



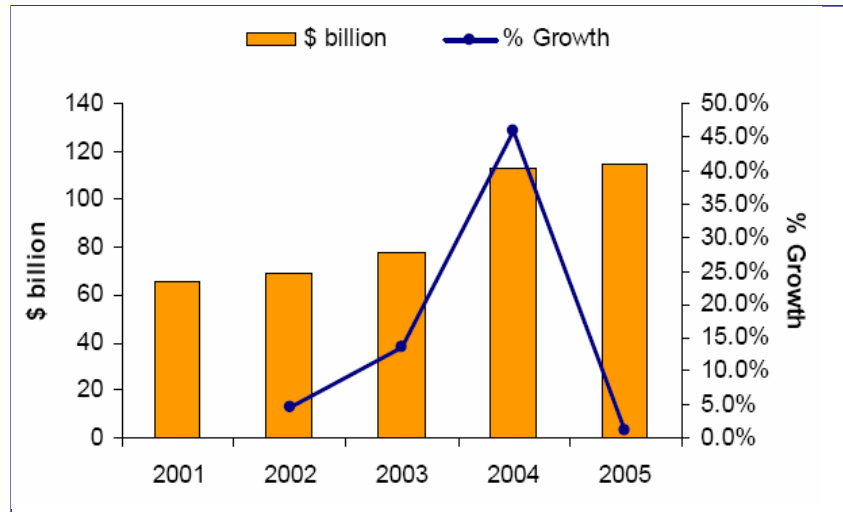
The European Steel Industry

2006 witnessed a record growth in European steel consumption, surpassing even the unusually high level of 2004. Recent figures indicate that while the growth in European demand slackened during 2007, overall demand for steel remained strong. During 2006, the key drivers of strong demand growth were stock replenishments together with a marked upswing in the non-residential construction industry.

As a result of robust European demand throughout 2006-2007, rising steel prices and the steady rise of the Euro, Europe has become the preferred export destination for most third country exporters. This had a dramatic impact on the European steel market. Indeed, while Europe registered net exports of 2 million metric tones (mmt) in 2005, it experienced a dramatic swing to net imports of 9.7 mmt in 2006. The increase in imports can be largely explained by a growth in Chinese imports, rising from 2 mmt in 2005 to 5-7 mmt in 2006, and registering further dramatic increases during 2007.

This rapid increase in Chinese steel imports is fuelled by the growth of China's domestic steel industry. In 2006 alone, output of Chinese crude steel has risen by 20% even outpacing strong domestic demand growth of 10%. Consequently, China's bullish steel industry has been looking for foreign markets. The sudden rise of Chinese imports in both Europe and the US has led to allegations of dumping, exporting below cost price, with both currently considering the implementation of safeguard measures against this.

European Steel Industry Value (US\$ billion)



Source: Datamonitor, Industry Profile: Steel in Europe, December 2006

The Historic Role of the ECSC in European Integration

The European steel industry can be understood only within the wider context of European integration. The first step towards European integration came with the foundation of the European Coal and Steel Community (ECSC) in 1951 and the modern EU is built upon it.

Coming out of the Second World War, European countries had to rebuild their economies while maintaining economic and political stability and security. The Schuman Plan for a common market in coal, iron and steel produced by France, Germany and other countries willing to join, promised to pursue these goals simultaneously. Its result was the creation of the European Coal and Steel Community in 1951 by Germany, France, Italy and the Benelux countries.

It was the success of the ECSC that persuaded some countries to further pursue European integration with the Treaty of Rome in 1957, creating the European Atomic Energy Community (EURATOM) and the European Economic Community (EEC). The member states set about removing trade barriers between them and forming a “common market”. In 1967, the institutions of the three European communities were merged under a single Commission and Council of Ministers, overseen by a European Parliament. The rest of the story is well known.

The ECSC Treaty expired after fifty years in July 2002. With its expiration, it was decided to integrate the rules governing the European coal and steel industries into the Treaty establishing the European Community. Since then, Article 157 of the EC Treaty has governed EU level actions concerning the European steel industry.

