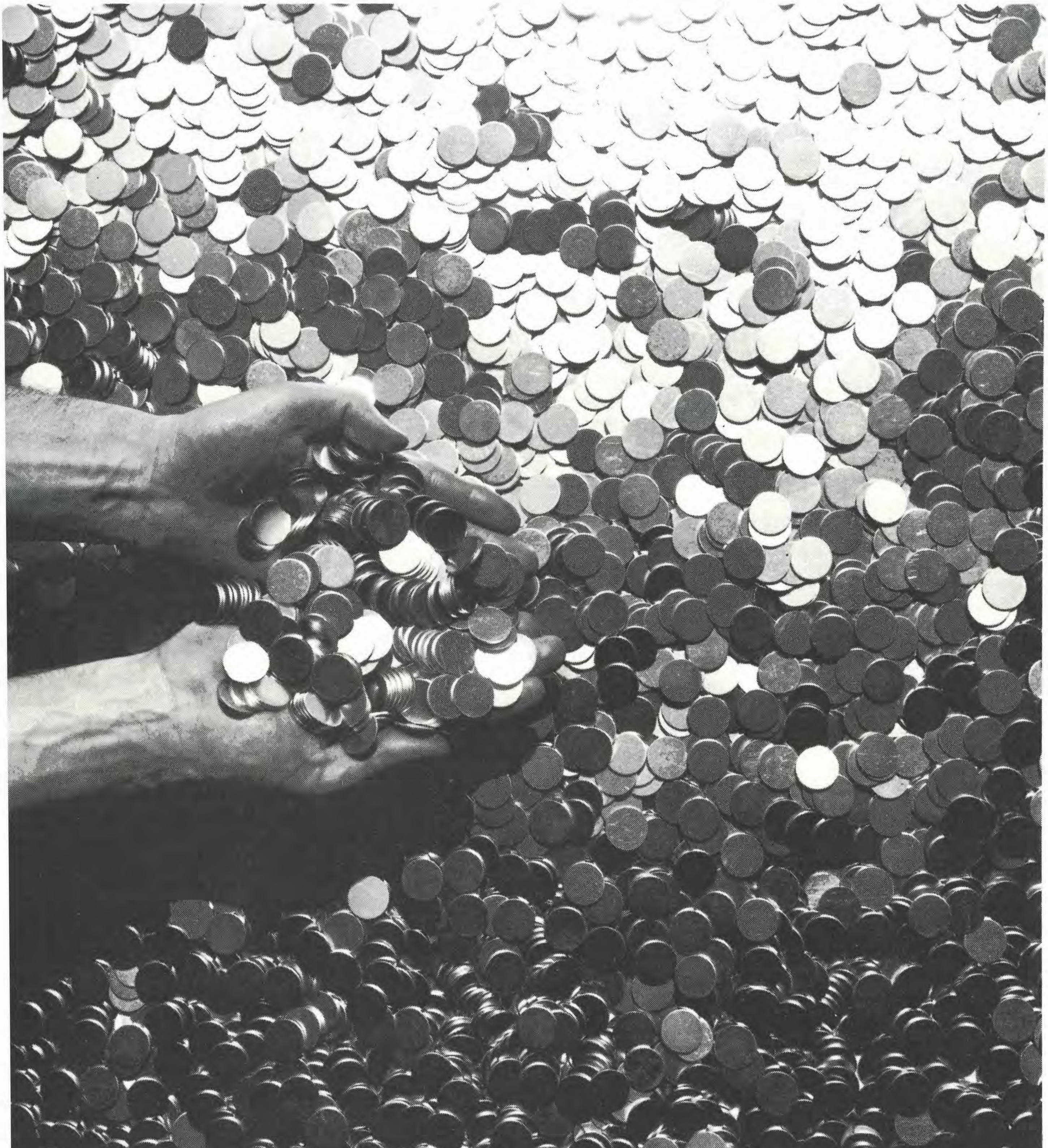
Close-up of an inspector's hands handling annealed planchets. Sherritt Gordon Nickel Refinery, Fort Saskatchewan, Alberta.



COMMODITY REPORT

The world nickel market – a North American perspective

By Peter Warrian

Canada is the leading producer of nickel in the capitalist world. It is also the host country for two of the largest nickel TNCs, Inco and Falconbridge. In this perspective developments in the Canadian nickel industry are of crucial importance to the future of the world nickel markets. Peter Warrian analyses the background to the current deep crisis in the nickel industry, looks at the strategies adopted by the Canadian government, the companies and suggests a way out of the crisis.

