7 percent. Industrial production also fell, by 5.2 and 1.5 percent respectively. This economic contraction followed signs that both economies were beginning to recover from the economic downturn that had followed the breakup of the Soviet Union. The economic downturn deprives the Russian steel industry of a healthy domestic market for its products and complicates the task of downsizing and restructuring since few other industries can pick up the slack.

The Russian economy appears to have partially recovered in 1999. Industrial production (up by 9 percent in June over 1998 levels) has been helped by the sharp fall in the ruble, which has led to import substitution. Higher oil prices and recovery in Russia's Asian markets also help. There are signs that barter transactions are declining and cash transactions growing. Wage arrears in both the private and public sectors are down and employment is up slightly. However, real consumption is still 20 percent down from a year ago and real per capita incomes are down 22 percent. This growth, however, is largely due to one-time factors like the fall in the ruble and the rise in oil prices and may not be sustainable without growth in domestic demand and investment, which are still below 1998 levels.

Ukraine's economy also appears to be recovering. Real GDP continued to fall in the first half of 1999, with the decline slowing as the year progressed. Industrial output actually showed positive growth in the first half of 1999. However, like Russia, Ukraine still faces challenges. Export earnings have fallen dramatically, especially to Russia. Ukraine faces a difficult debt situation next year with some \$3 billion coming due and a substantial financing gap. The IMF and World Bank hope to use the debt crisis to push faster economic reform in Ukraine.

Economic Assistance

U.S. Economic Assistance

U.S. assistance to the NIS began in 1992, right after the breakup of the Soviet Union. Our economic assistance is directed towards facilitating the economic reforms that will create an open and

competitive market economy in which all industries, including the steel industry, can develop and prosper. In addition, the U.S. supports democratic reforms, rule of law, health, environmental, and social programs that also play an important role in establishing a stable and prosperous society. The USG works closely with other OECD countries and with international financial institutions to stabilize the Russian and Ukrainian economies and promote market-based reforms. We are encouraging Russia and Ukraine to take the economic steps necessary to join the World Trade Organization and have provided technical assistance to that end. Such integration with the global economy will help promote the development of new industries and foster restructuring in old industries, such as steel.

USG assistance to Russia from fiscal year 1992 to 1998 totaled \$5.45 billion. In 1999, U.S. assistance was approximately \$1.7 billion (including nearly \$1 billion in food assistance). U.S. funded advisors are working closely with Russian federal government officials and legislators on tax reform and with regional officials on public finance. The U.S. has supported small business development in Russia by training over 250,000 Russians in starting and running a small business, by providing consulting services and by providing financing. The U.S.-Russian Investment Fund (TUSRIF) has disbursed about \$93 million in loans or direct investment to small business. The USG also contributes to the EBRD Russian Small Business Fund. Hundreds of Russian managers and entrepreneurs have participated in exchange programs with U.S. businesses designed to expose them to market business practices.

From 1992 to 1998, the USG provided \$2.03 billion in assistance to Ukraine. In 1999 assistance amounted to \$199 million, of which about \$45 million focussed on promoting economic reform and \$1.6 million on financing for small and medium size business. U.S. assistance helped to create an over-the-counter trading system for Ukrainian stocks and helped develop laws, regulations and institutions to regulate Ukraine's new financial markets. The USG helped Ukrainian banks convert to international accounting standards and assisted in designing and implementing privatization. USAID has also provided technical assistance to develop basic legal norms in such areas as customs valuation, IPR, sanitary and phyto-sanitary measures and technical barriers to trade. USAID and the Peace Corp are providing training to small and medium size businesses and USAID has worked with the government of Ukraine to reduce tax and regulatory burdens on small business. Through the SABIT program many Ukrainian managers have traveled to the U.S. for internships.

Steel Industry Programs

I. Market Reform and Restructuring

Technical Assistance on Complying with U.S. Fair Trade Laws

In February 1999, the Department of Commerce signed a joint memorandum of understanding with the Russian Federation related to the promotion of fair trade between the United States and Russia. As part of this effort, in coordination with the U.S.-Russia Business Development Committee, Commerce will provide in-depth training programs on U.S. dumping and subsidy laws and relevant international agreements and; working with the Russian government to develop monitoring systems designed to help Russian producers price their products without dumping; and training Russian producers on cost accounting methodology, market-based pricing and market-oriented business practices.

The first phase of this program is already underway. In September, Commerce conducted a fact-finding mission designed to narrow the focus of the broader program to fit the specific needs of the Russian government and producers. Commerce expects to send another delegation to tour the individual

steel producers in mid-November to conduct on-site assessments of their accounting systems and business practices.

The second phase, a series of trade law seminars, will be conducted in December and January. Topics to be covered in presentations to Russian government and company representatives include: an overview of U.S. trade laws, dumping theory and calculations, including case studies, cost accounting principles, and market-oriented business practices. Commerce will also work with the Russian government to ensure that trade practices are consistent with the rules and standards of the WTO, including specifically the discussion of government practices that are considered subsidies under U.S. and international rules.

