West German Steel Crisis (1983)

Abstract

In this essay, an economist explains the reasons for the “steel crisis” of overproduction. The crisis led to structural unemployment and deindustrialization in West Germany, on account of increasing competition from cheaper steel manufactured in Japan and the so-called Asian tiger states.

Source

An End to the Crisis is Nowhere in Sight

Finding solutions to the European steel crisis is becoming ever more urgent. With the not uncontroversial recommendations of the “steel moderators,” a concept for the steel industry in the Federal Republic has finally been put on the table. Presently it is still difficult to assess the chances of these recommendations being put into practice. How did the steel crisis come about? Can a quick recovery for the steel industry be expected?

The once flourishing steel industry in the countries of the European Community has been in a serious crisis since 1975. The steel industry in the Federal Republic of Germany has also been directly affected: its production of raw steel peaked in 1974 at 53 million tons. By contrast, in 1982, only 36 million tons were still smelted, which, given operational capacities of 68 million tons, amounts to a utilization of only 53%.

The causes of the steel crisis in the countries of the European Community extend back well into the 1960s. The inflation-driven overall economic growth in that decade—on average, in the Western industrialized countries, gross national product grew at an annual rate of 5%—boosted steel consumption strongly and promoted the construction of more and more steel plants. The demand for steel seemed unlimited; within the European Community it had grown annually by 4.5%, and even by 6% worldwide. To be sure, the serious crisis in the steel markets in 1971-72 served as an initial warning sign that such growth rates could not be assumed to continue, but the inflation and the steel boom in 1973-74—in retrospect, the crest of the wave about to break—quickly calmed any nascent concerns.

Loss of Competitiveness

But it was not only that projections about the future demand for steel were off; changes in competitiveness were also not sufficiently recognized. In the fifties, the steel industries in the countries of the European Community had grown to become the leading steel suppliers to the rest of the world. Over the course of the sixties, however, their dominant position came under increasing assault and was eventually taken over by rising steel companies in Japan. However, the steel works in the European Community wanted to counter with investments in the style of their Japanese competitors. Their ideas were dominated by dreams of enormous steel plants with capacities of 15 million tons per year—the old integrated works reached only 2 to 4 million tons—along the coasts of Europe. Impressed by the technical productivity of the modern large mills, policymakers paid little attention to increasingly evident loss of competitiveness of integrated large steel plants in highly industrialized countries.

Japan’s steel production advantages result not only from the use of highly productive large-scale technology and the way in which the raw materials procurement process is organized. They also result from low labor costs and a domestic steel consumption rate that, in the wake of that country’s rapid industrialization, is growing more than twice as fast as those in the countries of the European Community. Therefore, while Japan’s competitive advantage could be reduced through large-scale

investments in the countries of the European Community, it could not be matched.

Moreover, these sorts of advantages were not limited to Japan; rather, they also became increasingly emergent in a number of new, rising industrialized and developing countries, which had previously procured steel from Europe and were now rapidly transitioning to independent steel production. On top of this, superior competitors to the integrated “giants” arose also within the European Community—the nimbler “mini steel works” are successfully contesting the market in the area of “light extrusion.”

Gigantic Excess Capacities

The turning point for the steel industry in the European Community began with the crisis in 1975. The global production of raw steel fell by 9%, in the European Community by 19%, and in the Federal Republic of Germany by no less than 24%.

What initially looked like a cyclical downturn proved—increasingly so—to be more of a permanent condition:

—Steel consumption in the European Community is stagnating, in fact it is declining.
—The export markets have grown only slightly and are more competitive than ever before.

Robust growth resulted only from enhanced capacity: because it takes so long for investments in the steel industry to come to fruition, the expansion projects launched during the steel boom of 1973-74 resulted in expanded capacity for several more years, especially since the permanent change was not registered at first and was clearly recognized only at the end of the seventies.

Between 1970 and 1980, the steel capacity of the countries of the European Community grew from just under 160 million tons to a generous 200 million tons. By contrast, internal steel consumption declined by 20 million tons to around 100 million tons. In spite of considerable price concessions, exports could barely be raised, even though the demand for steel in the young industrializing and developing countries—unlike in the highly industrialized countries—also grew rapidly in the seventies.

