

# U.S. Steel Industry at the Crossroads

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Although it may not seem like it now, the current depression in the U.S. steel industry might actually lead to a stronger industry in the future.

The American steelmakers have finally realized two important facts. First of all, that a steel shortage is unlikely. Secondly, that their production facilities are not competitive worldwide. These two realizations have led to the closure of old outmoded facilities and a concerted effort to improve productivity and decrease energy consumption. Technology is now being acquired, wherever available, to the extent that the domestic steelmakers have funds available and can justify the investment based upon investment return criteria.

All the major United States steelmakers have technology agreements with Japanese steelmakers. In some cases the benefits of this help have been spectacular. However, a lot more has to be done before the domestic steelmakers can again claim to be internationally competitive. For one thing, employment costs of steelworkers in the United States were 83% above that of steelworkers in the other industrialized countries during 1981 according to the U.S. Department of Labor, Bureau of Labor Statistics. During 1979, this wage premium was only 52%. Inasmuch as employment costs account for about 40% of the cost of making steel in the U.S., the extent of the problem becomes obvious. This is probably the key factor that must be addressed by the U.S. steelmakers if they want to become competitive and thus might lead to a major steel strike in the U.S. next August 1.

## Current Situation

During the third quarter of 1982, the operating rate of the U.S. steelmakers ranged around 40% of capability, the lowest recorded since the 1930s. At the current rate, steel production might be less than 70 million metric tons for the year, the lowest since 1946. Steel deliveries are like to total not much more than 60 mil-

lion metric tons compared to 79 million metric tons during 1981. Thus raw steel production during 1982 is likely to decline 35% from the 1981 level and deliveries decrease 24%. The difference between these two rates of decline is being made up by steelmakers liquidating their in-plant inventories.

We believe that approximately one-half of the decrease in deliveries has been due to steel users also liquidating their own inventories. The high interest rates of the United States have made it very attractive to use up inventories rather than to borrow funds from banks, etc. Apparently, steel users have found that they can run their operations with much less steel than they had thought before. Unfortunately, the U.S. government does not keep accurate statistics about steel user inventories so that estimates of the amount of steel held by the users tend to be only educated guesses.

At some point, the steel users will run out of what they consider to be excess steel inventories and will again have to buy as much steel as they are consuming. Thus, without any economic recovery, steel deliveries will have to recover about one-half of the 1982 decline. However, if an economic recovery sets in and steel consumption increases, then inventory levels might have to be rebuilt, which would lead to an even bigger rebound.

Most economists in the United States seem to believe that only a slow economic recovery is in the offing for next year, but that the second half of the year will be a lot better than the first half. If this forecast turns out to be realistic, then steel consumption is likely to increase a small amount, possibly 4%.

If steel users begin to take the steel strike threat more seriously, as we believe they should, then first half 1983 steel shipments might increase at a rate far above our forecast due to inventory rebuilding. Should a strike not occur on August 1, 1983, then a sharp reduction in shipments would be likely unless the economy has begun a strong recovery by that time. This

on again, off again business situation is not efficient for the steelmakers.

As far as steel employment is concerned, approximately 30% of the workers are laid off, with a lot of those not likely to be recalled for a long time, if ever. The facilities closed were the low productivity plants or parts of plants and are not likely to be reopened. Thus the number of employees on layoff exceeds by far the amount of capacity closed.

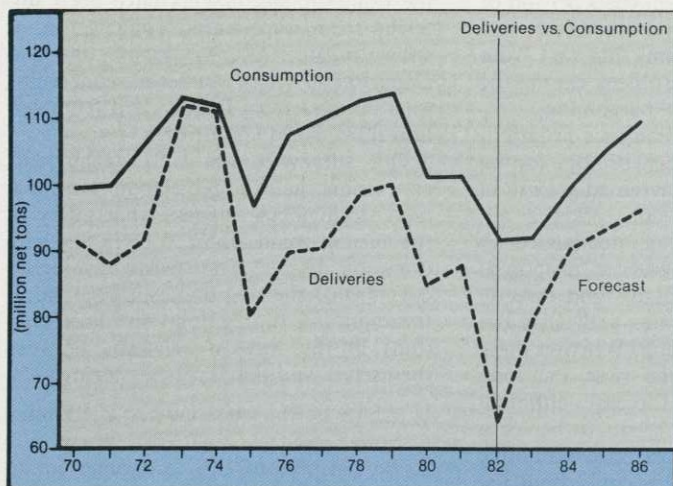
After the 1980 recession, steel industry productivity increased 9% during the rebound year of 1981. This was not due to improved equipment or more strenuous effort by the steelworkers, but was caused by the closure of some inefficient plants, the combining of facilities (so that the best parts of the two would act together as one plant), or by the elimination of some work rules that had inhibited the efficient usage of personnel.

