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Steel Trap:
How Subsidies and Protectionism Weaken the U.S. Steel Industry

by Dan Ikenson

Executive Summary

On March 6, President Bush is expected to announce specific Section 201 measures to further protect the domestic steel industry from import competition. By any relevant economic measure, the costs of protection will far exceed the benefits, and any benefits accruing to steel firms from that protection will be fleeting.

Section 201 relief for steel producers could invite WTO-legal retaliation against other U.S. export sectors, undermine prospects for trade agreements and related job growth, and saddle downstream steel-using industries with price hikes and supply shortages that will handicap them vis-à-vis their international competitors.

Protection will only prolong crippling overcapacity in the domestic steel market. Over the past three decades, U.S. steel producers have been shielded from foreign competition by quotas, voluntary export restraints, minimum price undertakings, and hundreds of antidumping, countervailing duty, and safeguard measures. Federally subsidized loan guarantees, pension bailouts, and "Buy American" preferences have likewise fostered uneconomic excess capacity within the industry and discouraged unsuccessful firms from the otherwise rational decision to exit the market.

The steel debate is not about "unfair trade." Antidumping duties unfairly punish foreign producers for engaging in practices that are routine and perfectly legal for domestic producers. Under the current definition of dumping in U.S. law, every U.S. steel company that is losing money is guilty of dumping here in its home market.

Claims that steel imports threaten national security are without foundation. A Section 232 investigation by the Department of Commerce recently concluded that domestic steel capacity far exceeds any potential needs of the U.S. military.

The U.S. steel industry—but more important, the country—will be best served if the president resists the temptation to impose new trade restrictions.

Dan Ikenson is a trade policy analyst with the Center for Trade Policy Studies at the Cato Institute.

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Introduction

On March 6, President Bush is expected to announce specific measures to further insulate the domestic steel industry from import competition. By any relevant economic measure, the costs of such a decision will far exceed the benefits. And any benefits accruing to steel firms from that protection are sure to be fleeting.

The current round of import restraints under consideration stem from an investigation that the Bush administration launched last June under Section 201 of the Trade Act of 1974. That investigation led the U.S. International Trade Commission (ITC) to conclude that imports have been a "substantial cause of serious injury"[1] to the domestic industry and to recommend a variety of "remedies" to the president, including quotas and tariffs on imported steel. The president now must decide whether to accept, reject, or modify the ITC recommendations.

It would be difficult to find another U.S. industry already more coddled and protected from the realities of the marketplace than the steel industry. This fact, more than any other, explains the steel industry's perennial problems. Over the past three decades, U.S. steel producers have been shielded from foreign competition by quotas, voluntary export restraints, minimum price undertakings, and hundreds of antidumping, countervailing duty, and safeguard measures. Federally subsidized loan guarantees, pension bailouts, and "Buy American" preferences have likewise fostered uneconomic excess capacity within the industry and discouraged unsuccessful firms from the otherwise rational decision to exit the market.

Steel users employ 57 workers for every one employed in steel production.[2] Steel users account for 13.1 percent of gross domestic product (GDP), while steel producers account for only 0.5 percent.[3] Yet responding to steel producers' self-inflicted problems with more protectionism will only saddle downstream steel-using industries with price hikes and supply shortages that handicap them vis-à-vis their international competitors. It is bad enough to punish one sector for the failures of another; it is downright foolish, though, to do so when the punished sector is of overwhelmingly greater economic significance.

Protectionism has been characterized as an exercise in picking winners and losers; in the case of protecting steel, however, there are only losers. Despite decades of intervention, the same problems persist. It is reasonable to conclude that even with a new layer of import restrictions, the steel industry will continue to suffer many of the ills currently cited as evidence of import-caused injury.

In all industries there are winners and losers. The key to ensuring the vitality of an industry, however, is that the losers contract or cease operations altogether. Otherwise, the health of the entire industry is compromised. Since December 31, 1997, there have been 30 bankruptcies within the "steel industry." Only 18 of those 30 are actually steel producers.[4] But many of those companies are still operating or have emerged from bankruptcy status. The continued operation of steel companies that are chronic money losers poses a threat to the profitable firms. Allowing these firms to expire will do more for the health of the steel industry than any reality-deferring protectionism possibly can.

The "Unfair Trade" Diversion

Winning the hearts and minds of policymakers and the general public has been a strategic goal of the steel industry for years. And, in large measure, the industry has succeeded in drumming up sympathy for its plight. The public relations and lobbying efforts to this end have relied on systematic misstatements and factual distortions.

Representative of these tactics is a recent opinion piece by Sen. John D. Rockefeller IV (D–WV), which appeared in some national newspapers. Rockefeller perpetuates the myth that "our steelmakers simply can't compete with subsidized foreign competitors operating in protected sanctuary markets."[5] What he doesn't acknowledge is that the U.S. industry itself is heavily subsidized and protected—and has been so for decades. He also neglects to mention that the 1997–98 Asian crisis—the catalyst for the steel import surge that followed—and the current Section 201 proceeding have nothing to do with sanctuary markets or urban legends about "unfair trade." The steel industry and its handlers intentionally ignore these facts because stigmatizing imports as unfair is a useful smokescreen for protectionism as usual.

