

688

INFLATIONARY IMPACT OF PRICING BY CONCENTRATED INDUSTRIES

HEARINGS
BEFORE THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES
NINETY-THIRD CONGRESS
SECOND SESSION
(Pursuant to S. Con. Res. 93)

SEPTEMBER 4 AND 9, AND OCTOBER 7, 1974

Printed for the use of the Joint Economic Committee



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1974

47-103

880

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

WRIGHT PATMAN, Texas, *Chairman*
WILLIAM PROXMIRE, Wisconsin, *Vice Chairman*

HOUSE OF REPRESENTATIVES

RICHARD BOLLING, Missouri
HENRY S. REUSS, Wisconsin
MARTHA W. GRIFFITHS, Michigan
WILLIAM S. MOORHEAD, Pennsylvania
HUGH L. CAREY, New York
WILLIAM B. WIDNALL, New Jersey
BARBER B. CONABLE, Jr., New York
CLARENCE J. BROWN, Ohio
BEN B. BLACKBURN, Georgia

SENATE

JOHN SPARKMAN, Alabama
J. W. FULBRIGHT, Arkansas
ABRAHAM RIBICOFF, Connecticut
HUBERT H. HUMPHREY, Minnesota
LLOYD M. BENTSEN, Jr., Texas
JACOB K. JAVITS, New York
CHARLES H. PERCY, Illinois
JAMES B. PEARSON, Kansas
RICHARD S. SCHWEIKER, Pennsylvania

JOHN R. STARK, *Executive Director*
JOHN R. KARLIK, *Senior Economist*
LOUGHLIN F. MCHUGH, *Senior Economist*
COURTENAY M. SLATER, *Senior Economist*
RICHARD F. KAUFMAN, *General Counsel*

ECONOMISTS

WILLIAM A. COX
SARAH JACKSON
CARL V. SEARS

LUCY A. FALCONE
JERRY J. JASINOWSKI
GEORGE R. TYLER

ROBERT D. HAMBIN
L. DOUGLAS LEE
LARRY YUSPEH

MINORITY

LESLIE J. BANDER **GEORGE D. KRUMBHAR, Jr. (Counsel)** **WALTER B. LAESSIG (Counsel)**

CONTENTS

WITNESSES AND STATEMENTS

WEDNESDAY, SEPTEMBER 4, 1974

| | |
|--|-----------|
| Proxmire, Hon. William, vice chairman of the Joint Economic Committee: Opening statement..... | Page 1 |
| Scherer, Frederic M., Director-designate, Bureau of Economics, Federal Trade Commission..... | 2 |
| Weston, J. Fred, professor, Graduate School of Management, University of California, Los Angeles..... | 13 |
| Mueller, Willard F., Vilas Research Professor, University of Wisconsin..... | 30 |

MONDAY, SEPTEMBER 9, 1974

| | |
|---|----|
| Proxmire, Hon. William, vice chairman of the Joint Economic Committee: Opening statement..... | 61 |
| Metzenbaum, Hon. Howard M., a U.S. Senator from the State of Ohio.... | 62 |
| Kauper, Hon. Thomas E., Assistant Attorney General, Antitrust Division, Department of Justice, accompanied by George A. Hay, Director of Economics..... | 73 |
| Dirlam, Joel B., professor of economics, University of Rhode Island..... | 81 |

MONDAY, OCTOBER 7, 1974

| | |
|--|-----|
| Proxmire, Hon. William, vice chairman of the Joint Economic Committee: Opening statement..... | 119 |
| West, Frederic W., Jr., president, Bethlehem Steel Corp., accompanied by Charles W. Ganzel, senior vice president, commercial; Bruce E. Haslett, assistant vice president, accounting, and assistant comptroller; and Curtis H. Barnette, assistant general counsel and assistant secretary.... | 121 |
| Jaicks, Frederick G., chairman, Inland Steel Co., Chicago, Ill..... | 137 |
| Speer, Edgar B., chairman of the board, United States Steel Corp., accom- panied by David M. Roderick, chairman, finance committee, and M. G. Heatwole, general counsel..... | 149 |

SUBMISSIONS FOR THE RECORD

WEDNESDAY, SEPTEMBER 4, 1974

| | |
|--|----|
| Mueller, Willard F.: Prepared statement..... | 35 |
| Scherer, Frederic M.: Prepared statement..... | 5 |
| Weston, J. Fred: Prepared statement..... | 16 |
| Paper entitled "An Anti-Inflation Program"..... | 22 |

MONDAY, SEPTEMBER 9, 1974

| | |
|--|-----|
| Dirlam, Joel B.: Prepared statement..... | 85 |
| Kauper, Hon. Thomas E., et al.: Prepared statement..... | 76 |
| Response to Senator Proxmire's request to supply for the record both civil and criminal cases terminated by the Antitrust Division of the Department of Justice during the period 1972-74..... | 93 |
| Response to Senator Proxmire's request to supply for the record the pretrial order on International Business Machines Corp..... | 109 |
| Response to Senator Proxmire's request to supply a breakout of the Antitrust Division's budget figures from the consolidated budget of the Department of Justice..... | 117 |

IV

| | |
|---|------|
| Metzenbaum, Hon. Howard M.: | Page |
| Table showing selected oil company profits..... | 64 |
| Table showing oil industry control of coal production..... | 66 |
| Table showing interlocking directorates between selected oil companies and financial institutions..... | 67 |

MONDAY, OCTOBER 7, 1974

| | |
|--|-----|
| Speer, Edgar B., et al.: | |
| Prepared statement..... | 154 |
| Letter to Senator Proxmire from Edgar B. Speer, dated October 24, 1974, in response to Senator Proxmire's request to supply for the record information regarding unfair foreign competition in steel as evidenced by subsidized and dumped imports..... | 188 |
| West, Frederic W., Jr., et al.: | |
| Prepared statement..... | 126 |

POINTS OF INTEREST

WEDNESDAY, SEPTEMBER 4, 1974

| | |
|--|----|
| Conable, Hon. Barber B., Jr.: | |
| Colloquy and interrogation: | |
| Scherer, Frederic M.: | |
| Nature and role of conglomerates..... | 42 |
| Subsidization of steel industry..... | 46 |
| Weston, J. Fred: | |
| Defining a concentrated industry..... | 43 |
| World markets and the steel industry..... | 44 |
| Mueller, Willard F.: | |
| Nature and future of concentration..... | 54 |
| Javits, Hon. Jacob K.: | |
| Colloquy and interrogation: | |
| Mueller, Willard F.: | |
| Antitrust approach slow..... | 51 |
| Need to increase productivity..... | 52 |
| Mueller, Willard F.: | |
| Oral statement: | |
| Return to oldtime religion..... | 30 |
| Cannot rely solely on monetary and fiscal policy..... | 30 |
| Arguments on inflationary impact of market power..... | 31 |
| Methods of dealing with market-power induced inflation..... | 33 |
| Proxmire, Hon. William: | |
| Opening statement: | |
| Price increases in concentrated industries..... | 1 |
| Colloquy and interrogation: | |
| Scherer, Frederic M.: | |
| No excessive demand..... | 38 |
| Weston, Fred J.: | |
| The role of oil..... | 40 |
| Future of prices..... | 46 |
| Mueller, Willard F.: | |
| Programs against inflation..... | 47 |
| Chances for depression..... | 58 |
| Scherer, Frederic M.: | |
| Oral statement: | |
| Different behavior of concentrated and atomistically structured industries..... | 3 |
| Role of antitrust..... | 5 |

| | |
|--|------|
| Weston, Fred J.: | |
| Oral statement: | Page |
| Wages and productivity in concentrated industries..... | 13 |
| Interpretation of cause and effect..... | 13 |
| Policy implications..... | 15 |

MONDAY, SEPTEMBER 9, 1974

| | |
|--|-----|
| Conable, Hon. Barber B., Jr.: | |
| Colloquy and interrogation: | |
| Kauper, Hon. Thomas E., et al.: | |
| Size of the antitrust division's budget..... | 99 |
| Concentration in the food industry..... | 101 |
| Dirlam, Joel B.: | |
| Steel and imports..... | 102 |
| Dirlam, Joel B.: | |
| Oral statement: | |
| Steel industry and inflation..... | 83 |
| Expansion of capacity and profits in the steel industry..... | 84 |
| Kauper, Hon. Thomas E.: | |
| Oral statement: | |
| Conflicting views on impact of administered pricing on inflation.. | 73 |
| Directing antitrust enforcement toward concentrated industries.. | 75 |
| Problems of regulated industries..... | 75 |
| Metzenbaum, Hon. Howard M.: | |
| Oral statement: | |
| Oil price rollback essential to controlling inflation..... | 63 |
| Oil companies move into alternate energy sources..... | 65 |
| Oil companies invade other industries..... | 66 |
| Proxmire, Hon. William: | |
| Opening statement: | |
| Outrageous price and profit increases in concentrated industries.. | 61 |
| Colloquy and interrogation: | |
| Metzenbaum, Hon. Howard M.: | |
| Nature and need for high oil company profits..... | 69 |
| Impact of oil prices on inflation..... | 71 |
| Kauper, Hon. Thomas E.: | |
| Effectiveness of antitrust action..... | 106 |
| IBM case..... | 108 |
| Sale to Lockheed of surplus plant..... | 110 |
| Strengthening the antitrust laws..... | 113 |

MONDAY, OCTOBER 7, 1974

| | |
|---|-----|
| Jaicks, Frederick G.: | |
| Oral statement: | |
| Origin of the steel shortage..... | 137 |
| Inland's experience under price controls..... | 139 |
| Current profitability..... | 140 |
| Economics of new investment..... | 140 |
| Need of the Nation for improved capital recovery in steel..... | 141 |
| Summary..... | 142 |
| Proxmire, Hon. William: | |
| Colloquy and interrogation: | |
| West, Frederic W., et al.: | |
| Projected sources and uses of funds..... | 174 |
| Steel price outlook..... | 175 |
| R. & D. in the steel industry..... | 192 |
| Historical versus replacement-cost depreciation formulas.... | 194 |
| Summary and conclusions..... | 194 |
| Speer, Edgar B., et al.: | |
| Demand pull versus administered inflation..... | 177 |
| Measurement and expansion of steelmaking capacity..... | 180 |
| Return on sales versus return on equity..... | 191 |
| Jaicks, Frederic G.: | |
| Phaseout of "voluntary restraint agreements" on imports and new anti-dumping provisions..... | 186 |

VI

| | |
|--|-------------|
| Speer, Edgar B., et al.: | |
| Oral statement: | Page |
| Expansion of U.S. steelmaking capacity----- | 150 |
| Industry return on sales since 1954----- | 151 |
| Experience under price controls----- | 152 |
| Needs for investment capital----- | 153 |
| West, Frederic W., Jr., et al.: | |
| Oral statement: | |
| Efforts to contain cost increases----- | 121 |
| Production capacity and its limitations----- | 123 |
| Summary and recommendations----- | 125 |

APPENDIX

| | |
|---|-----|
| Letter to 13 steel corporation chairmen from Senator Proxmire, dated October 1, 1974, informing them that the Joint Economic Committee is conducting an emergency study of the current state of the American economy and requested the steel companies to furnish specific data— with responses from various steel companies----- | 197 |
| Press release entitled "Senator Proxmire Reveals Steel Capacity Data," Joint Economic Committee, November 29, 1974----- | 211 |
| Letter to Chairman Patman from Lester S. Jayson, Director, Congressional Research Service, Library of Congress, transmitting a report entitled "Recent Steel Prices and Pricing Practices in the United States: Background and Issues"----- | 212 |
| Memorandum entitled "Steel: How Many Years of Grass Does the Mastodon Have Left? by Mitchell, Hutchins, Inc., September 10, 1974----- | 240 |

INFLATIONARY IMPACT OF PRICING BY CONCENTRATED INDUSTRIES

WEDNESDAY, SEPTEMBER 4, 1974

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (vice chairman of the committee) presiding.

Present: Senators Proxmire and Javits; and Representative Conable.

Also present: John R. Stark, executive director; Richard F. Kaufman, general counsel; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and Leslie J. Bander, minority economist.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. On August 7, 1974, the Congress agreed to a joint resolution calling for "an emergency study of the current state of the economy and of the problems relating thereto, with special reference to inflation." The resolution went on to say the Joint Economic Committee was "to provide the Congress with specific recommendations for legislation to remedy the existing ills and improve the performance of the economy."

As we begin these hearings today, President Ford has proclaimed inflation the No. 1 problem facing the United States. I fully agree with the President. Consumer prices have risen over 40 percent in the last 5 years, 12 percent in the last year alone. Wholesale prices have risen over 50 percent in the last 5 years, over 20 percent in the last 12 months. Wages have been unable to keep up with prices, and therefore, real wages are lower today than they were a year ago.

