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Consolidation in the World Steel Industry –

a government policy point of view: EU competition policy aspects

OECD Steel Roundtable on Consolidation in the World Steel Industry

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Ladies and gentlemen,

I am very pleased to be given the opportunity to comment from a European perspective on the current consolidation of the world steel sector.[1]

When looking at the consolidation of the industry in recent years, Arcelor/Mittal and Tata/Corus are amongst the most spectacular. However they are only the latest in a long series of concentrations that have affected the steel industry in most regions of the world. As far as we see, perhaps the only significant steel producing region to escape this tendency up to now is China where there has been little if any consolidation to date.

Over the years we have seen several factors encouraging consolidation. At different times different factors have been more or less important. They include;

- the necessity to have a certain size to make optimum scale capital investments,
- more and more important, access to technology,
- defensive measures to reinforce the acquiring companies position on the market, and
- mergers taking the acquirers into new product or geographic areas.

The current round of consolidation seems to be characterised by complementary concentrations. During the recent examination of both Mittal/Arcelor and Tata/Corus under EU merger control law, we found that the acquirers extended their geographic and product ranges while obtaining access to more sophisticated technology. The acquirers also gained access to additional outlets

[1] The opinions put forward in this paper are the views of the author. Thanks are due to Mr. John Gatti, European Commission, DGCOMP for contributing to this paper

for their low cost raw materials and semi-finished steel. Similar patterns can be observed in the acquisitions by Russian and Indian steelmakers of operations in the United States.

The previous round of consolidation, which included Usinor's acquisition of Cockerill Sambre, and the creation of Arcelor, Thyssen Krupp and JFE (Japan) involved concentrations between companies with similar product ranges and geographic scope. The operations were aimed at reinforcing the participants' positions on markets where they were already established.

Is consolidation essential? It is not for us to determine if it is essential but it appears to be inevitable. A brief look into the history of Arbed shows that the process has been going on for a long period. Arbed was formed by the merger of Luxembourg's three largest steel makers as far back as 1911. Over the succeeding years it acquired subsidiaries in Brazil, Belgium, Germany, and Spain before becoming part of Arcelor and finally of Arcelor Mittal. History thus seems to repeat itself on an ever larger scale.

To understand the European approach to the sector, it seems necessary to go back some time. Both the ECSC (European Coal and Steel Community) Treaty and the EEC (now EU) treaty were founded upon the establishment of a common market, first for coal and steel and later for all products and services. The Treaties' task was to contribute to the economic expansion, growth in employment and a rising standard of living in the Member States.

The European Commission does not believe that it is better placed than producers to decide how the steel or any other industry should be organised. It does, however, have a duty to protect competition and to ensure that a given concentration does not allow the parties concerned to impede effective competition. It is striking that the instruments that were developed to ensure competition in the aftermath of World War II have been effective in dealing with the changing fortunes of the industry over the last fifty or so years.

In the immediate post war years, coal and steel were the most important sectors of a country's economy. Coal was by far the largest source of energy and steel was the foundation of economic and military strength. Europe had just emerged from six years of war that had ravaged both industries. A second consideration was the common conviction that placing all of the founding Member States' coal and steel industries under joint international oversight was a major measure for guaranteeing peace and mutual trust in Europe – a conviction at the very origin of the creation of the European Coal and Steel Community. This conviction also demonstrates the consciousness at the time of the wider political and social implications of the development of the sector.

Given the lack of precedents, the men who drafted the ECSC Treaty did a remarkable job. Most of their arrangements for controlling the commercial and competitive behaviour of coal and steel companies and their governments have proved their worth and have been carried forward in the subsequent treaties and regulations. The European Coal and Steel Treaty set out rules in three areas of competition policy:

- prohibiting cartels and anti-competitive agreements
- limiting state aid, and
- controlling concentrations.