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Peter Warrian is Research Director of the United Steelworkers of America (USWA), Canadian Division.

Address: USWA National Office, 55 Eglington Ave. East, Toronto, M4P 1B5, Ontario, Canada.

The deterioration of nickel prices has been caused by the world recession triggered last year by the high interest rate and restrictive economic policies led by the Reagan administration in the United States, and endorsed by the Canadian government and others throughout the industrialized countries. The level of unemployment, fear and uncertainty has caused consumers to hold back and save their money, with the result that we have an all time record savings rate of 13 per cent. If people don't buy, then companies don't invest, with a result that there has been a 12 per cent drop in overall business spending on investment and a staggering 25 per cent drop in investment in manufacturing. This is the heart of the downward spiral in the Canadian, and North American economy.

In addition, prices have been undermined and held down by actions of certain foreign producers such as Botswana and the Philippines which sell nickel below cost to earn foreign currency and maintain employment. The indebtedness and threat of default on loans to international banks, has created pressures on these countries to almost virtually produce at any price. Further, increased sales by the Soviet Union and Cuba at low prices have resulted, in the view of a number of analysts, in the USSR displacing Inco as the largest nickel deliverer into the European market. The USSR also needs foreign currency to pay for the Pipeline and grain purchases.

Inco and Falconbridge dug in at their official producer price of 3.20 USD in the first half of 1982, while spot prices dropped dramatically. As a result the Canadian producers lost a critically important share of the market. Inco, which 1981 accounted for 32.5 per cent of total world nickel consumption, is estimated now to be producing 20 per cent. Falconbridge, which last year had 10 per cent of the world market, has watched its share drop to 5 per cent.

At a price of 2.40 USD per lb, analysts believe Inco's operating costs would be covered, without taking into account depreciation and financial changes. Falconbridge's costs would not be met. Even at these price levels, markets have been disrupted by dumping. The interventions of the Soviet Union and Cuba have been referred to above. Amax has dumped up to 100 million pounds onto the market, undercutting all other prices. The phenomenon of social subsidization continues and expands, one of the latest examples being the decision of the Philippine's government to assume the costs of Marinduque's interest of foreign debt this year.

In summary, it is not too much to say that the nickel market has been 'politicized'. The more obvious examples are the interventions of the Socialist countries into the international market and the political decisions in Third World countries to continue and subsidize production regardless of price and cost. Taken together, these have created the downward spiral of nickel prices an end to which is not yet in sight. It is a situation of 'beggar thy neighbour' competition for shares in a contracting market. To turn the market around toward growth requires a reversal in economic policies in the industrialized countries away from high interest rates and cutbacks, and onto a path of economic stimulation and growth. Given the sheer size and importance of the US market, the policies of the US administration is pivotal. Politics is in fact determining the head and the tail of the market.

Long term market situation

The long term view of the world nickel market has become unpredictable and erratic. However, the more pessimistic views have been more often right than wrong.

For much of this century there has been a steady, but slow growth in nickel consumption. As the lower left section of the following graph shows, there was a sharp rise in nickel consumption from the early 1930s to the early 1940s, associated with new uses of nickel alloys and war production. There was an even steeper rise in production from the late 1950s through the 1960s, associated with a boom of capital investment, a catch-up of consumption in Western Europe and Japan to levels of the USA, and war production for Vietnam.

The crisis in world nickel markets and production in the 1980's was set by events and decisions in the 1970s. The rapid growth of nickel consumption in the late 1950s and 1960s was taken by almost all private and government forecasters as a permanent trend in the world economy. As a result, as the second diagram indicates, growth rates of 6 per cent were projected onward and upward towards the year 2000, creating impossibly high expectations. The United Nations (UNCTAD) itself projected world nickel production of 4.5 Mt by the year 2000. At the same time that these forecasts were made, public opinion was made scared of scarcity through the famous Club of Rome Report ('Limits to Growth') which pictured the world running drastically short of natural resources. The case in point in everybody's mind was the world oil scare.

What was ignored was the fact that by the late 1960s, there was beginning to be a flattening of the demand for nickel products. The economies of North America, Europe and Japan were reaching something of a saturation point in consumption of steel products, the largest single outlet for nickel production. There was, and still is, a long term slow down in the so-called 'mature industries' such as steel and auto, in North America and Western Europe.

