

**GREAT LAKES COMMISSION
ECONOMIC ANALYSIS AND POLICY TASK FORCE**

**POLICY OPTIONS TO DEVELOP A STRATEGY TO
ENHANCE THE COMPETITIVE POSITION OF THE STEEL INDUSTRY**

November 3, 1986

INTRODUCTION

The Council of Great Lakes Governors adopted a resolution at its May 25, 1983 Economic Summit expressing the intent to act in concert to assist our basic industries:

Retention of the basic industries of this region being vital to its economic health, an intergovernmental and public/private reinvestment strategy will be developed to enhance the competitive positions in the world economy of such industries as automobiles, automobile parts, steel and machine tools. (emphasis added)

The Great Lakes Commission has created an Economic Analysis and Policy Task Force to:

Analyze the data to identify trends, areas of regional strength to be preserved and areas of regional weakness to be overcome;

Develop additional information necessary to support research findings or develop policy recommendations;

Make explicit research findings; and

Present policy recommendations based on the research findings.
(Adopted at GLC Annual Meeting, October 17, 1985)

This document is a compilation of research findings and policy options focused on the steel industry so as to address the desires of the Great Lakes Governors and the directive of the Great Lakes Commission. The policy options are the result of a comprehensive process undertaken by the Commission's Task Force. Policy recommendations were solicited and received from a wide spectrum of interested individuals and organizations including corporate officials, academic experts, governmental agencies and trade/research organizations.

The goal of the Commission's effort is to develop steel industry policy options to be considered by the Governors of the eight Great Lakes states. We hope and expect the lessons learned from the steel industry investigation to have broader applicability to durable goods manufacturing generally. Suggested policies have three basic objectives; coordination among the region's states to effectively influence federal policy and action on steel sector and other manufacturing sector issues, development of or targeting existing state or state-administered programs to assist the steel sector in resolving specific problems and consideration among the states of action on a regional program to increase the international competitiveness of the U.S. steel industry.

The principal theme guiding the development of these policy options and their possible implementation is management of change. Steel industry policies that gain acceptance of public and private sector decision makers will not be formulated to prevent change which is inevitable and part of a normal, evolutionary economic process. Instead, such policies should consider measures designed to guide development and assist economic adaptive response.

THE GREAT LAKES ECONOMY AND THE STEEL INDUSTRY

The steel and related iron ore industries are a vital component of the region's durable goods manufacturing cluster and are important to the national economy. In recent years, the Great Lakes states have accounted for nearly 70% of domestic steel production and almost all of the iron ore mining and taconite pellet production. The region's national dominance in durable goods production including motor vehicles, farm equipment, machine tools and other capital equipment ties such manufacturing inextricably to steel usage and associated energy production and transportation/distribution functions.

The region's steel industry, particularly the integrated plant sector, has been buffeted by domestic and international forces. These forces have a bearing on the industry's short-term viability and future prospects. Penetration of traditional markets by foreign producers and U.S. minimills coupled with increasing obsolescence of physical plant and the pressing need for continued large-scale reinvestment for modernization have placed the industry in a pivotal, historic position.

The international milieu that represents and sustains the global economy is shaping the steel and iron ore industries in the Great Lakes region. For this reason the steel industry is offered as a vehicle for analysis, to assist with the review and consideration of the basic industries of the region, especially as they confront and adjust to the realities of the current international trade environment.

U.S. INTERNATIONAL COMPETITIVE POSITION

The United States has become uncompetitive in the global marketplace. Trade statistics document the deterioration of our competitive position.

The Bureau of the Census summarized trade statistics into 37 major commodity groups. Of that number only nine show a positive trade balance for 1985. They are agricultural products, anthracite coal, bituminous coal and lignite, tobacco manufactures, chemicals and allied products, nonelectrical machinery, manufactured commodities not identified by kind, and scrap and waste. Large imbalances occur in apparel and related products, petroleum refining and related products, primary metal products, electrical and electronic machinery and supplies, and transportation equipment. Even what would be considered a "high tech" industry like scientific and professional equipment shows a net trade deficit.

