Outlook For Steel: 'Mandatory' Shrinkage Underway

A number of leading investment banks, the U.S. government, and major U.S. steel companies have, in effect, made the decision to attempt to "rescue" the collapsing profitability of the industry and protect its long-term debt by shutting "excess," inefficient capacity and propping up prices.

BUSINESS OUTLOOK

A new study of the industry by Merrill Lynch, Wall Street's largest investment bank, recommends straight "Schacht" treatment — "mandatory" shutdowns of antiquated capacity and an end to the government's "de facto price controls" on steel.

The study is unusual in that it points to the advanced state of decay of the U.S. steel industry as the prime reason for its uncompetitive position vis-a-vis the modern Japanese industry. As such, the study conflicts with the white paper prepared recently by Putnam, Hayes and Bartlett for the American Iron and Steel Institute (AISI) which tries to blame the industry's lagging profitability on "dumping" by the Japanese and implicitly recommends protectionist import measures. Merrill Lynch recommendations, however, boil down to industry "rationalization," along the lines of the so-called Davignon plan now being implemented in Europe.

A Merrill Lynch analyst who helped prepare the study said matter of factly in an interview, "It would be good for the industry to get rid of the old capacity. It would force customers to keep higher inventories, it would raise operating rates in the remaining capacity, and it would improve profitability." The analyst added that U.S. Steel's projected $3 billion integrated Lake Eire steel plant "couldn't be justified to its stock holders — there's no need for that capacity." On issuing its new study, Merrill Lynch took all but U.S. Steel and Inland off its recommended stock list.

A series of interviews with steel industry analysts at Putnam, Hayes, and Bartlett; Arthur D. Little; and the Ford Foundation revealed that the Merrill Lynch position — that "excess," uncompetitive capacity has to be shut down — is widespread. Paul Marshall, one of the three authors of the Putnam-AISI study, criticized Merrill Lynch's analysis as "sloppy" and misleading. However, Marshall endorses the Merrill Lynch conclusion that the industry must scrap its uncompetitive capacity — even though he is pessimistic about the prospects for government action to spur capital formation in the industry. "There's a restructuring of the industry in the works...The net effect of government's independent actions (environmental regulations, failure to act on accelerated depreciation, etc.) is to make that likely."

An analyst at the Ford Foundation was even more emphatic. "You *hope* they're planning to phase out their uncompetitive capacity. That's what managers get paid for. But no management likes to shrink."

U.S. Steel itself is in effect carrying out Merrill Lynch's rationalization program. U.S. Steel along with Armco have made the decision to diversify in non-steel areas.

Early last week U.S. Steel laid off 800 workers (by the union's count) and put 2100 more workers on short-time at its 10,000 man Southworks structural steel plant in Chicago and is now operating only 2 out of 7 blast furnaces at the plant. The layoffs were expected because days before the layoffs were announced, U.S. Steel sent out letters to its suppliers telling them to suspend all further deliveries to Southworks; that the plant would only receive deliveries as they were needed. But on July 21 U.S. Steel announced that it was raising prices on structural steel and tin mill products an average of 6 percent effective Sept. 4. "That's a typical steel industry response," said the Ford Foundation's steel industry analyst. "Raise prices and lay people off. Reduce capacity and try to get a higher price. But Washington is going to clobber them when they come for import relief."

Washington is already doing just that, as a means for keeping the industry in line and helping along the rationalization process. A special OECD steel group has just begun discussions on the world steel situation; however, on July 20 Carter's Special Trade Negotiator Robert Strauss told U.S. Steel companies not to expect any help from the government on the import front. A day later President Carter and CEA head Charles Schultze responded to U.S. Steel's announcement of new price increases with disapproval. Otherwise, officials at the Treasury Department and at Commerce say they expect no government action on the industry's requests for tax breaks or relief from the present environmental regulations. Thus, the governmnet is de facto supporting the triage policy.

There may be some selectivity in this de facto policy, insofar as the consultant at Arthur D. Little who is preparing the environmental impact study for U.S. Steel's projected Lake Erie plant says there has been unusual cooperation between government agencies, both state and federal, and the company and its consultants to accelerate the impact analysis.

In general the Carter Administration appears to be doing everything it can to bankrupt sections of the industry. Carter's coal conversion plan, which is now breezing through Congressional committees and is scheduled to arrive on the floor of the House this week, would have a disastrous effect on the steel industry. According to testimony submitted last spring by the American Boiler Makers Association and others the cost of converting to coal-fired boilers would be enormous and save little energy. Moreover, the use of coal in present boilers would yield only 40 percent of the energy that oil or natural gas-fueled boilers yield. The only sensible thing would be to phase out old boilers and build modern coal-fired ones for the industry's steam generation needs — but how many steel companies are in the financial position to do that?

