THE HINDU
Online edition of India's National Newspaper
Tuesday, Aug 23, 2005

Opinion

Posco venture: capital investment or exodus?

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The Orissa Government's memorandum of understanding with the Korean steel major, Posco, means that, among other things, India is set to alienate a billion tonnes of iron ore in favour of a global competitor.

THE LATEST *denouement* in India's globalisation and the consequent open-door policy drama is the opening up of its underground treasures, literally. The most important of the *dramatis personae* to enter the scene are the global mining and manufacturing companies eyeing India's hitherto protected mineral wealth. At least for some of them, survival depends on access to cheap and plentiful raw materials from convenient locations. From a purely business perspective, this *denouement* should have been a consummation devoutly to be wished for. It would position India as a supplier to be wooed and, therefore, in a position to call the shots.

Under the circumstances, the most recent twist in the mineral resource drama — where the country is set to alienate a billion tonnes of iron ore in favour of a global competitor — seems to be not a little curious. Not since the aborted sale of the Bailadila mines has any mineral-based deal created such a furore as the Government of Orissa's memorandum of understanding with the Korean steel major, Posco (Pohang Iron & Steel Company Ltd.) has done. Nor has any other deal been backed by such a massive propaganda as the one drummed up to position it as the biggest-ever foreign direct investment in the country. Between the lines, there emerges a different story — one that may well mean the largest ever exodus of wealth, estimated at some Rs. 200,000 crore, from the State and Central exchequers, on the conditionality of privileged pricing being offered for the Korean.

There are facts of the case. There is the economics of the deal. Further, as in everything Indian, there are emotions around it. To deal with emotions first: even conceding the compulsions of the "reforms era" in India, the country and its development should have the first right on its resources.On a simple logic of equity, the first right to resources should go to well-run public sector or government entities; the second should lie with well-run existing domestic companies using a specific raw material; the third rightful claimant should be new players with sound financial, environmental, and ethical credentials (because mining is necessarily an environmental issue), preferably for industries being planned in backward regions of the country; and so on. Handing over mineral resources of a billion tonnes on an approximate discount of Rs. 2,000 per tonne on the market price to a Korean rival surely defies all logic.

Is any dramatic technology being brought in? The answer is `no.' Thus far, Posco's Finex technology is an unknown quantity. Have any other steel-makers in India — the Steel Authority of India included — been asked to invest in any State on the terms Posco has been? The answer is `no.' Are the investment numbers — Rs. 51,000 crore for a 12 million-tonne plant — dramatic enough to warrant such massive concessions? `No' again. In fact, the numbers seem to be inflated; according to independent industry estimates, the consolidated investment by the Korean steel major should not exceed Rs. 40,000 crore. The final question: is India in a position to export iron ore at a Rs. 2,000 per tonne discount to ensure that a global rival survives? There is no need for an answer to this.

The iron ore needs of a developing country such as India should be assessed on the basis of its projected demand for steel rather than its current levels of steel consumption, which are necessarily low and for obvious reasons; it is 30 kg per capita as against China's 220 kg per capita, for instance. Even conservative estimates place the expected per capita demand for steel over a two-decade period at around 200 kg. It would be myopic, to say the least, for the country not to husband its iron resources from a long-term perspective, especially because global sources of iron ore are limited to around 10 countries and some small players who account for around 32 billion tonnes. India's own reserves are not too substantial at 18 billion tonnes, and its projected requirement, assuming 250 million tonne steel consumption over the next 25 years, will be around 300 million tonnes a year. This should double to 600 million tonnes of domestic iron ore offtake from 2050-2060. Once again, the question whether India can afford such generosity with its scarce iron ore reserves answers itself in the negative.