EXPORTS, GENERAL IMPORTS, AND MERCHANDISE TRADE BALANCE
(millions of dollars)

STATISTICAL PERIOD	EXPORTS f.a.s.	IMPORTS c.i.f.	TRADE BALANCE
Jan - June, 1986	108,118.9	192,039.5	- 83,920.6
1985	213,146.1	361,626.3	-148,480.2
1984	217,888.0	341,176.8	-123,288.8
1983	200,537.6	269,878.2	- 69,340.6
1982	212,274.6	254,884.5	- 42,609.9
1981	233,739.1	273,352.2	- 39,613.1

Source: U.S. Bureau of the Census, Highlights of the U.S. Export and Import Trade, FT990/December 1985 and special release by telephone.

According to the DRI Report on U.S. Manufacturing Industries, "There are so few exceptions to the decline of the international positions of U.S. manufacturing industries that one must seek more general causes that act on the entire economy. Without a strongly advancing manufacturing industry, the U.S. economy is hardly likely to maintain its progress in the decades ahead".

The Brookings Institution has estimated that half the jobs lost in manufacturing from 1980 to 1982 can be traced to increased imports and decreased exports. Robert Lawrence of Brookings has further calculated that to regain an equal balance in our balance of trade, the U.S. would need a 28% decline in the value of the dollar. That implies a fall in our standard of living which would be socially and politically disruptive.

The present U.S. trade imbalance is attributable, in part, to increased foreign competition and to non-tariff barriers faced by U.S. companies in their efforts to export products overseas. These foreign barriers include local content requirements, minimum export requirements that obligate firms to export and subsidies to companies that experience competition from imports.

RESEARCH FINDINGS

There is substantial excess capacity in steel production in both worldwide and domestic markets.

Vigorous competition exists in the United States and more sheltered markets characterize the economies of our major trading partners.

State of the art steel production technology is equally available to all countries.

Reinvestment in more advanced steel making facilities by domestic producers exceeds operating profits.

Current federal efforts to maintain an orderly domestic market and prevent predatory competition are only partially successful.

- target share of imports exceeded by more than 20%
- circumvention of voluntary trade agreements is common
- non signatory countries are increasing their import penetration

IMPLICATIONS

A process of substantial down-sizing of domestic steel production capacity is underway.

- Since 1976, production capability has fallen from 158 million tons to 128 million at the beginning of 1986 and is expected to decline to some 100 million tons in the next four-to-five years.
- Since 1980, employment has declined by 54%.

The demand for investment funds by the domestic steel industry exceeds the value of equity and their ability to borrow.

- LTV is in bankruptcy and analysts have a grim prognosis for Bethlehem and Armco.

Recent investment has been \$7 billion in the last four years and the industry needs to invest at least that much over the next five years.

The social and economic costs of plant closings are very large.

- Cost to companies is \$50,000 to \$60,000 per employee, plus overall costs of \$3 billion to \$8 billion to the industry.
- Cost to communities and states involve loss of tax base and increased demand for governmental services.
- Cost to individuals and families involves higher loss of income, homes and social distress.

POLICY OPTIONS

Otto Eckstein, in his last work before his death, counseled that "A nation that casually surrenders leading industrial positions through policies of neglect will find it difficult to stage a comeback, particularly if the period of non-competitiveness stretches on for more than a few years."

The following policy options constitute a coherent and coordinated program for the Great Lakes states to assist in the revitalization of the integrated steel industry. These policy options recognize that steel industry management and labor and the financial community are primarily responsible for revitalizing the industry.

Steel Research Policy

1. The Great Lakes Governors should urge Congress and the Administration to sustain funding for the Steel Industry/Federal Labs Initiative aimed at advanced technologies for steel making.
2. The Great Lakes Governors should provide state financial support for participation by state universities in the recently-established Steel Resource Center at Northwestern University.
3. The Minnesota and Michigan Governors should provide a joint program for their states designed to forge greater coordination and cooperation on iron ore and taconite research and related applied technology at the university level--University of Minnesota at Duluth and Michigan Technological University at Houghton.