In the third phase, Commerce will work directly with individual Russian producers to implement cost accounting systems to avoid dumping and improve business practices. In particular, this training will focus on monitoring export data, identifying public sources of U.S. prices and market trends, and selling directly to U.S. customers.

In September 1999, Commerce initialed a memorandum of understanding with Ukraine agreeing to provide a similar technical assistance program.

Divestiture of Municipal Services

Most of the large integrated steel works in Russia (Cherepovets, Novolipetsk, Magnitogorsk, Nizhnii Tagil, et al.) are located in "company towns," each with several hundred thousand residents, many or most of which work at the mills. Typically, these towns grew up in such a way that the mills provided municipal services, such as housing, electricity, water supply, and even some retail services. One way of encouraging steel industry restructuring is to help local governments assume responsibility for the provision of such services.

Since 1994, the EPA has worked with the city government in Nizhnii Tagil to upgrade the city's water supply. This work has included some short-term measures, such as providing drinking water filters to the city's hospitals and schools. More important, over the longer term, it has included the installation of large drinking water filters in the hot water supply for 125,000 residents of the city's Dzerzhinsk Raion, the installation of new chlorinators at the city's only drinking water treatment plant, the provision of equipment for the city's new drinking water laboratory, and improvements in reservoir management. The World Bank has a water loan program for Russian cities under 500,000 population. So far none of the major steel-producing cities are included in the project, but the EPA would be happy to work with the World Bank on including such cities.

Severskiy Pipe Plant Feasibility Study

TDA contributed \$300,000 toward a \$650,000 Feasibility Study on the Severskiy Tube Works (STW) modernization project in Polevskoi, Russia. This request was made by the General Director of STW, in support of a sole source proposal by ICF Kaiser Engineers of Fairfax, Virginia. STW, which is currently the largest supplier of oil country tubular products to Gazprom and Lukoil, has embarked on a modernization project to produce high quality tubular grades. (Note: Shares in STW are owned by Bank of New York (23%). CS First Boston (20.8%, First Voucher Fund 12.3%, Ural-Market (11.7%). Ergobank (8.3%).

The STW reconstruction plan aims to accomplish the following tasks: replace existing open-hearth furnaces with modern EAF steel making to improve the quality of steel and address environmental concerns; install a complex steel treatment unit to improve the purity of steel, and introduce the continuous

casting process to improve the strength of seamless pipes and achieve production flexibility. The reconstructed STW would continue supplying its Russian oil and gas customers.

SABIT Program

The U.S. Department of Commerce's Special American Business Internship Program (SABIT), exposes managers and scientist from Russia and other countries of the New Independent States of the former Soviet Union to American ways of innovation and management. NIS executives are placed in three to six month internships in U.S. companies in order to gain firsthand experience in a market economy. SABIT alumni return to their countries armed with the knowledge to transform their industries and companies. SABIT has approved an internship with the North American Steel framing Alliance (NAFSA). The intern would be working within all departments of NAFSA for a six-month period in order to gain a solid foundation in all areas of the organization. The internship is seen by NAFSA and AISI as a step towards developing a market foundation for steel framing in Russia, thereby playing a role in helping rebuild Russian demand for Russian steel. SABIT is also considering sponsoring an internship with a steel service center in the U.S. with the aim of helping Russia and Ukrainian steel companies to market their product in an orderly, rational way.

II. Environmental Programs

Volgograd Project

The EPA has installed and tested a "pre-cast delta" (lid for an electric arc furnace) at an electric arc furnace at a steel plant in Volgograd. These lids are made of pre-cast concrete, which enables them to last longer and reduces downtime needs for repairs (as opposed to the existing lids that are made of brick and break down easily). Importantly, these lids reduce fugitive emissions from electric arc furnaces by 50 percent. The next step in this project is a feasibility study for the Russian production of these pre-cast deltas for use in 400-600 other electric arc furnaces throughout the former USSR.

Nizhnii Tagil Project

EPA provided a \$100,000 grant to the Nizhnii Tagil Metallurgical Combine to create a facility for the production of activated carbon from coking waste and recycling operations. The activated carbon will be used as a sorben in pollution control devices such as drinking water filters and end-of-pipe controls at the coking plants. The production facility will be completed by the end of 1999, and the sorben will be used beginning in 2000. The projected reductions in toxic hydrocarbons are 150,000 pounds per year, or 15-20 percent of current emissions.

Dorogobuzh Project

The EPA is installing a low-cost, end-of-pipe technology called E-SO_x at a heating plant and municipal incinerator in Russia. E-SO_x is an electrostatic precipitator that adds control of sulfur dioxide and other acid gases to existing particulate control. E-Sox technology also has the potential to control emission of mercury and dioxins at iron and steel plants, and is applicable at any plant that uses electrostatic precipitators as a primary means of pollution control (as do most Soviet-era facilities). This technology will be especially effective in the short to medium term, when NIS firms lack the capital to fully modernize their approach to pollution control.