The wealth of arguments against India signing the deal is only matched by the wealth of reasons in favour of Posco going all out to grab this deal. Posco's most critical business concern in its bid to remain among the lowest cost steel producer — on which its globally competitive advantage lies — is access to raw material. For all its technological excellence, Posco is hamstrung by the absence of iron ore in Korea and it has been striking strategic alliances globally. This is to ensure that it has control over raw material, especially since iron ore prices doubled last year, threatening its plans of being the lowest cost steel producer in the world.

The ideal situation for the Korean steel major is to secure access to captive iron ore mine from any willing source. It first made a try with Brazil. Posco had an understanding with CVRD (Companhia Vale do Rio Doce) for setting up an integrated steel plant to produce slabs at Sao Luis, a port city in northeast Brazil. The ore was to come from the Carajas mine, but CVRD refused to include the mine as a part of the joint venture, which was asked to buy ore from CVRD at market price, literally defenestrating Posco's cheap resource plan. Enter Orissa, which agreed to a mining lease for a billion tonnes of iron ore to supply Posco's Indian operations and "sell or export surplus ore to domestic and foreign consumers." The Posco-India project plan presented in April 2005 envisages the export of a "minimum 10 million tonne/year of captive iron ore for Posco steelworks in Korea."

Posco's demands would have been hilarious had they not been so serious and on the verge of being granted: "[the] Government of Orissa to guarantee legally clean and quality commercial reserve of 600 million tonnes iron ore for captive mine for steel plant; Guarantee export surplus iron ore [10 million tonne/year] for steel plant to Posco works [Pohang, Gwangyang] in Korea [by specifying it on MOU]." How does Posco come up with the iron ore surplus? "Iron ore resulted from the gap of construction period between steel plant and mine; unbalanced amount of ore between the consumed and the produced amount of iron ore needed for blending in steel plant operation; Surplus iron ore [fine/lump] resulted from the process [blast furnace/Finex]; Iron ore equal to the amount of imported coal for steel plants." The demands get more strident: "Mines granted by Government of Orissa ... [are] expected to take a long period of time for development ... therefore, mines which allow prompt development are required." Additionally, Posco wants "grants of additional 400 million tonne iron ore for efficient development of mines by economy of scales and for the investment in coke plant and infrastructure."

Backdoor exports

The spate of criticism against the export clause was overcome by the simple expedient of Posco saying the high alumina Indian ore would not suit its technology for Orissa and getting the Government to agree to a swap of Indian iron ore for low alumina ore that Posco would be allowed to import. In other words, exports through the backdoor. Even a modest understanding of steel technology makes it clear that iron ore can be beneficiated, which indeed is the practice adopted by all countries with quality issues around their iron ore. The solution that demands carting millions of tonnes of iron ore to and from Orissa seems outlandish in this day and age.

Experts point out that the Orissa ore is low in phosphorous. Since the phosphorous in iron ore joins in the iron-making process and has to be removed during steel-making, it is entirely possible that the clue to the expensive ore exchange operation lies here. Indian ore is of very high quality; there are few suppliers globally who can match its low phosphorous content. Access to Indian ore would be a sweetener for easily available ore from other continents.

Two other morbid terms stand out.

First, Posco will be given land for the port and rights to iron ore through prospecting licences even before making any investments in the plant. It will be required to complete the plant in 36 months from the date all relevant clearances are with the company. Meanwhile, the prospecting licence will be in hand. This is something not permitted for Indian companies; they must commence work without any iron ore guarantees.

Secondly, the Posco project will come under the aegis of a Special Economic Zone (SEZ) with all the concessions on offer for such projects, including exemption from customs duty on capital goods and raw material imports, as well as other exemptions and reimbursements of Central sales tax. The Orissa Government release places the revenue expectation from the project at Rs. 1,15,000 crore over 30 years. However, given that SEZs are meant to be for development projects, the rule of the thumb says revenues range between 10 per cent and 15 per cent, which should peg them at around Rs. 17,000 crore in this case.

The simple question India will need to answer is: Is Orissa the richest State in South Korea?

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