The issues surrounding inflation are very complex. The JEC intends to explore as many aspects of the problem as time allows. We begin today with an examination of the weaknesses in our economy's price-setting mechanisms. A number of economists, such as Hendrik Houthakker, Paul McCracken, and Arthur Burns, have called for the need to break up arrangements which contribute to our inflationary spiral.

PRICE INCREASES IN CONCENTRATED INDUSTRIES

When we examine the price increases and profits of a number of major concentrated industries during the past months, we see unbelievable figures.

Prices rose more than 50 percent for industrial chemicals in the past year, while profits of the chemical industry have increased by 62 percent over the same period. These profit results are in marked contrast to expectations when the oil embargo began.

It certainly appears that this industry has increased prices by much more than would be justified by the increases in oil and other input prices.

During the past 12 months, the wholesale prices of iron and steel have increased by over 40 percent—now, it is hard for us to appreciate what 40 percent is, but 40 percent is by far the biggest increase in any year in our history for steel—while the industry's profits have increased by 80 percent. Prices of nonferrous metals have increased over 46 percent, while profits in the metal and mining industry rose by 91 percent. Sales of automobiles have fallen off, the auto companies agreed to increase the prices of 1974 cars by only \$150 when their industry was decontrolled, and yet the price of cars rose by \$500 in 1974 and are going up another \$400 to \$500 for the start of model year 1975.

Clearly, increases of this magnitude in basic industries have a substantial impact on the entire price structure of both products and services in our Nation and hence, are an important aspect of our inflation study.

We now proceed to examine the impact of these industries upon inflation. We thank our three expert witnesses for coming here today and welcome their ideas and policy recommendations. Mr. Scherer, you may proceed with your statement. And we will follow with Mr. Weston and then Mr. Mueller.

**STATEMENT OF FREDERIC M. SCHERER, DIRECTOR-DESIGNATE,
BUREAU OF ECONOMICS, FEDERAL TRADE COMMISSION**

Mr. SCHERER. Thank you very much, Senator Proxmire.

My prepared statement would take about an hour to read, which might be almost as painful a burden as the present inflation. I shall, therefore, try to boil it down to about 15 minutes.

Senator PROXMIRE. Fine. I requested my staff inform you gentlemen to confine your remarks to 10 or 15 minutes, if you can. We have had an opportunity to see your prepared statement, Mr. Scherer.

Mr. SCHERER. Fine. I will cut it still more sharply at the end.

There are three main points: A discussion of the current stagnation problem, an examination of how monopoly power and inflationary behavior are linked, and some implication for antitrust policy. I shall spend more of my time on the second part.

I might not at the outset that I am stating only my own views and not necessarily those of the Federal Trade Commission.

Two observable factors stand out in the present inflationary spiral. It is international in scope, and it has resulted in part from a series of well-known shocks.

At a more fundamental level, the inflation reflects a worldwide competition for dwindling resources to support high standards of living—a competition likely to become increasingly intense in the future. Someone must reduce his aspirations. But who—in America or other lands? And within the United States, what groups?

The outcome of this income distribution struggle will be decided by a combination of market forces, Government policies, and the exercise of raw power.

This abbreviated overview brings us to the central issue in today's debate: Can the exploitation of monopoly power lead to inflation?

I see no way of denying that the precipitous crude oil price increases effected this past year by the newly perfected OPEC cartel have had a worldwide inflationary impact. But perhaps we should write such history off as a rare event akin to the appearance of a nearby celestial nova. The more difficult question is, can the exercise of monopoly power which has existed and been exploited all along lead to inflation?

On this point economists disagree strongly.

My procedure will be to concede certain points to Professor Weston, and then to highlight the remaining points of difference.

DIFFERENT BEHAVIOR OF CONCENTRATED AND ATOMISTICALLY STRUCTURED INDUSTRIES

What I hope can be agreed is that concentrated and atomistically structured industries behave somewhat differently over the business cycle. When demand is declining, prices in concentrated industries tend to fall less or to rise more than in atomistic industry. During booms, on the other hand, prices in concentrated industries tend only to keep pace with economywide trends, or even to fall behind.

Data collected on 92 manufacturing industries by my associate, David Qualls, show, for example, that prices in highly concentrated and less concentrated groups rose by about the same percent between 1967 and the August 1971 price freeze. During the period of controls the more concentrated industries fell behind, probably because they were controlled more tightly. From the end of controls in April through June of this year, an interval of growing unemployment, prices have risen significantly more rapidly in the highly concentrated industries, 8.3 percent in 3 months compared to 6.5 percent.

Professor Weston will presumably present evidence suggesting that over the long run of the past two decades, averaging recession and boom, prices have risen no more rapidly, and perhaps even less rapidly in the more concentrated industries.

Though I have some qualms about his details, I accept these results as not intrinsically implausible.

For at least two reasons, however, it does not follow that the pricing behavior of concentrated industries is free of special inflationary biases.

For one, during at least half of the past 13 years some system of controls has been in effect. And those controls have bitten harder on the more concentrated industries. There may have been insufficient time for the concentrated industries to catch up fully in the intervening uncontrolled years.

Very recent developments in autos, steel, brewing, soft drinks, and a host of other concentrated industries, lead me to believe that a lot of catching up is still to be witnessed.

Second, and more importantly, this statement of the issue begs the critical question of who is catching up with whom.

One might argue that the answer is arbitrary. It depends upon whether one begins reading his price history at the end of a recession without price controls or after a boom, with or without controls. That, however, is too simple.

Profit margins in concentrated industries tend to be significantly higher than those of atomistic industries under normal and depressed business conditions, and insignificantly different during periods of open inflation.

Concentrated industries thus set the profit pattern to which others aspire.

Likewise, wage levels in concentrated manufacturing industries tend in both good times and bad to be higher than in atomistically structured industries, partly because the former are more compact and easier to unionize, and partly because the higher profits of concentrated firms provide a fat target during collective bargaining.

As with prices, atomistic producers gain ground on wages during boom. But the pattern remains. And here it is more than merely a matter of emulation for emulation's sake. As concentrated firms increase their wage premium during soft markets, they become able gradually to pull superior workers away from atomistic producers. This is a flow which cannot persist indefinitely, however. When booming business conditions permit atomistic producers bid up wages aggressively to recoup their positions.

With respect then to both profits and wages, it is the concentrated industries which establish the pace. When during a recession they take advantage of their power to increase the profit, and with a lag, the wage differential, they are setting the stage for a subsequent catchup which raises the overall price level to a new threshold. That they had not gone as far as their power might have permitted in the previous boom seems to me to be of less importance than the fact that in the recession they went further than market conditions alone would justify.

And in this sense the wage and price behavior of concentrated industries contributes to so-called ratchet effect inflation.

Furthermore, debating average price tendencies in concentrated as contrasted to atomistic industries, misses an important part of the administered price debate.

Since the essence of matter involves the dynamics of price and wage change leadership and catching up, what the entire array of concentrated industries does may be less important than the patterns set by a few large powerful industries.

Taking this more selective approach to the alleged administration price inflation of the 1950's, Prof. Jesse Markham studied pricing patterns in nine major concentrated industries. He found that only two, autos and steel, exhibited pricing behavior patently inconsistent with supply and demand movements. My prepared statement examines the more recent pricing record of those two industries, and concludes that once again there is reason to believe a power play is underway. In steel, moreover, there exists a substantial danger that the industry will once again price itself out of world markets and be forced to seek the artificial protection of extended import quotas.

I believe in sum that the exercise of discretionary pricing power has contributed to inflation in the past, albeit modestly. And more importantly, at the present historical juncture, when the struggle over income distribution is particularly intense, it can have an especially substantial inflationary impact.

ROLE OF ANTITRUST

The question remains, what can antitrust do to suppress that impact? Wonders cannot be promised. The most urgent needs today are to shatter existing inflationary expectations and to induce belt tightening commensurate with growing worldwide competition for scarce resources, the effects of the oil cartel, and the costs of combating environmental degradation. A different kind of medicine is required for the belt tightening job. And the wheels of due process grind too slowly for antitrust to have a dramatic expectational impact. Antitrust actions with the greatest shortrun promise include a redoubling of efforts to detect and prosecute price-fixing conspiracies, and turning the glare of publicity on industries which effect price increases unwarranted by cost and demand conditions.

One important instrument of publicity will be the Federal Trade Commission's new line of business statistical program, with its first full survey covering 1974, when the problem of administered price inflation is so imminent.

For the longer run, the key question is whether antitrust can affect the basic ratchet effect character of concentrated industry pricing.

To do so would require some fundamental restructuring of the American economy. How much restructuring would be needed is unclear, since we have too many gaps in our understanding of the price and wage leadership dynamics.

Several important structural cases are now underway at the Federal Trade Commission and the Justice Department. How successful they will be remains to be seen. Meanwhile, Congress should certainly be considering backup measures which strengthen the enforcement agencies' ability to carry out a carefully weighed program of deconcentration.

These and the other measures outlined in my prepared statement can be no panacea to the inflation problem. They will help, however, and I am convinced that the present inflation will not yield readily to simple doses of the oldtime religion. Only by using all the instruments at hand, including antitrust, with the utmost vigor, imagination and skill, are we likely to achieve an early, lasting stabilization of price levels.

I thank you.

Senator PROXMIRE. Thank you, Mr. Scherer.

[The prepared statement of Mr. Scherer follows:]

PREPARED STATEMENT OF FREDERIC M. SCHERER*

Our task today is to examine the causes, consequences, and cures of the nation's current inflationary malaise. No inflation is "typical." Yet it seems clear that what we are presently experiencing is peculiarly unprecedented and atypical.

My own diagnosis, though hardly unorthodox, is colored by the fact that I have been living and studying economic conditions in Europe for the past two years. One salient characteristic is that the present inflation is clearly international. No single nation, even one as self-sufficient as the United States has historically been, seems able to isolate itself from the upward pressure on price levels. That

*This statement has not been approved by the Federal Trade Commission. It reflects my own views and not necessarily those of the Commission.

pressure can in significant measure be traced to several shocks of world-wide scope. One was the devaluation of the dollar, which simultaneously made imported materials and services more expensive to Americans while bringing the foodstuffs supplied by America's highly productive farmers and ranchers within easier reach of foreign consumers' pocketbooks. The more closely interlocked grain markets created by currency revaluations were soon impacted by production setbacks, leading first to the depletion of U.S. grain reserves due among other things to massive Soviet Union purchases and most recently to drought in the American midwest and floods in Asia. In tandem came the oil crisis of the past year, sharply raising the cost not only of petroleum products but also of substitute fuels throughout the world. Simultaneously, the prices of other important raw materials such as copper, bauxite, iron ore, steel scrap, wood pulp, and phosphoric rock—all traded on world markets—escalated. These food, fuel, and mineral price increases have in turn precipitated manufactured product price and catch-up wage increases in a spiral whose end we cannot yet see.

One might view all this as just a run of bad luck which will end and from which, with good fiscal management, we shall soon recover. I am not so sanguine. I view our present problems as the result of more fundamental developments which will not readily disappear. One is that a sizeable fraction of the world's population has achieved unprecedented prosperity. Three hundred million western Europeans now enjoy standards of living approaching those which once only Americans could grasp. One hundred million Japanese, another hundred million Brazilians, and seventy million citizens of the middle eastern oil lands and Venezuela have developed or are cultivating similar aspirations. All want more meat, autos, and television along with better housing and clothing. Satisfying these rapidly growing demands has placed a severe strain on world food, energy, and mineral resources, whose supply can be expanded only slowly and in many instances (because the best lands and deposits are already worked) only at rising unit cost. This worldwide demand-pull would under any plausible circumstances have led to price increases. For consumers the actual circumstances have led to price increases. For consumers the actual circumstances have been less than ideal, however, since rising demand has interacted with rising political and economic aspirations to facilitate cartelization of oil supplies and perhaps in the near future the supply of other key minerals such as bauxite, copper, and iron ore. In the future, I believe, competition for resources to support high standards of living is going to become even more intense—if not through bootstrap economic development, then through political blackmail supported by proliferating nuclear weapons as large have-not nations demand a reversal of the trend toward rising inequality of incomes between themselves and the developed nations.

For Americans this growing competition for resources has in recent years meant and will continue to mean that we cannot maintain the rate of growth in consumption which we have enjoyed in the past. A parallel development has the same implication. With the blessings of prosperity have come some banes—notably, greatly increased pollution of the air and water, noise; and traffic congestion. This is also not uniquely American. As an infrequent but intensive visitor in Europe I have been shocked at the vividness with which environmental degradation has materialized there. To combat the problem requires a massive injection of resources—resources which could otherwise be used to provide cars, summer cottages, air conditioning, and vacation trips. Both Americans and Europeans have in recent years concluded that these environmental cleanup costs can no longer be avoided. What they have not yet determined is how the costs will be borne, and specifically, whose belt must be tightened the most.