The fact is that Section 201 cases are about injury caused by *fair trade*. In bringing the case, the domestic industry formally acknowledges the crucial distinction that its condition is not necessarily a result of unfair or predatory foreign practices.[6] Section 201 does not require any finding of unfair trade—only that a rising level of imports has caused injury to the domestic industry. The protection-seeking industry is obliged to explain why it should be entitled to relief and how it intends to improve its condition if protection is granted. Hence, the law requires—and relief is conditioned on—submission of a detailed and credible recovery plan. Unfortunately, import restraints will only delay genuine recovery by prolonging the industry's overcapacity problem.

But the tenor of the debate shows no signs of contrition on the part of the steel industry. Despite the fact that Section 201 relief for steel producers burdens steel users disproportionately, could invite WTO-legal retaliation against other U.S. export sectors, and undermines prospects for trade agreements and related job growth, the steel industry remains on the offensive, deflecting any blame for its own state of affairs, as if it is owed an enormous debt. Of course, contrition would undermine the carefully crafted public relations message. That message: the U.S. government, through its failed trade policies, is responsible for the unfair imports that have driven the industry to the brink of collapse, and must therefore make amends. In other words, the steel industry bears no responsibility for its condition.

Many in the press, Congress, and the administration have adopted, knowingly or not, the slanted terminology so central to crafting the steel industry's victim's image. Popular press accounts refer to steel imports as "dumped" or "subsidized" as a matter of generic qualification, as if all imports warranted a derisive label. A recent press release from the office of Rep. Sherrod Brown (D-Ohio) incorrectly announced that, "… on October 22, 2001, the U.S. International Trade Commission (ITC) found that *illegal* imports had caused significant injury to the domestic steel industry."[7] (Emphasis added.) There was nothing illegal about the imports in question.

Brown went on to implore, "Without immediate action by the President, the situation is dire. Inundated by illegal imports, 29 domestic steel companies have either declared bankruptcy or gone out of business entirely in the last four years. Nearly 30,000 American steelworkers have lost their jobs in just the last 16 months. The pace is accelerating, with another steel company declaring bankruptcy, on average, every nine days. In order for the domestic industry to consolidate and survive, *the federal government must vigorously enforce U.S. trade laws*."[8] (Emphasis added.) Again, the mischaracterization of imports as "illegal" is used to support the conclusion that the government "must vigorously enforce U.S. trade laws." In reality, exercising Section 201 "rights," also known as the "escape clause" because it allows countries to escape temporarily from their commitments to tariff reduction and market access, is an exception to those commitments and not a rule to be "vigorously enforced."

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Antidumping and Double Standards

Integrated steel production entails high fixed costs—that is, heavy investments in plant and equipment that must be amortized regardless of the volume actually produced and sold. A large volume must therefore be produced and sold before an integrated mill can cover fixed costs and turn a profit. After a certain production level is surpassed, the average cost of producing a ton of steel starts to decline and profit margins can increase.

In times of falling demand, firms respond by some combination of cutting prices and curtailing

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output. When output is cut, however, the average unit cost of producing a ton of steel increases. Profitability is squeezed at both ends: costs increase at the same time prices fall. This state of affairs thus imposes severe pressures on steel firms to keep costs as low as possible so that occasional storms can be weathered.

But the steel industry found a way to reduce these pressures with an ingenious political fix. Specifically, it recognized that the cyclical price-cost squeeze could be manipulated to domestic producers' advantage if changes to the then seldom-used antidumping law were implemented. Changes in 1974 included the introduction of what has come to be known as the "cost test." The cost test requires that sales made by a foreign firm in its home market at prices below the full cost of production be excluded from calculating average prices in that market. It does not, however, exclude sales by that foreign firm made at prices below cost from the calculation of average prices in the U.S. market. As a result, comparisons of a foreign firm's U.S. and home-market price averages (the dumping margin calculation) are almost always skewed in favor of finding dumping because the home-market price average is based on a higher-priced (above full cost) subset of all home-market sales.

This change in the antidumping law in 1974 sets up foreign firms to be punished for responding rationally to slackening demand. To avoid antidumping exposure, foreign producers would be required to always sell above their costs of production, which would require price hikes during economic downturns—a patently irrational business strategy. As a result of this poorly understood feature of the antidumping law, findings of dumping have nothing to do with market reality—and certainly are no evidence of "unfair trade."[9] They are simply an artifact of a deeply flawed methodology. The steel industry has exploited this flaw with a vengeance: Although steel imports constitute only about 2 percent of total U.S. imports, more than 50 percent of all outstanding U.S. antidumping measures are against steel imports (while most of the rest are against imports in other high fixed-cost industries). And because the details of how antidumping law actually works are not generally understood, the U.S. industry is able to point to this explosion of antidumping cases as evidence that "unfair trade" is the cause of its problems.

