

Summary of the Japanese Views on Steel Industry and Trade Policy*

by

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1. Overview on steel industry promotion

We, on the Japanese side, conditionally support Viet Nam's effort to designate steel as a national industry, aim at partial import substitution, plan a new integrated steelworks (NISW) as a long-term goal, and realize these objectives under restrained import protection. The condition for our support is that Viet Nam should implement these with sequencing and methods that are realistic and concrete. It will take a long time for Viet Nam to learn steel production technology and operational know-how appropriate for international integration. At present, Vietnamese enterprises do not possess sufficient technology or management skill, and the Vietnamese government lacks a proper policy framework or crisis management capability. It is risky to try to promote capital-intensive industries, including the steel industry, without simultaneously strengthening domestic capability. We urge Viet Nam to use the rather difficult process of steel industry promotion under international integration as an excellent opportunity to improve domestic capability. In promoting the steel industry, we do not consider it proper to give it a very special priority status, well above other candidate industries (however, moderate support on a par with other industries is acceptable). Even in the case of import substitution, a strict criterion based on efficiency and international competition is required.

2. Timing of construction of an NISW

In strengthening the steel industry, Viet Nam should adopt a gradual and

* This document summarizes the common view at this moment of the Japanese members of Trade and Industry Group (Kenichi Ohno, Nozomu Kawabata and Fukunari Kimura) based on intensive consultations with the concerned members of General Commentary Group (Koichiro Fukui and Takao Aiba) and a JICA expert (Nobuyoshi Tanaka), and the results of Intensive Steel Seminar in Hanoi, October 2000, and Hanoi Workshop, December 2000. It is drafted by Kenichi Ohno.

two-track approach. That is to say, rather than immediately starting to construct an NISW, Viet Nam should initially build relatively small-scale facilities independently from the proposed NISW—such as a cold rolling mill (CRM), a hot strip mill (HSM) and billet centers—at appropriate sites and step by step (the first track). Only after making adequate preparations and gaining sufficient experiences, Viet Nam should seriously undertake the construction of an NISW mainly during the 2010s (the second track). One possible scenario of NISW construction which we regard as appropriate entails the following: start port construction and land preparation around 2008, complete a CRM and an HSM around 2013, complete the first blast furnace (BF) around 2017, and complete the second BF around 2021. The “Base Case” presented by VSC is also a two-track approach, but it proposes to build an NISW at a much accelerated pace than what we regard as suitable.

We recommend the two-track gradualism above for the following reasons:

- (i) By extending the construction period, annually required financial resources will be reduced and the experience of steel promotion can be accumulated. These will in turn facilitate the mobilization of domestic and foreign resources, which will have to be very large eventually.
- (ii) An NISW is a huge and concentrated technological complex. Viet Nam needs a sufficient learning time before it can acquire operational and management skills.
- (iii) The menu of technology available to Viet Nam is always changing and expanding. To maximize the degrees of freedom, Viet Nam should select technology over time, rather than making irreversible commitments for the entire projects at the outset.
- (iv) Adequate room for adjustment must be preserved in order to respond effectively to possible negative shocks, such as global recession, regional crisis, sharp falls in international steel prices or deterioration of the domestic economy. Should an extremely adverse situation emerge, Viet Nam also needs the flexibility to postpone the construction of an NISW for a certain period.

3. The role of the first hot strip mill (HSM1)

In view of the above consideration, we do not take the position that HSM1 should be constructed as a prior investment to the future NISW. Now that Phu My has been selected as the site of the first cold rolling mill (CRM1), we recommend that HSM1 should be built on the site adjacent to it. If HSM1 is deemed as a prior investment to an NISW, its construction is subject to inadvertent delay since an NISW itself may face difficulty in raising funds or other problems and be postponed. For a timely establishment of the domestic supply capacity of flat products in line with growing demand, we consider it

important to build HSM1 separately from and in advance of an NISW. Inter-process linkage can be ensured by locating CRM1 and HSM1 on the same site. As to the problem of stable supply of slabs, it must be noted that slab imports will be necessary anyway, regardless of whether HSM1 is built separately from or together with an NISW, until two BFs of an NISW are completed and steel-making capacity is greatly enhanced. To ensure stable sourcing of imported slabs, we recommend long-term contracts with countries which are likely to have excess capacity in slab production. In addition, it may be worthwhile to study the possibility of EAF-based slab production. (As for HSM2, it can be constructed as the same site as an NISW.)

4. Usability of domestic raw materials

We recommend a full-scale feasibility study (F/S) on the usability of Thach khe ore. However, we are already informed that this ore suffers from high zinc content and is not suitable for BF use, and that it will also be difficult to develop due to geographical and geological reasons (deposits are located from and up to 400-700 meters below sea level, requiring vast draining). For the purpose of realizing efficient BF operation under international competition, the extent to which Thach khe ore can be used in BF is impossible to judge at the moment. Usability, required investment and operational costs should be evaluated by a full-scale F/S. If the outcome of F/S is unfavorable, importing 100% of raw materials and deciding not to exploit domestic mines becomes a plausible option. Generally speaking, domestic raw materials should be used only if they are equal to internationally best materials in terms of quality and cost. Any compromise in quality or cost of raw materials will seriously endanger the survivability of the industry under international integration. This is true not only with raw material procurement but also with the location of the NISW or selection of technology as discussed below.