That, I maintain, is the nub of our immediate inflation problem. Increased competition for the world's resources forces a slackening of accustomed consumption growth rates. So does combatting the external diseconomies generated by high-level consumption. Someone must reduce his aspirations. But who? Shall it be the European more than the Americans, the Japanese and Argentinians more than the Arabs? And given the overall United States reaction, shall it be wage earners or pensioners or executives; farmers, corporate stockholders, or teachers? What we are experiencing right now is an intensification of a struggle over how the impact will be distributed. Everyone wants to maintain his relative position, but not everyone can. Moreover, if my prognosis concerning world economic developments of the next two decades is at all accurate, the struggle is apt to be a particularly bitter one.

Both within individual nations and between nations there have long been substantial income distribution inequalities and inequities. People were willing

to accept these inequities with reasonable complaisance as long as real per capita incomes were on average growing appreciably. Today's inequity was compensated by the expectation of a better tomorrow. But if increasing environmental costs and the pressures of growing population upon imperfectly expandible food, energy, and mineral resources lead to a retardation of real income growth, dissatisfaction with the existing income distribution is likely to escalate both inter- and intranationally.

How the current and forthcoming income distribution struggle turns out depends upon three main factors. First, the market will operate. Those who have resources or skills in relatively short supply will do well; those who do not will do badly. Second, the policies adopted by government matter. A dose of the "old time religion" will deflate demand by increasing unemployment among those at the margins of the work force—the young, the elderly, and the unskilled—with a probable increase in distributional inequality. Third, sheer power will count. The implications of an international power struggle over income distribution need no belaboring. Within the United States, business firms with incompletely exploited market power are likely to try to improve their relative positions, as are powerful unions, many of which appear willing to make substantial membership size sacrifices to secure higher wages for members who continue to be employed after concomitant price increases curtail demand for the products of their employers.

The pressure on corporations to increase their profits is apt to be peculiarly strong at the present time, for anticipated inflation has boosted interest rates and stock yields, thereby deflating the net worth of corporate shareholders by a much higher percentage than actual inflation has eroded the buying power of the average consumer.

I shall return to the question of market power and its consequences momentarily. First however the macroeconomic argument must be completed. If my analysis is anywhere near correct, two things must be achieved simultaneously to break out of the present inflationary spiral. Belt-tightening must take place on a world-wide plane so that effective demand and supply are brought into balance, and inflationary expectations must be dampened. The first without the second is inadequate. This means that the old-time religion alone will not solve the problem, or (more precisely) will solve it only slowly at inordinately high social cost if we fail to eliminate the fears of being left behind which stimulate producers to exploit their power in seeking higher wages, prices, and profits.

MARKET POWER AND INFLATION

This brings us to the central issue in today's debate: can the exploitation of monopoly power lead to inflation? My colleague Professor Weston apparently believes it cannot, for in a recent paper he characterized as "the most general position of economists" George Stigler's statement, "The traditional economic theory argues that oligopoly and monopoly prices have no special relevance to inflation."¹

If indeed this is to be considered universally valid, my only reaction can be, "Tell it to an oil sheik." For I see no way of denying that the precipitous crude oil price increases effected this past year by the OPEC cartel, exhibiting for the first time in its history a disciplined ability to withhold supplies and curb production, have had a world-wide inflationary impact. If one concedes that such a massive cartel-induced shock can be inflationary, with second- and third-order tremors in substitute markets, energy-using industries, and catch-up wage bargains magnifying the first-order price effect, one must, I think, also agree that the formation or perfection of lesser cartels has an impact differing only in degree.

Nevertheless, industry structure changes for the most part only slowly. The more difficult question is, can the exercise of monopoly power which has existed and been exploited all along lead to inflation? Or in a more dynamic sense, it is not unreasonable to infer that with rare exceptions like the OPEC case, the formation of new cartels which raise prices is on average counterbalanced by the dissolution of old cartels, accompanied by declining prices. Thus the net inflationary impact of cartelization tends toward zero. If then the *average* level of monopoly or cartelization does not change significantly, how can inflation be caused?

¹ J. Fred Weston and Steven H. Lustgarten, "Concentration and Inflation," paper presented at the Columbia Law School Conference on Industrial Concentration (March 1974), p. 1.

It will not, I suspect, surprise the committee to hear that on this point economists disagree strongly. Professor Weston will, I am sure, eloquently present the case against the existence of administered price inflation. My strategy will be to concede certain points which now seem fairly well established in favor of his argument and then highlight the remaining points of difference.

What I hope can be agreed, though there are always dissenters, is that concentrated and atomistically-structured industries behave somewhat differently over the business cycle. When demand is falling one should as a rule expect prices to fall. Although there are wide variations due to differing cost structures, input price patterns, and demand shifts, this prediction appears to be fulfilled less completely in concentrated industries than in atomistically-structured lines. Economists first became aware of the phenomenon during the early 1930's, when prices of nickel and aluminum fell insignificantly while wheat prices dropped by more than 60 percent. The next episode, precipitating an extended debate over administered prices before this and other Congressional committees, was the tendency of prices in concentrated industries to rise more rapidly on average than those of unconcentrated industries during the soft economic conditions of the middle and late 1950's. The recession of 1969-70 is a third probable example, and I shall argue that the present period of falling economic activity but rising prices is a fourth.

During booms, on the other hand, prices in concentrated industries tend only to keep pace with economy-wide trends or even to fall behind. There are three main reasons why powerful sellers' prices may increase less rapidly during the upswing.

First, to maximize their profits oligopolistic sellers must be conscious of their interdependence, and abrupt changes are discouraged by awareness that a misstep could upset the established pattern of coordination. Second, firms with substantial market positions commonly pursue deliberate pricing policies which among other things hold the flow of new entry at a level which maximizes long-run profits. Such a policy often implies taking less profit than one can get in any short-run situation. Firms in atomistically-structured markets have no such power, so they respond with less restraint to boom conditions. Third, four expansionary periods in recent U. S. history—World War II, part of the Korean War period, the early and mid-1960's, and the last three years—were accompanied by government price controls or formal suasion programs of greater or lesser effectiveness. Such controls tend to be more effective with respect to concentrated industries, all of whose leaders can be assembled in a single room for jawboning, than in atomistically-structured industries. Even with the patriotic spirit which accompanied World War II, price controls were rather unsuccessful in such fragmented industries as textile and garment manufacturing.

This point can be illustrated by some data my associate David Qualls has pulled together in the first preliminary phase of a study of inflationary patterns. The full text of his memorandum will be submitted for the record. He classified 92 four-digit manufacturing industries on which comprehensive wholesale price statistics are available into two categories: 38 industries with 1967 eight-firm concentration ratios of 70 or more and 54 industries with lower concentration ratios. The simple average wholesale price index increases for three recent periods in these two categories were as follows:

PERCENTAGE INCREASE IN WHOLESALE PRICE INDEX

| | Concentration of 79 or less | Concentration of 80 or more |
|--------------------------------|--------------------------------|--------------------------------|
| 1967 to August 1971..... | 16.3 | 15.1 |
| August 1971 to April 1974..... | 32.9 | 23.4 |
| April 1974 to July 1974..... | 6.5 | 8.3 |

During the period from 1967 to the price freeze in August 1971, prices rose by almost the same amount in the two groups. During the period of active controls, the more concentrated industries fell behind significantly. From the end of controls in April 1974 through June—an interval of increasing unemployment—price increases have been significantly more rapid in the more concentrated industry group, although the ground lost during controls had not yet been recovered. It is worth noting that the concentration threshold used to divide the groups is somewhat arbitrary, and that both petroleum refining and steel—oligopolies by almost any set of standards—are classified here among the less concentrated industries.

I think it can be stipulated that sometimes concentrated industries lead the price increase parade and sometimes they lag behind. Professor Weston has presented elsewhere,² and presumably he will present again today, evidence suggesting that over the past two decades, averaging recession and boom, prices have risen no more rapidly and perhaps even less rapidly in the more concentrated manufacturing industries. I have not conducted an independent study, and although I have some doubts about his sample and measurement techniques, I would at least for the present concede that his statistics may adequately portray what has actually happened. For at least two reasons however it does not follow that the pricing behavior of concentrated industries is free of special inflationary biases.

For one, during at least half of the past thirteen years some system of controls has been in effect, and to repeat, those controls have bitten harder on the more concentrated industries. It is by no means clear that there has been time for those industries to catch up fully in the intervening uncontrolled years. Very recent developments in autos, steel, brewing, soft drinks, and a host of other concentrated industries lead me to believe that a lot of "catching up" is still to be witnessed.

Second and more importantly, this statement of the issue begs the critical question of who is catching up with whom. One might argue that the answer is totally arbitrary; it depends upon whether one begins reading his price history at the end of a recession without price controls or after a boom, with or without controls. That however is too simple. I know Professor Weston will disagree, but the weight of evidence suggests that profit margins in concentrated industries tend to be significantly higher than those of atomistic industries under "normal" and depressed business conditions and insignificantly different during periods of open inflation.³ Concentrated industries set the pattern to which others aspire, but only occasionally achieve. Likewise, wage levels in concentrated manufacturing industries tend in both good times and bad to be higher than in atomistically structured industries, partly because the former are more compact and easier to organize, and partly because the higher profits of concentrated firms provide a fat target during collective bargaining.

As with prices, atomistic producers gain ground during booms, but the pattern remains. And here it is more than merely a matter of emulation for emulation's sake. All other things equal (and some, such as the degree of job dissatisfaction, may not be), workers should be roughly indifferent to working in a concentrated or atomistic industry. As concentrated firms increase their wage premium during soft markets, they become able gradually to pull superior workers away from atomistic producers. This is a flow which cannot persist indefinitely, however. When booming business conditions permit, atomistic producers bid up wages aggressively to recoup their positions. With respect then to both profits and wages, it is the concentrated industries which establish the pace. When during a recession they take advantage of their power to increase the profit and (with a lag) wage differential, they are setting the stage for a subsequent catch-up which raises the overall price level to a new threshold. That they had not gone as far as their power might have permitted in the previous boom seems to me to be of less importance than the fact that in the recession they went further than market conditions alone would justify. And in this sense the price and wage behavior of concentrated industries contributes to a kind of "ratchet effect" inflation.

There is more to the ratchet argument. In a competitively functioning market one would normally expect prices to rise during booms and to fall during slumps. Abstracting from secular patterns associated with technological advance or resource depletion, this seems to be the pattern in atomistically-structured industries. On the other hand, it is asserted by Gardiner Means and others that prices in concentrated industries are stickier downward (i.e., during recessions) than they are flexible upward. The evidence supporting this view has been challenged, most notably by Professor George Stigler, but Means, recasting Stigler's data, has argued in return that the facts support his own position.⁴ It is all very confusing, and I confess having devoted too little effort to see who has the better case. If Means is right, and if Charles Schultze was right in his

² *Ibid.*

³ See the debate between Harold Demsetz and Leonard Weiss in the Columbia University Conference on Industrial Concentration proceedings, *op. cit.*

⁴ See Gardiner C. Means, "The Administered-Price Thesis Reconfirmed," *American Economic Review*, June 1972, pp. 292-306; and George J. Stigler and James K. Kindahl, "Industrial Prices, as Administered by Dr. Means," *American Economic Review*, September 1973, pp. 717-721.

study paper written for this committee in 1959,⁵ the pricing behavior of oligopolistic firms contributes all the more consistently to a kind of ratchet-effect inflation. Their prices go up when demand rises but fall much less when demand declines. To the extent that this is true, there is nowhere to go on the average but up.

One further question concerning broad statistical patterns deserves to be explored. Work by Professors Weston and Lustgarten suggests that between 1954 and 1970 wages per man-hour increased more rapidly in concentrated than in unconcentrated industries, but this disparity did not lead to more rapid price increases in the concentrated lines because productivity simultaneously rose at a higher rate.⁶ Whether or not their sample is representative and their productivity measure accurate I cannot say. Based upon four years of intensive research on scale economies in 12 industries, I do find one of the two causes they identify—"the enlarged scope of managerial economies of scale"—to be totally unconvincing. Yet the key point is this. If in fact productivity has risen more rapidly in concentrated industries, why have the benefits been distributed primarily to workers in the form of higher wages rather than to consumers in the form of lower prices? There is no evidence that concentrated manufacturing industries have been expanding their hiring relative to other industries, and numerous studies reveal no net tendency for technological changes to make working conditions relatively less attractive. Nor is it clear that automation or increases in plant scale systematically raise job skill requirements.⁷ So why the rising wage premium? Absent differences in demand growth, skill needs, or job attractiveness, the wage-price pattern identified by Professor Weston can only lead to labor market disequilibrium, forcing firms experiencing slower technological progress to bid up wages when they can—that is, during booms—to retain or regain superior workers. The long-run effect again is inflationary.