With the current steel industry situation much more desperate than during 1980, even more has been done to improve efficiency. Where steelworkers have refused to accept company demands to become more efficient in equipment manning etc. plants have been closed entirely, such as in the case of the Fairfield, Alabama plant of U.S. Steel. In many other cases, the steelworkers realized that without more efficient equipment manning etc. the domestic steel industry would not be able to keep up with overseas competition.

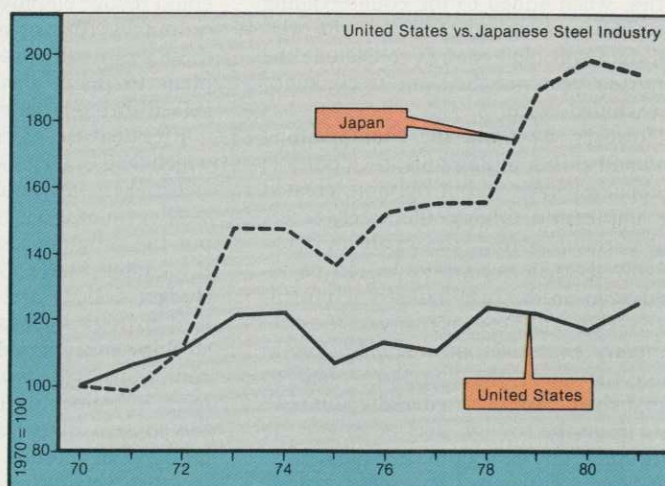
The steel industry and the United Steelworkers Union held negotiations during July to see if they could modify their contract so as to save the companies money, and to improve the job security of the union members. Unfortunately, the two sides could not come to an agreement, partly, we believe, due to union membership misunderstanding the real lack of competitiveness of the industry caused by excessive employment costs and unsatisfactory productivity. We actually believe that the industry demands of the union actually would not have corrected the problem, and the union offer was clearly unsatisfactory.