If selling below cost really does constitute unfair trade, U.S. producers have some explaining to do. Under the current definition of dumping under U.S. law, every U.S. steel company that is losing money is guilty of dumping here in its home market. Bethlehem Steel lost money in 6 of the 10 years between 1991 and 2000. National Steel and Weirton Steel lost money in 4 of those 10 years. LTV and Geneva Steel lost money in 4 of the 9 years between 1992 and 2000, while Wheeling-Pittsburgh lost money in 3 of those 9 years.[10] If selling below cost is a problem, which under most definitions of economic rationality it is not, then why are there different policy responses to foreign firms than there are to domestic firms engaging in this practice? If healthy firms are compromised by unhealthy ones selling below cost, which could be the only tenable objection to the practice, then should they be more compromised when the offending firm is foreign?

California Steel Industries thinks not. Its chief executive officer, C. Lourenco Goncalves, said in an article in *American Metal Market*, that while integrated and mini-mills in the East and Midwest continue to blame imports for their woes, those same producers "are currently the responsible parties for the extremely low prices on the West Coast." The article cites reports from steel buyers who claimed that imported hot-rolled sheet was not widely available at low prices, but that producers east of the Rockies had been "offering low-priced hot rolled that has undercut the local mills' attempt to increase [price] tags even when freight to the West Coast is included." Mr. Goncalves said, "If I had antidumping laws to protect CSI against this irrational behavior, I would use them against these mills. Unfortunately, I don't have."[11]

Protectionism, Subsidies, and Overcapacity

The verdict of the marketplace is unambiguous: The U.S. steel industry suffers from excessive, uneconomic capacity. The proof lies in the number of steel producers now in bankruptcy. The large number of bankrupt firms makes clear that there is more steelmaking capacity in the United States than is currently economically viable.

The steelmakers' response to this excess is to call for more subsidies and protectionism. But the fact is that the current excess exists in no small part precisely because of subsidies and protectionism. Responding to the industry's woes with more of the same will not resolve the problem; indeed, over the long term it will merely add fuel to the fire.

Government interventions to assist the steel industry have been more or less continuous for the past three decades. Pension guarantees, loan guarantees, special tax and environmental exemptions, research and development grants, and "Buy American" provisions have been pervasive. By conservative estimates, these subsidies have equaled more than $23 billion since 1975.[12] An Ernst & Young LLP study reported that the U.S. steel industry received more than $30 billion in government subsidies during the 1980s alone.[13]

Protection from import competition has also been the norm over the past 30 years. From 1969 to 1974, there were "voluntary" import restraints—restraints observed under the threat of statutory quota legislation. From 1978 to 1982, there were minimum import price arrangements—a scheme perpetrated while 19 antidumping petitions were pending. From 1982 to 1992, there were new quotas affecting a range of steel products from many different countries. Since then, there have been literally hundreds of antidumping and countervailing duty cases brought against every relevant foreign producer from every region of the world. Many of these measures are still in effect today. It is on top of this that the industry is now pursuing an enormous campaign for global import restraints under Section 201.

Any student of Economics 101 knows that when you subsidize something, you get more of it. For three decades interventionist policies have been subsidizing U.S. steel production. It therefore follows that the artificial support provided by these interventionist policies has resulted in U.S. steel capacity over and above what would have existed in the absence of that support. Consequently, the steel industry's vulnerability as of 1997–98 when the industry's current problems began was heightened by past policies.

Further, more interventionist policies since 1997–98 have exacerbated the burdens of excess capacity by creating "barriers to exit"—that is, distortions of market signals that discourage failed firms from ceasing operations. The continued existence of these inefficient firms weakens the entire industry, both by depressing prices and by robbing healthier firms of the scale economies they could enjoy with larger market shares.

The Organization for Economic Cooperation and Development (OECD) is currently sponsoring international negotiations designed to reduce excess, uneconomic steel capacity around the world. In the context of those talks, the U.S. government has taken the position that there are no significant structural barriers to exit in the U.S. market:

> In light of the primacy of market forces in shaping the U.S. steel industry, there currently are limited government impediments to the closure of excess inefficient steelmaking capacity in the United States. The U.S. government does not provide significant subsidies or similar assistance to the U.S. steel industry. The most visible federal program directed toward the steel industry, the Emergency Steel Loan Guarantee Program, adopted in 1999, is limited in scope and, to date, has resulted in the disbursement of a single loan by a private lender under the guarantee program—$110 million to Geneva Steel last year.[14]

This assessment ignores important realities. First, exit is systematically discouraged by the ongoing spate of antidumping and countervailing duty cases. As of December 2001 there were 290 outstanding antidumping and countervailing duty measures in place, of which 156 (53.8 percent) cover steel products.[15] But as significant as these steel figures are, they belie the trend that demonstrates the industry's growing addiction to

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trade remedy laws. Since 1997, 78 of the 103 antidumping and countervailing duty measures imposed were on steel products—more than three-quarters of the caseload.[16] And the number of cases still pending (where a final determination has not been rendered) as of January 2002 was 104, of which 70 cover steel products.[17]

These cases result in temporary shifts in market share and temporary increases in prices relative to market outcomes. These jolts of artificial stimulus help to maintain weaker firms that otherwise would go under. If President Bush accedes to steel industry lobbying and imposes new trade barriers under Section 201, some of the industry's weaker firms will have won yet another reprieve from market accountability.