Summing up, the broad statistical evidence suggests no tendency for prices in concentrated industries to rise more rapidly than in unconcentrated industries over the long run. There are however definite differences in behavior at different stages in the business cycle, and there are grounds for believing that the more concentrated industries exercise leadership in implementing discretionary price and wage increases, stimulating firms with less market power to catch up when they can. We know far too little about the precise dynamics of these lead and lag relationships. To deny that they can induce a net inflationary bias would in my opinion be unwarranted. And I believe the role of companies possessing market power is likely to be much more important in the unprecedented stagflation we are now experiencing than it has been in past periods of more moderate "administered price" inflation.

It may well be however that debating average price tendencies in concentrated as contrasted to atomistic industries misses an important part of the administered price issue. For one thing, concentration indices do not always measure monopoly power effectively. National concentration is extremely low in the various health care delivery fields, but discretionary pricing power is great because of market localization, entry barriers, and doctor-patient-hospital lock-in effects. Price increases in health care have been dramatically rapid since the end of price controls last April 30. Also, when one recognizes that the essence of the administered price problem involves the dynamics of price and wage change leadership and the subsequent catching-up process, it should become clear that what the entire array of concentrated industries does may be less important than the patterns set by a few large powerful industries.

I doubt whether anyone would single out the highly concentrated photographic film and paper industry for inflationary pattern-setting any more than they would the large but atomistically-structured garment trades. Rather, one looks to autos, steel, industrial chemicals, electrical equipment, and petroleum refining.

Taking this more selective approach to the alleged administered price inflation of the 1950's, Professor Markham conducted a detailed study of pricing patterns in nine major concentrated and four atomistic manufacturing industries.⁸ He

⁵ Charles L. Schultze, "Recent Inflation in the United States," Study Paper No. 1, Joint Economic Committee, September 1959.

⁶ *Op. cit.*, pp. 2-10.

⁷ A reexamination of trends in the 12 manufacturing industries I have studied recently suggests that there may be some tendency for automation to be biased toward displacing relatively highly skilled workers in low-wage industries but unskilled workers in high-wage industries. Whether this is the *cause* or *effect* of high and rising wage differentials is arguable.

⁸ Jesse W. Markham, "Administered Prices and the Recent Inflation," in the Commission on Money and Credit Compendium, *Inflation, Growth, and Employment* (Prentice-Hall, 1964), pp. 144-173.

found that only two of the concentrated industries—steel and autos—exhibited pricing patterns patently inconsistent with supply and demand movements, with prices rising during severe recessions as well as in boom periods. Should it surprise us that the same two industries stand out for having implemented enormous price increases during the current stagflation?

Granted, the circumstances are somewhat different today, especially for steel. During the late 1950's steel producers raised prices despite severe under-capacity operation. Today there is a world-wide steel boom; both domestic and foreign producers have been straining to fill orders. Demand-pull is clearly present. Also, profit rates in the American steel industry have been severely depressed in recent years, largely because of tough foreign competition. Whether the 40 percent price increase effected this year will bring them back to the "right" level or overshoot is more questionable. And more important, what will the longer-run consequence be, once the world steel boom abates? During the past four years I have made a careful study of steel industry investment and efficiency in seven nations.

It has become clear that the United States has lost its technological leadership in steel, and I suspect the most recent figures will show that the Japanese have overtaken American producers in average productivity per worker. It is hard to predict the future, given volatile currency exchange rates, severe wage inflation abroad, and the development of new steel capacity near prime ore and energy sources. Still I shall not be surprised if U.S. steel companies find that through their recent price increases they have squandered their opportunity to become competitive in world markets. Then they will among other things beat a path to Congress asking for extension of the steel import quotas which have protected them from bearing the consequences of past prodigality.

One can find no demand-pull rationale for recent auto price increases. Nor is there any indication that the industry needs especially high rates of return to attract new capital for above-average rates of expansion. With 1.5 percent carbon monoxide levels in nearly half of all non-smoking large city residents' blood, who needs more cars? The auto producers have cited increased costs as the reason for their price increases. It is plain that costs have risen, among other things, to cover the introduction of catalytic mufflers and higher steel prices.

But do the recent and contemplated price increases cover only unavoidable cost increases, or is an attempt being made to return to the high profit margins General Motors enjoyed in the 1950's and 1960's? Would the auto producers have included wage escalator clauses in their union contracts had they not been confident of their ability to raise prices even when demand is weak? To what extent are the increased costs now being covered the costs associated with sub-optimal capacity utilization and reconverting lines away from gas-guzzling models previously emphasized by the Big Three and especially General Motors? Given that General Motors has derived much of its superior profitability from its strength in the larger luxury cars, which carry particularly high profit margins, is it now trying to recoup by pushing margins upward in the moderate price range, to which U.S. consumer demand has shifted and against which import competition has been blunted by the dollar's devaluation and inflation abroad? These are questions I would want to see answered fully before concluding that recent auto price increases were in any sense unavoidable and hence no more inflationary than economic conditions warranted.

THE ROLE OF ANTITRUST

I believe in sum that the exercise of discretionary pricing power has contributed to inflation in the past and may at the present historical juncture have an especially important inflationary impact. The question remains, what can our traditional instruments for combatting monopoly power do to suppress that impact? What is the role of antitrust?

Wonders are scarcely to be expected. To the extent that monopoly is responsible for at least part of our inflationary woes, it must follow that past antitrust enforcement has failed us, which is hardly a favorable future omen. Also, as I have stressed earlier, the most urgent needs today are to shatter existing inflationary expectations and to induce a discontinuous downward adjustment in the time path of consumption commensurate with increasing world-wide competition for scarce resources, the effects of the crude oil cartel, and the costs of combatting environmental degradation. Antitrust can do nothing to induce belt-tightening; that calls instead for well-tailored fiscal adjustments and strong moral leadership. It can do little about the first problem either, for the wheels of due process grind too slowly to have the dramatic impact on expectations we pres-

ently need. The one possible exception might involve price-fixing conspiracies, where an investigation with criminal charges can sometimes be sufficient to frighten faint-hearted conspirators and thereby precipitate a break from collusive price levels. We should be redoubling our vigilance here. I would like to tell you that the antitrust agencies might do something about the greatest price-fixing cartel in modern history—OPEC, but I am afraid its conduct lies largely or even entirely outside our jurisdiction.

As time goes on the impact is likely to be greater. In my first month at the Federal Trade Commission, I have been greatly impressed by the vigor of its staff and the strong desire among all concerned to direct our antitrust and consumer protection resources into areas where they will yield maximum social benefit. The "Little Old Lady on Pennsylvania Avenue" is moving, and the results are beginning to unfold.

I have the impression that similar movement is underway at the Justice Department. But it takes time and enormous effort to carry to successful completion cases involving any matter more complex than blatant per se law violations. What we can accomplish is all too finite. Partly for that reason and partly because many inflationary developments have no simple links to identifiable antitrust law violations, one cannot expect antitrust to "solve" all or even a large fraction of the inflation problem.

The question remains, can antitrust affect the basic pattern of concentrated industry pricing which leads, after a catch-up phase, to an upward ratchet effect? To do so would require some fundamental restructuring of American industry. How much restructuring would be needed I cannot say, largely because we do not know whether the upward leadership role is concentrated in a few key pattern-setting industries or whether it is more widely diffused. We surely need further research on the dynamics of administered price inflation. But meanwhile we are also acting. The Justice Department has major structural cases underway in the computer and tire industries and the FTC in petroleum refining, copying machines, and breakfast cereals. How successful we will be remains to be seen. Whether we can successfully bring further cases depends in part upon resources and partly upon whether adequate relief can be foreseen given existing laws and such economic realities as the presence of scale economies. One component of our longer-run struggle against inflation should surely be the consideration of measures strengthening existing or new antitrust agencies' ability to restructure concentrations of economic power.

My own research during the past four years has been focused primarily on the question of whether scale economy losses following such restructuring would be great. I don't want to oversimplify what is in fact a very complex issue, but in general I find that the economies presently enjoyed by large multi-plant firms as a result of their multi-plant posture are not very substantial, and consequently post-divestiture scale economy losses would not be severe.

Another possibility is that the antitrust laws might be revised to create a stronger deterrent to inflationary pricing behavior. What I have in mind would be provisions making price increases not warranted by demand or exogenous cost pressures material evidence in price-fixing, monopolization, and unfair methods of competition cases. Given the difficulty of determining whether a price increase was in fact "warranted," I am not sure such provisions would be a good idea. They do however deserve thought. If enacted, they would surely have a deterrent effect materializing much more swiftly than the ultimate impact a successful but protracted case prosecution can.

Finally, the antitrust agencies and particularly the Federal Trade Commission can help by simply informing Congress and the public what is happening in our major industries. As Justice Brandeis said long ago, "Sunlight is the best antiseptic." The FTC's new line of business reporting program will be one vehicle for illuminating the effects of price behavior on profit performance.

That the first full survey will cover 1974, which could be marked in history as the year of the great administered price inflation, may in part explain Big Business' massive opposition to the program. Without the kind of information our Line of Business Survey will provide, I do not know how a system of jaw-bone price controls can function. But statistics on profits, promotional outlays, and the like by industry are not sufficient. What we really need if we are to make well-informed judgements concerning industrial performance are comprehensive interpretive studies of particular industries' structure, behavior, and performance. Many excellent industry studies have been written by academic economists, but such research has fallen out of fashion with the rise of mathematical economics and econometrics, so the stock of up-to-date studies has

been dwindling. The FTC Bureau of Economics also has a long and honorable tradition here. I consider it one of my highest priority tasks at the FTC to increase our industry study output so that the nation's decision-makers have at hand solid factual and analytic reports on the most important non-regulated industries. That too, I hope, will make a significant contribution to the continuing struggle against inflation.

Perhaps my imagination is too limited or my heart too faint, so perhaps anti-trust could do more than I have outlined here. What we have to offer is far from a complete cure, but it is also not negligible. We at the FTC would be grateful to members of the Committee for suggestions as to how we can do more.

I thank you.

Senator PROXMIRE. Mr. Weston, please proceed.

STATEMENT OF J. FRED WESTON, PROFESSOR, GRADUATE SCHOOL OF MANAGEMENT, UNIVERSITY OF CALIFORNIA, LOS ANGELES

Mr. WESTON. There is a big difference between the role of prices, wages, and monetary fiscal policy during the longer periods of relative stability as compared with the problem after inflation has been underway for a number of years and inflationary expectations have been developed.

Therefore, I will summarize briefly my prepared statement, which deals mainly with the longer term perspective and add some comments relevant to the transition problem, the immediate problem.

The background for the prepared statement that I prepared for presentation is contained in a longer paper, which I submitted for the record.¹

As Mr. Scherer has indicated, there is no major disagreement with regard to the pattern over longer periods of years with respect to the role of concentrated versus less concentrated industries in price formation and in price changes.

WAGES AND PRODUCTIVITY IN CONCENTRATED INDUSTRIES

With regard to the facts on wages in concentrated industries, there is apparent support for the argument that wages are higher in concentrated industries if one just looks at the data in table 1 of my prepared statement which shows that wages per man-hour have increased more in the most concentrated industries over almost any time segment that you take since 1954.

On the other hand, productivity has increased more in the most concentrated industries. And so over all of the time period, with the one exception of the 1969-70 recession, unit labor costs have increased less in the most concentrated industries than in the less concentrated industries. And, indeed, other studies show that even in unionized versus not unionized industries, adjusted for differences in years of education and experience of workers, that it is doubtful whether wages are even higher in the unionized as compared with the nonunionized industries.

INTERPRETATION OF CAUSE AND EFFECT

There are some important matters of interpretation of cause and effect here which time does not permit me to go into.

¹ See paper entitled "An Anti-Inflation Program," beginning on p. 22.

The correlative to the facts that unit wage costs, unit wage increases are not higher in concentrated industries as compared with less concentrated industries, is also found in the data on price changes. And, again, taking any time period since 1954, the data show generally that price increases in the most concentrated industries have, in fact, over the long pull been less than price increases in the least concentrated industries.

The period 1958 through 1965 is of particular interest. During that 7-year interval, when the structure of American industry and the strength of unions was not fundamentally different from what it is today, or what it was in 1966 and on when the high rate of inflation began, the average rate of price increase per annum during that 7-year interval preceding the subsequent period of very rapid inflation was 0.42 percent per year, less than one-half of 1 percent per year. In fact, in the most concentrated industries, there was an average price decrease per annum of 0.35.