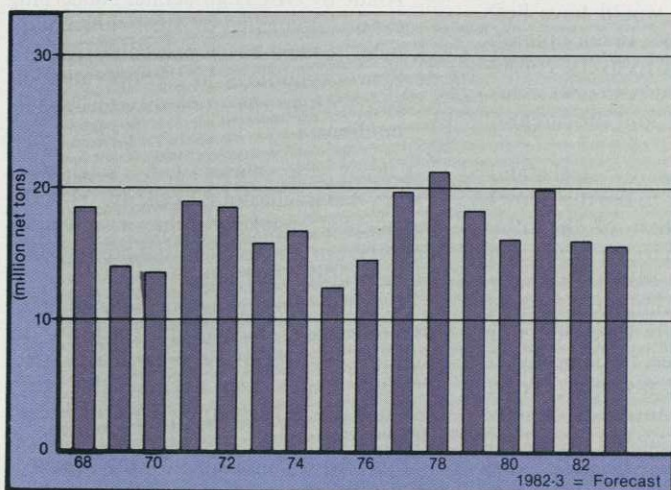
## U.S. Steel Industry



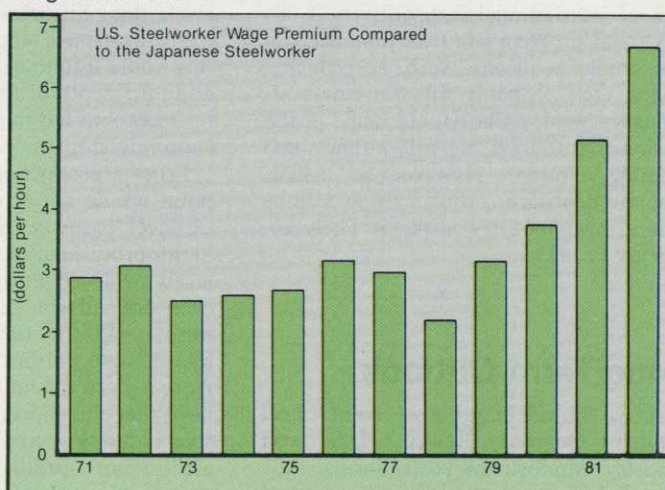
## Productivity



## Steel Imports



## Wage Differential



From a financial standpoint, even with the efficiency gains mentioned above, all the major integrated steelmakers will show large losses from their steelmaking operations during 1982. Some of these losses will amount to hundreds of millions of dollars for individual companies and will seriously inhibit their ability to modernize their operations. However, we believe that even if the domestic steelmakers had sufficient funds to modernize, the economic incentive would still be lacking due to an expected low profit (or no profit) level on the new equipment. Unfortunately, the cost of new steelmaking equipment in the United States, except for continuous casting machines, is so great that the saving the equipment would bring in manpower and energy would be less than the interest cost and depreciation for the investment.

Clearly, part of the problem has been the high interest rates of the United States, but part is also due to the inordinate delay in getting government approval for new plant construction, which dramatically increases the cost of construction.

The domestic steel industry attack on its overseas competition, primarily European competition, has not been overly successful in the U.S. Department of Commerce, which must rule upon the merits of cases as to whether or not the overseas competitor has been receiving subsidies, is guilty of dumping or has been selling below cost during an extended period of time. Of the countervailing duty cases that have received final Department of Commerce rulings, three major European steel exporting countries were essentially found to be free of significant subsidies and four were found to have been subsidized for some product exports. If the U.S. International Trade Commission rules that the four subsidized countries were also guilty of having caused material injury to the domestic steelmakers with their subsidized imports, then import duties ranging from 18% to 30% will be applied to their exports to the U.S. This would, in our opinion, stop the importing of the steel products in question since duties of these amounts would make the sales unprofitable. Any duties of less than 15% would probably be absorbed by the seller, in our

opinion. However, if the four "guilty" parties are stopped from these sales, there is nothing in any law that would stop the "innocent" from picking up much of the lost volume. We thus believe that at best, the U.S. steelmakers might have cut back imports by 500,000 tons.

The final rulings on the anti-dumping suits will not occur until December 31, 1982, but the preliminary rulings showed that the overseas steelmakers that supplied sufficient information to the Department of Commerce were generally found to be innocent of dumping except in minor amounts. However, those steelmakers that did not supply what the U.S. Department of Commerce needed in the way of information, generally had large proposed anti-dumping amounts because the Department of Commerce had to use the most adverse information in that situation. We therefore expect to see the anti-dumping margins reduced dramatically when the final rulings are made and recent currency values used in the calculations. Inasmuch as essentially the same countries were found "guilty" of dumping as were found "guilty" of being sub-



dized, we believe that the extra dumping duties, when added to the countervailing duty, will be meaningless because the original duty was high enough to exclude the imported steel and the same steel cannot be excluded twice.

However, by filing the countervailing duty and anti-dumping suits, the domestic steelmakers have, in our opinion, created the impression among the steelworkers that if the imported steel problem could be solved, then everything would be alright again in the steel industry. Unfortunately, this is not true as many of the steel company executives now realize, but in filing the suits, the companies had to blame their current "materially injured" state upon the foreign steel otherwise the suits could not be legitimately filed.

It is now apparent that excessive wage rates and unsatisfactory productivity are the real causes of the problem, namely the lack of international competitiveness. To solve that problem will take time because the simple solutions, such as reducing wages, etc., probably will not work, although a weak dollar would help. In the section that follows, we will outline some possible solutions. However, we believe that the near-term problem is so serious that a steel industry strike is likely on August 1, 1983.

## Long-Term Outlook

As we showed in our most recent "Steel Industry Quarterly Review," U.S. steel industry employment costs during 1981 exceeded those of the other major steel producing countries by 83%, compared to 52% during 1979. Domestically steelworker employment costs exceeded average manufacturing employment costs by 75% compared to a 26% premium for steelworkers in other countries.

