Economic Perspective 2

SCOTTISH STEEL IN THE POST-THATCHER DECADE

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On 9 November, BS plc indicated their intention of closing the Clydesdale Tubeworks at Bellshill, Lanarkshire by March 1991. This follows the announcement in May that the Hot Strip Mill at BS's Ravenscraig works at Motherwell will cease production next April. Both these measures were not unexpected. In previous Commentaries and elsewhere, we have illustrated the financial incentive to BS deriving from rationalisation and stressed the vulnerability of both these operations to the then anticipated slowdown of activity projected for 1990-91. Recent events in the middle east and the consequent oil price shock have contributed to a further deterioration in the short-term outlook for steel markets. In addition, the prospect of military conflict promises to both prolong and deepen the recession now confronting the world economy.

The reaction to these closures has proved furious as Scottish politicians, trade unions and industrial leaders set out to confront an entrenched British Steel. There are few in Scotland who do not see BS's current activities as part of a phased withdrawal from Scottish locations. Indeed, BS have done little or nothing to counter such suspicions. In heated meetings with Scottish Office Ministers and opposition delegations, BS have refused to set out the detailed analysis of why they require to close these plants. However, perhaps more significantly, BS have declined to make any sort of clear statement or commitment concerning their modern and efficient steelmaking capacity at Ravenscraig or their serviced steel making site, stockyards and deep water ore terminal at Hunterston.

The political debate seems to be moving in favour of the notion of the sale of the Scottish assets to another owner. In recent weeks, the Clydesdale decision has precipitated such calls and placed pressure upon Scottish decision makers to advocate the creation of an independent Scottish steel industry. Proper reluctance on the part of Mr Rifkind, Mr Dewar and the Standing Commission for the Defence of the Scottish Steel Industry to rush along this path has been criticised in certain quarters. The argument is that the Scottish Lobby shy away from such a competitive solution because all concerned realise that there is no Scottish Steel industry worth saving. This may well be correct but does not imply that a competitive solution at the UK level could not be enforced which would provide the basis for the commercial survival of BS's Scottish plants.

The FAI has been aware of this argument since before privatisation and had no trouble in becoming corporately involved in the preparation of the 1987 Arthur Young report for Motherwell District Council which called for the setting up of a second force in UK flat products. The RSD option was placed before the House of Commons in the form of an amendment to the Steel Bill and rejected by Government. A full analysis of the reaction of the DTI and certain Conservative back-benchers was fully set out in Love and Stevens (1988). However, it should be noted that the Arthur Young report rejected the facile concept of an independent Scottish Steel company. The BS Scottish assets were and remain incoherent and, in all probability, unsaleable. Any such company would lack finishing facilities, final customers, a distribution network and key managerial and R & D functions. For that reason, Arthur Young proposed a UK solution involving the Ravenscraig steelmaking and hot strip mill, the Dalzell Platemill and the Shotton CR mill and coatings complex in North Wales.

Since Autumn 1989, we have been pressing for a wide-ranging and fully resourced study into the prospects for the Scottish Steel Industry. In July, the then Scottish Secretary, Mr Malcolm Rifkind, under pressure from Mr Donald Dewar, agreed to ask the SDA to appoint consultants to undertake such a review. The discussion which follows provides a personal view of some issues relating to bulk steelmaking at Ravenscraig which should be addressed by Arthur D Little, the US consultants appointed to conduct the SDA's assessment.

Given the difficult short term outlook, it is important to consider the evolution of steel markets beyond the aftermath of the present oil shock. We are reasonably sanguine about the future course of world steel production and our optimism is grounded on the forecasts of activity produced by Mr Peter Marcus, the Senior Vice President of Paine Webber/World Steel Dynamics. Mr Marcus views the mid 1990s as a period of steel shortage conditions due to strong growth out of the early 1990s recession. He predicts that many producers will face capacity constraints early in the projected upturn and that a booming market in semi-finished steel products will emerge.

Developments in process technology are likely to become relevant in the 1990s. With reference to the publicised difficulties at Nucor, Scottish decision makers require further information on thin slab casting, its potential and the likely timescale for adoption. The likelihood of the emergence of direct smelting techniques, and BS's lead in the development of such processes should be considered. Because BS had been privatised with an overhand of steel making and certain types of rolling capacity, the incentive to quickly adopt new techniques may be absent. The study must, inter alia, review the technological developments likely to emerge in the 1990s in order to clarify if adoption at Scottish sites might underpin feasible options for Scottish Steel.