The steel industry, like other capital intensive industries subject to cyclical variations in demand, is prone to cartels and other anti-competitive agreements. In addition to raising customers costs and stifling innovation cartels maintain the *status quo* and prevent the optimal organisation of the industry. The Commission's policy of seeking out cartels and severely punishing their participants creates an environment in which steel, and other industries, can restructure and consolidate to reach the optimal organisation.

Let me add here one remark on state aid and subsidies in the sector, of course a well known topic to this committee. All State Aid to European steel companies is closely controlled, and the rules are stricter than for other industrial sectors. While certain horizontal aid is permitted, under strict conditions, inter alia for projects to improve the environment and for research and development, investment and restructuring aid to the steel sector is in principle banned. Only the EU's new Member States were allowed to give such aid a single time before accession and it had to be based on a national restructuring programme and aimed at eliminating obsolete and excess capacity. A number of the new EU Member States, such as Poland and the Czech Republic did so. The restrictive application of the EU State Aid rules prevents the use of state funds to support inefficient steelmaking operations, and therefore encourages resolving outstanding issues by sound restructuring.

As far as the control of concentrations is concerned the ECSC’s High Authority was granted exclusive jurisdiction to authorise mergers and other concentrations between steel companies that would have an effect in the territories covered by the European Coal and Steel Treaty. The criteria for authorising concentrations were that the proposed operation would not give the parties concerned the power;

- to determine prices, control or restrict production or distribution, or restrict effective competition on an important part of the market for steel products , or

- to avoid, particularly by establishing an artificially privileged position, giving substantial advantages in access to supplies or outlets.

After the expiry of the ECSC Treaty in 2002 and the integration of coal and steel into the general EU Treaty framework, the EU Merger Regulation has applied to the concentrations in the coal and steel industries which fall within its jurisdiction. The wording may have changed but the underlying principles are the same. The Commission is now required to approve concentrations that would “not significantly impede competition in the common market or in a substantial part of it, in particular as the result of the creation or strengthening of a dominant position”.

Under the EU merger control regime, the European Commission carries out a rigorous investigation into each steel concentration under its jurisdiction. The decisive criterion is impact on the EU's, respectively the EEA's, market, not the location of enterprises. The analysis can be divided into three main stages:

- the definition of the relevant product markets
- the definition of the relevant geographic markets
- an examination of the effects of the operation market by market.

The careful investigation of effective product markets is decisive in any competition analysis because they serve as the basis for determining the remaining competitive constraints on the merged entity, once created. In other words, they determine the remaining effective choice for the steel users in a particular region, after the new global player has been established.

Generally speaking steel product market definitions have been long established, essentially because from both the supply and demand side steel products are not interchangeable. The Commission of course considers whether other materials, such as aluminium should be considered as being in the same product market. Our analysis, with very limited exceptions, has shown that it is not at present possible to substitute steel with other products.

For many years now, the Commission has defined EEA wide geographic steel markets for the purposes of its analysis of the remaining competitive constraints on the new player, largely on the basis of trade flows and price convergence within the European Economic Area (including besides the EU also Norway, Iceland and Liechtenstein). With continuing globalisation this may change, but recent market investigations indicate that wider markets are not yet appropriate.

Let me be clear. It may seem to some as a paradox to define markets in a regional context when global players plan their strategies in the sector on a global scale. Again, one has to keep in mind the purpose of the analysis. The very purpose of merger control is to avoid that steel users are exploited by global companies because they obtain through the transaction local monopoly power. What counts is the maintenance post-merger of effective choice for the user, not the intention or the requirement for the merged entity to plan in the context of a global strategy. While we have other sectors, where users have effective choice on the global market, according to our careful market tests with steel users this is still not the case in many segments of the steel market. Our decisions have to be based on substantiated analysis of the remaining effective choices that steel users will retain after the merger. The concept of globalisation must not be allowed building monopoly power in specific regions but must mean real choice for the user in the markets concerned.