Reorganization proceedings under Chapter 11 can act as a subsidy for failing firms, allowing them to continue to operate despite insolvency, then relieving them of debts and sending them out into the world to fail again.

Another structural barrier to exit can be found in the federal bankruptcy process. Reorganization proceedings under Chapter 11 can act as a subsidy for failing firms, allowing them to continue to operate despite insolvency, then relieving them of debts and sending them out into the world to fail again. As one bankruptcy expert concluded, "Chapter 11 reorganization often protects inefficient businesses and results in the continued waste of resources."[18] A number of steel producers have been repeat wards of the bankruptcy courts. LTV Corporation, Wheeling-Pittsburgh Steel Corporation, Laclede Steel Company, and Edgewater Steel have all gone through Chapter 11 only to return. Many producers treat bankruptcy as a strategic makeover, which painlessly removes the wrinkles of unwanted debt. Geneva Steel's chairman, Joseph Cannon, said of the bankruptcy process, "With our balance sheet restructured, Geneva Steel will be producing steel for many years to come."[19] The current lenient procedures are a significant contributor to excess capacity.

Another major barrier to exit is supplied by the steelworkers' union, the United Steelworkers of America (USWA). The union uses the full extent of its considerable bargaining power to resist plant closings. USWA's role in this process is aptly summarized by its president, Leo Gerard, who said, "We are committed to working constructively toward a rational consolidation, one that ensures the *preservation and revitalization of existing U.S. steelmaking capacity*. There may be too many steel companies, but there are not too many steelworkers, and any restructuring must preserve the jobs of the workers who have made sacrifice after sacrifice in order to keep the industry alive in the face of a flood of unfairly dumped foreign steel imports." [20] (Emphasis added.) This is utter nonsense. What exactly is "rational consolidation that ensures the preservation and revitalization of existing" capacity? How can there be too many steel companies but not too many steelworkers? The union's interest in maintaining membership supersedes its interest in its members.

Attempts to preserve jobs at failing firms have come at the expense of jobs at relatively healthy firms. To preserve jobs, the USWA has led efforts toward employee purchases of failed and failing mills. Although on their face these efforts are pursued to preserve jobs, they have invariably failed to change the fate of the mills and have maintained a cloud of uncertainty throughout the industry. Research on employee stock ownership plans (ESOP) has revealed that "The proposition that employees with an equity stake will be more productive and improve firm performance is not supported."[21]

Al Tech Specialty Steel Corporation of Dunkirk, New York, entered bankruptcy at the end of 1997. In an effort to keep the plant from shutting down, the USWA oversaw the partial employee purchase of the plant, which emerged from bankruptcy as Empire Specialty Steel in 1998. Despite new capital and ownership, the firm shut down permanently in June 2001. Laclede Steel of Missouri and Erie Forge & Steel of New York were both temporarily resuscitated from bankruptcy through partial employee funding coordinated by the USWA. Each subsequently failed anyway.

The case of Bar Technologies (BarTech) demonstrates how USWA resistance to plant closures has made matters worse for the industry. After reports suggesting that there was already too much steel bar capacity on the market, Bethlehem Steel abandoned plans to refurbish and expand bar-making facilities at its Johnstown, Pennsylvania, and Lackawanna, New York, locations. Despite the assessment that overcapacity would preclude appropriate returns on capital, the

USWA led efforts to purchase the plant and add more than 1 million tons of capacity, which was effectuated in 1994 through subsidies from the states of New York and Pennsylvania and the Veritas Investment Group.[22]

The primary customers for these specialty bar products were the big automakers and companies that produce axles and cranks for automobiles. Because these big customers already commanded a high level of market power, the introduction of the extra capacity drove prices down substantially. Despite losing money, BarTech pursued expansion plans through acquisition and upgrades, purchasing Republic Engineered Steels in 1998 and then most of USS/Kobe in 1999. In 2001, the combined entity, Republic Technologies, entered bankruptcy. What began as a union effort to stop two plant closures, affecting a few hundred workers, ballooned into a bankruptcy jeopardizing 4,600 employees.[23]

Although the steel industry tries to blame unfair foreign practices for all of its problems, the fact is that the U.S. market is itself badly distorted by past and present interventionist policies. These direct and implicit subsidies block the market signals that would lead to reductions in uneconomic capacity through attrition of the least efficient producers. As a result, healthier steelmakers must bear the burden of excess capacity.

