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STATE SUBSIDIES – INCONSISTENT WITH FREE ENTERPRISE?

Last month's *American Metal Market* carried a story about Mississippi's efforts to land a new mini-mill to be built by SteelCorr. This campaign included more than \$100 million of incentives, including \$37 million in outright grants by the state and localities and \$85 million of construction overrun loans at the state's cost of capital. The plant is supposed to cost \$650 million.

This is not a new development. For decades, steel producers have benefited from all sorts of incentives offered by states and localities to start new operations or to keep existing ones open. Nor is the phenomenon limited to the steel industry – Intel is being courted by Arizona and Oregon offering property and income tax cuts worth tens of millions of dollars each year to benefit a proposed new plant. The company already enjoys the fruits of a New Mexico industrial revenue bond that are worth an estimated \$2 billion. Meanwhile, China, Singapore and Malaysia are dangling free land and tax holidays as bait. (Ireland was for a time in the game, with an incentive package worth \$225 million, but the EU authorities blew the whistle on that one.)

According to Mississippi development officials, the SteelCorr project is to employ 450 workers at salaries averaging \$70,000 per year. (According to the US Bureau of Labor Statistics, the average annual wage in Mississippi in 2002 was about \$26,000 and \$30,000 in the manufacturing sector.) Arkansas was another candidate for the plant but lost in the bidding war. Nucor has opposed the state assistance package and underwrote a study by an economics professor who challenged the financial projections on which the project is based.

These state subsidies for business ventures lead one to question our country's professed commitment to the free enterprise system. It may well be that the realities of interstate and international competition may make these bidding circuses inevitable. However, if so, we need to reexamine our understanding of the economic principles we are working under. As a start, the politicians who promote these kinds of subsidies should be made to show that they are at least aware of the harm they can cause to competing companies and to anyone else competing for the same resources of the state.

On that note, it would be best to turn to some steel market specifics:

- Scrap. The recent price declines continued unabated in the last month. Number 1 dealer bundles and #1 busheling (Chicago) were both at \$242 per mt in early March. This represents a drop of almost \$200 per mt since last November. These declines may be due to the efforts of scrap users to seek alternative sources – lower cost “obsolete” scrap, pig iron and DRI. Sales (and imports) of these substitutes have been increasing dramatically.
- Pig Iron. Bucking the trend in scrap prices, pig iron went up last month. The spot price for Brazilian pig iron (CIF New Orleans) rose \$15 to \$310 per mt, still below the \$350 range that held from last July through January of this year. Reasons for price firming might be purchases by US users looking for substitutes for scrap and increased buying by EU companies. Pig iron is sold for dollars and is thus less expensive to Europeans buying with euros. Iron ore prices are heading up in 2005 – last month I reported that the Brazilians had announced a 90% increase, and now the Australians have told their Japanese customers to pay 71.5% more. Chinese demand appears to have motivated these increases.
- Ocean Freight. This cost component also climbed last month. The Baltic Capesize Index rose to 6605, an 11% increase. These rates are many times what they were only 18 months ago.
- Natural Gas. The Nymex Contract price in early March was \$6.68, another increase. These prices are still well below last November’s \$8.75, but, given the record crude oil prices and the cold winter, they are probably headed upwards for a while.
- Exchange Rates. The budget and trade deficits, plus growing concerns about the willingness of foreigners to finance those deficits have weakened the dollar again. The euro is again trading near \$1.35 and the pound reached a new modern high of \$1.93. The Canadian dollar is also headed up.
- Pricing. There has been a softening of sheet prices in recent months, but most observers attribute it to an overhang of inventory during last year’s boom market. As these inventories are working off, prices should firm, if the economy continues to improve. China’s exports were down in January, and US steel prices are about the same as world prices, so imports may not provide a downward pressure on prices, once supply and demand is adjusted in the marketplace.

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