Overview of the European Steel Industry: Facts & Figures

- The structure of the European steel industry today is the result of large scale restructuring which took place in the 1980s. After strong growth in the aftermath of WWII, the European steel industry slid into a prolonged crisis following the oil shock of 1974. As the crisis deepened, the European Commission, under the powers provided by the ECSC Treaty, imposed a large scale restructuring on the market. As a result of Commission measures, significant surplus capacity was taken out of the market and state aid was effectively ended.
- Following European Commission-led market restructuring, from the late 1980s onwards, European steel policy became radically market oriented. European steel producers were rapidly privatized, triggering a process of consolidation in the industry. Simultaneously, EU steel import rules were drastically liberalized, making the EU the most open steel market in the world from the 1990s onward. Finally, European steel makers increasingly participated in the globalization of the steel industry, both expanding abroad and accepting the increased presence of global steel makers in Europe.
- Today, following its enlargement to 27 members, the European Union is the second biggest steel producer in the world, after China. Moreover, EU steel makers are the world market leaders in terms of manufacturing skills, equipment performance, product quality, distribution and innovative capacity. In 2006, the EU-27 produced 198.4 mmt, compared with China's 418.8 mmt and Japan's 116.2 mmt. Currently the EU steel sector employs some 250,000 workers and account for around 1.8% of European Union GDP.
- Over the past decade, European steel demand growth has been sluggish (1.6% since 1996) as a result of the reorientation of the European economy towards services and the dislocation of heavy-industry. Consequently, European steel makers have reoriented production towards high-quality products. However Europe's market share in world steel production has declines from 23% in 1996 to 16% in 2006 and is forecasted to fall to 12% by 2015.
- The ten largest EU steel producing countries in 2006, in terms of mmt of crude steel produced are: Germany with 47.2 mmt; Italy with 31.6 mmt; France with 19.9 mmt; Spain with 18.4 mmt; the UK with 13.9 mmt; Belgium with 11.6 mmt; Poland with 10.0 mmt, Austria with 7.1 mmt, the Czech Republic with 6.9 mmt, and the Netherlands with 6.4 mmt.
- Until recently, the production of steel in Europe was undertaken principally by five companies: Arbed of Luxemburg, the French Usinor, the Anglo-Dutch Corus, the German ThyssenKrupp and the Italian Riva. Out of these, Arbed and Usinor

merged with Spain's Aceralia in 2001 to form the second largest steel making group in the world, Arcelor. Following a bid from Mittal Steel in 2006, a new group called ArcelorMittal was formed. ArcelorMittal is the world's leading steel producer with over 320,000 employees and a presence in 60 countries.

World Steel Production (mmt)

Country/Region	1996	2006	% change p.a.
EU-25	169.6	198.4	1.6
Germany	39.8	47.2	1.7
Italy	23.9	31.6	2.8
UK	18.0	13.9	-2.6
France	17.6	19.9	1.2
GUS	76.9	119.7	4.5
Russia	49.3	70.8	4.1
United States	95.5	98.5	0.3
Latin America	35.9	45.3	2.4
Brazil	25.2	30.9	2.1
Asia	288.0	665.7	8.7
China	101.2	418.8	15.3
Japan	98.8	116.2	1.6
India	23.8	44.0	6.3

Source: International Iron and Steel Institute, World Steel in Figures 2007

Top Steel Producers by Volume (2006)

Company	Country	Million metric tones (mmt)
ArcelorMittal	Luxembourg	117.2
Nippon Steel	Japan	32.7
JFE	Japan	32.0
POSCO	Korea	30.1
Baosteel	China	22.5
US Steel	US	21.2
Nucor	US	20.3
Tangshan	China	19.1
Corus Group	Anglo-Dutch	18.3
Riva Group	Italy	18.2

Source: International Iron and Steel Institute, World Steel in Figures 2007

The Globalization of the European Steel Industry

The last few years have seen European steel industries being increasingly globalized. While European companies have been expanding abroad, other global players, especially from Asia, have sought to increase their footprint in the European market. Two mergers in 2006 especially stirred the European steel industry: Mittal Steel's take-over of Arcelor and Tata's acquisition of the Anglo-Dutch Corus Group.