Legacy Costs

The request for new trade barriers under Section 201 has forced the steel industry to acknowledge the need for some kind of restructuring. The present focus is on consolidation—that is, mergers between firms or acquisitions of small firms by larger ones. By consolidating, the industry will supposedly regain its strength and no longer require Section 201 relief.

There is, however, a catch. Any move toward consolidation is currently stymied by the issue of "legacy costs"—certain health care and benefits owed to retired, unionized steelworkers. These costs total about $13 billion for the industry.[24] A number of firms now have negative net worth once legacy costs are taken into account—a state of affairs that disqualifies these firms as viable acquisition targets. Accordingly, integrated steelmakers are insisting that the federal government assume those legacy costs as a precondition to any consolidation. In particular, U.S. Steel has expressed interest in purchasing three failing firms, National, Wheeling-Pitt, and Bethlehem. But these would-be targets have legacy liabilities of at least $12 billion. As U.S. Steel's CEO Tom Usher argues, the government should cover those costs since his company would be helping the Bush Administration accomplish its goal of worldwide capacity reduction.[25]

The chutzpah here is striking. Section 201 requires that industries seeking import relief justify that temporary protectionism with credible plans to restructure and become more competitive. Yet the integrated steelmakers' recovery plan is simply to seek yet another government bailout.

Legacy costs are the legacy of greed. They are the product of an intransigent union and a management confident that the government would bail them out of obligations they could not meet. In the 1980s, several steel companies intentionally underfunded their pension obligations, forcing taxpayers, through the federally funded Pension Benefits Guarantee Corporation (PBGC), to cover their indiscretions.[26] By 1999, nearly 40 percent of the value of all claims on the PBGC were attributable to steel firms.[27]

In labor negotiations during the late 1980s and early 1990s, unions agreed to smaller pay increases for workers in exchange for larger benefits packages for retirees. The impetus for this approach was that retiree benefits were "off balance sheet" items, while labor expenses were observed as current expenses on income statements. In an "Enronesque" effort to show better income results to potential investors, the legacy cost issue was born. Changes to tax reporting requirements by the Financial Accounting Standards Board in 1993 required the reporting of the formerly unreported retiree benefits on the financial statements.[28] Moving these expenses onto the balance sheet, combined with soaring health care costs, drove current reported expenses through the roof, reducing profits and dissuading further investment.

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The union, for its part, is opposed to capacity reduction through consolidation. Instead, it argues that ailing firms should be kept afloat with loan guarantees, while legacy costs should be funded from special surcharges on steel shipments. But if the unions are really concerned about their retirees, why not advocate direct subsidies to them? Clearly, it would be less costly than funding retirement plans through the continued operation of inefficient mills under the stewardship of a self-interested union.

Many of today's healthy steel firms, like Nucor, Steel Dynamics, and other electric-arc furnace producers known as "mini-mills," have no legacy costs. They had nothing to do with the backroom deals that led the industry down this path. Why should they be forced to subsidize their competition with surcharges? And why should the government favor mills that the capital markets have deemed unworthy? The mini-mills are opposed to these unwarranted interventions: "Government assistance to troubled steel companies for continued operation or legacy costs is unacceptable. That assistance is unfair to those steel companies who are not troubled. Government funding to aid displaced workers from closed facilities through retraining and relocation is encouraged."[29]

Rise of the Mini-mills

"As you know we really have increasingly two steel industries in this country. One is based on the older technologies…and the other is the mini-mills, which are evolving at a very dramatic pace…"[30]

Despite this important reminder by Federal Reserve Chairman Alan Greenspan, one could easily gather from popular accounts that the steel industry has fallen into a bottomless descent. There are reports of 30 bankruptcies since 1998 and 10,000 annual job losses in the industry—statistics, of course, that are ascribed to unfair or illegal import competition. The reality, however, is that some firms are doing quite well. It is important to appreciate the difference between these two distinct groups of U.S. steel producers—the integrated mills and the mini-mills. The former is where the industry has been; the latter is where it's going.

"Mini-mills as a group are highly competitive in the North American market and will continue to take a larger share of that market. U.S. shipments of steel rose about 20 million tons from the level obtained in the early 1990s, and the mini-mills now account for close to one half of total steel shipments. In 2000, the mini-mills' share of U.S. shipments was nearly 100 percent of the long products and a third of flat products. In three or four years they will account for a preponderant share of U.S. steel production."[31] These are the recent words of Thomas Danjczek, president of the Steel Manufacturers Association (the trade association for mini-mills). Is this irrational exuberance or is there something to these claims?