So that over this period of time it can be seen that there is no structural problem fundamentally in the economy. True jawboning started in the latter part of that time period, but it was not present in the earlier part. So that in the major portion of that 7-year period of time this was the operation of free market forces. It was a period of price stability.

But, unfortunately, happy periods of that kind have not been with us since the onset of the very rapid inflation beginning in 1966.

But the structure of the economy did not change. Something else changed. It was monetary-fiscal policy. We piled a war in Southeast Asia on top of a heightening of some domestic programs. Most of the domestic programs, in my judgment, had value from a long-term standpoint in increasing the productivity, particularly of the disadvantaged in our economy. But piled on along with escalation of hostilities in Southeast Asia without proper monetary fiscal offsets, it got the inflation started.

So then, the problem becomes one of, what do you do after an inflationary period has gotten underway, how do you get out of it? And here, then, it is proper to make inquiry as to the role of concentrated industries, because I would acknowledge that there is a difference in the role of strong unions in concentrated industries during a period of relative price stability as compared to a period where there are strong inflationary expectations.

And it is clear also that there is practical value in moderating the rate of wage increases during a period when inflationary expectations have been created, because wages represent the only cost that business firms have that does not represent a cost of some other business firm. It is, therefore, critical in its role in controlling inflationary expectations.

Now, my own data indicate that in the immediate months following decontrols, indeed price increases have been somewhat higher in the most concentrated industries than in the least concentrated industries. And the data would suggest that this represents, then, the taking over indeed of the operation of market forces.

Now, there are two broad approaches to attempting to change inflationary expectations in concentrated industries in the wage setting, wage bargaining processes. One is Government intervention, direct

Government intervention. As I read past history on this, direct Government intervention in wage disputes and major industries has leaned on the side in a number of industries toward wage increases that were inflationary in their impact.

It should be recognized, however, that despite the general disrepute into which wage controls have fallen on the basis of our experience in 1971, 1972, and 1973, that if you look at the data over all, while the average percentage increase in wages for the first year in the wage negotiations in 1971 was 11.3 percent, they dropped to 7.3 percent for 1972, and to 5.8 percent for 1973. So that the role of wage stabilization even in the face of inflationary expectations was relatively good. I will grant that the 5.8 is something of an understatement, because there were escalator clauses built in which had an ultimate effect.

Incidentally, this, I think, also calls for a comment on indexing, because indexing in this regard, if you are trying to really wind down an inflation, does the opposite of what you are trying to do.

The point I wanted to emphasize here is that the other policy, a more general approach, is a more desirable one. I would say that emphasis should be placed on an area that has been relatively neglected in the discussions and which I would like to briefly summarize and then close.

POLICY IMPLICATIONS

I believe that more attention must be given to the role on the financial side in this interaction between wages and prices in the hopes of securing a continuation of what really has been a relatively statesman-like role of labor during this inflationary period. And I think the kinds of financial policies called for would include the following: One, a freeze on dividend levels; two, consideration of an increase in corporate tax rates; and three, a 2 to 3 year excess profits tax on industries where windfall profits are occurring. This is complicated in that when one looks at profit increases, one has to take into account that reported profit increases are somewhat illusory. For example, between the fourth quarter of 1973 and the first quarter of 1974, corporate profits before taxes appeared to rise from \$127 billion to \$140 billion, an increase of 10 percent. On the other hand, corporate profits before taxes, taking into account inventory valuation adjustments, actually dropped from \$112 to \$109 billion, by \$3 billion. This does not take into account the parallel adjustment that would have to be made for depreciation at replacement costs rather than at historical costs.

In addition to a consideration of the kinds of tax increases on corporate profits that I have listed would be an increase in the investment tax credit. The aim of the combined tax policies would be to stimulate the use of funds into capacity-increasing and, therefore, supply-increasing allocations of funds which would mitigate the inflationary problem from the supply side and at the same time, hopefully provide an atmosphere in which wage increases could be moderated under present circumstances.

But in addition, it seems to me that we also need to establish some machinery in the form of a capital allocation committee and broad rules for channeling the flow of investments. We are learning that monetary control is not really impersonal in its impact. It does not treat all groups alike. When tight monetary controls increase money

and capital costs, there is actually some tendency to allocate funds to the highly speculative areas that can promise very high rates of return. And this argues, then, for some forms of capital allocation plan to work on the flow of funds into the areas where the supply side of the inflationary problem can make a contribution to diminishing inflationary impacts.

And, therefore, I conclude that particularly in the financial area there is an important role to play, after inflation has been underway, with financial policies of the type that have been outlined in order to achieve a winding down of a wage-price spiral.

Thank you.

Senator PROXMIRE. Thank you very much, Mr. Weston.

[The prepared statement of Mr. Weston and the paper entitled "An Anti-Inflation Program" follow.]

PREPARED STATEMENT OF J. FRED WESTON

ADMINISTERED PRICING: A SLOGAN IN SEARCH OF A PHENOMENON

The oligopoly-wage-price spiral argument implies that wages are higher and increase faster in concentrated industries compared with less concentrated industries. The issue is a factual one and relevant evidence is presented in Table 1. Table 1 presents data on average annual percentage changes in wages, productivity and unit labor costs for various time periods since 1954. Computations are made for 4-digit SIC industries, summarized into 4 concentration groups. The concentration ratio employed is the generally used share of shipments accounted for by the four largest firms in each industry. The results are organized by placing industries into four quartiles by concentration ratio.

Table 1 shows that wages per man hour (WMH) increase faster in the more concentrated industries as compared to less concentrated industries. But the data also show that productivity (QMH) increases even faster in the more concentrated industries. The net result is that unit labor costs (WSQ) rise less rapidly in the more concentrated industries. Indeed, other studies show that when adjustment is made for the educational and experience levels of workers in concentrated industries, that there is no significant difference between the wages paid to workers in concentrated industries as compared with workers in less concentrated industries. [Haworth and Rasmussen (1971) ; Weiss (1966)]. Table 1 shows that for most of the time periods since 1954 that unit labor costs in the most concentrated industries have actually declined and declined to a greater extent than in the least concentrated industries. Only since the onset of strong inflationary forces after 1966 have unit labor costs began to increase by more than 1 percent per annum on the average in the most concentrated industries. The data on the 1969-70 recession represent the basis upon which broad generalizations are frequently made, yet from the perspective provided by Table 1, the 1969-70 recession represents an exception to the general pattern.

TABLE 1.—AVERAGE ANNUAL PERCENTAGE CHANGE¹ IN WAGES (WMH), PRODUCTIVITY (QMH) AND UNIT LABOR COST (WSQ) FOR PERIODS BETWEEN 1954 AND 1970 BY LEVEL OF INDUSTRY CONCENTRATION

| Period | CR4<25, N-138 | | | 25<CR4<50, N-157 | | | 50<CR4<75, N-78 | | | CR4>75, N-24 | | |
|-----------------------|---------------|-------|-------|------------------|-------|-------|-----------------|-------|-------|--------------|--------|--------|
| | WMH | QMH | WSQ | WMH | QMH | WSQ | WMH | QMH | WSQ | WMH | QMH | WSQ |
| (1) 1954 to 1958..... | (?) | 4.05 | 1.57 | (?) | 4.59 | 1.52 | (?) | 4.88 | 1.52 | (?) | 6.16 | 0.70 |
| | | (.34) | (.26) | | (2.9) | (.27) | | (.54) | (.48) | | (1.13) | (.83) |
| (2) 1958 to 1963..... | 2.69 | 3.27 | -.48 | 3.03 | 4.35 | -.99 | 3.35 | 5.14 | -1.01 | 3.73 | 5.82 | -1.38 |
| | (.08) | (.18) | (.12) | (.11) | (.23) | (.15) | (.16) | (.44) | (.25) | (.13) | (.54) | (.47) |
| (3) 1963 to 1966..... | 2.97 | 3.99 | -.16 | 3.05 | 3.68 | .43 | 3.57 | 4.48 | -.59 | 3.05 | 4.59 | -.73 |
| | (.14) | (.38) | (.34) | (.14) | (.45) | (.44) | (.31) | (.58) | (.40) | (.26) | (1.60) | (1.21) |
| (4) 1958 to 1965..... | 2.75 | 3.68 | -.54 | 3.00 | 4.46 | -.72 | 3.47 | 5.56 | -1.00 | 3.72 | 6.38 | -1.42 |
| | (.08) | (.21) | (.14) | (.09) | (.28) | (.19) | (.10) | (.50) | (.24) | (.15) | (1.03) | (.53) |
| (5) 1966 to 1969..... | 6.24 | 2.95 | 3.95 | 5.86 | 4.26 | 2.86 | 5.15 | 2.61 | 2.92 | 5.65 | 4.59 | 1.51 |
| | (.20) | (.45) | (.49) | (.22) | (.53) | (.56) | (.22) | (.51) | (.53) | (.25) | (.87) | (.82) |
| (6) 1969 to 1970..... | 4.67 | 2.45 | 4.37 | 5.17 | .78 | 6.62 | 6.49 | 2.16 | 5.82 | 5.85 | -.45 | 7.76 |
| | (.62) | (.97) | (.97) | (.53) | (.87) | (.86) | (.84) | (.83) | (.95) | (.77) | (1.63) | (1.83) |

¹ Standard error in parentheses.

² Not available.

Source: 1954-58 U.S. Bureau of the Census, "Census of Manufacturers 1963," vol. 4. 1958-70 U.S. Bureau of the Census, "Industry Profiles" (1972) and Board of Governors, Federal Reserve (Annual Index of Production), the Federal Reserve Bulletin (July 1971).

Another formulation of the sellers' inflation theory is that while prices in less concentrated industries are set by impersonal market forces, firms in concentrated industries exercise discretion over the prices that they announce. This discretion over price is said to permit sellers to raise prices as desired. (Ackley, 1959). This argument has also been expressed in the concept of target return pricing. [Lanzillotti (1958), Eckstein and Fromm (1968)] Oligopolistic firms are said to start with some target rate of return on investments which they consider satisfactory, then set a price which will enable them to earn that return when plant utilization is at some standard rate (e.g., 80% of capacity).

At the theoretical level the target return pricing concept is inconsistent with the basic economic proposition that rational firm behavior calls for profit maximization. It also reflects some misconceptions of how financial planning and control and related processes represent the activities by which the optimizing results are approximated. One aspect of the planning and control activities of business firms is that they seek to avoid allocating funds to investments that do not promise to earn the firm's cost of capital. Investments whose forecasted returns are above the firm's cost of capital will receive high priority.

The target return is a screening device in choosing among alternative allocations of funds. The use of a target objective provides no assurance that opportunities to earn these targets can be found. The targets do not determine profit levels; market demand and supply conditions and the relative levels of managerial efficiency determine the profit levels that will be actually realized.

The argument to this point has proceeded on a theoretical level. It may therefore be useful to evaluate the two alternative explanations of how prices are set by reference to the facts. Table presents evidence on prices changes by industries grouped by concentration quartiles as was done in Table 1. Various time periods are covered between 1954 and September 1973. The average price change for each industry was calculated by taking the ratio of the annual price index at the ending year of the period to the price index at the beginning year for each time period, expressing the change as a percent, and dividing by the number of years in the period.

TABLE 2.—AVERAGE ANNUAL PERCENTAGE PRICE CHANGE¹ FOR SELECTED TIME PERIODS BETWEEN 1954 AND 1973 BY LEVEL OF INDUSTRY CONCENTRATION

| Period | CR4<25 | 25<CR4<50 | 50<CR4<75 | CR4>75 | All |
|------------------------|-----------------|----------------|---------------|----------------|---------------|
| | N=132 (1) | N=150 (2) | N=76 (3) | N=23 (4) | N=381 (5) |
| (1) 1954 to 1958 | 1.70 (.23) | 1.79 (.22) | 1.77 (.29) | 1.58 (.67) | 1.74 (.14) |
| | N=65 | N=89 | N=59 | N=22 | N=235 |
| (2) 1958 to 1963 | 0.28 (.20) | 0.40 (.16) | 0.39 (.29) | -0.24 (.42) | 0.31 (.12) |
| (3) 1963 to 1966 | 1.98 (.29) | 1.56 (.29) | .86 (.27) | -.28 (.71) | 1.33 (.17) |
| (4) 1958 to 1965 | .51 (.15) | .54 (.14) | .42 (.22) | -.35 (.45) | .42 (.10) |
| (5) 1966 to 1969 | 2.89 (.33) | 2.40 (.26) | 2.59 (.36) | 1.85 (.75) | 2.53 (.18) |
| (6) 1969 to 1970 | 2.01 (.72) | 4.22 (.48) | 4.03 (.58) | 4.39 (1.29) | 3.80 (.32) |
| | N=14 | N=31 | N=32 | N=14 | N=91 |
| (7) 1970 to 1973 | 12.56 (9.25) | 9.58 (1.92) | 4.86 (.55) | 2.86 (.86) | 7.34 (.87) |
| (8) 1966 to 1973 | 7.47 (1.42) | 5.83 (.70) | 4.33 (.44) | 2.54 (.73) | 5.05 (.40) |

¹ Standard errors shown in parentheses.