State Coordination

1. Each state with a major stake in the steel industry could develop an inter-agency coordination group to address steel issues as they come up, analagous to Michigan's Auto Policy Group.
2. A multi-state cooperative effort could be organized that would entail on-location expert assistance to communities affected by steel plant closures. This would provide a mechanism for shared learning about adaptive reuse of obsolete plants, displaced worker programs and other transitional programs in order to lessen the damage from plant closings.
3. The Great Lakes Governors should convene and participate in a "steel summit" meeting in 1987 at which the region's public sector and industry labor/management officials would meet to map out a long-term strategy plan for the region's steel industry

Adjustment Assistance Programs

1. An agreement to provide advance notice of plant closings should be obtained from companies in industries for whom the United States has negotiated import restrictions such as voluntary restraint agreements. Specifically, the Secretary of Labor should negotiate Voluntary Notice Agreements (VNA) with firms operating integrated steel mills. The VNA's would provide for advance notice of three to six months of a closing of a facility with a blast furnace or basic oxygen process for the production of raw steel. The Secretary should report the progress of the negotiations to the Office of the Trade Representative with recommendations concerning the continuation or extension of Voluntary Restraint Agreements. The VNA's would be of the same duration as the VRA's.
2. A comprehensive set of services to workers who face displacement because of plant closings should be provided through a coordinated program of public and private services. They include training and assessment, counseling, job search skills training, job development, vocational skills training, and remedial education. Management, employee organizations, community based service agencies and state agencies should participate in providing the services.
3. Changes in the rules governing the payment of unemployment benefits should be enacted. If the displaced worker chooses to try to start his or her own business, the benefits should be continued for 26 weeks. In order to be eligible for this alternative unemployment compensation program, the worker would have to provide a business plan determined to be reasonably likely to succeed by a designated small business service agency.
4. Extended unemployment benefits may be paid if a state meets certain criteria. The formula should be changed to permit sub-state regions to attain eligibility in the case of a major plant closing.
5. A federally funded community assistance program to encourage the adaptive reuse of the abandoned facility or site should be enacted.

Investment Policy

1. During the period that VRAs are in place, both U.S.-owned and foreign-owned manufacturing plants that have received state investment/construction assistance or incentives should purchase steel from domestic U.S. steel companies.
2. Encourage the construction of manufacturing plants in the U.S. by foreign producers of steel-intensive goods such as autos, trucks and farm equipment. This could serve to increase the consumption of domestic steel and reduce indirect steel imports of foreign-produced steel into the United States.
3. Great Lakes states should target financial assistance and marketing programs to retain and attract firms involved in steel fabrication, distribution and use of steel in the manufacturing process. This could readily stabilize the size of the regional market for the products of integrated steel mills.

4. Implement the recommendation of the 1986 Report by the House Committee on Science and Technology, entitled "New Technology And The Future of Steel", which calls on the Congressional Budget Office to prepare a report identifying Federal policies that influence capital formation in the steel industry and describing alternatives that would maximize the generation of investment funds.

Trade Policy

1. Annually extend the program of Voluntary Restraint Arrangements (VRAs) with foreign steel producers beyond the five-year expiration date of September, 1989, upon a determination by the Secretary of Commerce and the International Trade Representative that the program in the previous year did not meet the goal of limiting imports of finished steel to 18.5 percent of domestic supply and imports of semi-finished steel to 1.7 million tons.
2. Enter into VRAs with important foreign steel suppliers not yet covered by the program either within the current structure of the VRA program or through on-going bilateral trade talks.
3. Prohibit circumvention of the VRA program by covered countries that ship products to the U.S. through countries not subject to VRAs.
4. Encourage Western Europe governments to eliminate financial support for exports of steelmaking equipment to developing countries for such time as steel remains in oversupply worldwide.
5. Continue efforts by the U.S. government to encourage foreign countries to stimulate their domestic economies, reduce trade barriers and increase the accessibility of their markets to U.S. exports.
6. Provide the U.S. Customs Service with adequate manpower and equipment to conduct full inspections of iron and steel imports and to review forms transmitted by Customs house brokers for clearance of iron and steel products to prevent fraudulent imports.

Tax Policy

The tax reform legislation signed into law in 1986 will have an impact on the region's steel and other durable goods industries. A "transition rule" for steel will provide for a 15-year carryback of 50% of the value of unused investment tax credits against taxes paid in previous years. This provision, which would provide over \$400 million to the steel industry, is conditioned upon the funds being invested in steelmaking operations, which would be consistent with the requirements of the Steel Import Stabilization Act of 1984. Other changes will have an adverse impact on the durable goods sector.

Additional changes in the Internal Revenue Code may be proposed in future years. Therefore, the following principles should be considered in the development of new legislation.

1. Minimum taxes should not be imposed on non-profitable, capital-intensive basic industries including the steel industry. If imposed, the minimum tax should provide for net operating loss carryovers, including book losses, to be applied against the taxes.
2. Short-term depreciation of five years should apply to capital equipment acquired by capital-intensive basic industries.

