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obsolescent capacity, with the result that the average age of plant and equipment in the industry is now only 10 to 15 years. While EC industry commissioner Etienne Davignon, British industry minister Keith Joseph, and President Carter's deputy special trade representative Robert Hormats are calling for a planned shrinkage in OECD countries' "excess" steel-making capacity, West German producers have a very different perspective. In private discussions with *EIR*, they forecast a world steel *shortage* emerging in the 1980s, particularly if the developing sector is to make further strides toward industrialization.

The accompanying article by *EIR* European correspondent George Gregory, elaborates on the West German position in the EC steel dispute. The West German companies objected to Davignon's efforts to impose mandatory across-the-board production cuts in the EC industry, on the ground that they had recently invested heavily in high-value specialty steels which could not be accorded the same treatment as other types of steel. In the end, West Germany did gain some exemptions for specialty steel, but agreed to overall cutbacks amounting to some 18 percent, out of fear that waning consumption of steel in the current recession could spark cutthroat competition among EC producers.

The fact that the West German producers were forced to accept this compromise and that Hoesch is now postponing the construction of a DM 500 million plant in Dortmund reflects a larger failure in West German political diplomacy—the failure to move ahead on the creation of new monetary institutions (e.g., the EMF) that could provide the developing sectors with the wherewithal to pay for increased capital goods imports.

An associated problem is the reluctance of the Bundesbank to lower domestic interest rates, out of concern that this would spur greater speculation against the deutschemark and cause further outflow of capital to Wall Street and London. Deutsche Bank chairman Wilhelm Christians recently complained that, if rates did not drop off soon, capital investment would decline along with labor productivity—the motor of the West German "economic miracle."

A report issued by spokesmen for the five leading economic institutes last week, the so-called Five Wise Men, even went so far as to argue that the Bundesbank should tolerate a short-term deutschemark devaluation, if necessary, to reduce interest rates and get the economy moving again. But, as the West German financial daily *Handelsblatt* pointed out, devaluation is not a realistic solution because of the problems it would create for West Germany's European trading partners, and could even undermine the fixed-rate arrangements of the European Monetary System (EMS).

German steel battles the EC

by George Gregory

After seven and a half hours of bargaining into the night of Oct. 30, of German government team, sent to the European Commission of the European Community (EC) to salvage German steel producers in the "manifest crisis" of the European industry, agreed to accept secret production quotas supervised by the EC Commission for the eight months up to June 30, 1981. As far as German producers were concerned, even before the decision, the best of all possible deals, the most magnanimous concessions, were going to amount to a very miserable package. One that, at best, offered no solution to shrinking markets and price war conditions.

The Oct. 30 decision had an eerie aura of historical irony. On Sept. 30, 1926, steel industrialists from Belgium, Luxembourg, France, Germany, and the Saar, met in Brussels under chairmanship of Emile Mayrisch, president of the Dutch-Luxembourgeois Arbed firm, to work out a cartel arrangement to regulate competition and restrict "overproduction," under crisis conditions created by the Versailles Treaty, British control of international credit flows, and general contraction of world trade.

This time, the job of current Arbed president Emmanuel Tesch, as chairman of the voluntary Eurofer club for European steel makers, has been replaced by Belgian Count Etienne Davignon in an obligatory club. Even if the deal wrung out of Count Davignon did not "punish" German producers as they had feared, they still felt cheated. Fifteen years ago, German producers had charted a strategic modernization plan of all their facilities. They had indeed built after the war, but today the average age of a German steel plant is 10 to 15 years old. The modernization was predicated on the simple calculation that, in a world where industrial nations have to gear up capital investments to guarantee profitability and base their margins on high rates of productivity, and where industrialization is progressing in the developing sector, there could not fail to be a demand for high-

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quality steel and steel products made by state-of-the-art technologies.

