

## **U.S. Steel Users Claim Tariffs “Protect a Few at the Expense of the Majority”**

U.S. steel users are paying about a third more for their raw material than they did a year ago, forcing thousands of job losses and leading some to seek cheaper steel from overseas suppliers. Others are threatening to move their own businesses offshore to escape what they say is the prohibitive cost of doing business in the U.S.

It's a prospect that may result in a permanent loss of business for U.S. steel makers at a time when the industry is striving to consolidate and become more efficient.

The main reason for the surge in steel prices is the tariff program imposed by the Bush administration in March 2002. The government set duties as high as 30% on 14 types of foreign steel for three years in a bid to protect the domestic industry from imports that in some cases were being “dumped” or sold at below the cost of production. The action followed a finding by the International Trade Commission, a federal government body, that the domestic industry had been hurt by the imports.

Steel users are now urging President Bush to make a detailed study of the effect of the tariffs on their businesses when his administration conducts its “mid-term review” of the duties in September 2003. Bush should scrap the tariffs, they argue, and allow global market forces to prevail in the steel industry.

Some 200,000 jobs have been lost in the steel-consuming industries since prices jumped by around 40% in early 2002, according to the Consuming Industries Trade Action Coalition (CITAC), which represents steel users such as makers of automotive parts.

The CITAC study didn't quantify the influence of the tariffs in the overall price rise although it is likely to have accounted for about half the increase, according to Ben Goodrich, a trade analyst at the Institute for International Economics in Washington. The rest was driven by lower production and a pickup in demand, he said.

Nearly all of the steel-consuming companies are small businesses employing fewer than 500 people; they are unable to insist their clients pay higher prices, CITAC says.

### **Cost Cutting, Pay Cuts**

At Spring Engineering and Manufacturing Corp., a Canton, Mich.-based supplier of precision components to the auto industry, steel costs have risen 27% overall since the tariffs were imposed although smaller orders for some types of steel have increased by as much as 90%, according to vice president and general manager Dan Blatt.

For 2002 the higher costs resulted in an additional 4% loss, on top of an already unprofitable year. The price hikes have also prompted no fewer than 280 cost-cutting measures including reducing the workforce from 102 to 85, prolonging a wage freeze – now 18 months old – and even eliminating free coffee for remaining workers. Executives have taken a 10% pay cut.

Spring's capital budget has been slashed to \$500,000 from \$1.2 million, eroding its ability to invest in new plant and equipment that would enable it to break into new

markets. "This has depleted our ability to fund growth and left us bidding [only] on jobs that we already have the equipment for," says Blatt. "It's a long-term slow-death spiral."

Sourcing steel offshore isn't an option, Blatt adds, because of the tariffs which apply to 90% of the metal the company buys. He says he's read through all 728 exclusions to the tariff regime and none apply to him. And even if he found a loophole, Spring simply doesn't order enough steel to attract a competitive price from a foreign supplier.

Blatt also contends with suppliers whose reliability is diminished by the financial strictures of bankruptcy. So he has just signed on with two new suppliers in return for agreeing to pay an extra 6% on top of the existing 27% rise.

His efforts to pass the higher costs on to clients have had some success. Of 12 customers who were recently asked to pay more, seven agreed to "help" while five took their business elsewhere. In light of that, Blatt decided not to approach the company's remaining 18 customers because the risks of losing the business were too great.

Would he ever consider moving the company overseas to avoid the tariffs? Only when all other options fail, he says, because it "would leave 85 families without a wage earner."

Meanwhile, bigger steel users such as the automobile industry have been less affected by the higher steel prices for two reasons: They have long-term contracts with steelmakers and a greater ability to dictate terms with component suppliers because of their size.

Daimler-Chrysler, for example, last year imposed a 5% reduction in the prices paid to all its suppliers – including Spring Engineering – in an effort to offset the financial impact of the zero percent financing deals now offered to car buyers, according to Wharton management professor [John Paul MacDuffie](#).

In easier economic times, the suppliers might have been able to renegotiate their contracts with Daimler-Chrysler and its competitors but in the current climate "most of the wiggle room has been squeezed out," says MacDuffie, who is co-director of the school's [Reginald H. Jones Center for Management Policy, Strategy and Organization](#).

Although the big automakers have been hurt by higher steel prices, they have avoided joining the suppliers' protests because they don't wish to antagonize an administration that has treated them well in other respects. "Generally, they are trying to support the administration's position and not have an open break with the government," MacDuffie says. "Some of its policies have been helpful to the industry."

### **Vote-getting in Steelmaking States**

Overall, the job loss among steel users exceeds the 185,000 employed by steel makers, CITAC says, reinforcing the users' conviction that the tariffs have benefited the steel makers at the expense of their customers.

"More than half a million Americans work in steel-consuming jobs," says William Gaskin, president of the Precision Metalforming Association, which represents

companies like Spring Engineering. "We cannot continue to have a trade policy that protects a few at the expense of the majority."

