

# Mining firms impose huge price hike on Chinese steelmakers: a sign of global inflation

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On February 22, Brazilian mining giant Companhia Vale do Rio Doce announced that Chinese steelmaker Baosteel, in negotiations on behalf of the Chinese steel industry, had accepted a price hike of 65 percent for iron ore. The move followed a February 18 agreement between Vale and Japanese and Korean steelmakers, Nippon and Posco Steel, who also agreed to a 65 percent price increase.

While Baosteel indicated that it would grant similar price rises to the other main iron mining firms—Anglo-Australian firm Rio Tinto and Australian giant BHP-Billiton—Rio Tinto has refused to conclude negotiations. It is seeking a minimum 71 percent increase, with a price rise of up to 100 percent for top-grade ores.

On February 25, Baosteel, the largest Chinese steelmaker, announced that it would raise prices for both hot-rolled steel coils and cold-rolled steel by 800 yuan per ton (20 and 16.7 percent, respectively)—far more than the approximately 400 yuan per ton that market analysts had calculated would be needed for Baosteel to pass on the iron ore price increase to its customers.

Yang Baofeng, an analyst at Orient Securities, told the *China Daily*, “The price hike [for steel] is beyond my expectations and is likely to boost the company’s profits.” Baosteel had apparently already increased steel prices by 10 percent since the beginning of the year. Baosteel shares rose slightly (0.28 percent) to 17.67 yuan on the news.

To a significant extent, these remarkable price increases reflect the widely varying market power of the different industries. The highly concentrated iron mining industry—in which the top three producers, Vale, BHP-Billiton and Rio Tinto, control over two-thirds of world production, largely from mines in Brazil and Australia—can essentially dictate terms to the steel industry, which is far more fragmented. The top 10 steel firms produce 29 percent of the world’s steel.

*China Daily* quoted analyst Hu Kai as saying, “The steel price hike is likely to aggravate inflation, because it will lead to a chain reaction of higher prices for cars, home appliances and equipment that relies heavily on steel as a raw material.”

Despite Baosteel’s ability to pass on higher iron ore costs to its consumers, Chinese steel executives have complained bitterly during the negotiations, which started in December 2007. At that time, Luo Bingsheng, vice-chairman of the China Iron and Steel Association (CISA), denounced increased shipping costs for Brazilian iron ore to China as “unusual and unreasonable” and as having “gone beyond an acceptable level.” He also proposed that the Chinese government set up an iron ore reserve to insulate Chinese steelmakers from high prices on iron ore spot markets.

On February 21, Baosteel announced that it had formed a joint venture with the China Shipping Development Company to ship iron ore to its factories and reduce shipping costs.

Last week’s iron price hike is only the latest in a series of price rises in recent years. According to figures published in the French daily *Le Monde*, prices have increased 176 percent over the last five years, with price rises of 71.5 percent, 19.5 percent, and 9.5 percent in 2005, 2006, and 2007.

Despite claims that price rises reflect the increasing strain on mining companies to meet Chinese construction firms’ demand for steel, it is clear that the massive price hikes are being imposed to fatten the mining firms’ already immense profits.

According to the companies’ income statements, published by Dow Jones Market Watch, from 2003 to 2006 Vale’s operating revenues went from \$5.4 billion to \$19.7 billion and gross operating profit from \$2.5 billion to \$10.1 billion; BHP Billiton’s operating revenues went from \$22.9 billion to \$39.5 billion and gross operating

profit from \$10.3 billion to \$26.1 billion; Rio Tinto's operating revenues went from \$9.2 billion to \$22.5 billion and gross operating profit from \$4.3 billion to \$15.2 billion.

The mining executives' frame of mind was aired in an October 2007 piece in the *Sydney Morning Herald*, provocatively titled "The Big Steel." Noting that China's construction boom led it to build "from scratch a city the size of Brisbane every month," it commented, "Australian mining executives are well aware of their new-found bargaining power. They are using ungentlemanly words like 'blood' and 'bodies.' They say they will tear apart a global negotiating framework that has been in place for 40 years.... Concepts of 'fairness' will have nothing to do with what Chinese steelmakers will pay for Australian ore. It will come down to supply and demand."

The rise in iron ore prices is only part of a far broader rise in basic industrial and agricultural commodities over recent years. According to figures compiled by the Insee (France's National Institute for Statistics and Economic Studies), the world market price for the Goldman Sachs Commodities Index (GSCI)—a basket of basic commodities including coal, industrial metals, grains, cotton, wool, coffee, sugar and precious metals—tripled between mid-2002 and late 2007.

Again according to Insee statistics, 2007 saw sharp rises in world market prices of most GSCI commodities, particularly wheat (59 percent), soybeans (44 percent), corn (44 percent), coal (36 percent), nickel (54 percent), paper pulp (18 percent), and cocoa (25 percent). This has particularly impacted China, whose massive cheap-labor manufacturing base depends on large-scale imports of food and basic industrial raw materials.

Commenting on the driving forces of the speculative bubble in raw materials, analyst Alexandre Mirlicourtois of the Xerfi market research firm wrote: "The explosive developments in raw material prices have only the most tenuous links with the real economy.... The real reason for the commodity bubble is investors' growing concerns—about real estate, the solidity of the banking system, growth in the industrialized economies, about the stock market—which make them redistribute funds towards financial vehicles that are weakly correlated to traditional asset classes."

In short, the world bourgeoisie, as it seeks to preserve its profits from the instability afflicting more traditional investments—stocks, bonds and real estate—is inflating the value of daily necessities beyond the financial reach of large sections of the world working class.

Even as the foreign mining firms and the Chinese steel industry agreed to a 20 percent increase in steel prices, Chinese inflation figures released for 2007 showed a 7 percent rise in prices—the highest rate in 11 years. Food has been particularly affected (up 18 percent), with a 59 percent increase in the price of pork, a staple meat, and a 37 percent increase in the price of cooking oil.

Sections of the bourgeoisie are increasingly concerned about the social consequences of these developments. Société Générale's chief Asian economist, Glen Maguire, remarked to *Le Monde*: "Periods of strong social instability in China have always followed inflation in food prices."

The US financial crisis is also feeding inflation in Asia and the Middle East. The Chinese financial and real estate sectors have been flooded with US money (so-called "hot money") seeking to profit from higher interest rates in China and the general expectation that the Chinese yuan will rise against the dollar. This flood of cash has contributed to further rises in Chinese price levels.

There are also growing concerns among US financial authorities that Chinese inflation could spread to the US, increasing prices for financially strapped US consumers. These fears were underlined in an October 2007 speech by former Federal Reserve chairman Alan Greenspan in London, where he warned that "the ability of China to continuously suppress the world general price level is beginning to run into trouble.... It was truly a golden age and it is in the process of being over. Inflationary pressures are beginning to mount."



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