In our opinion, high wage rates can only be justified by high productivity, but that is not resulting in the United States, as far as the steelworkers are concerned. Steel industry productivity in the U.S. is not as great as in Japan, Canada, Germany, Luxembourg or the Netherlands. In addition, a number of third world countries are making major strides in steelmaking with modern, efficient plants and very low wage rates.

Thus in order to have a long-term future, the domestic steelmakers must get their costs and productivity into line with the competition. This cannot be done easily, although a weaker U.S. dollar would help a lot. Wages must grow at slower rates than steelworker wages overseas, both in percentage and absolute terms. Fringe benefit costs must be reduced sharply, through less vacation time, etc. Work rules at the plant locations must be eliminated if they interfere with

the efficient use of personnel. This alone could reduce employment costs per ton of output by 10% or more. However, since these are usually problems that vary from plant to plant, this problem cannot be solved through national bargaining.

President Reagan's economic program, which held out a great deal of hope for the steelmakers, as far as increased growth in steel consumption, has not worked at all, but the program also was not passed by the United States Congress as proposed. Budget deficits are massive and directly lead to high interest rates and customer steel inventory liquidation. Whether these conditions will continue over the long term is impossible to forecast, although the consensus forecast seems to be for a rebound in interest rates once economic recovery gets going. This could limit the rebound in steel and permanently cause steel users to maintain lower inventory levels than historically would have been the case during a rebound. In our opinion, this would lead to a slow recovery, considering the depth of the current steel industry recession, but might limit the extent of future downturns.

From a production of raw steel standpoint, we do not expect to see the domestic steel industry, or that of the other major producers, return to the production levels achieved during 1973-1974. However, the advent of continuous casting raises yields by 10% to 15% and thus allows more finished steel to be produced from a given amount of raw steel. We believe that the shortage forecasts of some steel industry observers are not logical and are counter-productive because they encourage some producers to keep outmoded equipment in service because these plants "might" be highly profitable during a shortage. The latest such forecast that is making the rounds predicts a steel shortage in 1986, as opposed to 1983. We believe that such a shortage is highly unlikely and actually damaging to the outlook of the industry.

## International Competition

For the world's steel industry to thrive, we believe that competition must be fair. Natural advantages should determine where steel is produced rather than artificial subsidies or government import restrictions upon imports. The more efficient producers should gain market share and the less efficient should either close their doors or modernize.

In the case of the United States, conditions are not that simple. Not all steel companies are inefficient and a basic steel industry is necessary for the economic survival of the country. However, the least efficient plants must be closed and others

modernized. But while this is occurring the domestic steelmakers have been suffering from some unfair competition, as shown in some recent rulings by the U.S. Department of Commerce concerning steel imports from Europe and from certain third world countries.

Our survey of the U.S. steelmakers, concerning their thoughts about the Japanese steelmakers, suggests that many of the current trends seem to be in line with domestic desires. The "wish" list below covers what the U.S. domestic steel industry might like (based upon our interpretation) in the way of relations between themselves and the Japanese steelmakers.

1. Abide by the trade laws of the United States
2. Be sensitive to U.S. economic conditions
3. Even out product market shares
4. Abide by OECD guidelines concerning export financing of steel mill equipment for less developed countries
5. Share technology in a cooperative effort to help the domestic steelmakers modernize

Clearly the above U.S. steelmaker "wish" list might not make sense from the Japanese steelmakers' point of view in its entirety, but a number of the points could be helpful to both sides.

Since no countervailing duty or anti-dumping suits have been filed by the major U.S. steelmakers on major steel products, they must believe that they could not win such suits. This takes care of the first point.

It is next to impossible for the Japanese steel industry to comply with the second of the domestic steelmakers requests because steel industry forecasts in the United States have been so inaccurate over the years. For example, one major steel company economist projected 1982 domestic steel shipments at 97 million net tons. It is now clear that actual shipments will be significantly less than 70 million tons. Thus, if export plans were made, with the typical four to six month lag, a major increase in market share would occur, even if not intended.

The third point mentioned above might not make that much sense since economic reality makes clear that in some products, such as high grade seamless pipe, the Japanese steelmakers have major quality advantages.

It would also be difficult to stop less developed countries from obtaining modern steelmaking technology as there are a number of suppliers, not only Japan.

Technology sharing between Japan and the United States has progressed over the last several years to the point where each of the U.S. steelmakers has a technology link with one or more of the Japanese steelmakers. ●