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Would Wage Concessions Help the Steel Industry?

Abstract

[Excerpt]The American steel industry is dying. 150,000 steelworkers are laid off, and thousands of them will never work in steel again. The steel companies will report losses of some \$2 billion for 1982, and Wall Street analysts predict— advocate—that as much as 20 per cent of the industry's primary capacity will be eliminated. The loss of steel jobs threatens more than a dozen local and regional economies with decades of Depression-like conditions. And the worst is not likely to be over soon.

Even though most people recognize that the primary cause of this situation is the misguided and mean-spirited policies of the Reagan administration, public opinion seems to have accepted a simple logic: If the industry is in such trouble, steelworkers should help it by granting concessions on wages and work rules.

Keywords

steelworkers, steel industry, concessions

Would Wage Concessions Help the Steel Industry?

by Jack Metzgar
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The American steel industry is dying. 150,000 steelworkers are laid off, and thousands of them will never work in steel again. The steel companies will report losses of some \$2 billion for 1982, and Wall Street analysts predict—advocate—that as much as 20 per cent of the industry's primary capacity will be eliminated. The loss of steel jobs threatens more than a dozen local and regional economies with decades of Depression-like conditions. And the worst is not likely to be over soon.

Even though most people recognize that the primary cause of this situation is the misguided and mean-spirited policies of the Reagan administration, public opinion seems to have accepted a simple logic: If the industry is in such trouble, steelworkers should help it by granting concessions on wages and work rules.

But it's not that simple. The immediate crisis in steel was brought on by Reaganomics' wild experiment with a government-imposed "free market." But the industry's root problems are deep, serious and long-term. They will not be solved by steelworkers' giving back what it has taken them more than 40 years to win.

In fact, though there are important differences among the various companies, in general any additional money the companies get through wage

concessions is more likely to stimulate them to get out of steel than it is to help save the industry. Concessions may help the companies, their managers and stockholders, but they will not necessarily help "the industry."

What is "the steel industry"? And who is in trouble when it is in trouble?

The steel industry is not simply the list of companies whose principal business is making steel. Among those companies, the worse things get in steel, the more likely they are to abandon the industry—the less likely they are to "throw good money after bad" by investing in the modernization program the industry so badly needs. No, the steel companies are not the steel industry. As its chairman David Roderick has said, "U.S. Steel is not in the business of making steel. It is in the business of making money."

Because the steel companies are not synonymous with the steel industry, the people who own and control those companies are not in trouble.

The top management of the companies, for example, is doing quite well despite the industry's troubles. Their total compensation (salaries, bonuses and other cash benefits) increased in 1981 from 17 per cent to 97 per cent. Their "wages" range from \$300,000 to over \$1 million a year. *Their* jobs are secure, at least so long as they

Annual Salaries, Supplementary Compensation, Fees, and Other Cash Compensation for the Top Executive Officers of Four Steel Companies

	1980	1981	% Increase
Bethlehem Steel			
Lewis W. Foy <i>Chairman of the Board</i>	\$452,403	Retired	
C. William Ritterhoff <i>Executive Vice President</i>	\$270,706	\$327,710	21%
Richard M. Smith <i>Vice Chairman of the Board</i>	\$248,201	\$349,284	40.7%
Donald H. Trautlein <i>Chairman of the Board</i>	\$280,880	\$555,986	97.9%
Walter F. Williams <i>President</i>	\$239,954	\$416,931	73.7%
Inland Steel			
Frederick G. Jaicks <i>Chairman of the Board</i>	\$430,000	\$505,000	17.4%
Raymond N. Carlen <i>Vice Chairman of the Board</i>	\$237,496	\$280,000	17.9%
Frank W. Luerssen <i>President</i>	\$240,840	\$305,000	26.7%
Derrick L. Brewster <i>Vice President—Sales</i>	\$188,936	—	—
O. Robert Nottelman <i>Senior Vice President</i>	\$172,326	\$208,336	21%
LTV-J & L Steel			
Paul Thayer <i>Chairman of the Board</i>	\$791,555	\$1,163,622	47%
Raymond Hay <i>President of LTV</i>	\$678,425	\$995,694	54.8%
Thomas Graham <i>President of J & L Steel</i>	\$408,300	\$661,073	61.9%
James J. Paulos <i>Senior Vice President</i>	\$347,063	\$485,074	39.8%
U.S. Steel			
David M. Roderick <i>Chairman of the Board</i>	\$609,167	\$783,750	28.7%
William R. Roesch <i>President</i>	\$504,167	\$650,000	28.9%
W. Bruce Thomas <i>Executive Vice President</i>	\$345,417	\$446,250	29.2%
M. G. Heatwole <i>General Counsel</i>	\$250,000	\$335,000	34%

