U.S. Steel Industry Protection: Bad for America

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Introduction

A little over a year ago, Paul Wilhelm, President of USX, the nation's largest steel company, was on top of the world. Order books were full and 1998 shipments were already running 10 percent ahead of a banner 1997. "There's no reason why this market can't go on like this for a long time," he told the press.[1]

The steel industry is singing a different tune today. Companies have filed trade-throttling "dumping" suits against imports of hot- and cold-rolled sheet, and steel plate. West Virginia steelmakers are pushing Congress for bailout loans for their weak steel companies. A billion dollar tax break for the industry is making its way through Congress, with Administration support.

Of immediate concern, however, is one of the worst pieces of trade legislation to make its way into Congress since the Smoot-Hawley tariff of 1930. The United Steelworkers' union is pushing an extraordinarily protectionist bill through Congress. It calls for quotas to be set on every major category of steel imports (and iron ore), based on 1995-97 levels. This legislation (H.R. 975) has already passed the House by a veto-proof majority and will be acted upon by the Senate shortly.

Judging by all this action, you would think that imports were threatening to put every last American steel company and worker out of business. Nothing could be further from the truth.

A Resilient Industry

First, American-based steel companies are still producing at near-record levels. Steel mill shipments last year were 102 million tons, the second highest volume in the last two decades. Volume this year is likely to be close to last year's level, at slightly under 100 million tons. Employment, it is true, continues to shrink, as it has over the past two decades, as new investment and rising productivity reduce the required number of workers. But the 10,000 industry jobs lost in 1998 pale

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in light of the two and half million new jobs created elsewhere in the economy.

Second, last year's extraordinary conditions in international steel markets, which saw an upsurge in U.S. imports of finished products, are gradually disappearing. The East Asian financial crisis and the subsequent regional economic downturn savaged steel markets for Japanese and Korean producers, who then turned to the U.S. as an alternative outlet. Now, local demand is strengthening in many of the affected countries. At the same time, their currency exchange rates, which further encouraged exports to the U.S. in 1998, have strengthened, reducing somewhat Asian steel competitiveness.

Russian steel exports to the U.S., which surged in the wake of that country's financial collapse and currency devaluation, have moderated significantly. While import restrictions placed on Russian steel have certainly played a major role in reducing their shipments to the U.S., the pressures to rationalize a heavy industry organized on Soviet-era economics and accounting will have an increasing impact in the future, acting to further limit their exports.

Third, the U.S. continues to have some of the most efficient, technologically advanced steelmaking capacity in the world. In the past five years, the industry has added over 10 million tons of advanced new capacity—which, along with imports, has helped to keep steel prices under pressure.

Certainly, all domestic firms saw their profitability hurt by the upsurge in high-end steel imports in 1998.[2] And some steel firms are buckling under fierce competitive pressure. Their workers, shareholders and communities are being hurt. But this is largely the result of companies with aging plant and equipment, union-imposed work rule agreements that stifle productivity, slow-to-change management strategies, and poor geographic locations. Most of these firms have made major efforts in recent years to restructure themselves, but their competitors at home and abroad are changing even more rapidly.

Who Pays for Protection?

The trade-throttling measures making their way through Washington are designed to raise steel prices for steel-using companies that employ over eight million American workers. If these companies were able to pass on to their customers all of the cost increase (without losing any business) then the cost of protection will be borne by consumers. For example, if steel prices were raised by an average of $50 a ton, Americans would pay an extra $6 billion a year for the 120 million tons of steel consumed annually.

Of course, the critical assumption is that imports of steel-using products do not increase—which is clearly incorrect. Dumping actions against Japanese producers of semiconductors in the 1980s gave Japanese computer makers like Toshiba an extra edge in the U.S. market; protecting Georgia peanut producers against foreign competition makes importing peanut butter more profitable. In the case of steel, the entirely predictable result of raising trade barriers will be to give foreign competitors of steel-using industries (autos, appliances, steel fabricators, and the like) an additional incentive to export to the U.S. market.

Raising the costs of steel-using industries will hurt their ability to export. For example, Caterpillar is one of the country's leading exporters. It has come out strongly against legislation, such as H.R. 975, which will raise its costs and hurt its international competitiveness. It is particularly concerned that foreign countries will retaliate against steel-intensive U.S. exports, such as Caterpillar's earthmoving equipment.[3]

The Case against Quotas

Each of the weapons that steel industry protectionists are brandishing has serious flaws. Quotas would be exceptionally disruptive for many steel users (including some steel producers, since semi-finished steel products are covered under the legislation), as well as illegal under our international commitments to the World Trade Organization. As documented in the March 17 Congressional debate on H.R. 975, many companies—from Connecticut to Illinois, Texas, and the State of Washington—would find it difficult or extraordinarily expensive to import special grades or sizes of steel which are not made in this country, and which are vital to the products they make. A Congressman from the Pacific Northwest pointed out that, "When we built the trade center in Seattle, we needed a piece of steel to span the freeway to rest the building on. There was no place to buy that steel except Korea. That is where we bought it."[4]

More broadly, shifts in industry requirements mean that quotas based on 1995-97 levels will not reflect current operating needs of the industry or steel users. Furthermore, under a quota system of trade protection, higher steel prices mean that the foreign steel producers who are lucky enough to get quota allocations will be among the primary beneficiaries.[5]

A final point: over time, quotas are relatively easy to evade. Production shifts to countries not covered by quotas; certificates of origin are falsified or shipments are routed through uncovered third countries; additional processing transforms a product into a new, uncovered classification. Quota "leakage" or evasion is limited only by the ingenuity of the thousands of participants in global steel trade.