After a prolonged take-over battle Mittal Steel, headed by Indian magnate Lakshmi Mittal, succeeded with its hostile takeover bid for the world's second largest steel-maker

Arcelor in 2006. The US \$32 billion takeover has created the world's largest steel-maker, with headquarters in Luxembourg. ArcelorMittal has a production capacity of more than three times its nearest rival Nippon Steel of Japan. The combined entity has a 10% share of the global steel capacity and is controlled by the Mittal family which retains 43.4% of the company's shares. Doubts about the merger were initially raised by European governments (France, Spain, Luxembourg), but they could do little to fend off the hostile takeover. The European Commission refused to intervene on the grounds that the merger did not represent a risk to competition. ArcelorMittal has since continued its expansion becoming in 2007 the first western firm to take a controlling stake in a Chinese steel maker. Skillful maneuvering enabled it to acquire 73% of mid-sized China Oriental Group, thereby circumventing Chinese laws that ban foreign control.

Europe's steel industry witnessed another large take-over in late 2006 with the acquisition of the Anglo-Dutch Corus Group, Europe's second largest steel maker, by the Indian company Tata Steel. The combined company will form the world's fifth largest steel maker. Tata Steel paid US \$13.3 billion for Corus after winning a bidding contest with Brazilian steel manufacturer Companhia Siderurgica Nacional (CSN). Both merges have shaken the European and global steel industry, which overall remains highly fragmented. It is widely expected that further consolidation of the global steel industry will follow. Given the aggressive global climate, the fate of Europe's remaining large steel makers, the Riva Group of Italy and Thyssen-Krupp of Germany, remains uncertain.

Chinese Steel Imports: A looming trade war with China?

During the last few years, the most dramatic development in the international steel market has been the rapid growth of Chinese steel exports. The boom experienced by the market in recent years has been primarily led by an acceleration of demand in the BRIC economies (Brazil, Russia, India, China). The Chinese boom has been the largest driver of the market for some time. This has made China a net importer of steel, with its imports peaking in 2003 at approximately 35 mmt. Then, as China developed its own steel industry, and demand for steel picked up in other areas of the world, China turned from a net importer to a net exporter within only three years. Indeed, by 2006, China was exporting more than 30 mmt a year.

Initially, Chinese exports primarily went to other Asian countries, especially Taiwan and South Korea, and the US. However, with steel prices in Europe at a record high, Chinese steel has increasingly targeted the European market. This led to a dramatic shift in the European balance of trade in the steel sector. While Europe was a net exporter of steel in 2005, by 2006 it was importing close to 10 mmt, with the balance worsening throughout 2007. The majority of these new imports originate from China, raising the specter of resource dependency with China.

Growing increasingly worried about the prospect of being edged out of their home markets, European steel producers have asked the European Commission to impose tariffs on Chinese imports, which according to them are being dumped on the European

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market at prices below market value. In its official statement concerning the matter, the European Confederation of Iron and Steel Industries (Eurofer) alleged that “massive volumes have been dumped on the EU market at dumping margins of up to 40 percent. EU domestic prices have been undercut by up to 25 percent.” As a consequence EU steel makers have demanded duties of 25-40 percent on cold-rolled and galvanized steel, most commonly used in engineering and construction work.

Deliberations on the matter by the European Commission will certainly have a large impact on the future of Chinese-European trade relations. The Commission could impose provisional measures as early as mid-2008. However, any decision on the matter is likely to prove divisive. In its deliberations, it is likely that the European Commission will be guided by the impact antidumping measures would have on the overall health of the European economy. Thus, while there are some 250,000 jobs in the steel making sector which are threatened by Chinese imports, Europe has some 7 million jobs in the metalworking and mechanical engineering sector, which would be hurt by higher steel prices. It is therefore unlikely that the Commission would take any drastic actions that might threaten Europe’s metalworkers.

Nevertheless, there are numerous signs that the patience of the European Commission with China is running out. Peter Mandelson, the EU trade commissioner, has on several occasions indicated that in his opinion a conciliatory approach with Beijing has delivered few results. Moreover, as Europe’s trade gap with China widened even further in 2007, Mandelson warned the Chinese to take rapid action or be faced with antidumping measures in several sectors.

Summary

Europe’s steel industry has witnessed large scale changes over the past decade. It has seen its share of the world market decline and its companies have increasingly become the target of new emerging competitors from Asia. A focus on high-quality products has enabled it to maintain an edge over its competitors in this sector, but it is increasingly unable to compete in the low-cost sector, dominated by Chinese steel-makers. With steel exports a major element of China’s accelerating trade surplus with Europe, the sector seems likely to be at the core of any future trade war between the two competitors. However, whether or not the European Commission will impose anti-dumping measures on Chinese steel makers will in the end depend on the impact these measures might have on Europe’s powerful metalworking industry.