While ignoring these facts, there was a large rush into new nickel production in the 1970s, particularly in the lateritic deposits of the Third World, such as Guatemala, Indonesia, Dominican Republic, etc. The myth of 6 per cent + growth still hung over the discussions of the Law of the Sea Conference at the United Nations. The result has been the current crisis of over-capacity in the 1980s.

The most consistent contrary voice has been the Ontario Ministry of Natural Resources. Since 1977, as the chart indicates, they have been projecting much lower rates of growth. The current projections of the Ministry are for a dismal 0.5 to 1.5 per cent in the first half of this decade, and *perhaps* a 2.0 to 3.0 per cent growth in the second half of the decade.

As the third graph shows, in the top section, the highest real price for nickel were achieved in 1902, when everything is placed in 1967 dollars and offset for inflation. Nickel prices through the 1970s were, in real terms, higher than any time since 1902, with the exception of the first three years of World War I. During the 1970s there was a small dip in 1974 and a more severe dip in 1978, but in 1978 the real prices only sank to the level of the early 1930s. A significant fall in the real price of nickel from the 1970s level, is a real possibility in the 1980s.

An additional, and serious, complication in the world nickel market which is already in a crisis of over-capacity, is the introduction of new capacity in the Third World and in the Socialist countries. There have been new capacities recently installed in Colombia and in the Soviet Union. As the final graph shows, the percentage of world nickel production coming from North America has been falling continuously since the Second World War, while production from the Socialist countries has been rising. This presents a serious concern for the *future*, particularly in regard to the intentions of the Soviet Union and China, though it is *not* the cause of *present* difficulties.

World nickel production can be broken down into the following categories:

- Canadian production;
- 'Social production', that is from socialist countries and other countries where production is politically decided or subsidized.
- Other competitive producers.

These account for the following shares of world production:

Canada	25 per cent
Social producers	30 per cent
Other competitive producers	45 per cent

These pessimistic remarks on the world nickel market, must however be qualified in several ways. The low projections for growth assume only a 2–3 per cent growth in Western economies for the next decade and are based on current restricted government economic policies. A low 1–2 per cent growth is assumed for the Soviet Union, Eastern European and Third World economies. The Third World countries who installed major new capacities in the 1970s and have been subsidizing 'social production' through the subsidies in recent times, may not be able to sustain these activities in the 1980s. The indebtedness and recent defaults in the Third World means that financing of development, replacement of equipment and operating subsidies may be limited and capacity will have to be reduced. Finally, it should be kept in mind that the operating producers in the Third World are often the same corporations, like Inco and Falconbridge, that are producing in Canada.

A financial analysis of the TNCs

High financial charges as well as substantially reduced nickel prices caused by weak demand and over-supply were the main causes for *Inco's* poor operation results in 1981 and have continued to plague it during 1982. Financial charges on long-term debt have more than doubled since 1977. Table 3 shows the dramatic rise in the interest expense over the period 1977–1981.

In an attempt to reduce this expense, Inco Ltd. decided to halt its diversification program and refocus its attention on its base metals market. The first and most obvious subsidiary on the chopping block became Inco Electro Energy Corporation. As a result of this policy reversal, the company during 1981 sold the following subsidiaries of Inco Electro Energy. – Universal Electric Company, Inco Safety Products Company and Willard Africa – for a total of 70 M USD.

Earlier this year, Inco signed a letter of intent to sell the US, European, Canadian and Far Eastern operations of Ray-O-Vac to ROV Industries, a private company. A price was not disclosed for this deal. In continuing its efforts to bail out of the battery business, Inco Ltd. of Toronto recently signed a letter of intent with Spectrum Group Inc. to sell Exide Corporation. Exide, with operations in Canada, the United States and Mexico, is the major unit of Inco Electro Energy Corporation. It is expected that Inco will receive at least 205 MUSD – an amount consistent with previous estimates. Reportedly, the deal also includes provision for Inco to retain approximately 30 per cent equity interest in Exide. The exact equity holding will depend on the company's performance on closing the deal.

In addition to the sale of assets, Inco Ltd. raised 89,898,864 USD in cash by selling 6,900,000 common shares and 3,450,000 warrants. Of this amount 72.4 MUSD was used to reduce total debt held by the company.