German steel producers are at least willing to admit that Count Davignon and the EC Commission had a good sense of timing for their an 18 percent production cut for European steel. European exports to the United States had fallen in 1979 by 12 percent. Even without antidumping suits hanging over their heads, European exporters know that the Volcker "super interest rates" policy, the "investment/construction cold-turkey" treatment for the U.S. economy, has all but dried up that market. Then, when Iran fell into the hands of Khomeini, European exports to the OPEC countries dropped by a full one-third. Trade with East Europe began to be carried in 1980 by the Mannesmann pipeline deal for the natural gas line from western Siberia to Europe, but the future is read as uncertain.

At home, construction is dampened, not least because of the spill-over of American interest rates into Germany. The machine tool industry, after holding even this year, expects a 1.5 percent drop in production for 1981, while holding onto a decent volume overall. Auto production is down, with slipping rates of productivity in 1979; profits were already fading away in the first quarter of 1980 with 17 percent increases in ore prices and coke prices following suit. German coking coal is 25 deutschemarks higher than world market prices. And overall energy costs are increasing.

For a country like West Germany, which exports a hefty 40 percent of its steel production, such figures add up to a situation in which major efforts are being concentrated just on trying to break even. Production in the current year is down overall by 2.5 percent. Domestic consumption is down by 1.5 percent. This worries the industry far less than the fact that rates of incoming orders are far behind, which shows up in forecasts of another 3 percent drop in production in 1981 in the Federal Republic, and 6 to 7 percent in the rest of the EC. Market shifts—in part due to agreements Bonn made at the 1978 economic summit meeting to import more, resulting in additional market shares for other EC countries and non-EC countries—are estimated to account for at least 5 million tons less produced in the Federal Republic in 1979. Production last year was 46 million tons, this year 44 million tons.

The German end of the deal

A good part of the responsibility for the lower German production figures, however, had little to do with German producers' losing the competitive edge. This is especially so since the 1974 "boom year," when the Federal Republic produced 53 million tons of crude steel. Major new modern facilities have come on line, replacing outmoded plant, thus only temporarily representing a drop in capacity. In fact, the Klöckner firm broke out of the Eurofer voluntary cartel because the rates fixed for Germany did not take into account that Klöckner's modern furnace in Bremen was under construction, but not yet on line.

The Germans made a major shift toward production of specialty steels, so that, on the average, 15 to 19 percent of total German crude steel production is worked up into higher-grade steels, often accounting for as much as 39 percent of their production. For the giants, such as Krupp Steel, a mere one-fifth of production in 1970 was devoted to the specialty steels. Today it is a full one-half, representing the difference between 500 million DM in 1970 and 2.6 billion DM today, out of a total of about 5 billion DM turnover. These special steels are also the major feeder for Mannesmann's pipes. Mannesmann accounts for 60 percent of all German pipe production, one-half of which is annually sold to the Soviet Union.

This explains why the protests from German steel producers were so loud and penetrating when the British—once Count Davignon had moved to declare a "manifest crisis"—demanded that special steels not be excluded from production limit quotas. Even the most anglophile of German producers had to perceive this as a virtual stab in the back, or worse—a betrayal of the "British virtue of fair-play." It had not, after all, been the Germans who lunged into the gap in British steel production (down from 1979's 16.236 million tons to 8.299 million tons, or 48.9 percent) during Britain's steel strike. It has been, instead, estimated that a full half of the growth of EC steel production in 1980 has been due to producers filling the British markets, and only France (up by 8.7 percent) and Italy (up by 14.4 percent) have managed to book increases in production.

That the British had set their sights on the German steel throat gave rise to even more indignant reactions. As one spokesman for Krupp Steel put it: "During the same decade that we invested 3.1 billion DM, 2.5 billion DM of that out of our own resources, with a meagerly 600 million DM in credit for modernizaton, rationalization and restructuring, British Steel received 8 billion DM in subsidies for the same purposes. But they didn't *do* anything with the money. They just swallowed it. . . . The French have a much more rational national steel policy," he added. "With them we would have much less of a problem even coming to temporary voluntary agreements to restrict production for the sake of an orderly market."