Source: Stockholders' Proxy Statements.

fulfill their basic responsibilities. And their most basic responsibility is *not* to build a strong steel industry, but to make money for their companies' stockholders.

The stockholders are doing all right, too. Though again, there are important differences among the various companies, holders of steel company stocks do not generally experience the same kind of cyclical industry that steelworkers and steel communities do. They get their dividends no matter how much steel is being produced in South Chicago or Lackawanna. Though dividends are higher in good years and lower in bad ones, they do not fluctuate nearly as much as do production, jobs or even profits. In 1977, for example, the industry's profits decreased by 98 per cent, but total dividends decreased only 13 per cent; in that year, the entire industry made only \$22 million in after-tax profits, but the companies paid out \$555 million in dividends. (See the table on "Profit Rates & Cash Flow...")

The steel industry is not the steel companies. The industry is *the total collection of material, capital and human resources which are engaged in making steel and primary steel products*. Though the steel companies are necessarily affected by the industry and though some of them may also be in trouble because of the condition of the industry, to say that the industry's problems are deep, serious and long-term is to say nothing about any individual steel company. And, it has nothing to do with what stocks you should invest in. That the steel industry is in serious trouble directly affects only two groups of people: steelworkers and people who live in communities whose economies

"... their most basic responsibility is not to build a strong steel industry, but to make more money for their companies' stockholders."

are built around steel.

These groups are the only ones who have a vested interest in helping the industry, and in the past they have tried to do that by helping the companies. Steel communities are lenient with tax assessments, for example, and steelworkers increase their productivity even as the equipment they work with grows more ancient. Both groups have provided the essential political support for the companies' various schemes to get more money from the federal government. *In the past* this made some sense: As long as the mills were producing and the companies were profitable, everybody benefited.

But the crisis in the industry has changed this equation. The very depth and seriousness of the industry's problems now make helping the companies a risky business. To see why, we need to take a closer look at the *industry's* basic problem.

The industry's basic problem is that it is not "profitable." That's what the companies say and that's what business analysts say. And, in terms of what they understand by "profitability," they're right.