Gross steelmaking capacity in the United States grew by 16 million metric tons to 124 million metric tons between 1995 and 2000. Nearly all of this increase was capacity added to electric-arc furnace operations (i.e. the mini-mills).[32] Mini-mills produce a ton of steel with far less labor than is required at integrated mills. A recent comparison of actual man-hours per ton demonstrates that mini-mills are seven times more efficient than integrated producers in terms of labor productivity.[33] It should be no mystery why there have been employment declines in the steel industry. Mini-mills, which are responsible for a greater share of domestic production each year, require less labor.

The mini-mills are smaller, nimbler, relatively new creations that make steel products primarily from scrap metal in electric-arc furnaces. They do not produce raw steel, and therefore depend less on dwindling inputs that have become increasingly costly to ship to the large mills, many of which are located great distances from iron ore stocks and from their markets. Essentially, their operations by-pass the labor-intensive, high-cost process of making raw steel. Importantly, the labor force is generally not unionized.

Mini-mills do not rely on iron ore or coal, but rather use steel scrap as their primary material input. In the United States, scrap is cheap relative to the cost of the equivalent process of bringing iron ore and coal to a comparable property, and relative to scrap prices abroad. The clincher for mini-mills, though, is the pro-cyclical nature of its primary input and its output. When steel demand is high, prices are high, and profits are good. When demand is low, prices fall, but so do the costs of scrap, which account for about 50 percent of the total cost of producing steel at a mini-mill.[34] This relationship mitigates profit contractions during periods of slackening demand.

The largest mini-mill operation, Nucor Steel of Charlotte, North Carolina, has shown operating profits and net profits in each of the 10 years from 1991 to 2000.[35] Only 2 of the 18 steel producers in bankruptcy since 1998 are mini-mills, but neither of the two achieved full operational status before technical problems crippled their operations.

Until recent years, mini-mills were averse to using trade remedies. Mini-mills had no grievance with imports and they were generally profitable. But eventually they succumbed to the temptation of the inflated prices—and profits—that trade barriers could deliver. Also, the mini-mills began to see their destiny of preeminence challenged by domestic firms who produce finished steel products from imported slab. In rare common cause, the mini-mills and the unions fought hard to ensure that slab was included in the recent injury finding.

The National Security Canard

The terrorist attacks in September drew attention to a frequently repeated claim of the steel industry—that domestic steel production is a matter of national security. Using September 11 as a segue, Jim Robinson, an assistant director of the USWA, said, "This should be a reminder to people that steel is a critical industry for the United States, both strategically and economically. Driving steel out of business economically has the same impact as physical bombings."[36]

Paul Gipson, president of a local union representing workers at Bethlehem Steel, had the following insights: "We have become so lax. We have opened our borders to anyone. We have opened our industries to anyone in the world. What happened Tuesday is a threat to our nation. We are talking about our national defense. We are threatened on a daily basis by imported steel, which is a direct threat to our national security. Foreign countries have been working to cripple this country economically."[37]

The president of the USWA, Leo Gerard, also tried to capitalize on the tragedy, calling for "…immediate and comprehensive relief to prevent America from being seriously compromised in its ability to satisfy the steel demand so critical for our national security...Wall Street has literally turned its back on the American steel industry. But in light of the tragic events of the past week, we do not believe that America can afford to turn its back on the reality that, unless this government gives immediate relief to our industry and its workers, it is likely that steel will soon become a commodity, like oil, whose price is controlled by governments abroad."[38]

Even President Bush lent support to the national security argument at a USWA picnic last summer. He said, "If you're the Commander in Chief, it makes sense, common sense, not to be heavily reliant upon materials such as steel. If you're worried about the security of the country and you become over-reliant upon foreign sources of steel, it can easily affect the capacity of our military to be well supplied."[39]

In reality, claims of a threat to national security are totally without foundation. In 2000, the U.S. military accounted for only 0.03 percent of steel industry deliveries. Shipments to the military in 1991—the year of the Persian Gulf War—were only 0.1 percent of total industry deliveries.[40] The fact is that U.S. steel capacity and production so exceed military demand that even massive production cutbacks have no security implications.

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Last year the U.S. Department of Commerce conducted an investigation under Section 232 of U.S. trade law to determine whether imports of iron ore and semifinished steel pose a threat to national security. The Commerce Department's final report, issued last October, announced the following conclusion: "National defense requirements, as communicated to the Department of Commerce by DOD, for *finished steel*—and thus for iron ore or semifinished steel as inputs—are very low and likely to remain flat over the next five years. DOD's current and projected demand for iron ore and steel can be readily satisfied by domestic production…"[41] (Emphasis added.)

Those sincerely concerned with U.S. national security should be relieved by the Commerce Department's findings. It is interesting, then, that the USWA was "bitterly disappointed"[42] by the results of the Section 232 investigation.