As regards BS's position in Scotland, three possible outcomes to the current steel crisis are evident. On the basis of our present knowledge, the most likely outcome is that Scotland would lose its steelmaking capacity at some point in the mid to late 1990s. This assessment is based on the fact that BS has an effective steel making capacity of 17.5 million tpy at its five Heritage sites and a potential to double the steelmaking throughput at Lackenby by constructing new iron-making plant. If such bottlenecks were removed by investment BS has a potential steelmake of 21 million tpy. It therefore appeared that BS, as they have subsequently confirmed, would move to a plant configuration based on 2 major centres ie Teeside for long products and South Wales for strip and related products. In the long run, both the inefficient inland sites at Scunthorpe and Motherwell will be deserted although this may take 15-20 years to complete. The rate at which this process will occur depends critically on both the evolution of steel demand and the readiness of new technological developments in steel making. However, contemplating a future for Scotland's steel assets either inside or outside BS is not an entirely hopeless proposition.

The consultants require to construct alternative visions of how BS could evolve. In essence, this involves arguing that BS should contemplate a third major steel making centre located in Scotland. The rational end point of such a strategy involves the siting of new processes at the coastal site at Hunterston. However, such developments are not likely before the turn of the century and that the immediate task is to present market based arguments for the continuation of steelmaking at the present Scottish sites. BS are unlikely to be deflected from closing the Ravenscraig HSM because of the poor short-term market outlook and because any decision to reverse the closure announcement would totally undermine Bob Scholey's position as Chairman. However, there is little further scope to round out the Welsh strip-plants and that if strip demand evolved strongly the construction of a thin slab caster at Ravenscraig may be justified should this technology prove in the way many expect. Labour and other markets in South Wales and the East Midlands seem set to tighten dramatically across the coming decade and Scotland would afford a low cost base for steel production. The Ravenscraig furnaces, built and rebuilt in the late 1970s, require relines and possible rebuilds at some point in the late 1990s. The cost of such investments may not be as high as either the shop stewards or the FAI have previously implied.

How can the continued existence of a Scottish steelmaking capacity best be justified within the present strategic orientation of BS? BS seem set to become a global player and wish to operate finishing capacity in other countries to improve market penetration. Although the efforts to date have proved somewhat disappointing, such developments would result in major calls for semi-finished feedstock and such demand could be best satisfied from BS's efficient UK oxygen furnaces.

At the time of privatisation BS was the most cost effective bulk steel maker in the world.

Following the elimination of the EC quota system, we expected that BS would make its cost advantage tell against less efficient continental competitors. BS have been frustrated in this by the producer dominated nature of European steel distribution channels and imperfections in the market for corporate control which has prevented BS from purchasing EC finishing and stockholding assets on the scale which their profitability would allow. Because of the restricted access to many EC and North American markets, we have consistently supported BS's efforts to buy overseas capacity. Those who suggest that BS should invest in the UK and export to EC customers ignore the realities of the cartelised European market or the protected nature of the US steel sector. In our view, a successful European acquisition and investment programme creates the soundest basis for utilising the Ravenscraig steel making post 1994. A few adroit purchases could transform the prospects for BS's demand for liquid steel. Given their past and recent experiences on the Continent, we support BS's call for a supra-national control of EC steel mergers and acquisitions to prevent local states and industry continuing their attempts to freeze out BS.

Thus, greater liberalisation of world and European markets and consequent strong growth of steel trade affords opportunities for BS to utilise their Scottish assets as suppliers of feed to a global network of finishing capacity. In particular, likely medium term developments in Eastern Europe should be stressed, along with the view that the Scottish capacity could serve these markets in one of two distinct ways. First, the Scottish plant may be closed and sold to producers in capital constrained markets such as Eastern Europe or China. Second, BS could become involved in developments or joint ventures in Eastern Europe in which finishing capacity was supplied with feed from present UK sites.

In terms of a protected European market, a sensible case could be made for producing steel products at peripheral coastal sites for finishing nearer the final markets. This follows because all raw material inputs require to be transported from other continents and that processing raw materials at the periphery presents a strong a priori economic and environmental alternative to transporting bulk inputs into the centre. In the long run, the deep water port at Hunterston and its expandable serviced steel making site could emerge as a strong and rational focus within BS's plans to become a global player.

Although many in Scottish public life take the view that Ravenscraig will close when its major internal markets at Dalzell and South Wales dry up, the potential for the Motherwell plant to operate as a producer of semi-finished goods should be fully explored. This advocacy is grounded upon the prospect of alternate internal markets in the EC, East Europe and North America. Thus, this scenario complements BS's known strategic approach. To be wholly credible, BS should be outlining their new strategy to develop overseas internal markets for Ravenscraig and considering whether the product base should be diversified by the installation of bloom casters. These would be needed to feed the long products plants recently purchased in Germany and Spain.