Other reorganizational moves have included reduction in capital spending, implementing technological change, salary freezes, major reductions in the workforce and extended shutdowns.

In reviewing the position of the company in July, Mr. R S Maloney, an analyst with New York-based Wood Gundy Inc. said Inco has shown "not a bad performance at all in the current recession". Speaking on Inco's cost cutting program, Mr. Maloney said "A lot of people have been overemphasizing its financial problems".

However, since that time, the price of nickel has been declining and expected gains have not materialized in the face of heavy international competition for reduced markets. The company has relied mainly on extending shutdowns, selling from nickel inventories and a resumption

Fig 1
Review of nickel consumption forecasts

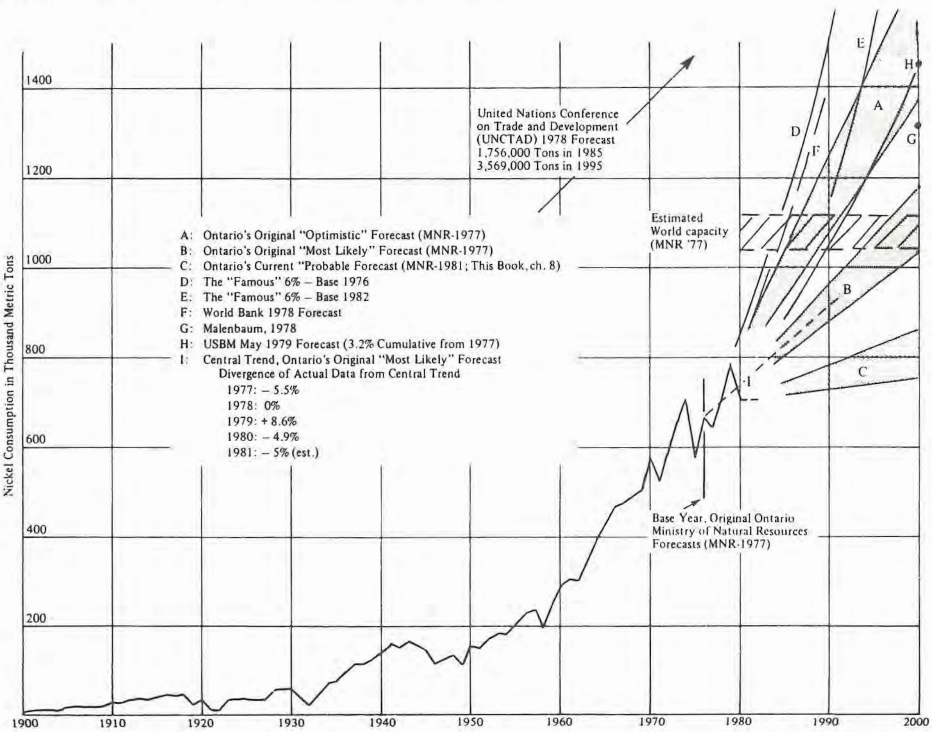


Fig 2
Changing nickel consumption forecasts

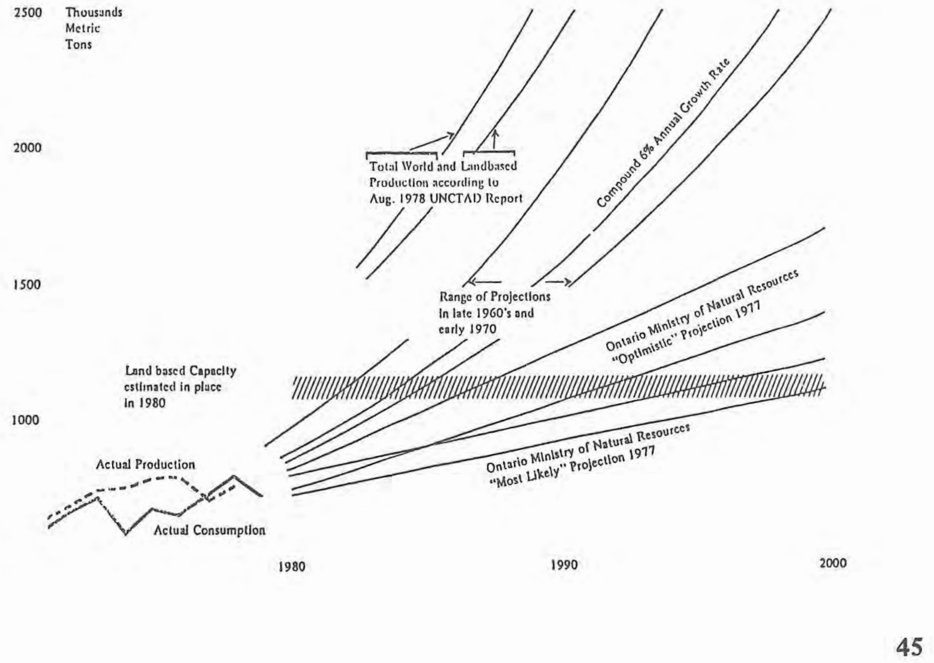
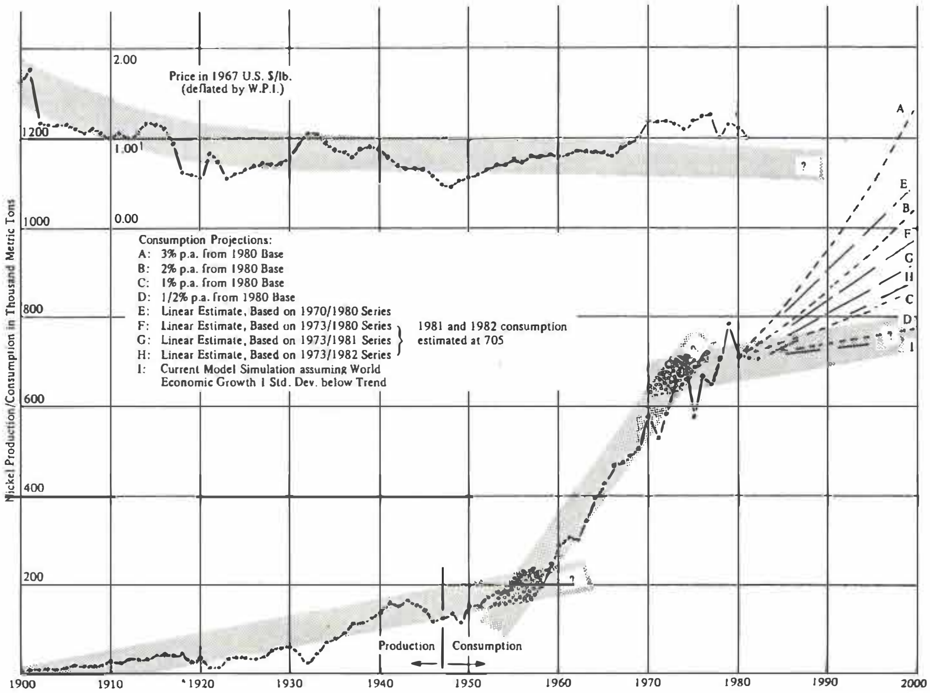


Fig 3
World nickel prices and consumption



of copper refining all as means for generating cash.

Unlike Inco, *Falconbridge* has not embarked on a major diversification strategy during the 1970s. However, in November 1981, the company borrowed 171,4 M USD to maintain liquidity through the recession. Long term debt jumped from 286 M USD in 1980 to 465 M USD in 1981. Since then the company has also been experiencing low metal prices, higher operating costs and dramatic increases in interest and exploration costs. As Table 4 indicates the interest expense has almost doubled since 1977 and the exploration expense has almost quadrupled over the same period.

In response to these pressures, the company has embarked on a program similar to other major nickel producers. It has deferred certain development projects, mothballed its unit in the Dominican Republic (although recently it has reactivited its facilities there), reduced its workforce, imposed salary freezes for non-union employees, demanded concessions from hourly-rated production workers and extended shutdown notices.

Falconbridge's total costs of production have been estimated to be 3.50 USD/lb. Placed against the estimated 2 USD/lb that most producers expect to receive, those costs are still high and the company expects to cut these costs even further. To meet these cost objectives, Mr. William James, president and chief operation officer will not discuss whether any further workforce cutbacks will be necessary. To date the company has announced that fourteen hundred jobs have been trimmed from the production workforce leaving a total of 2,600 workers.