If one combines the countries of Latin America, Africa, the Middle East, and Asia (minus Japan and the People’s Republic of China), it is clear that their demand for steel grew at an average annual rate of 8.5%, from just under 40 million tons in 1970 to 90 million tons in 1980. That increased demand, however, was met almost entirely by domestic production. The production of raw steel in those countries expanded at an average annual rate of 11.5%, from 20 million tons to nearly 60 million tons, and their share of global production grew from 3.5% to 8%.

By contrast, during that same period the share of global production in the countries of the European Community declined from 23 to 18%. As a result, production has not come anywhere close to the peak of 1974—155 million tons of raw steel were smelted at that time; since 1975, capacity utilization has never been higher than 70%.

Failure to Adjust

Such a persistent underutilization is unusual even for the steel industry, which engages in long-term planning; still, capacity has yet to be adjusted to the reduced demand.

The reasons for this are manifold. On the one hand, they are closely related to government-sponsored steel industry subsidies that have been driven by ever more comprehensive regional and labor-market policies. But they also relate to the fact that the integrated smelting works are too big to fail, but too small to be adjusted within existing enterprises. That is presumably why losses were accepted for years in the—vain—hope that competitors would drop out.

In a Dead End

The “restructuring” goal pursued since 1977 by the Commission of the European Community, which has been responsible for steel policy since the 1951 European Coal and Steel Community Treaty (ECSC), initially envisaged boosting competitiveness without any significant reduction in capacity. Over the years, however, this restructuring grew into an expanding thicket of price, production, and trade monitoring. Moreover, in many countries, maintenance subsidies for steel companies, which are explicitly prohibited by the ECSC treaty, began to proliferate, meaning that companies subject to the treaty [and thus ineligible for maintenance subsidies] ran into more and more difficulties.

Because of the persistent weakness in demand, the path of boosting competitiveness alone has proven to be a dead end. Now, the problem of declining capacity, which was previously neglected, is to be corrected by 1985 by a tour de force effort. And it is to be done without relinquishing the goal of “equality of sacrifice” between the various steel companies in the countries of the European Community, which pays little attention to the different levels of productivity.

For a long time, the German government also offered only inadequate resistance to the spreading subsidies for steel companies in the other countries of the European Community, probably in the hopes that the German companies, on average more productive, would already be able to compete with those receiving state subsidies. But that hope proved illusory: the subsidized competitors in the other countries have by now modernized their operations with state aid, in some cases significantly so, while the plants in the Federal Republic lost the capacity needed to do just that and are now themselves dependent on subsidies—with the result that the prohibition of subsidies enacted at the end of 1981 under pressure from the German government is now turning in an almost tragic fashion against the government and against the steel industry in the Federal Republic.

Prospects for the Future

As a supplier on the world markets, the steel industry in the European Community will continue to lose ground. The production of ordinary steel does not require much highly qualified labor, meaning that young industrialized countries, where steel consumption is growing rapidly alongside industrialization and where labor costs are lower than in the countries of the European Community, are turning into superior production locations, especially since the procurement and distribution channels are often more favorable there than they are here. Consequently, the still considerable surplus of steel exports from the countries of the European Community will likely keep declining in the future.

Thus, steel production depends less on the development of steel consumption throughout the world, and more on steel consumption within the countries of the European Community itself. If the low overall economic growth continues, a further decline in steel consumption is preordained, because in highly industrialized countries steel consumption grows only with overall economic growth of more than 3 to 4% per year. Such growth rates are considered unlikely in the years ahead, meaning that there is no reason to expect demand to become commensurate with existing capacities.

Continuing to maintain the existing capacities would presumably require rapidly increasing state subsidies and thus tie up funds that could be invested in other areas in a more growth-appropriate way, especially since the comparative advantages of the countries of the European Community surely do no lie in steel production. All that is left, therefore, is a rapid reduction of excess capacities. Opinions diverge on questions such as how much, where, and how; and it is these questions, first and foremost, that the steel companies must answer for themselves.

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Source: Helmut Wienert, *Ein Ende der Krise ist nicht in Sicht: Stahlkrise, Wirtschaftsdienst*. Volume 63, 2. Hamburg, Verlag Weltarchiv, 1983, pp. 72–75. Republished with permission from the author.

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