Profit Rates and Cash Flow in the American Steel Industry

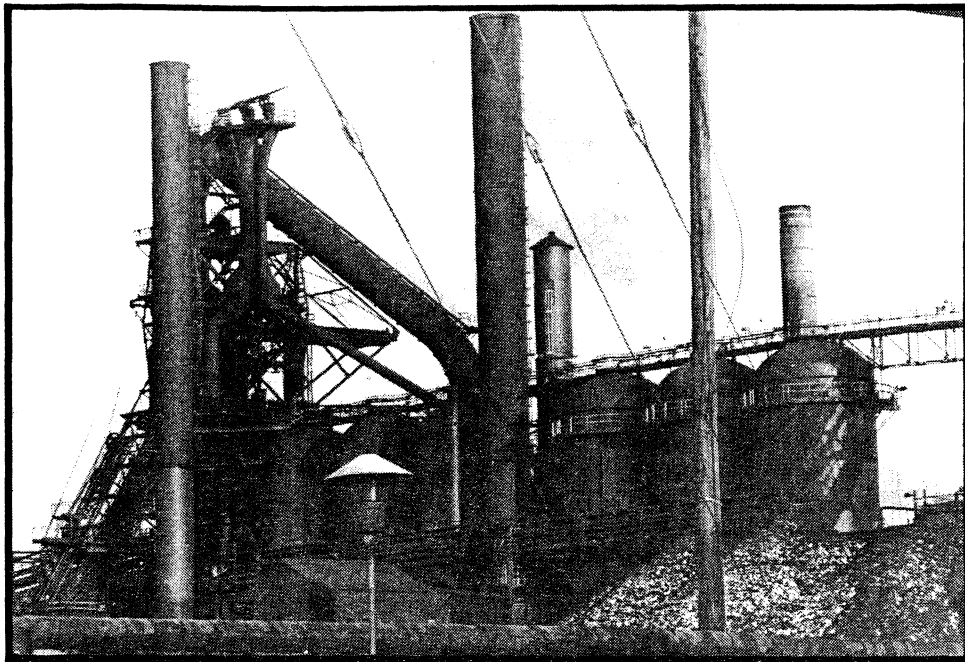
(in millions of dollars)

	Rate of Profit ¹	Profits After Taxes	Depreciation, Depletion, etc. ²	Gross Cash Flow	Cash Dividends	Net Cash Flow	Capital Expenditures
1954	9.4%	\$ 637	\$ 703	\$ 1,340	\$ 343	\$ 997	\$ 609
1955	15.4	1,099	783	1,882	437	1,445	714
1956	14.1	1,113	794	1,907	508	1,399	1,311
1957	13.1	1,132	816	1,948	566	1,382	1,723
1958	8.3	788	713	1,501	540	961	1,136
1959	8.4	831	653	1,484	553	931	934
1960	7.9	811	840	1,651	564	1,087	1,521
1961	6.5	690	749	1,439	557	882	960
1962	5.3	566	958	1,524	508	1,016	911
1963	7.3	782	1,034	1,816	443	1,373	1,040
1964	9.0	992	1,046	2,038	462	1,576	1,600
1965	9.4	1,069	1,117	2,186	468	1,718	1,823
1966	8.9	1,075	1,199	2,274	483	1,791	1,953
1967	6.9	830	1,444	2,274	481	1,793	2,146
1968	8.2	992	1,316	2,308	452	1,856	2,307
1969	7.0	879	1,173	2,052	489	1,563	2,047
1970	4.1	532	1,128	1,660	488	1,172	1,736
1971	4.3	653	1,123	1,686	390	1,296	1,425
1972	5.8	775	1,196	1,971	402	1,569	1,174
1973	9.3	1,272	1,329	2,601	443	2,158	1,400
1974	17.1	2,475	1,553	4,028	674	3,354	2,115
1975	9.8	1,595	1,591	3,186	658	2,528	3,179
1976	7.8	1,337	1,614	2,951	637	2,314	3,253
1977	0.1	22	1,888	1,910	555	1,355	2,850
1978	7.3	1,292	2,010	3,302	533	2,769	2,538
1979	6.5	1,154	2,453	3,607	593	3,014	3,312
1980	9.6	1,735	2,290	4,025	630	3,395	3,390
1981	13.3	2,584	3,000	5,584	659	4,925	3,451

Sources: For 1954-1978, American Iron and Steel Institute, *Steel at the Crossroads*, pp. 89-90. For 1979-1981, American Iron and Steel Institute, *Annual Statistical Report 1981*, p. 9.

¹ Profits After Taxes as percentage of stockholders' equity, based on equity at the beginning of the year.

² Includes changes in reserves.



That the industry is not "profitable" is not immediately apparent to those of us who are not corporate managers or private investors. Look at the Cash Flow data (see appendix beginning on page 36). The industry generally makes over \$1 billion a year in after-tax profits. In 1974 (the industry's best year in 3 decades) and again in 1981, it cleared around \$2.5 billion. That's a lot of money, but it is not enough for the industry to be considered "profitable."