Sources: Price change 1958-73; U.S. Bureau of Labor Statistics, Wholesale Price Index, Industry Sector Price Indexes. Price change 1954-58; Census Unit Value Indexes, "Census of Manufacturers 1963," vol. 4. Concentration ratios (CR); U.S. Bureau of Census, "Concentration Ratios in Manufacturing," MC67(S)-2.1.

Table 2 demonstrates that for all periods covered except 1969-70 the average percentage price rise for the highest concentration group was less than that for

the lowest concentration group of industries. Thus, both for extended periods of years or relatively short periods of years, generally, the higher the concentration the smaller the extent of price change. Again the single recession year 1969-70 represents an exception. Price data are available for the later years so that we can put the 1969-70 year into broader perspective. Between 1970-73 the price performance of the most concentrated industries is far superior to that of the least concentrated industries and over the entire inflationary period, 1966-73, which includes the 1969-70 year, the price performance of the concentrated industries is again much superior. In fact, the annual rate of price increase in the least concentrated industries was about 5 times that in the most concentrated industries during the 1966-73 period. Price controls are a part of the explanation since 1971, but that is also evidence that controls are more binding on large firms in concentrated industries.

Table 3 brings the analysis up to date based on available data in the August 1974 *Monthly Labor Review* of the BLS. Table 2 had covered the period through 1973 with evidence of superiority in price performance over time of the most concentrated industries. For the period May 1973 through April 1974 when the wage and price control mechanism was formally disbanded the performance of the most concentrated industries continued to be superior to that of the least concentrated industries. Price changes in industries with concentration exceeding 75 percent were 7 percent over the period as compared with 10.9 percent in the least concentrated industries. Price increases in the industries with concentration between 50 and 75 percent were lower than in industries with concentration between 25 and 50 percent.

TABLE 3.—AVERAGE ANNUAL PERCENTAGE PRICE CHANGE¹ FOR SELECTED TIME PERIODS BETWEEN MAY 1973 AND MAY 1974 BY LEVEL OF INDUSTRY CONCENTRATION

| Period | CR4<25, N=32 | 25<CR4<50, N=50 | 50<CR4<75, N=36 | CR4>75, N=13 | All, N=131 |
|---------------------------------|-----------------|--------------------|--------------------|-----------------|---------------|
| | (1) | (2) | (3) | (4) | (5) |
| (1) May 1973 to April 1974..... | 10.9 | 18.0 | 13.6 | 7.1 | 14.0 |
| | (1.81) | (3.08) | (3.52) | (3.62) | (1.64) |
| (2) May 1973 to May 1974..... | 11.8 | 21.2 | 19.2 | 8.6 | 17.1 |
| | (1.91) | (3.71) | (4.68) | (3.66) | (2.02) |
| (3) April 1974 to May 1974..... | .8 | 2.4 | 4.3 | 1.4 | 2.4 |
| | (.71) | (.75) | (.91) | (.68) | (.43) |

¹ Standard errors shown in parentheses.

Sources: Price changes. Computed from data in U.S. Department of Labor, Bureau of Labor Statistics, "Monthly Labor Review," August 1974, Price Indexes for the Output of Selected SIC Industries, pp. 131-132. Concentration ratios are from: U.S. Bureau of the Census, "Annual Survey of Manufactures: 1970, Value of Shipment Concentration Ratios," M70(AS)-9, Washington, D.C.: U.S. Government Printing Office, 1972.

The pattern is similar for the period including the first month of the formal disbanding of controls. From May 1973 to May 1974 the smallest extent of price increases took place in the most concentrated industries. However, when the analysis is made for the price changes that took place in the single month of May, the last month for which data are available in public form, the price increases in the most concentrated industries were somewhat higher than in the least concentrated industries. The price increases in the industries with concentration between 50 and 75 percent were higher than in the industries with concentration between 25 and 50 percent. Also, the overall price change on an annualized basis was at a disturbingly high annual rate of increase. But the data for the first month of decontrols as well as the earlier data indicated that the impact of price controls bore most heavily on the most concentrated industries. When controls were removed then normal economic forces again were operative.

But as the data for Table 2 demonstrate, when price behavior of the most concentrated industries is viewed over long time periods, including periods of decontrol in which their prices may rise more rapidly the price performance of the most concentrated industries is superior to the price performance of the least concentrated industries. Thus it is erroneous to develop all kinds of complicated explanations for the behavior of prices in concentrated industries during a period following a period of price controls. The evidence demonstrates that administered prices is a phenomenon which takes place when the government controls wages and prices in either formal machinery or by "jaw boning."

The evidence is that, absent government controls, administered pricing is not a phenomenon observed in concentrated industries.

Of particular importance is the period 1958-65 when prices rose by less than 0.5% per year on the average for all industries. This contrasts sharply with the period since 1966, the onset of the Vietnam escalation, during which prices have risen by more than 5% a year on the average and in recent years have moved us into a 2-digit level of price inflation.

The data for 1958-65 provides important evidence relevant to another current argument. This argument says that it will not be possible to bring the current inflation under control unless fundamental changes in the strength of the labor unions are made and until the structure of concentration that dominates the major American industries is altered. But there have been no significant changes either in the strength of labor unions or in industry structures between the 1958-65 years and the 1966-73 years. But what has changed? What changed was the fundamental alteration in government fiscal and monetary policies beginning in 1966. The escalation of hostilities in Southeast Asia took place simultaneously with large increases in government outlays related to domestic programs. The federal deficit in the calendar years 1967 and 1968 totaled some \$19 billions. The deficits in the federal budget for the fiscal years ending 1971-73 have totaled \$60.5 billions. Even in recent years the money supply and the monetary base have grown 7-9% per annum.

But the evidence as shown in Table 2 and 3 is that the price behavior of industries of highest concentration has moderated the rate of inflation rather than the opposite. In fact, in industries with the highest levels of concentration price decreases were actually achieved during each of the time segments, 1958-63, 1963-66, and 1958-65. How do we explain the superior performance of concentrated industries in achieving lower levels of price increase?

What is involved here is a contrast between two theories of the behavior of concentrated industries. Among the numerous branches of oligopoly theory one may be referred to as the structural theory. The structural theory holds that when concentration variously measured exceeds some number the effects on competition will be unfavorable. The structural theory holds that concentration and oligopoly results in developing a state of awareness on the part of one firm as to the effects of its decisions and actions on other firms. This is said to result in recognized interdependence among the firms. This in turn is said to produce cooperative or collusive behavior, resulting in shared monopoly.

The structural theory is based upon the traditional static formulation of the theory of the firm. It is a formulation in which output is the only decision variable available to the firm. But in reality economic processes involve decisions over a wide range of variables. These include product quality differences, product characteristic differences, research and development efforts directed toward improved longer term market positions, alternative methods of promoting and distributing products through the channels of distribution, etc. And for each of these many decision variables there are a wide range of choices that may be made. As a consequence the timing and ability of rivals to react is less predictable. Efficiency is stimulated because advantages or disadvantages among firms are not readily equalized. Because of the time involved in the development of an efficiently operating organization, successful efforts will enable a well-managed firm to continue to achieve a differential advantage over its rivals. As a result cost functions are of different shapes and firms are of different sizes.

It is frequently argued that oligopolists do not engage in price competition and that their prices do not fluctuate as frequently as the products produced in less concentrated industries. This generalization is of doubtful validity for a number of reasons. First because of product quality differences it is not meaningful to state that prices are the same for products of different characteristics. Even when nominal prices may appear to be the same the effective prices are different. And many dimensions are involved. Second, whether the nominal prices in concentrated industries fluctuate more or less than the nominal prices in less concentrated industries is not certain. Many statements about inflexible prices refer to list prices. Actual transactions prices are much more flexible. Third, in the decisions by large and small firms alike a balance is sought between outlays on price changes, quality change, research and development, promotion, etc. The balance is determined by the preferences of consumers in relation to the costs of responding to the consumer preferences. Sometimes in this mix of policies, price changes are of greater importance and at other times nonprice changes will be employed. In those instances where price competition may appear to be used

less than nonprice competition the nature and impact of competitive forces may be equal or greater than when the use of price competition alone is involved. As Professor Scherer has stated in his textbook, "Any fool can match a price cut." (p. 355) Indeed, in many circumstances nonprice competition may be the more important form of competition.

Under these circumstances both cost efficiency and innovation may be stimulated. Cost efficiency is stimulated because large advantages or disadvantages among firms may not be readily matched and may produce differential profits that will persist over some period of time. Innovation may give a firm a proprietary position for a period of time. Thus all of the processes that make for efficiency under the model of atomistic competition, in fact, are operative in concentrated industries and the factual data are consistent with this theory of the behavior of firms in concentrated industries.

REFERENCES

- Ackley, Gardner, "Administered Prices and the Inflationary Process," *American Economic Review*, XLIX (May 1959) 419-461.
- Bain, J. S., *Barriers to New Competition*, Cambridge, Harvard University Press, 1956.
- Blair, John M., "Administered Prices: A Phenomenon in Search of a Theory," *American Economic Review*, (May 1959).
- Blair, J. M., "Administered Prices and Oligopolistic Inflation: A Reply," *Journal of Business*, University of Chicago, 37 (January 1964) pp. 68-81.
- Cabinet Committee on Price Stability, "Study Paper Number 2: Industrial Structure and Competition Policy," *Studies by the Staff of the Cabinet Committee on Price Stability*, (Washington: U.S. Government Printing Office, January 1969).
- De Podwin, H. J. and R. T. Selden, "Business Pricing Policies and Inflation," *Journal of Political Economy*, LXXXI (April 1963) 116-127.
- Eckstein, O., and G. Fromm, "The Price Equation," *American Economic Review*, LVIII (December 1968), pp. 1159-83.
- Galbraith, John, Presentation to the Kefauver Hearings, Part I, (1957).
- Galbraith, John, Presentation to the Kefauver Hearings, Part X, (1957).
- Haworth, C. T. and D. W. Rasmussen, "Human Capital and Inter-Industry Wages in Manufacturing," *The Review of Economics and Statistics*, LII (November 1971), pp. 376-379.
- Lanzillotti, R. F., "Pricing Objectives in Large Companies," *American Economic Review*, XLVIII (December 1958), pp. 921-40.
- Lerner, Abba, "Sellers Inflation and Administered Depression," *Administered Prices: A Compendium on Public Policy*, Senate Judiciary Committee, 88 Congress, 1st Session, U.S. Government Printing Office, (Washington, D.C., 1963).
- Means, Gardner C., "The Administered-Price Thesis Reconfirmed," *American Economic Review*, LXII (June 1972) 292-306.
- Phillips, Louis, "Business Pricing Policies and Inflation—Some Evidence from E.E.C.," *Journal of Industrial Economics*, XVIII (November 1969) 1-14.
- Ripley, Frank C. and Lydia Segal, "Price Determination in 396 Manufacturing Industries," *Review of Economics and Statistics*, LV (August 1973), pp. 263-271.
- Simon, Julian L., "Issues in the Economics of Advertising," Urbana: University of Illinois Press, 1970.
- Stigler, George, "Administered Prices and Oligopolistic Inflation," *Journal of Business*, XXXV (January 1962) 1-13.
- Stigler, George and Kindahl, James, *The Behavior of Industrial Prices* (New York: National Bureau of Economic Research, 1970).
- Telsler, Lester G., "Advertising and Competition," *Journal of Political Economy*, LXXII (December 1964) 537-562.
- Telsler, Lester G., "Supply and Demand for Advertising Messages," *American Economic Review*, LVI (May 1966) 457-475.
- U.S. Department of Justice, "Merger Guidelines," (May 30, 1968), pp. 1-27.
- Weiss, Leonard W., "Business Pricing Policies and Inflation Reconsidered," *Journal of Political Economy*, LXXIV (April 1966).
- Weiss, L. W., "Concentration and Labor Earnings," *The American Economic Review*, LVI (March 1966), pp. 96-117.
- Weston, J. Fred, "Pricing Behavior of Large Firms," *Western Economic Journal*, (March, 1972) 1-18.

Weston, J. F., and S. H. Lustgarten, "Concentration and Inflation," Columbia Law School Conference, *Industrial Concentration: The Economic Issues*, March 1, 1974.

Yordan, W. J., "Industrial Concentration and Price Flexibility Under Inflation," *Review of Economics and Statistics*, (August 1961).