The Germans they don't like having to compete against 25 billion DM worth of subsidies over the past decade in the other European countries generally, but British behavior, clearly moving the EC Commission on their behalf, was particularly irksome.

As things stand now, Bonn's Economics Minister managed to save a major part of German specialty steel

capacity from coming under the quota system. All pipes, railway track, and tin plate are excluded from the system, and all companies producing less than 2,000 tons of special steel per month are excluded. In addition, German producers are to be guaranteed 32.25 percent of the European market, more or less matching the 32.6 percent they had in 1974. Then, of course, they were producing 53 million tons, whereas today they are only producing 44 million, and the overall reduction in production under the quota system is to amount to 18 percent retroactive to Oct. 1, 1980.

Even this EC Commission package, put together after one week of consultations necessitated by the British-motivated demand that special steels be included, would still be in renegotiation if Chancellor Helmut Schmidt had not gotten on the phone with Margaret Thatcher.

'A sledgehammer repair'

According to spokesmen for the German Association of Iron and Steel Producers, the commission's quota system hasn't a prayer of working. "This system is like trying to repair a precision watch with a sledgehammer," they say.

The first objection is that it will be virtually impossible for the commission to effectively monitor whether or not the various quotas for individual companies—which will be kept confidential—are being held to. Second, even if the next eight months are used to initiate modernization and rationalization programs in the rest of Europe (and the deepest doubts apply, of course, to England), such programs could not produce tangible results by June 30, 1981. Third, while a mere contraction of European production is expected to increase prices by 10 to 15 percent and thus undercut the intra-European price war, it is argued that this will exert powerful suction for cheap imports from outside Europe. Either the commission will find its own plan undermined, or it will be forced next to apply import restrictions, and risk a global protectionist chain reaction, further hindering and constricting world trade.

German strategy on the block

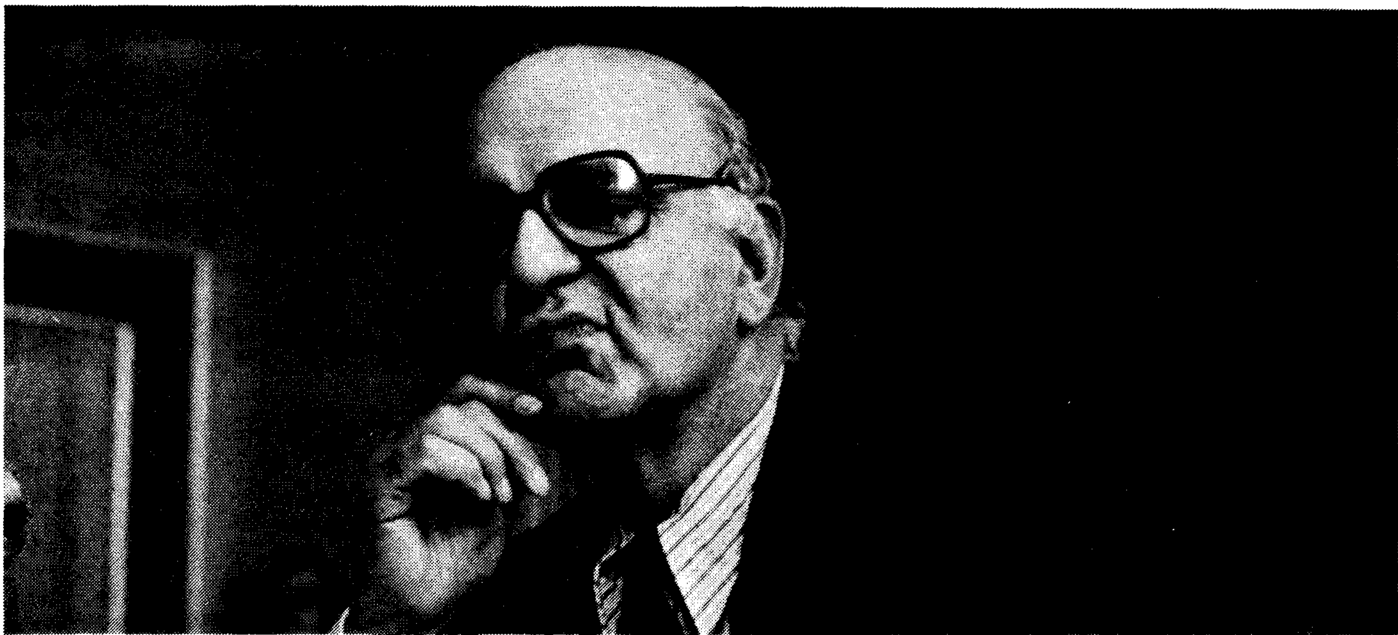
The mood in the German steel industry indicates that producers are going to dig their heels in and hold the line. Their basic problem, however, is that if they can neither find customers and financing for a forced export drive, nor access to capital to finance additional modernization investments, their productivity edge is going to dwindle, and the markets for which they designed their state-of-the-art steel technologies just will not exist. In the coming months, the issue will be whether or not the political chieftains of the steel producers step forward in support of implementing the expanded European investment credit facilities of the European Monetary System in its Phase Two. As Dr. Ruprecht Vondran, chairman of the German Association of Iron and Steel Producers stated in a speech just before the EC decision, "Standing still when you're swimming against the stream is tantamount to backsliding."