In business investment, whether an industry is "profitable" depends on its *rate of profit* in comparison with other potential investments. While the companies had an exceptionally good year in 1981, the steel industry's *average* rate of profit is around *8 per cent*, while the average rate in all manufacturing is close to *15 per cent*, and the average rate

economy-wide in the past 10 years has been *18 per cent*.

If I invest \$100 and I get \$108 back from that investment, in common sense terms my investment has been "profitable." But for a corporate manager or a private investor, if that same \$100 could have made \$115 by my investing in something else, then the first investment is not "profitable."

You can see, then, why the industry's rate of profit is a problem for corporate managers since their responsibility is to *maximize* profits. But the industry is still profitable in ordinary terms and it has billions of dollars to reinvest in the new technology that would make the industry competitive with steel industries in Japan, Europe and the Third World, right?

Well, yes and no. In fact, the

industry's main source of money available for reinvestment is not its reported profits, but the cash it gets from depreciation allowances (which are not reported as part of profits). Look at the Cash Flow data.

Money from depreciation allowances is almost always higher than money from profits and it is much more consistent. Profits fluctuate from year to year, often dramatically, but cash flow from depreciation allowances almost always increases (look at 1976 and 1977, for example).

From 1979 through 1981, the industry's *net cash flow* (profits plus cash from depreciation allowances, minus what it pays out to stockholders in dividends) has averaged \$3.8 billion.

Again, that's a lot of money, but it's not enough to modernize the industry. And, unless the industry is thoroughly modernized, it will not be "profitable"

in the business sense, and the companies will increasingly put their money elsewhere.

The American Iron and Steel Institute (AISI) has estimated that a thorough modernization program would require an investment of \$7 billion a year for 10 years from 1979 through 1988. As we saw above, the industry's net cash flow for the first three of those years was slightly more than half of what AISI said is needed. Though AISI's estimate of the industry's capital needs is on the high side, by all estimates the industry does not have nearly enough money to engage in a thorough modernization program (see Appendix for a more detailed treatment of this subject).

Convinced of this "capital shortage" in the steel industry, the federal government (in both the Carter and Reagan administrations) has sought to get more money to the steel companies and to

Capital Expenditures in Steel

(dollars in millions, figures in parantheses are millions of 1979 dollars)

%/year is the change from the previous year and % total is the percentage of total company investment that went into steel.

	1981	%/'80	% total	1980	%/'79	% total	1979	% total
Armco	\$220.7 (176.1)	110	56	\$105 (92.5)	47	38	\$71.2	44
Bethlehem	393.5 (314.0)	-12	86	448.8 (395.3)	28	89	349.7	84
Inland	115.9 (92.5)	-13	90	221.2 (194.9)	-15	92	261.5	92
LTV (J & L)	239.7 (191.3)	23	64	193.5 (170.4)	-31	85	279.6	88
National	186.1 (148.5)	-30	90	265.3 (233.7)	32	90	200.5	88
Republic ¹	299.2 (238.8)	-14	—	346.4 305.1	2	—	341.1	
U.S. Steel	408.6 (326.1)	-17	48	448.8 (395.3)	-5	66	521.1	53

¹ Republic did not breakdown their areas of investment in their annual report.

improve their profit rates. Corporate taxes were slashed, more generous depreciation allowances granted, and EPA and OSHA requirements were "relaxed." This helped the companies achieve in 1981 the highest net cash flow they have ever had (\$4.9 billion) and their second best rate of profit in the past 25 years. But, still they were well short of what they need *every year* to thoroughly modernize the industry.

And this is the problem: Even in the best of times, the companies can't accumulate enough money to modernize the industry and make it "profitable." And the clearer this becomes to them, the less likely they are to invest in the industry with whatever money they can lay their hands on.

