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CO-OPERATION BETWEEN THE NIS AND THE STEEL COMMUNITY

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by Jacobus Aarts, European Commission

1. Industrial co-operation is a multi-faceted area, interfacing administrations and the business world on a large range of common points of interest. The usefulness of a workshop such as this lies in the opportunity it offers to hold open discussions on whether or not achievements in this field have been satisfactory, and where to proceed from this point on. It is in some way a double-edged benchmarking exercise: (1) have co-operation programmes achieved what they were intended for? (2) to identify the most successful programmes of OECD Members so that they can be used as models for the future.

A. What type of steel specific co-operation has been offered by the European Union?

2. Workshop document n° 27 describes the kind of co-operation, through technical assistance programmes, that the European Union and individual OECD Member States have already put in place for Russia and Ukraine for a considerable number of years. As far as the activities of the European Union are concerned, I would like to point to the two main types of steel industry specific assistance programmes:
 - firm specific programmes
 - implementation of Protocol B

Let me briefly summarise what the European Commission has done so far (more details can be found in workshop doc. n°27):

Firm specific programmes:

- Six projects, specific to steel, have so far been completed in the Russian steel sector, including a major 2 million ECU project between 1994-1996 to develop an overall steel sector restructuring strategy, and work at the level of selected enterprises to assess their technical and economic situation and to develop business plans. Moreover, two further steel projects with individual Russian steel mills are currently running: they assist these steel firms to implement international accounting standards, to establish a benchmarking system based on international best practices and to improve the marketing of Russian steel products in the EU, in the form of advice on sound pricing and commercialisation practices.
- After running for several years, the TACIS project concerning the restructuring of the Ukraine steel industry has been finalised. Whereas the first part of the project included the diagnosis and analysis of the sector, a forecast of future markets and finally a proposal for a sector strategy, the second part offered individual assistance to steel plants as well as to the Ukraine Ministry of Industrial Policy. The four selected companies received customised assistance, based on their respective situation, strategic choices and request. At first, seminars on marketing, financing, quality, organisation and management were organised, followed by a two-week traineeship in the EU. According to the steel plants' individual needs, assistance included the development of a cost calculation system, preparation of

individual restructuring actions, market research, marketing assistance and the transposition of financial accounts to international standards. Assistance to the Ministry of Industrial Policy was aimed at encouraging the implementation of restructuring actions and an update of an earlier restructuring strategy plan.

Implementation of Protocol B

- This part provides support to the Russian and Ukrainian authorities on the implementation of Protocol B of the bilateral steel agreement. This Protocol aims at facilitating the achievement of appropriate market conditions for liberalisation of trade in steel products, through the progressive application of disciplines in respect of competition, state aid and environmental protection, to make these compatible with those in the EU.
3. The key target for the first type of assistance is creating conditions for the development of viable steel companies on the basis of economically justified long-term sustainable growth plans. For the time being, these actions focus on a selected group of companies with the expectation that experience gained will be disseminated to other steel companies. The Protocol B approach is of a more fundamental nature as it envisages the modernisation of the economic framework legislation.

B. What has been achieved with these approaches so far?

4. In the area of the individual firm approach, a limited number of success stories in the NIS exist – steelworks which are on their way to achieve world class performance. However, the large majority is still “muddling through”, without clear changes in management strategies and no real attempts to elaborate individual restructuring plans leading to the viability of (part of) the steelworks. It has to be observed, however, that this problem is not limited to NIS countries, this phenomenon can also be found in some Central European countries.

Moreover, this unsatisfactory state of affairs also creates a major reason for instability in world steel markets and will continue to do so as long as these steelworks try to save their existence through increased exports. It is therefore necessary to analyse the reasons behind this state of affairs.

5. Despite the fact that labour costs per tonne of output are by far the lowest in NIS countries, although considerable over-employment exists, it is remarkable that most NIS producers still have much higher production costs per tonne than their competitors elsewhere. A main reason for this lies in the inefficient use of natural resources. For example, Russia’s steel industry consumes 25% of all coal mined in the country and 28% of the electric supply (energy consumption by the steel industry is substantially lower in the European Union, although production here is much higher). In order to improve competitiveness and reduce environmental pollution, the industry has to considerably reduce specific energy consumption with the double gain of reducing production cost and emissions. The question is: why does this concept receive so little attention both from the Russian authorities and from companies?