If that political challenge to move into Phase Two of the EMS is met, German steel producers are well-equipped to meet the challenges they see resulting in a net steel scarcity globally as early as 1983, even if the total highest conceivable world capacity of 900 million tons (from 1974) were utilized at 100 percent.

As noted above, German steel plant has been nearly totally replaced in the last 10 to 15 years. Between 1960 and 1976, the Thomas process which accounted for 40 percent of crude production has been totally phased out. In 15 years, the number of Siemens-Martin furnaces has been reduced from 180 to 30, and ought to be reduced to zero if modernization investments regain momentum. A full 75 percent of German crude steel is produced in oxygen blast furnaces, and in 1979, 20 percent of crude block steel was produced in electric furnaces. Major efforts have been made to introduce continuous casting, which today accounts for 40 percent of cast steel production—even more major investments will be required to catch up with Japan in this area. For a company like Krupp Steel, this means that fully two-thirds of all production facilities will have been totally replaced with the most modern plant over a decade.

Did this effort to boost productivity result in lowering the break-even point? No one can say for sure, because all this modern plant and equipment has hardly been set loose to do what it was built to do—supply steel for high-technology oriented industrial nations and steel-hungry industrializing developing nations. The investments of the past 10 to 15 years haven't had a chance to pay off.

For the time being, however, most of the additional investment in modernization are being shelved. ESTEL-Hoesch has decided not to build a new 500 million DM oxygen blast furnace to replace three old Siemens-Martin furnaces. The argument offered is that it just does not make sense to invest in expanding capacities at a time when the EC is restricting production. But in fact, since the plant would not come on line for about two years, the decision reflects a basically shaken confidence in the future. Instead, "innovation" is directed toward price-saving measures, useful in themselves, but hardly a solution to the crisis. Industry sources indicate that this tendency toward filling the "efficiency gaps" will accelerate under the EC quota system, and there is even speculation that the industry will put the Bonn government to the gun for subsidies if additional labor force or capacities threaten to be idled as a result of the quota's squeeze.



"Watchful observers tend to ask themselves whether Volcker and Miller are merely incompetent or downright insane."

– **Lyndon H. LaRouche**
Contributing editor, *Executive Intelligence Review*

When Federal Reserve Chairman Paul Volcker introduced his credit control policies last year, the EIR was quick to sound the alarm to the danger of "Dr. Volcker's horse liniment." The Volcker package would not be anti-inflationary, EIR warned, but would carry the "Friedmanite stagflation" of the Nixon years to extremes.

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