Look what happened in 1981. What did the companies do with their record profits?

Different companies did different things. U.S. Steel, for example, used its increased 1981 cash flow to leverage its 1982 purchase of Marathon Oil. Among the top seven companies, only Armco and LTV (J & L) increased the level of their investments in steel. U.S., Bethlehem, Inland, National and Republic actually decreased their steel investments.

For the industry as a whole, while the companies decreased their capital expenditures in steel by about \$250 million or 9 per cent, they increased their non-steel investments by \$311 million or 44 per cent. From 1979 to 1981, the percentage of the companies' investment in steel has dropped from 77 per cent to almost 70 per cent. Non-steel *assets* have increased during the same period from 29 per cent to nearly 40 per cent. *And* these industry-wide figures

Steel vs. Other Company Businesses

(millions of dollars)

	1981	1980	1979
Identifiable Assets			
Steel Segment	\$29,525.2	\$28,872.3	\$28,594.6
All Other Segments	17,934.1	14,824.6	11,594.7
Total	\$47,459.3	\$43,696.9	\$40,189.3
% Steel of Total	62.2	66.1	71.1
Capital Expenditures			
Steel Segment	\$ 2,434.4	\$ 2,684.2	\$ 2,547.9
All Other Segments	1,016.8	705.4	764.0
Total	\$ 3,451.2	\$ 3,389.6	\$ 3,311.9
% Steel of Total	70.5	79.1	76.9

Note: Steel segment generally includes raw materials operations dedicated to the support of steel operations. All other segments include corporate items not allocated to operating segments.

Source: American Iron & Steel Institute, *Annual Statistical Report 1981*, p. 13a.

for 1981 do *not* include the entry of Marathon Oil into the "steel industry."

A clear picture has begun to emerge: Though the *industry* desperately needs money to invest in a thorough modernization, whatever money the *companies* get is as likely to end up helping them get out of the industry as it is to help the industry.

Many people see this pattern of investment as simply a matter of bad management. But the problem goes deeper than that.

The management of American steel companies has been roundly (and justifiably) criticized for its ineptitude and incompetence in almost every area of management. They invested in new Open Hearth furnaces when BOFs were becoming the state of the art, and then spent millions of dollars in legal and political maneuvering to protect these polluting dinosaurs from environmental regulation. When they did begin to invest in the new generation of steel technology (only after they were well

behind the Japanese and other industries), they did so in a haphazard and piecemeal fashion: they built BOFs for rolling mills that could handle only a fraction of the new furnace's capacity, while at the same time putting continuous casters with Open Hearths that couldn't produce enough steel to keep the new casting systems busy.

Steel companies are legendary for their authoritarian shopfloor work relations and production inefficiencies. And a U.S. General Accounting Office (GAO) study even found their marketing attitudes and procedures to be chasing U.S. customers away.* We are not, in a word, dealing with financial and production geniuses of the caliber of J.P. Morgan and Andrew Carnegie.

But the lackluster record of steel managers has not been achieved in a vacuum. They manage an industry which no other country in the world allows to be run exclusively in the interests and by the lights of private management and investors. And they exist in the world's most unplanned economy where the allocation of resources is determined almost exclusively by yearly—and even quarterly—rates of return on investment. In such an economy you cannot expect the managers of steel companies to engage in far-sighted planning and

coordination of production and investment.

Of all the differences between the U.S. industry and those in Japan and elsewhere, the most important is this: The Japanese steel industry is not expected to make a "competitive rate of return." Investment in that industry is ensured and coordinated by the government as part of an overall economic plan.