Will we be less secure if American bridges and roads (termed "transportation security infrastructure" by American Iron and Steel Institute president Andrew Sharkey)[43] as well as petroleum refineries and storage tanks ("energy security infrastructure")[44] are made with steel from Canada or France or Brazil? Notwithstanding the steel industry's special pleading, the fact is that we are more secure when foreign steel is available, because competition creates better products and lower prices for the people and companies that use this input to manufacture value-added materials and equipment. Most revealing of the industry's descent into desperate diatribe is its simultaneous insistence on curtailing supply while warning of impending shortages.

Conclusion

The U.S. steel industry—but more important, the country—will be best served if President Bush resists the temptation to impose new trade restrictions. As politically expedient as this approach may seem, additional trade barriers will hamper adjustment in the industry, unfairly and unwisely burdening healthy steel producers. Such restrictions will cause the production costs of the far more numerous and economically significant steel users to rise, unjustifiably saddling them with cost disadvantages. More steel protection will encourage retaliation from abroad, punishing U.S. exporters in other sectors and dissuading foreign governments from undertaking necessary reforms to make their markets more accessible to imports. Finally, the gross hypocrisy of another layer of steel protection in the midst of U.S.-led efforts to reduce worldwide steel capacity undermines U.S. leadership on trade and prospects for new trade agreements, which benefit all Americans.

Consolidation is not the only alternative for eliminating inefficient capacity. Attrition works if the inefficient firms are liquidated in bankruptcy, and their assets are auctioned to the highest bidders.

Protectionism is always bad policy. But in the case of the steel industry, in which protectionism has been tried so often with such consistently disappointing results, it would be delinquent to pass on the current opportunity to change course once and for all. There are simply too many inefficient firms suppressing prices and profitability. This situation would not pose a long-term problem if these firms could shut down, but failed mills face exit barriers that undermine this vital attrition process. Trade restrictions only strengthen these barriers.

Some say that industry consolidation is necessary, but that significant legacy costs are preventing mergers and acquisitions. That may be true, but consolidation is not the only alternative for eliminating inefficient capacity. Attrition works too. Attrition works if the inefficient firms are liquidated in bankruptcy, and their assets are auctioned to the highest bidders.

The largest obstacles to attrition are subsidy programs like the Emergency Steel Loan Guarantee Program, unrealistic unions seeking to prevent shutdowns, and the U.S. trade remedy laws. Inefficient operations need to be retired, and this can be accomplished only if market signals are not distorted by these interferences. When an operation is inefficient and losing money, access to investment naturally dwindles. Attempts to mitigate this outcome perpetuate the root problem. Although its expansion is being considered under different legislation pending in Congress, the Emergency Steel Loan Guarantee program should be abolished.

Within the context of multilateral negotiations initiated at Doha, Qatar, last year, the U.S. government should agree to reforms designed to improve the aim of the antidumping law. Currently, the antidumping law goes well beyond its purpose, punishing rational behavior and practices that are legal in a domestic context. This scapegoating represents a significant barrier to exit, which maintains inefficient domestic capacity.

The United States is currently, and will be for the foreseeable future, the largest steel market in the world. As such, there is demand for import competition. A strong domestic steel industry, one comprising primarily electric-arc furnace producers and a few integrated mills, can compete with imports. The weak domestic firms are the ones most threatened by import competition. If they cannot compete, they should shut down permanently.

If the effects of a one-time surge in imports—even a dramatic surge—can reverberate for 4 years and precipitate 30 bankruptcies, it is evident that the industry requires some restructuring. An industry in which margins are that volatile, in which any exogenous event could spell disaster for so many firms, should not be artificially supported. Many other industries experienced similar shocks in 1998 caused by the same macroeconomic events abroad. But those industries have prevailed without resort to protectionism and subsidies. The future of the U.S. steel industry depends on its ability to dispense with these crutches as well.

Notes

1. "Substantial cause of serious injury" is the legal threshold for an affirmative injury finding under Section 201 of the Trade Act of 1974. The U.S. International Trade Commission's interpretation of "substantial cause" has come under scrutiny in other 201 cases and has been found in some cases to be WTO-incompatible.

2. "Consumers to ITC: 'STEEL IMPORT RESTRICTIONS STEAL JOBS'," Consuming Industries Trade Action Coalition (www.citac-trade.org), Press Release, November 6, 2001.

3. U.S. Department of Commerce, Bureau of Economic Analysis, "Industry Accounts Data: Gross Domestic Product by Industry, 1994–2000," November 2001.

4. "Steel Companies Filing for Bankruptcy 1997–2002," Web site of the United Steelworkers of America www.uswa.org/sra/Bankruptcies%202002.pdf, as of February 11, 2002. According to the industry segment identified in that chart, 18 of the 30 companies in bankruptcy are steel producers; the other 12 include steel processors and distributors.

5. Sen. John D. Rockefeller IV, "Supporting American Steel," *The Washington Post*, January 8, 2002, p. A17.

6. But even definitions of "unfair" trade, under trade laws tailored to accommodate the steel industry, are so liberal as to warrant profound skepticism and invite case-by-case scrutiny.