Any strategic appraisal of the Scottish steel assets must attempt to build credible futures within BS. If BS rejects such solutions the argument then turns to whether the BS Scottish assets can be sold to new owners. The present constellation of Scottish steel capacity is incoherent and unsaleable and that an independent Scottish steel company is a nonsense concept engendered by politicians to support a wider ideological vision. The Arthur Young report rejected this approach because such an entity would lack finishing facilities, final customers, a distribution network and key managerial and R & D functions. This remains the case. Given this, these assets would only be attractive to another European or Japanese steel producer with the technical, financial and marketing resources required to absorb the Scottish steel assets. Unfortunately, both the Scottish Office and SRI report a cool response to this opportunity in European and Oriental board rooms and that the advocates of this concept, including the writer, require to rethink.

A competitive solution to the Scottish steel question is only coherent at a UK level. The Arthur Young report recognised this and advocated that the Shotton CR mill and coatings facility in North Wales should be linked to Ravenscraig and Dalzell to form a rounded saleable unit. If the UK government and the DTI were to suddenly favour a competitive solution, they would require to break up British Steel.

There is a widely canvassed red herring promulgated, inter alia by Mr Ian Lang, that BS is too closely integrated to be split up. It is certainly the case that it would be difficult to allocate discrete units of rolling mill and finishing capacity to each of the demerged companies without weakening both. However, the Scottish assets could be floated off with claims to some proportion of throughput at BS rolling and finishing works. In principle, the UK government could create a second force in UK bulk steelmaking through contractual arrangements similar to the basis on which joint ventures are conducted. In such arrangements, partners share the costs of construction of capacity and share throughput in proportion to the capital provided. Thus, a Scottish based steel company could obtain finishing capacity in this way and thus maintain a chosen product profile. The total package would also entail the allocation of managerial resources to the Scottish company and some share or access to the BS distribution network and R & D resource. There are variants of this approach which could be examined in greater detail and which allow a saleable package to be demerged over a period of time. The SDA study and the Select Committee on Trade and Industry should explore the feasibility of demerging BS in this way.

There are no grounds for believing that Mr Peter Lilley is intent on finding any solution to the likely run down of Scottish steel and this makes matters extremely difficult for the Scottish Office.

In recent Parliamentary debates, Mr Lilley has stressed two points. First, that he will not attempt to second guess BS's corporate strategy. second, that the privatisation of BS as a single unit serves the best interests of workers, shareholders and the nation. In truth, no one is seeking that Mr Lilley second guess BS's corporate strategy or anything else. The pressure he is currently facing results because he has not taken the trouble to assess and explain exactly what BS's current strategy actually is and where it leaves Scotland and the UK balance of payments. Thus, his assertion that the privatisation of BS engenders benefits all round seems based on dogma rather than a serious reflection upon possible alternative solutions.

Thus, an authoritative appraisal of options is a sine qua non if Mr Lang is to make any headway with his "crypto-monopolistic" Cabinet colleague. This implies that recent calls that the Scottish Secretary demand an immediate sell off of Scottish steel assets constitutes spectacularly bad advice on two clear counts. First, having asked the SDA to complete an investigation which is due to report on an interim basis in December, the Secretary of State would look extremely foolish to pre-empt the conclusions of this report and advocate a specific course of action. Second, the course of action being urged upon Mr Lang is not the strongest competitive option. If the Government could be persuaded that the competitive solution of creating a second force in UK steelmaking was optimal, why restrict the options to one which is highly likely to fail? The competitive arguments which would engender the flotation of the Scottish assets would equally support arguments to break up British Steel. Indeed, to advocate the sale of assets which are not likely to be saleable and to argue that this constitutes a competitive solution is the political economy of Disneyland.

In conclusion, there is likely to be no uniquely Scottish solution to the difficulties facing Scottish steel. Only UK solutions exist. This appreciation would appear to marginalise anyone who seeks to wrap Scottish steel in a threadbare tartan shawl. The present exercises being conducted by the SDA and Trade and Industry Select Committee should have two broad objectives. First, to clarify whether BS have any future use beyond the mid 1990s for their assets at Lanarkshire and Hunterston and to specify policy measures which would afford BS greater opportunities to acquire overseas market share and thus use these facilities to further its global strategies. Second, if BS reject such options, to establish whether the UK national interest would benefit from the creation of a saleable second force in UK bulk steel making. If this proves likely to be the case, then only the UK Monopolies and Mergers Commission could resolve the issue and plan and enforce a progressive demerger and thus promote a coherent Scottish based steel company.

It may well be that, following a detailed appraisal of the position facing BS, the Scottish Steel Lobby may require to learn new lines. However, the script should not involve calls to sell the Scottish steel assets but rather present a clear case for the UK government to break up British Steel. Only the UK government has the power to make this happen. The question remains one of whether, in a post-Thatcherite landscape, Scottish politicians can credibly advance such arguments and secure a MMC enquiry into the possibility of market based solutions.

REFERENCE

J Love and J Stevens "RSD: A Comment", Quarterly Economic Commentary, Vol. 13, No. 4, June 1988.