In examining the effects of the operation we therefore have to consider the extent to which the parties will be constrained by their customers and competitors both actual and potential. Where an operation would enable the merging parties to act independently of the market we seek remedies to alleviate the situation or if this proves impossible prohibit the operation.

The creation of Arcelor, authorised at the end of 2001 involved a concentration between three very similar companies, Usinor, Arbed and Aceralia; all of them active principally on the European market. The operation gave rise to significant overlaps for a number of steel production and distribution areas. The operation was only authorised after an in depth investigation (a so-called Phase II investigation under the EU merger control regulation) and after significant remedies were offered.

In contrast the concentration leading to the formation of Arcelor Mittal last year was far less problematic from a competition point of view, although the combined entity is twice the size of Arcelor alone. Mittal was particularly strong in long products and in Eastern and Central Europe whereas Arcelor was strong in high technology flat products and had its activities concentrated in Western Europe. As a result the only area where there was a significant overlap in Europe was in heavy sections where commitments given in the first phase of the Commission's investigation under the EU merger regulation were sufficient to remove any competition concerns. Commitments concerned the divestiture of steel mills in Germany, Italy and Poland together with related commercial and distribution assets, accounting for around 10% of the total production capacity for heavy section products in the EEA. In the US the operation was problematic only in relation to tinplate and again the difficulty could be solved by the sale of appropriate assets. As Tata Steel had hardly any sales in the EEA its acquisition of Corus later in the year was not problematic and was cleared by us without imposing remedies.

In both the Arcelor and Corus cases there were competing bids. The other potential buyers had the bulk of their turnover outside the European Union. Severstal, which made a competing offer for Mittal, has the bulk of its production in Russia, while the Brazilian company CSN had only very minor sales in Europe and neither of the proposed operations gave rise to competition concerns, as far as the European market was concerned.

Arcelor Mittal, now the world's biggest steel maker has a share of about 11% of global production and is about twice as big as the next largest producer. However the degree of concentration in the sector remains much lower than in other important sectors of the world economy; this means that there may be scope for the sort of consolidation we have seen recently where the transactions bring together operations that are complementary. Apart from the Mittal and Tata acquisitions, Russian companies have been acquiring steel operations in Western Europe, the US and South Africa; Indian companies have bought in the US; US companies have purchased in Europe. This type of consolidation may continue as companies position themselves for a global steel market that many observers believe will arrive in the foreseeable future.

The European Commission will continue to observe the restructuring of the steel market carefully, in order to ensure that concentrations do not distort competition. A task it undertakes in close liaison with its regulatory counterparts in the other jurisdictions.

Let me end on a more general point. I have concentrated in this paper on the competition policy aspects of consolidation. But we will also have to keep the profound social implications of the future development of the sector under careful review.

The European Commission has paid close attention to the social implications of the transformation of the steel sector ever since the creation of the Coal and

Steel Community Treaty. During the existence of the ECSC up to 2002 1.7 million workers have benefited from ECSC re-adaptation aid alone. Change was dramatic. By 2002 the European Steel industry employed 270 000 workers, down from a peak of 770 000 thirty years earlier. In 1953 the production of crude steel amounted to 39 million tons in the initial 6 Member Community (EUR6) , by 2002, at the end of the ECSC, production had risen to 159 million tons for the then 15 Member States (EUR15), now grown to 27 Member States.

But the policy pursued by the European Union for the sector has been constant, over all of the ups and downs of the last 50 years: policy was based overall on the conviction that the European Commission would not stand in the way of the restructuring of the sector if restructuring complies with the requirements of competition and state aid rules. European steel today is better, cheaper and cleaner.

Let me refer here to a statement by EU Competition Commissioner Neelie Kroes on the occasion of the approval of the Mittal/Arcelor merger:"our task is in all mergers notified to the European Commission to make sure that they would not harm competition in the industry, lead to price increases or result in less choice for business customers and final consumers."

I believe this statement summarises best the EU's approach.