Amax's recent moves to discount its price for nickel is a significant shift for the company's traditional posture in nickel markets. Since it was a producer, it has supported the producer price. When nickel markets began to turn sour, the company supported its shortcomings from profits in the molybdenum market. However, when the molybdenum market began to fall, Amax moved to cut nickel prices in an effort to reduce inventories. At that time their inventories stood at 60 million lbs. of matt and 50 million lbs. of finished nickel.

Hanna has put its operations in Riddle, Oregon on a standby basis until a significant upturn in the price of nickel has occured.

The importance of social costs in crisis decision making

Communities which rely on nickel markets are continuing to be squeezed as shutdowns are extended and jobs are permanently lost. Governments must begin to place more emphasis on the social costs of alternative policies selected to deal with this crisis as governments in other countries have done. It is unacceptable to view the crisis from a balance sheet perspective which doesn't include the wasted resources that are part of unemployment. Much more is at stake in Canada than just lost jobs in the nickel industry. By standing idly by while other governments are actively involved in maintaining their domestic nickel producers, we lose jobs, taxes and foreign exchange as well as seeing unemployment insurance and individual dislocation expenses rise dramatically. It is time to develop comprehensive short and long term strategies which recognize the importance of nickel to many large communities in Canada and to Canadians generally.

In the last nickel report, a number of short and long term strategies were presented for discussion. Some of these have become more urgent in respect of present market conditions. A brief summary of these is presented below for review and to help in developing a collective approach to our present problems.

Short term strategies

- Government should initiate a respite order or stockpiling subsidy program.
- Negotiate longer notification periods for lay-offs and shutdowns.

- Upgrade SUB to reflect the needs of the current unemployment levels.
- Advancement of 1983 vacation pay.
- Enforce no contracting-out.
- Upgrade retraining and relocation expenses for workers who are unavoidably permanently laid-off.
- Upgrade pension benefits to encourage early retirements. (Pensioners likely will stay in a community and add to the local economy. Young workers will move elsewhere).
- Lay-off time should be fully credited for pension purpose.
- Upgrade severance benefits.
- Investigate worksharing.

Long term strategies

- Tax Exempt Corporate Savings Fund

Governments should be pressed to amend the tax laws to allow companies to establish a tax exempt savings fund so that capital is available for measures to reduce or eliminate the negative consequences of lay-offs. During boom periods, companies must be encouraged to set aside part of their profits in counter-cyclical investment reserves. These funds would be used during periods of declining demand to pay for such things as retraining and relocation expenses of layed-off workers, work relief projects or for regional development purposes. Companies would have to apply to the government for permission to use the funds in any proposed program.

These tax exempt funds were initiated in Sweden in the late 1950s and research and evaluation indicate that these funds have promoted a more even development of investment through the business cycle. During the 1975 recession, more than 1 GUSD was released from the Swedish funds for investment purposes.

With such a fund, resources would be available when they are most needed. The political game of industry crying poor during periods of declining demand would no longer be an impediment to establishing needed relief programs.

Table 1 The supply/demand balance in primary nickel ('000 tonnes)

Production	**1980 Jan–Dec**	**1981 Jan–Dec**	**1982 Jan–Sept**
Canada	145.7	107.8	61.4
Japan	110.4	96.3	67.3
Europe	97.9	95.1	51.4
Other Non-Socialist Countries	191.5	189.9	116.1
Total	**545.5**	**489.1**	**296.2**
Change in producers' stocks	+59.3	+26.9	−0.9
Change in official stockpiles	–	–	–
Net Imports from Socialist	36.3	30	35
Total supply	**522.5**	**492.2**	**332.1**
Change in LME stocks	−1.2	−1.7	−0.4
Change in consumers' stocks	−15.6	+16	−5.5
Total Non-Socialist real consumption	**539.3**	**477.9**	**338.0**

Notes:

[1] Production figures are defined to avoid double counting of smelter and refinery products.

[2] 'Non-Socialist World' includes Yugoslavia but excludes USSR, Cuba, China and all COMECON countries.

Sources:

[1] Production: WBMS, Company and National Statistics
Consumption: USBM, USC, WBMS.
CRU Nickel Database.

[2] Figures underlined denote CRU estimates.
Forecast (July–Sept period)

Table 2 Inco Ltd
Six years financial review

Year	**Revenue**	**Net Income (000 USD)**	**Shareholders' Equity**	**Return on Shareholders' Equity per cent**
1977	1,953,328	99,859	1,914,829	5.2
1978	2,083,094	77,809	1,918,348	4.1
1979	2,488,543	141,725	2,006,255	7.1
1980	3,036,099	219,407	2,162,341	10.2
1981	1,885,900	(497,000)[2]	1,632,945	(30.4)
1982[1]	2,033,000	(66,400)	–	–

[1] For the nine month period ending Sept. 30th.