In this context, let me mention the problem of scrap supply. This has become a hotly debated subject, mainly between the European Commission and the Russian and Ukrainian government. The latter thought (and continue to think) that the clue to its solution is that because there is an insufficient supply of scrap, export must be reduced – either by export quotas or an export tax. Apart from the flagrant breach of bilateral and multilateral trade agreements that this implies, this demonstrates sheer economic nonsense. Scrap supply, according to Russian newspapers, is not at all in “short supply”:

some increase in prices will already lead to an abundant offer. Meanwhile, steelworks in certain parts of the Russian Federation had to stop production because of the insufficient scrap supply at unrealistically low prices.

6. No doubt, important investments must be made to modernise production processes and thus reduce production costs. It is true that such investment costs are considerable, even if one only calculates the minimum investment costs for the definitive closure and replacement of SM furnaces, coking batteries, the switch to oxygen steelmaking and the construction of sinter plants. But state of the art technology is generally not necessary and a number of steel plants can cut production costs considerably by improving existing processes. Some steelworks are able to finance certain investments by internal cash flow. At least, these are the conclusions reached by most of the experienced consultancy firms contracted by the Commission in the context of the Phare and Tacis programmes. But not only steel produced at lower cost makes the product attractive: it must fit the demand of customers, and not vice-versa. This is, however, often the reality in NIS countries. Steel consumers needs are frequently neglected: as an example in Russia and Ukraine, tube makers often cannot get enough pre-material of sufficient quality from the steelworks.
7. This brings me to the third main cause of poor achievement so far. There is a strong tendency for traditional industrial structures in steel regions to request help from local and regional authorities to survive. But not only are these government bodies themselves all too often ill-prepared to provide guidance towards new frontiers but there is frequently strong resistance to change as this could affect one's own position. Many examples of this exist in Central Europe and are, in my view, one of the reasons, if not the main ones, why restructuring is not yet sufficiently on track. But the same holds true for the NIS. It is understandable that it is difficult to restructure a region when the only employer is the steelworks and efforts to attract other business are not undertaken. But, restructuring very often has to imply doing away with old management structures and traditional links between plant managers and government officials; as long as this is not done, the region will remain unattractive to new investors, even small spin-offs. One of the big benign effects of privatisation in Western European steelmills had to do with the rupture of these types of relationships. However, they continue to flourish in most parts of the NIS. If one regularly reads the Russian and Ukrainian press, many examples can be found where despite privatisation, close links remain between local/provincial authorities and steelworks which hamper efforts to create more competitive structures through co-operation and specialisation among steelworks in the region. But fundamental changes in mentality have to be undertaken in order that part of the steel sector can survive. New projects are all too often torpedoed because of resistance from steel works managers and local politicians who fear for their jobs. For the same reason, restructuring plans and programmes by the central government are all too often not followed either.

This whole process can be very well described by the notions of pro-active or re-active governance, as Mr. Mangan mentioned in his paper: one of the main reasons why so little progress has been made over a relatively long time span in NIS countries is that public authorities and management have preferred a re-active rather than a pro-active approach. Where the latter is adopted, one sees steelworks which have become winners in national and international markets as well as examples of outsourcing because industrial zones for steel-related or non-steel activities are made available as well as other forms of industrial restructuring assistance.

8. This no-change scenario has a lot to do with a lack of courage to benchmark: industry managers and government officials have to do this but they don't like it. Too often, traditional thinking of steelworks managers and officials in public administrations that they know best prevails. My point is not that their knowledge is superfluous: quite the contrary. They know the area and the specific problems of steel making under current circumstances. But the world has not stood still and new solutions have to

be applied: whether they are useful can only be learnt by exchange of information with others who were or still are in comparable circumstances.

C. Which lessons to be drawn?

9. This brings me to the third part of my introductory remarks: what lessons can be drawn from co-operation/technical assistance efforts so far?