The American economy's exclusive reliance on short-term profit rates to allocate capital investment gives all U.S. corporations a certain character, as Nobel Prize winning economist Wassily Leontief has pointed out:

During the past ten years American corporations earned an average of 18 per cent on their investments while their Japanese counterparts earned only 11 per cent. This means that in the U.S. corporate managers are so cautious that they refuse to move until they can count on recovering newly invested capital in four and a half years. Managers in Japan are prepared to wait for eleven years. No wonder they continue to improve old plants and construct new ones while large U.S. corporations often prefer to maintain liquidity and to diversify their investments by buying up each other's stocks.*

Most of the investment that's needed to modernize the American steel industry cannot be "recovered" in four and a half years. Though the companies must continue to invest in steel in order

* A good summary of these criticisms of American steel management can be found in Chapter 13 of Ira C. Magaziner and Robert B. Reich, *Minding America's Business: The Decline and Rise of the American Economy* (New York: Harcourt Brace, 1982). The GAO study referred to is *New Strategy Required for Aiding Distressed Steel Industry*, January 1981 (EMD-81-29).

* *New York Review of Books*, August 12, 1982.

Profitability of the American Steel Industry is Higher Than Its Foreign Competitors

(1969-1977 Fiscal Years)

Net Income as % of
Net Fixed Assets

U.S.A.	6.7
Japan	1.7
West Germany	2.9
United Kingdom	-5.3
France (1972-76)	-8.3

Source: International Iron and Steel Institute.

to protect existing assets, any extra money they get is going to go towards non-steel investments with higher and quicker rates of return.

Even companies which have not engaged in extensive diversification in the past are likely to begin to position themselves to do so now. Bethlehem Steel, for example, has changed the composition of its board of directors in a way that many analysts believe prepares the company for a new non-steel strategy; Bethlehem's president, in fact, has told the *Wall Street Journal* that "we've got to look at a strategy involving diversification."* Likewise, Republic has a new chairman who analysts describe as "just the man to push Republic to think about... diversification."**

This poses a cruel dilemma for steelworkers. The industry in which they work is in very serious trouble, and it needs help. Above all, it needs capital. But in the present arrangement, any additional capital, the companies get is not going to be enough to make steel

"profitable" and the companies are, therefore, going to use a large part of it to finance their way out of the industry.

Thus, not only would concessions on wages and work rules *not* help the industry. They more likely would facilitate its further decline.

What is needed is a comprehensive program to save the industry from the companies and to protect the only people who have a direct stake in that industry: steelworkers and steel communities. Unless these groups can develop an alternative plan for the industry and pursue that plan on several fronts, the companies will do for steel what Penn Central did for the railroads.

Such an alternative plan would have to involve the federal government in an altogether new role. Supplying tax breaks and other unrestricted cash gifts to the companies will not help the industry. What is needed is what in other countries is called an *industrial policy*, an economic planning apparatus which distributes government loans, loan guarantees, tax benefits and direct subsidies *only if companies invest in specific projects* considered viable for the industry as a whole and in terms of an overall economic plan.

In one form or another, every other steel industry in the world is *subsidized* by its national government, and investment in those industries is *planned* and coordinated by the government. Very often substantial portions of the industry are government-owned. Without a similar arrangement in the U.S., our industry will be steadily depleted of capital and technology, of jobs and of the payrolls so many communities depend on.

**Wall Street Journal*, July 22, 1980.

***Business Week*, August 9, 1982.

A consensus is building towards such a planning approach to the U.S. economy. Important segments of business and of official labor (the AFL-CIO Executive Committee, the International Association of Machinists and the United Steelworkers, for example) are advocating it. But such a planning apparatus can take many different shapes, serving many different interests. Steelworkers and steel communities must become a part of planning their industry; they must initiate ways to wrest substantial portions of control of the industry away from the companies. The formation of an explicit government industrial policy can provide means and opportunities for

encroaching on the entire range of "management prerogatives."

This will not be an easy task, but it is essential if steel is to remain an important part of a vigorous industrial economy. That a steelworker-community alternative plan for the industry can be devised and implemented may not seem like a realistic possibility now, but the ground rules of American politics and economics are changing rapidly. Merely to defend their existing, already deteriorated conditions, steelworkers and steel communities will have to take a more active role in managing their industry.