[2] Of this amount, 464.6 M USD represents extraordinary losses including 245,000 M USD in provision for losses on disposal of discontinued operations and a 219,638 M USD loss on revaluation of investment in Exmibal. The actual operating loss for 1981 was 4,880 M USD.

- Public Ownership and Astute Taxation Policies

Extraordinary profits created by Canadian workers are being used to finance projects in other countries which, in some cases, have proved to be a complete waste of money or have served to undermine Canadian workers' interests. Our role as hewers of wood and drawers of water has not been significantly changed by the federal government or any of the provincial Tory governments.

- Regional Development Policy Implementation

Many commissions, studies and task forces have looked into the necessity for regional development policies. However, most of the problems which brought about these studies still remain as pressing issues today. In fact, with the federal Minister of Finance's decision to phase out the tax-free status of special benefits to workers in Northern areas, it appears that we are actually moving backwards.

More aggressive action is required on the part of federal, provincial and state governments, to achieve more balanced economic growth for raw material sectors which are hardest hit by general declines in demand for goods and services.

These short and long term strategies can aid nickel workers and workers in all natural resource industries to gain more control over their lives both at home and at work.

- Implementation of Technological Change Policy

This policy, which was passed with overwhelming support at the 1981 National Policy Conference, deals with one of the most important issues facing workers in the 1980s. The policy focuses on two general avenues for effectively handling technological change:

1. Policies to make our members better able to deal with the consequences of technological change;

Table 3 Interest expenses (1977–1981)

	1977	1978	1979 000 USD	1980	1981
Interest on long term debt	66,251	75,917	133,718	156,485	147,130

Table 4 Falconbridge Limited
(Name change effective April 20, 1982)
Six year financial review

Year	Revenue	Net Income (000 USD)	Shareholders' Equity	Return on Shareholders' Equity per cent
1977	381,684	(8,985)	308,090	(2.9)
1978	508,211	5,500	383,895	1.4
1979	789,418	130,561	495,913	26.3
1980	757,815	109,122	581,141	18.8
1981	712,952	(9,024)	489,648	(1.8)
1982[1]	251,194	(29,086)	–	–

[1] For the six month period ending June 30th.

Table 5 Interest and exploration expenses (1977–1981)

	1977	1978	1979 (000 USD)	1980	1981
Interest Expense	28,221	33,690	36,085	39,112	51,344
Exploration Expense	9,726	7,662	14,297	28,284	37,964

Table 6 Amax incorporated
Six year financial review[1]