AN ANTI-INFLATION PROGRAM*

(By J. Fred Weston, Professor, Graduate School of Management, UCLA)

The persistent and accelerating international worldwide pace of inflation has given rise to increased concern. We have had inflation in excess of a two-digit rate. Yet, unemployment among some groups has been running distressingly high. The stock market has collapsed and financing for business firms has become increasingly difficult. We are coming to the recognition that the problem is deeper than a matter of cyclical alternation in the prospects for the American economy. Some longer run forces are at work.

I. FUNDAMENTAL CHANGES AFFECTING U.S. STANDARDS OF LIVING

The first and most important point to be recognized is that some fundamental changes in the economic circumstances for the U.S. economy and its citizens have taken place and that no economic policy will be soundly based unless the changes in these fundamentals are recognized.

A root cause was our shooting some \$40-50 billion a year in the air in connection with the escalation of hostilities in Southeast Asia. This represented a decline in the real standard of living available to U.S. citizens that could not be made up simply by changes in financial policies as such. At the same time that the large expenditures on Viet Nam began to be escalated in 1966, large increases in a number of domestic programs were also launched.

These trends have reflected themselves in a continued pattern so that in the fiscal year 1975 what has come to be labeled benefit payments to individuals now represent 37% of total federal outlays. This is the largest single item in the budget and exceeds even national defense which accounts for 29% of the federal outlays. While these outlays may yield high returns in the long run, in the short run they use up current resources.

A third fundamental factor in the international sphere needs to be recognized. Many of the pressures that were developing from the mid-1950's on were disguised by the over valuation of the U.S. dollar in international trade. With only minor interruptions, the United States was running deficits in its balance of payments from the mid-1950's on. We were suppressing some of the underlying price increase trends by having the benefit of lower-priced foreign goods coming into the U.S. economy. We did not pay for these foreign goods in cash but rather by credits in the form of claims on dollars that ran to the magnitude of \$100 billion by the late 1960's.

Finally, aggravated by the foreign exchange losses due to the Viet Nam war, the persistent deficits in U.S. balance of payments resulted in formal devaluations of the U.S. dollar in 1971 and 1973. More freely fluctuating exchange rates brought about further revaluations of the U.S. dollar. To illustrate, the German mark had been valued at 4 to the dollar or 25 cents for 1 mark. By late 1973 the mark was valued at 2½ to the dollar or 40 cents. Since then there have been fluctuations in the value of the mark at something under 3 marks to the dollar. Such revaluations have a considerable effect on the prices paid for goods. For example, a German product that needed to be sold for 400 marks to cover German costs of production at an exchange rate of 4 to 1 could be purchased for \$100. At an exchange rate of 2½ to 1 the cost would be 400 marks divided by 2.5 or \$160, an increase of 60%. This represents a substantial upward pressure on U.S. prices. Even at an exchange rate of 3 to 1 the equivalent price increase in U.S. dollars is over 33%.

But even more significant is that with the revaluations of the dollar in relation to foreign currencies, the terms of trade, representing the prices at which goods are imported as compared with the prices received for goods exported,

*This paper was stimulated by discussions in the Hearings on Administered Price before the Joint Economic Committee, Senator William Proxmire presiding, September 4, 1974.

have turned unfavorably to the United States. This means that in terms of the real purchasing power from the efforts of U.S. production activity, the exchange ratios have moved adversely. Thus in terms of the real income to U.S. citizens the recent revaluations have meant a shift in an unfavorable direction in the terms of trade at which real goods are acquired by U.S. citizens.

The area in which the shift in the terms of trade has occurred most dramatically, of course, is on the commodity, oil. Oil which had been imported into the United States at \$3 a barrel was raised in price through the actions of OPEC, the oil producing export countries. In a cartel action following the embargo launched October 1973, the price of oil was increased to over \$12 a barrel, more than a fourfold increase. This represented a tremendous swing in the terms of trade at which oil could be acquired in relationship to the values received for goods exported.

To some extent the inflation that has been underway in the United States since 1966 reflects at least in part an unwillingness to face up to the necessity of a decline in the rate of increase in our real standards of living. We must either face up to the requirements of reconciling ourselves to a somewhat lower rate of increase in our standards of living or offset these underlying tendencies toward a slowing up by superior performance in other areas. We need to stop the errors of overborrowing and overspending in the illusion that some fundamental realities have not really changed. Inflation aggravates these problems; it is no real solution to them.

II. A PRAYER AGAINST THE OLD TIME RELIGION

This provides us then with a foundation for assessing what would be realistic and practical measures for coping with the current inflation problem. In this connection there has been much confusion engendered about the applicability of the "old time religion" (reliance on monetary and fiscal policies) as the proper approach for dealing with the inflation problem. Much confusion occurs because of the failure to recognize the role of the old time religion under different circumstances. There is a difference between what is sound economic policy to prevent an inflation and what is sound economic policy after the economy has already been in the throes of an inflation for a period of years. There is a big difference between what should be done to keep us all from sinning as compared to what is appropriate after we have fallen from grace and have been sinning for a number of years. Or to mix the metaphor somewhat more, there is a difference between what we do to prevent a person from becoming a drunkard and what we do after he has been a confirmed drunkard wallowing in the excesses of oversalubrious monetary flows and after having been for years on the hard drugs of the stimulus of substantial fiscal deficits.

By some criteria we have already gone pretty far in the application of the old time religion in recent months. Fiscal policy has been tightened to the point where the estimated deficit for Fiscal 1974 was only \$3 billion and we are, in fact, running a full employment surplus. Of course, there is some degree of illusion in a full employment surplus because in part this can be created by a high rate of inflation. Thus to some degree a full employment surplus may reflect the high degree of inflation that has taken place. Furthermore, when the borrowings of the federal agencies are included, the record on fiscal policy does not show up as well. Monetary policy has been widely heralded as having been very restrictive so that in recent months the growth in M_1 has been held to 4-5% annual rates. There is increasing concern that a continuation of tight fiscal and monetary policies will purchase a very small diminution in the inflation rate and involve considerable increases in the form of unemployment, a slowing of the real growth rate and unfavorable effects on productivity.

While precision tuning is not possible on such matters, it is clear that the risks of the continued application of the old time religion would be to create much more economic sorrow with very little alleviation of economic sinning. While overall unemployment rates are still relatively low, among certain groups unemployment is rising to socially unacceptable levels. Retail sales in real terms have been declining slightly. Consumer spending in real terms has not been increasing at rates characteristic of a vigorous economy. Thus we already have some symptoms that the old time religion has been stretched pretty tight and at least the risks are much greater.

The real concerns that are emerging now is that we may increasingly be experiencing the problems of (what in my judgment have been erroneously referred

to as) cost-push inflation. The real income of workers has been declining. At this juncture in economic developments increased attention must be given to a *cost-controls policy* along with an *incomes policy* to be spelled out. It is important to recognize the distinction between cost controls policy and an incomes policy and the difference between the two. A cost controls policy seeks to limit wage increases so that a wage-price spiral is not given momentum. An incomes policy aims to cause the economic adjustments that have to be made to be allocated among different income groups and different interest groups on a socially acceptable basis.

Of first priority is the need to achieve a social contract with labor unions in the key pattern-setting industry negotiations to lead the way in controlling wage cost increases. Wages represent the critical cost to be controlled because they represent the major cost paid by business firms that do not represent the prices of other business firms.

Here another important substantive point needs to be recognized. A number of the key pattern-setting industries are concentrated industries. They represent oligopolies that are relatively highly unionized. There are some underlying economic reasons for the joint relationships among some significant variables that we observe. In the highly concentrated industries we observe high capital intensity and high unionism. There are a number of forces at work here. The greater capital intensity in concentrated industries provides at least a partial explanation of the greater degree of unionization which appears to be found in concentrated industries. With a relatively greater role of capital and managerial technology, there is a greater ability to set wages by the job rather than related to individuals. This provides a basis for collective bargaining at the firm level as well as at the industry level because of the relatively greater uniformity of jobs given the greater relative role of capital.

III. THE ISSUE OF ADMINISTERED WAGES AND PRICES

In my judgment there is considerable evidence that in the product markets in which their goods are sold, concentrated industries or oligopolies yield performance results that are highly similar to those that take place in atomistic industries. But there are fundamental differences in the negotiation processes in arriving at factor-input prices for labor. Industry-wide labor unions have demonstrated that they have the economic power to bring an individual firm or an industry to a halt by strikes. The business firm does not have power to the same degree in the product market. The pattern of wages set in the exercise of union power in wage negotiations is not unlimited power. For workers as a whole, real wage increases cannot exceed productivity increases. Also, data show that in the long run productivity increases are higher and unit labor costs changes are lower in the more concentrated industries than in the least concentrated industries.

Over the entire inflationary period, 1966-73, the price performance of the concentrated industries is superior to that of the less concentrated industries. In fact, the annual rate of price increase in the *least concentrated* industries was about 5 times that in the *most concentrated* industries during the 1966-73 period. Price controls are a part of the explanation since 1971, but that is also evidence that pricing is not a phenomenon observed in concentrated industries.

When price behavior of the most concentrated industries is viewed over long time periods, including periods of decontrol in which their prices may rise more rapidly, the price performance of the most concentrated industries is superior to the price performance of the least concentrated industries. Thus it is erroneous to develop all kinds of complicated explanations for the behavior of prices in concentrated industries during a period following a period of price controls. The evidence demonstrates that administered prices is a phenomenon which takes place when the government controls prices in either formal machinery or by "jaw boning." The evidence is that, absent government controls, administered pricing is not a phenomenon observed in concentrated industries.

Of particular importance is the period 1958-65 when prices rose by less than 0.5% per year on the average for all industries. This contrasts sharply with the period since 1966, the onset of the Viet Nam escalation, during which prices have risen by more than 5% a year on the average and in recent years have moved us into a 2-digit level of price inflation.

The data for 1958-65 provides important evidence relevant to another current argument. This argument says that it will not be possible to bring the current inflation under control unless fundamental changes in the strength of the labor unions are made and until the structure of concentration that characterizes

the major American industries is altered. But there have been no significant changes either in the strength of labor unions or in industry structures between the 1958-65 years and the 1966-73 years. But what has changed? What changed was the fundamental alteration in government fiscal and monetary policies beginning in 1966. The escalation of hostilities in Southeast Asia took place simultaneously with large increases in government outlays related to domestic programs. The federal deficit in the calendar years 1967 and 1968 totaled some \$19 billions. The deficits in the federal budget for the fiscal years ending 1971-73 have totaled 60.5 billions. During these years the money supply and the monetary base have grown 7-9% per annum.

But the price behavior of industries of highest concentration has moderated the rate of inflation rather than the opposite. In fact, in industries with the highest levels of concentration price decreases were actually achieved during each of the time segments, 1958-63, 1963-66, and 1958-65.

IV. NEED FOR A WAGE GUIDELINES POLICY

Again, it is important to avoid the pitfalls of overgeneralization. Fiscal policy, monetary policy, the central ingredients of the old-time religion are particularly important to prevent an inflation, also in the early stages of turning around an inflation, and must be maintained at a steady level as other policies become critical. Concentration and oligopoly may not affect product profit margins, but negotiations with strong labor unions in these industries affect wage rates. In addition, wage changes in these industries establish patterns that become the basis for transmitting cost increases throughout the economy. On the average, wage increases are higher in the more concentrated industries, but price increases are smaller because of greater labor productivity increases. Some evidence of union power in concentrated industries is provided by the larger queues of available workers in these industries evidenced by lower quit rates and lower turnover rates. While unionism may not affect wage levels and relative income distribution in the long run, it can have important short run impacts on costs and, therefore, have very great significance for a stabilization program.

The strictures that Professor Friedman has set forth in his paper, "What Price Guideposts?" are directed toward a long-run policy. (Milton Friedman, *Guidelines, Informal Controls, and the Market Place*, G. P. Shultz and R. Z. Aliber, Eds., Chicago: The University of Chicago Press, 1966.) He has not considered the role that wage guideposts can perform to prevent cost inflation in the short run. Cost controls through wage guidelines have a significant and important role to play at this juncture of our program to achieve new and effective economic policies to combat inflation.

But a very difficult and practical problem will be to attain labor acquiescence in a restrained wage policy when the real income of labor has been eroded by the two-digit inflation that has been underway. The data demonstrate that the record of cooperation by labor to this point has been relatively good. There are important alternatives here: The old-time religion says create enough unemployment so as to moderate labor strength in wage negotiations. In a world of strong labor unions, such a policy is too costly in terms of potential overall growth in the economy that is lost. It is too devastating in terms of its negative impacts on productivity, and wholly unrealistic in terms of the stability in the social and moral fabric of relations in our economy and society generally.