To take the last observation concerning benchmarking first. There are many aspects to this:

- first: compare with your immediate neighbours, as there are remarkable examples of steel plant restructuring in NIS countries.
- second: compare with similar situations elsewhere and how these are or will be solved. You do not have to go back to the European Community's situation in the seventies. This workshop benefits from an interesting paper on the reform of the Chinese steel Industry by Mrs Lu Zhian: this contribution should in my view be used as a "benchmark guide".
- third: compare with what is going on in other industrialised countries, which have already restructured their steel industry. Mr. Christmas' introduction has made it clear that the outlook here is not always positive if one is not willing to think in terms of permanent restructuring and adaptation.

In this context, I would like to draw the attention of the audience to the latest Commission Communication on "The state of the competitiveness of the steel industry in the EU" which I finalised before leaving the Commission's steel department, and which will very probably be adopted by the EU Industry Council of 9 November. You will find here, i.a. recommendations concerning producer/client relationships, R&D and the need to work through clusters, which in my view are also applicable in the Russian and Ukrainian steel industry.

10. This brings me to a second target: a pro-active government and managerial approach does not look solely at what is good for the individual plant but rather how the region can benefit from a better co-operation between public authorities, steelworks and customers (including education, or start-up facilities for new SME's by former workers). This aspect seems to me to be very important in a NIS context, where several producers, each with different specificities, are "clustered" in regions which are geographically very far from each other and for which the regional market is important. If a region can work out a meaningful restructuring plan, it has all the more success to plead for the necessary infrastructure works to put its production to value. Tacis and similar programmes are then at hand to assist.
11. This also gives the necessary signals for investors. Predictability is a key requirement in this respect. The Government at national, regional and local level needs to create favourable conditions for the development of enterprises by the creation of the appropriate regulatory framework environment for business activities. Regulations governing firms (in particular company law, tax laws and social legislation) must be clear, fair and as stable as possible, whereas courts must enforce this body of law firmly and efficiently. In this context mention should also be made of the need to keep all types of administrative formalities as simple as possible. Apart from this, it is useful to have programmes which support steel consuming activities. Non-core business activities have to be separated from the steel enterprises. And, of course, public authorities need to create safe conditions for doing business. In this respect, I want to again underline the importance of Protocol B's implementation programmes in creating such predictable legal conditions for doing business. In Brussels, we unfortunately have too often the impression that the usefulness of this exercise is not taken seriously by NIS authorities.

12. Investors are, however, lured by “winners”: picking winners has become a favourite target in the merger wave, which now sweeps across the western world. Major investments for modernisation generally have to be made with outside help. If management demonstrates its willingness to modernise, and if it increases productivity and reduces input costs with means already at its disposal, it attracts attention, as I am convinced that the prospects of a number of NIS steelworks are basically good.
13. This brings me to my last point: what should the future of firm-specific assistance programmes be? As I pointed out earlier, Tacis actions have so far been concentrated on a selected group of firms (at least in Russia) in the hope that other companies may benefit from this experience. So far, our experience demonstrates that little has been achieved, outside the core-companies. This can easily lead to the conclusion that these types of programmes should be stopped altogether as it is not meaningful to support firms already belonging to the most developed in a country. I disagree with this conclusion for two reasons:
- first, the fact that there are winners in the survival race clearly demonstrates that assistance programmes bear fruit. The economy and self-esteem of a country always needs winners: in today’s globalised world, technical assistance programmes should not refrain from keeping them winners and further preparing them for global competitiveness.
 - secondly, besides today’s winners, there are other steelworks which could become competitive by specialising in specific product lines, thus cutting production costs, increasing value added for certain products, a leaner organisation, etc. This is mostly appropriate for smaller steelworks in specific regions, which necessitate co-operation with other steelworks. But this has to be learned and it is here that co-operation programmes should contribute. Such programmes should concentrate on several players: the management and workers of the steel plants, the local and regional public authorities, banks, specific interest groups. Management in the steelworks has to be convinced that these types of approaches and similar programmes (such as promotion of SMEs) can do much to prepare firms to concentrate on core business, provided management is willing to follow such a course. In view of the generally good relations between management and public authorities in these areas, the latter have a formidable task in convincing managers to look at things differently.