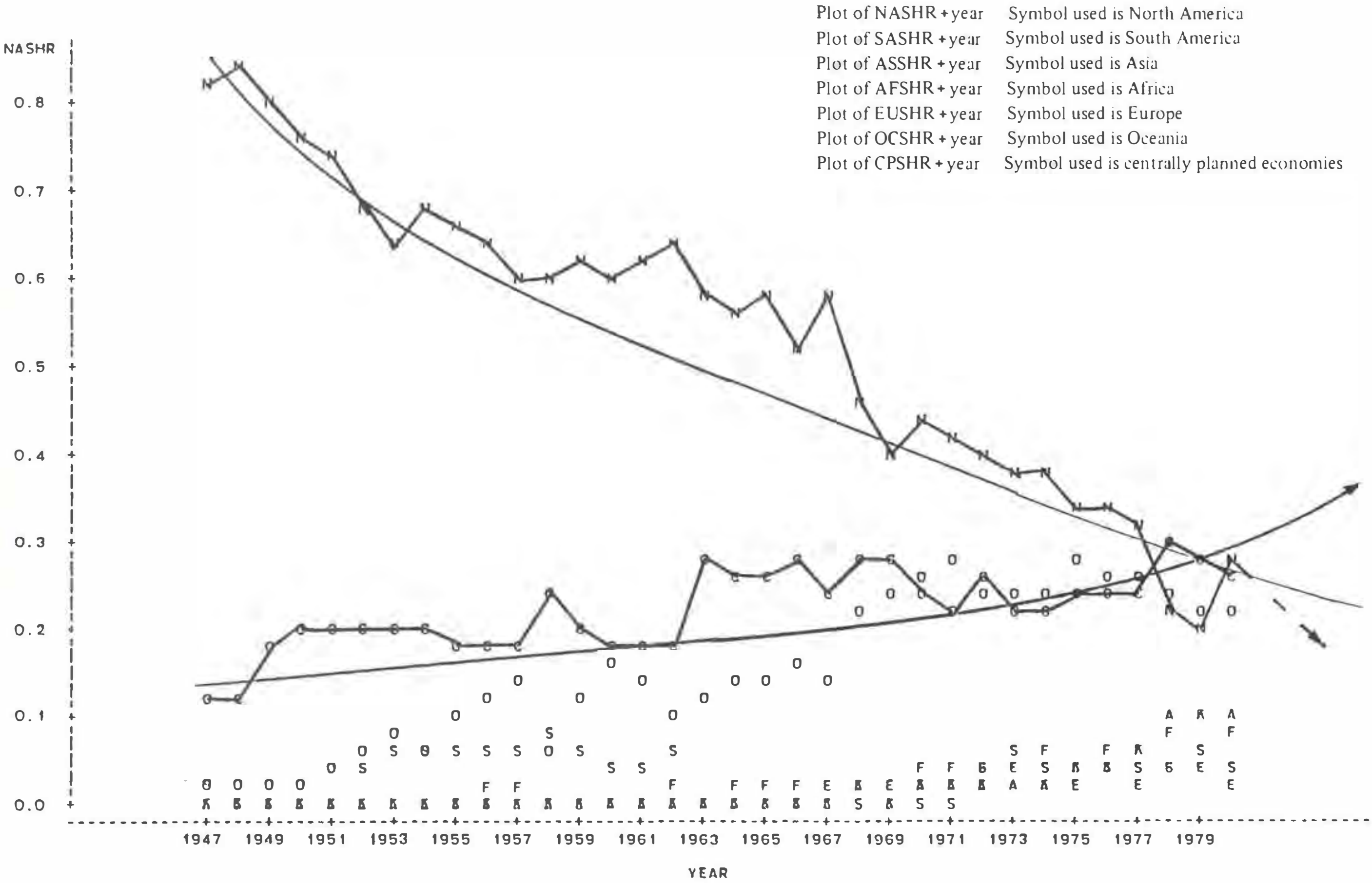
Year	Revenue	Net Income (000 USD)	Shareholders' Equity	Return on Shareholders' Equity per cent
1977	1,319,850	66,130	1,713,740	3.9
1978	1,727,290	160,010	1,873,590	8.5
1979	2,865,390	365,280	2,132,940	17.1
1980	2,949,170	470,390	2,719,490	17.3
1981	2,799,400	230,800	2,805,900	8.2
1982[2]	1,358,100	(48,500)	–	–

Notes:

[1] Consolidated statement includes results from all operations including Amax Nickel, Incorporated. The proportion that nickel operations account for in the above statements can not be determined from publicly available documents.

[2] For the six month period ending June 30th.

Fig 4
Percentage distribution of world nickel production



2. Policies to enable our members to influence the process of technological change itself, to deal with change before the consequences have developed.

These were translated into bargaining priorities to insure our members are informed about the introduction of technological change, that they participate in the evaluation, selection and adaptation of new technologies and finally that job security is guaranteed before, during and after technological change.

The policy also recognizes that political action is necessary if all workers are to be afforded the necessary protection against technological progress which can be destructive in the short run.

Through this policy on technological change, it is essential that a balance is struck between the need for progress and the need for economic security of our members; and between protecting our members from the effects of technology and enabling them to participate in the control of the process.

- Corporate Disclosure

Corporate disclosure should be upgraded to include more access to corporate financial plans for the future; public auditing of ore bodies; reporting of stockpiles; and the expansion of FIRA to review proposed exports of capital to determine net economic benefits to Canadians.

- New Economic Policy Directions

Pressure should be continued to get government to move off policies which support high interest rates and the consolidation of wealth among fewer individuals and corporations.

Instead, we should continue to demand an economic program which has job creation as its central theme. The stimulation of the economy through tax cuts and capital spending makes more sense than the concerted policy to precipitate and maintain a recession/depression economy.

Sources:

Globe and Mail
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Financial Times
Northern Miner
Metalsweek
Moody's Industrials
CRU Reports