7. "Rep. Brown Joins Calls For Immediate Assistance To Steel Industry," Press Release of the Office of Rep. Sherrod Brown (D-OH-13), December 19, 2001.

8. Ibid.

9. For a detailed discussion on how the antidumping law fails at measuring and redressing dumping, see Brink Lindsey, "The U.S. Antidumping Law: Rhetoric versus Reality," Cato Trade Policy Analysis no. 7, August 16, 1999.

10. See various 10-K financial reports, Securities and Exchange Commission, www.edgar-online.com.

11. Frank Haflich, "CSI says East mills play import role on W. Coast," *American Metal Market*, May 4, 2001, p. 1.

12. William H. Barringer and Kenneth J. Pierce, *Paying the Price for Big Steel* (Washington: American Institute for International Steel, 2000), p. 112.

13. Ibid.

14. OECD, "Follow-up to Special Meeting at High-Level on Steel Issue: U.S. Government Report" (Paris: OECD), December 17, 2001, p. 6.

15. This figure was compiled from data available at the International Trade Administration's Web site, http://ia.ita.doc.gov/stats/iastats1.html, and includes investigations under suspension agreement. Antidumping measures are current through December 1, 2001, while countervailing duty measures are current through November 15, 2001.

16. Ibid.

17. Ibid.

18. Joseph Pomykala, "Bankruptcy Reform: Principles and Guidelines (Revised Edition)," *Regulation*, Volume 20, Number 4, 1997, p. 6.

19. "Geneva becomes third U.S. steelmaker to file for Chapter 11," *New Steel*, March 1999, http://www.newsteel.com/news/nw990308.htm.

20. "Steel Workers' Union Welcomes Federal Legacy Cost Relief," The Business Journal Online, December 4, 2001, http://www.business-journal.com/LateDec01/SteelUnionCostRelief.html.

21. Lisa Borstadt and Thomas Zwirlein, "ESOPs in Publicly Held Companies: Evidence on Productivity and Firm Performance," *Journal of Financial and Strategic Decisions*, Spring 1995, p. 1.

22. Telephone conversation with steel analyst Charles Bradford of Bradford Research Incorporated, February 14, 2002.

23. Ibid.

24. Kevin Nevers, "Visclosky Pursues Steel Legacy Plan," *Chesterton Tribune*, November 28, 2001.

25. “USS Asks $12 Billion for Merger,” *Pittsburgh Post-Gazette*, January 8, 2002.

26. Barringer and Pierce, pp. 120-122.

27. Ibid., p. 127.

28. American Institute of Certified Public Accountants, “OPEBs: FASB prescribes strong medicine (accounting for other postretirement benefits according to the Financial Accounting Standards Board),” http://www.aicpa.org/index.htm.

29. Comments of Thomas Danjczek, President, Steel Manufacturers Association, at a Cato Institute Policy Forum entitled “What's Wrong with the U.S. Steel Industry—Again?” February 20, 2001.

30. Alan Greenspan, Chairman, Federal Reserve Board, before the Senate Banking Committee, July 28, 1999.

31. Thomas Danjczek, “The Sun Never Sets on Mini-mill Adjustment,” Steel Manufacturers Association Web site, http://www.steelnet.org/archive/6-20_ SMA _AMM.htm, June 2001.

32. OECD, “Follow-up to Special Meeting at High-Level on Steel Issue: U.S. Government Report” (Paris: OECD), December 17, 2001, p. 10.

33. Barringer and Pierce, pp. 256-257.

34. Ibid., p. 259. The table demonstrates that scrap costs equal $155 out of total cost of $315 to produce one ton of hot-rolled steel at a mini-mill.

35. See Nucor's 2000 10-K, Securities and Exchange Commission, www.edgar-online.com.

36. Robin Biesen, *The Times* (Munster, Ind.) Knight Ridder/Tribune Business News via COMTEX, September 13, 2001.

37. Ibid.

38. United Steel Workers of America, “USWA Tells ITC 'Immediate and Comprehensive Relief' Necessary to Prevent American Steel Industry's Collapse,” Press Release, September 17, 2001.

39. United Steel Workers of America, “USWA 'Bitterly Disappointed' With Bush Administration Iron Ore Ruling,” Press Release, January 10, 2002.

40. David Phelps, President, American Institute for International Steel, “The Steel Industry: Still in Distress After all These Years?” speech before the Break Bulk Expo 2001, October 1, 2001.

41. U.S. Department of Commerce, Bureau of Export Administration, “The Effect of Imports of Iron Ore and Semi-Finished Steel on the National Security,” An Investigation Conducted Under Section 232 of the Trade Expansion Act of 1962, as amended, October 2001, p. 1.

42. United Steel Workers of America, “USWA 'Bitterly Disappointed' With Bush Administration Iron Ore Ruling,” Press Release, January 10, 2002.

43. Andrew Sharkey, *The National Post* (Toronto, Canada), Editorial Section, October 22, 2001.

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