5. Location of the NISW

Regardless of whether raw materials are 100% imported or partially domestically supplied, the NISW should be built on a newly developed coastal site. To guarantee international competitiveness, Viet Nam must select a site suitable for building a deep sea port in Middle Region and use a large specialized vessel to transport raw materials. Inland areas, including Thai Nguyen, are not appropriate for building an NISW due to the permanent handicap in additional land transportation cost. When iron ore can be transported from Australia to Japan for \$6/ton, the current land transportation cost of \$6/ton or more between Hai Phong and Thai Nguyen is too large for financial viability.

6. Selection of technology, production capacity and product mix

Viet Nam should avoid both outdated equipment and untested frontier technology. Instead, it should select “state of art technology” from the set of “proven technology.” We call this the “fast-second approach.” At the level of individual production facilities, capacity must be sufficiently large to ensure operational efficiency. At the national level, the total output should cover only part of the domestic demand. We recommend partial import substitution because it enhances efficiency and crisis response capability. Under partial import substitution (compared with full import substitution), it is easier to maintain high operation ratios in the event of negative shocks. Moreover, technical integrity among different processes must always be the primary concern in making investment decisions. In transfer of technology, random buying of cheapest equipment should be avoided; instead, a comprehensive technology transfer contract covering basic design to stable operation should be concluded. As to the product mix, what to produce must be selected carefully based on the size and characteristics of domestic demand and avoidance of head-on clash with foreign exporters offering extremely low prices.

7. Financing

Financing is a problem common to all projects, but the difficulty is particularly severe in the case of an NISW requiring huge capital. We recommend the pursuit of joint venture (JV) arrangement (MOI and VSC have announced that 100% foreign investments in steel will not be permitted but JVs are acceptable). JVs are helpful since they share financing, risks and crisis management with the Vietnamese side. In order to attract FDI, however, investment plans must be realistic and concrete and Viet Nam’s ability to promote the steel industry must be dependable in the eyes of foreign partners. It should also be recognized that foreign partners are often in pursuit of their short-term commercial interests, and not the national interest of Viet Nam. As noted above, singling out the steel industry as the top priority among all industries and pouring a large amount of scarce national resources into it is not advisable. Such excessive promotion would also militate against the industry’s own effort to improve competitiveness.

8. Additional investment in TISCO

The first rehabilitation plan for TISCO looks reasonable, but we doubt whether its second rehabilitation plan is really necessary. As stated above, inland TISCO lacks the

conditions to become a steel industry center in the 21st century. Minor repairs to improve efficiency and to cope with the employment problem are desirable, but larger amounts should not be invested in TISCO. For the purpose of minimizing the social impact, TISCO should be allowed to survive as a small-scale steel plant located near raw material supply, as long as low-cost materials continue to be locally available. The idea of locating an NISW in Thai Nguyen must be abandoned.

9. Production of special steel

Special steel is characterized by great diversity, small lots and high quality (with the possible exceptions of structural steel and high-carbon steel produced in relatively large lots and with similar compositions to ordinary steel). We do not recommend building a special steel plant at this time since Viet Nam's domestic demand for this kind of steel will be too small for efficient production in the foreseeable future. Except for the items noted above, special steel should be imported.

10. Export orientation

MOI and DSI suggest steel exports as a target along with import substitution. However, the Vietnamese steel industry is too fragile to become a viable exporter in the competitive and demanding international market (beyond the current tiny exports to neighboring countries such as Laos and Cambodia). We regard import substitution as an appropriate target for now. Even with production for the domestic market, international competitive pressure can be used effectively as an incentive for productivity improvement. The important thing is not how much the industry exports, but whether it is exposed to international competition. Overly ambitious attempt at exporting may even run the risks of excessive investment or selecting the wrong product mix from the viewpoint of the domestic market.

11. AFTA and WTO policies

(i) International integration cannot, and should not, be avoided. Viet Nam should accept a free trade regime in principle. Each industry should take this as given when it conducts (forward-looking) new investments or (backward-looking) consolidation and closure of existing plants.

(ii) Deviation from AFTA (0-5% tariffs by 2006) may be permissible if it is only for

a small number of industries, temporary and the tariff rate is only moderately high. Before conducting such a policy, however, concrete and realistic promotion strategies for the proposed industries must be presented. If no such strategy exists, Viet Nam will be unable to negotiate with AFTA or WTO with “ownership.”

(iii) In WTO accession negotiations, MFN, “national treatment” and “transparency” must be strictly observed. On the other hand, there is room for negotiation in “market access” and “convergence of economic institutions.” For these demands, Viet Nam should decide whether or not to accept them individually and from the viewpoint of economic principles.

(iv) Viet Nam should consider the possibility of using WTO-consistent subsidies (satisfying non-specificity) as a means of selectively supporting domestic industries.

(v) Viet Nam should prepare “anti-dumping duties,” “counterveiling duties” and “safeguards” as defense measures against cheap exports from CIS or regional crisis. It must be noted however that these are short-term emergency measures and should not be confused with medium- to long-term industrial promotion policies.

(vi) At present, countries applying for WTO accession are facing demands which are more strict than those for existing LDC members, and some of these demands are unreasonable. It is advisable for Viet Nam to cooperate with countries in similar situations to make an appeal to international organizations and developed countries for fairer treatment.

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