The Case against Dumping Legislation

"Dumping" suits are based on U.S. laws that make illegal what are perfectly acceptable pricing practices in domestic trade. Foreign producers, who temporarily sell below their full costs (including normal profit margins) in the U.S. market, or below prices being charged in their home market, are considered to be "dumping" and liable for punitive, retroactive tariffs if their action has caused injury to U.S. producers.

If this concept were applied to supermarkets, there would be no "loss leaders"; forget "end of season" clearance sales at department stores; advertisements promising "below cost" specials would be equivalent to public announcements of law-breaking, if competitors complained.

The original intent of dumping legislation was to protect buyers from "predatory" pricing. The theory was that a foreign competitor would drive domestic firms out of business by selling below costs, and then jack up prices well above their original level in the absence of any competition. Some countries' dumping legislation continues to reflect this concern for consumers of steel and steel-using products. Canada, for example, requires government agencies to formally consider the interests of consumers in dumping suits brought by domestic producers.

If the predatory pricing theory ever had any validity, it certainly doesn't in today's world. The spread of technology, combined with lower transportation and information costs, has vastly expanded the number of potential suppliers in most industries, including steel. Any attempt to raise prices above their competitive level by one or a handful of foreign producers will shortly see new competitors enter the market. If the number of suppliers is small and they attempt to collude in raising prices, anti-trust legislation makes such action illegal—and expensive.[6]

The U.S. steel industry has perfected the use of dumping suits, or just the threat of dumping suits, to keep foreign steel out of the country. A study last year by the *Wall Street Journal* reported that over a 20-year period, the steel industry filed 46 percent of all "unfair" trade complaints, even though steel accounts for less than 5 percent of U.S. imports. Over the past decade, the industry has lost 54 percent of its cases, compared to a failure rate of 48 percent in nonsteel cases.[7] But just filing a case is enough to stanch the flow of imports, since penalty tariffs are imposed on any imports after the complaint has been filed.

The one form of temporary relief available to industry, which is designed for the current situation specifically, addresses "surges" in imports. So-called Section 201 legislation is consistent with WTO rules and would permit temporary duties on a nondiscriminatory basis. But, with one minor exception, the industry has chosen to ignore this route for temporary relief in its search for "instant" results, despite Administration encouragement to pursue this approach.

The Central Problem

The world's steel industry is radically changing its structure, technology, managerial mindset, and sources of capital. Over 30 percent of American steel-related imports are destined for further processing by steel producers themselves.[8] The industry imports increasing amounts of foreign capital, innovative equipment, and technical know-how. Japanese, Korean, and Brazilian firms have made major investments in U.S. plants in California and Ohio; British Steel is a major investor in new American steel companies; Inland Steel is now owned by London-based Ispat (the eighth largest steel company in the world, with operations in six countries). Foreign-owned industry equipment suppliers and engineering firms in Pittsburgh employ more people than the handful of remaining steel plants.

Antiquated, overstaffed, poorly located capacity—whether in West Virginia, Russia, or Germany—cannot compete effectively in the long run against facilities that use newer technology, have better-organized workforces and are better located. At the moment, in a situation of global excess capacity, governments around the world have been slow to permit market forces to remove these obsolete but politically powerful units. However, governments' efforts should be on making exit from the industry easier, rather than trying to delay it.

Conclusion

Trying to slow or turn back the clock on the globalization of the steel industry hurts everyone. It threatens to hurt American steel's customers (encouraging them to look for alternative materials) and raise prices for automobile and appliance buyers, as well as anyone else who uses steel. But, equally important, erecting new barriers to steel imports impedes the necessary evolution of many firms within the industry itself. By removing the continuing pressure to implement changes being forced on them by technology, customers, and competition, they—and their workers and shareholders—will create even larger problems for themselves and taxpayers in the years to come.

If the Congress really wishes to encourage a strong, healthy U.S. steel industry, it can do three things: defeat the pending quota legislation, reform U.S. dumping statutes, and pass legislation to ease the burden of adjustment on workers and communities where obsolete facilities are destined to close.

Notes

[1]"Steelmakers Ride Crest of Demand," *Pittsburgh Post-Gazette*, May 21, 1998.

[2]The nine largest steel companies incurred an operating loss of $155 million in the first quarter of 1999, compared to an operating profit of $383 million a year earlier. Standard & Poor's *Industry Outlook*, June 12, 1999.

[3]See the letter from Caterpillar President and CEO Glen Barton, *Congressional Record*, March 17, 1999, p. H1358.

[4]Congressman McDermott, *Congressional Record*, March 17, 1999, p. H1355.

[5]Under its system for administering U.S. quotas on apparel imports, the Hong Kong government auctions off quota rights to local producers—and keeps the proceeds.

[6]The recent $725 million Department of Justice fine against two foreign producers of vitamins is an example of such action. *Wall Street Journal*, May 21, 1999, p. A3.

[7]*Wall Street Journal*, March 27, 1998, p. A1.

[8]Pig iron imports are included in this calculation.