Rationalization Already in Effect

Alanwood, the small specialty steel producer in Eastern Pennsylvania, has filed for Chapter 11 bankruptcy. Inside sources say that two-thirds of the company's long-term debt is held by Prudential Life and the other third is held by Newark Life. Because of the miserable market for specialty steel, Alanwood was having trouble keeping up with debt payments, and the creditors threatened to pull the plug. Midvale-Heppenstall, which shut down its Philadelphia plant last year, postponed shutting down its Pittsburgh plant recently when its workers agreed to accept a wage cut. Phoenix, a third small Pennsylvania company, has shut down some of its operations. Bethlehem, the country's second largest company, which is heavily oriented to the capital goods and construction industry, has recently shut down a couple of its structural units. And U.S. Steel has just put workers at its Southworks structural steel unit on indefinite layoff.

An officer at the Commerce Department's iron and steel desk foresees an acceleration of this trend, come the next downturn. Unless there is a pickup in the industry this fall, he predicts widespread closings in the Mahoning Valley, south of Cleveland, where U.S. Steel and Republic plants are located; at Youngstown Sheet and Tube, and at Pittsburgh-Wheeling. "It's not an unhealthy thing...*if* we build new capacity." There is modernization underway at, for example, various company's Chicago plants, at Jones and Laughlin in Pittsburgh and at U.S. Steel's Alabama and Texas plants. However overall steel capacity is going to shrink.

New Steel Industry Studies

In addition to the New Merrill Lynch study, the Japanese Iron and Steel Exporters Association has answered AISI white paper charges that the industry is receiving special treatment. The Japanese steel industry, said Hiroshi Takano at a Toyko press conference last week, is the most productive, low-cost steel industry in the world because Japanese mills have pioneered the newest steel producing techniques. The big expansion in Japanese steel exports, said Takano, has not been to the U.S. but to the Middle East and Asia. In fact, the percentage of Japanese exports destined for the U.S. has dropped from 52.6 percent in 1968 to 20.1 percent last year. In contrast to the American institute, the JISEA foresees a serious steel shortage by 1980 unless other countries follow Japan's lead.

But as the Merrill Lynch study reveals, only one new medium-sized steel mill has been constructed in the U.S. in the last 15 years, compared to eight giant mills in Japan. Labor productivity is 50 percent higher in Japanese industry.

On modernization of the U.S. industry, Merrill Lynch makes the ludicrous proposal that all "de facto price controls" on steel be removed, allegedly to improve the industry's cash flow and boost capital formation. But under Wall Street credit policies, it would take a price increase on the order of 25 percent to raise sufficient funds for modernization and expansion in the steel industry today due to the inflated cost of capital goods. That sort of price increase, of course, would blow the rest of the economy out of the water.

The Merrill Lynch report also makes it clear that the U.S. industry has been living on borrowed time over the last several years. In 1973 Japan had a 30 percent cost advantage over the U.S. industry, largely because of its more efficient steel capacity. But the two dollar devaluations in the early 1970s and the OPEC price increase put Japan at a great disadvantage. Now the gap is back to 30 percent.

Conference Board Sees Slave Labor As U.S. Future

A report issued last week by the Conference Board, a prominent national businessmen's group, calls for slave labor to increase employment within the context of halting inflation.

SPECIAL REPORT

The report, which consists of the Fall 1976 speeches and panel discussion of the nation's leading Nazi technocratic "nuts and bolts" experts in the fields of manpower and national planning, recommends drastic measures.

Highlighted in the report is structural unemployment among youth, women, and minorities, with a proposal for shunting them into various forced work programs, with a heavy emphasis on labor productivity.

Typical is the recommendation of Eli Ginzberg, head of the federal National Commission on Manpower Policy. Ginzberg calls for revitalizing the Work Incentive Program (WIN) to employ welfare mothers at far below the minimum wage. "If you can offer them (WIN) jobs," Ginzberg reasoned, "then I want to begin pushing the people to take them."

As for reducing unemployment benefits, Ginzberg, a self-professed admirer of Adolf Hitler's labor policies, stated, "I want to take low-income people, who have been out of work for 15 weeks, and offer them a job at a modest figure ... a figure that would be 50 percent above the average unemployment compensation rates."