Sixteen states lost at least 4,500 steel-user jobs during 2002 – led by California with almost 20,000 – helping to explain why the administration is also under pressure from Congress to roll back the tariffs. Rep. Joe Knollenberg, a Republican from Michigan, and 51 co-sponsors back a resolution calling on the President to expand the existing midterm review to include an assessment of the impact of steel tariffs on consumers.

It was the desire to win Republican votes in steelmaking states like Pennsylvania, Ohio and West Virginia that inspired the tariffs in the first place, some analysts believe, rather than the stated intention of shielding the industry from market forces while it restructured. "It was pure politics," says Wharton management professor [Daniel Raff](#).

The steel industry dismisses the users' protests, saying that prices are falling from their highs and that steel users' jobs actually increased last year. "This claim of higher steel prices and supply disruptions by Rep. Knollenberg and CITAC is yesterday's story," said Dan DiMicco, chairman of the American Iron and Steel Institute – the industry's leading trade group – and CEO of Nucor Steel Corp., in a statement responding to the Congressional resolution. He noted that U.S. steel prices are now lower than in other producing nations including Japan, Taiwan, Britain and China, which has recently seen an increase in imports from the U.S.

"I understand that the guys who were benefiting from dirt-cheap prices during the most flagrant periods of illegal dumping may not be happy that steel prices have gone up somewhat from unsustainable, below-cost 20-year lows," DiMicco said. "But the steel industry was, in essence, under attack from foreign countries."

Although the price of hot-rolled coil, a benchmark grade, has fallen from its 2002 high spot price of \$400 a ton, the current level of \$300 is still 27% higher than the \$220 that users were paying in January 2002, according to Purchasing.com, an online purchasing industry publication that covers steel industry prices.

Pressure to roll back the tariffs may also come from the 14,000-member National Association of Manufacturers, the industry's biggest trade group, which is debating a resolution calling on the administration to examine the effects of the tariffs on "downstream" industries. Such a call would be unusual for the NAM which normally avoids involvement in sectoral disputes because it is likely to have members on both sides, as it does in the steel industry.

The complaints of steel consumers conform to the traditional pattern of tariff regimes in which the beneficiaries end up getting a subsidy, says Raff. "What happens when steel prices rise?" he asks. "A good deal of it lands on consumers. What it amounts to is the subsidy from one set of people to another."

The tariffs were intended to give the industry some "breathing space" to consolidate and modernize after low world prices drove about one third of U.S. steelmakers into bankruptcy by the end of 2001. The failures include LTV Corp. which ceased production in early 2002, and was then bought by International Steel Group, led by financier Wilbur Ross who restructured LTV with a much smaller workforce. ISG has also acquired most of bankrupt Bethlehem Steel and is now the nation's biggest

steelmaker. National Steel, also operating in Chapter 11, has received competing bids from AK Steel and U.S. Steel.

### **Consolidation Abroad**

But the breathing space may be short-lived if the World Trade Organization declares the tariffs illegal in response to complaints from the European Union and seven other countries. In that case, the U.S. is likely to rescind the duties rather than face trade retaliation on politically sensitive products during a Presidential election year, according to Goodrich of the IIE. The WTO's preliminary decision is expected to be made in March.

Without tariff protection, the U.S. steel industry will again be forced to confront its perennial problems of ageing infrastructure, high pensions and benefits costs, restrictive labor practices and technically advanced competitors. "All these are more important than foreign competition," Goodrich says.

Worldwide, the steel industry has been trying to ensure its long-term viability by eliminating so-called excess capacity – which produces steel that cannot be sold profitably – and reducing production to match demand.

In response to sagging prices and overproduction, steelmakers and government representatives from some 40 countries agreed in December 2001 to reduce excess capacity by almost 100 million tons, or about 9% of world production, over a 10-year period. That agreement was part of a process led by the Organization for Economic Cooperation and Development which has hosted a series of meetings on the issue and is currently focused on a U.S. initiative to eliminate subsidies.

The European steel industry has been leading the efforts to consolidate. Three of the continent's top producers, Usinor of France, Arbed of Luxembourg and Aceralia of Spain combined in November 2001 to form Arcelor, the world's biggest steelmaker, with 45 million tons of production. But even this behemoth represented only about 5% of world steel production at the time of its formation, indicating the fragmented nature of the industry and the difficulty of controlling production.

In January this year, Arcelor announced plans to shut about 20% of its European production over the next six years in an effort to boost profits. Six blast furnaces in Belgium, France and Germany will be closed and thousands of job losses are expected. Arcelor reported profits before tax and interest of 243 million euros in the third quarter of last year, 84% higher than a year earlier.

Whether the U.S. steel industry can follow the European lead is doubtful because tariffs will be removed, idled capacity will be reopened by new companies seeking to boost sales, and a sluggish economy is unlikely to soak up the increased production, says Goodrich of the IIE. "The outlook isn't that great for the steel industry in the short to medium term."

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