V. REVENUE POLICIES FOR A SOCIAL MARKET ECONOMY

But given that the old-time religion or the old-time economic medicine is not the right prescription at the present juncture, what is the appropriate policy to follow? The policies that are called for involve the application of a number of principles. To the extent feasible, the price system should be used. To a considerable extent, an income's policy can be used as a trade off for a cost-control wages policy. Some potentials from the financial side have been relatively neglected. Having disappointed labor in promises of controlling inflation over a series of years, it patently will not be easy to be convincing to labor that they should make sacrifices in real incomes for an additional year in the effort to control inflation.

Some trade off must be achieved to obtain labor's continued cooperation in cost control policies. These measures can also be consistent with the need to

expand capacity in a number of areas where supplies continue to be short, and bottlenecks contribute to increasing waves of cost and price increases.

To demonstrate that other groups are willing to make the kind of sacrifices and contributions that labor has made in recent years, a number of policies on the financial side deserve the most serious consideration.

Very serious consideration must be given to a combination of approaches to corporate income tax policy. Corporate income taxes which used to account for a substantial portion of the total revenues of the federal government now account for only 16 percent of total federal revenues. Individual income taxes account for 42 percent—two and one half times as much. Social insurance receipts account for 28 percent of federal revenues, representing more than one and a half times the receipts from corporate income taxes.

This is probably as it should be because corporate income taxes are the least defensible basis for applying taxation. Its main justification has been one of practical expediency. But again here is a juncture where both from the standpoint of securing labor's cooperation in a cost control policy as well as to stimulate investment and to direct investment into needed areas, the corporate income tax may have another practical expediency role to perform. Hence a policy deserving of consideration would be a two-year temporary additional surtax on corporate profits, coupled with an increase in the investment tax credit. The aim would be to recapture windfall corporate profits in a period of substantial economic change, at the same time providing an increased stimulus to real corporate investment to alleviate bottlenecks and increased long-term productivity. The aim of the corporate tax policies proposed for consideration would be to increase the investment rate, particularly in areas where capacity additions are needed to ameliorate pressures on prices and to be a part of a strong wage guidelines program to achieve cost controls. The aim is to get at the heart of the present main source of potential increase in the inflation rate.

This paper started with an emphasis that adjustments were required to deal with the inflation problem and that the adjustments must be made equitably. As a further part of a guidelines program to secure the cooperation of labor in controlling costs, an additional element deserving of consideration would be a two-year surtax on incomes in excess of some specified amount such as \$30,000 per year. Indeed, in this proposal consideration might well be given to a flat surtax on gross incomes in excess of some specified level such as \$40,000 in order to establish clearly that at least a portion of the general sacrifices called for would not be avoided. At the same time as a further part of the package of obtaining labor's concurrence in forgoing cost-increasing wage demands is a reduction in social security taxes and unemployment insurance taxes on incomes below some specified level such as \$12,000 per year. Indeed, with rising unemployment in individual segments of the economy, unemployment income supplements may necessarily be increased.

Hopefully one of the dividends of international detente could be a lowering of military expenditures abroad. This would provide a fiscal dividend, along with the revenue measures discussed in connection with corporate and personal income tax rates, to ameliorate the impact of tight fiscal policy and tight monetary policy (along with a subsiding inflation) on the income classes in the economy least able to bear the brunt of general economic policies.

Proposals for an overall income tax cut because of a sagging economy are misdirected. This is still a strong economy overall with important bottlenecks causing further price increases. Also, it is increasingly argued that the over 6 percent reported decrease in real gross national product for the first quarter of 1974 undoubtedly involved a misapplication of some of the price deflators. With the moderate decline in the Federal Reserve Board index of industrial production, it is implausible that the decline in real GNP during the first quarter was as large as reported.

There are important distinctions between proposals for either an overall tax increase or for an overall tax cut. My proposals are for selective tax increases and selective tax cuts. The tax increase is to be aimed at relatively high income levels as a matter of incomes policy—distributing the burden on real incomes described at the first part of this paper. The proposal for a tax cut is not to shore up aggregate demand but rather as a part of an incomes policy to prevent undue burdens on income levels close to the poverty margins.

The aim would be through the corporate and personal tax policies proposed to provide a basis for a firm guidelines policy on wage increases in the key pattern

bargaining industries. The aim in this regard should be to base wage decisions on the assumption that the inflation rate can be brought down to something to 50 to 60% below the inflation rate experienced during the most recent half year. The objective would be to achieve another decrease in the inflation rate by a 50 percent factor in the following year. Thus over a two- or three-year period of time the inflation rate could be brought down by a factor of 70-80 percent decrease from its previous levels.

These fiscal policies with emphasis on the revenue side may seem radical to some. In fact, they are consistent with economic policy measures that "should distort or disturb market processes as little as possible." (Egon Tuchtfeldt, "Social Market Economy and Demand Management," *German Economic Review*, Vol. 12, No. 2, 1974, p. 11). The proposals parallel similar actions taken by West Germany in 1970 and in 1973 to deal with the inflation problem. (*Encyclopedia Britannica*, Vol. 8, p. 59; *Britannica Book of the Year*, 1974, p. 332). The policies adopted in West Germany included a surtax on personal incomes in the middle and upper income brackets. Provision was also made for surtaxes on corporate incomes, subsequently refundable. This is consistent with the proposal of surtaxes on corporate income, modified by adjustments in the investment tax credit, particularly for bottleneck industries. Even if the net revenues from the corporate income tax were not increased, a substantial contribution could be made to mitigating inflationary pressures by the types of proposals outlined.

In addition, continued discipline is required on the spending side in the fiscal area. While the nominal budget is almost in balance, many pressures on the credit and capital markets remain. Net borrowing by Federal Agencies increased from \$9.7 billions in 1972 to \$22.1 billions in 1973. (*Morgan Guaranty Survey*, August 1974, p. 7). These figures do not include the obligations guaranteed by Federal Government Agencies; including these brings the "federal role in capital markets . . . uncomfortably close to the fifty-fifty point." M. L. Weidenbaum, *Inflation in the United States*, Conference Board, May 21, 1974, (p. 39). Further, of the non-federal long term borrowing, by 1973 the total for mortgages was \$73 billion as compared with corporate bonds of only \$10 billion. (J. J. O'Leary, *Idem.*, p. 41). Corporate long term borrowing has increased at commercial banks in the form of term loans reaching \$7.8 billion in 1973, more than double the previous high. Additional pressures on commercial banks have come from short-term credits to foreigners expected to reach \$19 billion in 1974 with an increase in the amount of \$5 billion during the first seven months of 1974 in connection with the impact of higher petroleum prices. (Henry Kaufman, "Comments on Credit", August 30, 1974, p. 4).

Thus there is a great need to reduce as much as possible the demands of the Federal Government, its agencies and its agency-guaranteed financing, as well as state and local governments, on the capital markets. Thus the impact of governments on the capital markets should continue to be constrained, while actions on the revenue side consistent with an incomes policy need to be taken.

VI. THE LIMITS OF MONETARY POLICY

The analysis next turns to the role of monetary policy. One of the virtues from the standpoint of the old time religion of monetary policy is that it presumably impacts all sectors of the economy in an evenhanded way. But we find that the impact of monetary policy is not, in fact, impersonal and evenhanded throughout the economy. Tight money has particularly had a severe impact on smaller business, on utilities, on the most capital intensive industries, on housing, on consumer durables goods industries generally and the related consumer credit financial intermediaries. Furthermore, while we have had tight money, the growth in the supply of near monies has proceeded very rapidly.

The housing industry particularly has been expected to perform an anti-cyclical role. However, we are beginning to understand the consequences of such a policy. In the first place it is not without substantial leakages. What is taken out of private sector financing of housing comes back through financing by the federal credit agencies. Thus a portion of the housing financing comes back by the shifts of private to federal financing.

But we recognize further that the costs of using housing as the anticyclical area are substantial. One of the reasons for the use of housing is that it is said that the same housing demand will be there even if postponed two or three years. But the economic costs are substantial. The instability in housing demand has resulted in very aggressive labor guild policies in the construction and building trades. As a consequence, wage rates in construction and building trades have

become ratcheted out of line with a healthy long-run housing and construction industry. In addition these high wage policies have had undesirable pattern-setting influences on wages in other sectors of the economy.

While some specific individual private financial intermediaries have felt the impact of general monetary controls, the flow of funds to individual sectors has not necessarily decreased because of the expansion of individual special government agency programs outside their formal budget. The special government agencies which have been expanding represent a response by government to special interest groups to prevent cutting off the flow of funds to individual segments of the economy during a period of tight money. Since a capital allocations process is taking place *de facto*, it would appear to be superior to do the job explicitly to formally have a capital issues committee with representation from the Treasury and the Federal Reserve System. Initially at least broad priority areas could be delineated. Broad policies could be made to designate priority segments of the economy, priority industries, priority types of loans and priority firm sizes.

There might also be a requirement for specific approval on loan programs by commercial banks and insurance companies in excess of some designated amounts such as \$10 million. The goal of directing loans and investments in priority directions could be implemented through the substantial bank supervision machinery. The mechanism could also be implemented by requiring differential supplemental reserves on both member and nonmember banks for nonpriority loans or investments. Loans and investments for priority purposes would be provided with credits against the supplemental reserve requirement. (Former FRB Governor Sherman Maisel is reported to have made proposals along these lines; *Los Angeles Times*, September 3, 1974, "Rep. Reuss Urges a Reallocation of Credit.") I recognize that such proposals would be anathema to adherents of a "free market" philosophy. However, the practical reality is that just as there are no free lunches, there are no free markets in a period of very tight and restrictive monetary policies in a world economy seriously out of equilibrium.

VII. INTERNATIONAL DIMENSIONS OF INFLATION

This brings us to the next logical step in the chain of the analysis. Increasingly we recognize that similar inflation problems and the problem of maintaining financial stability and standards of living are confronting all of the major developed countries of the world. An underlying cause was the piling up of something over \$100 billion in dollar claims through the persistent balance of payments deficits of the United States beginning in the mid-1950's. The resulting expansion of Euro-dollar deposit activity has been estimated to reach \$450 billion at the present time. The increase in the price of oil had been in part stimulated by worldwide inflation in the prices of agricultural and manufactured goods.

The national economic problems of the United States are not purely national and domestic in their source, impacts and nature. Similar problems are faced by the other nations of the world. Policies followed by the United States to deal with its domestic problems will have major impacts upon the economies of other countries of the world. Thus economic policies are no longer domestic policies and they cannot be pursued independently. International cooperation will be required to achieve international solutions to what are fundamentally international economic problems.

While economic summitry on an international basis would be highly desirable and might even have salutary results, the diversity of national interests makes it difficult to bring about substantial progress at the international level. Nevertheless cooperation on individual policies and as much communication and interaction as possible is desirable. It is essential to work out a coordinated system of domestic policies that will minimize inconsistencies and minimize their countering and neutralizing effects from an international dimension standpoint.

VIII. NEED FOR AN OIL POLICY

Of overriding significance is an adjustment to the massive financing dislocations caused by the more than fourfold increase in oil prices. The increases in oil prices have already had major effects on the economics of countries such as Italy, the UK, and Japan. The concerted action by the oil exporting nations would appear to call for rational coordinated behavior on the part of the oil consuming countries. This cooperation among the oil consuming countries has not been achievable to date. Therefore, the United States must develop domes-

tic policies that face up to the staggering financial dimensions of the impact of the higher oil prices on our balance of payments as well as the costs of a number of individual industries.

The United States can pursue domestic policies that would be consistent with sound cooperative policies on an international basis among oil consuming nations. It is unwise to have moved to policies of relative "normalcy" with regard to the use of oil and petroleum products in the United States since the lifting of the absolute oil embargo by the oil exporting nations. Domestic production of oil and oil substitutes must be increased in the framework of a long run energy policy. Clearly the tradeoffs between environmental considerations and economic consequences have been changed.

Multiple tier prices for domestic oil provides an artificial stimulation to consumption when the opposite policies are called for. While a rise in prices would alter consumption habits, it would bear most heavily upon lower income groups. The regressive impact of the use of the price mechanism in oil and petroleum products would be offset by the fiscal and incomes policies described previously. A large-scale mass transit program as a means of reducing oil consumption as well as other related urban problems would pay high dividends. X billions of dollars spent for mass transit to reduce Y billions of dollars for oil imports would be free of the negative balance of payments consequences of the oil imports. Further specific government policies might also call for sharply accelerated excise taxes in relation to the horse power of automobiles.

Without a meaningful response to the actions of the oil exporting nations, the oil exporting nations are in a strong bargaining position and cannot be expected to modify their policies. The lack of will on the part of a major consuming nation such as the United States is a signal that the consuming nations are willing to permit themselves to be boxed in more tightly before they take any serious actions. By that time the options available to the consuming nations will be severely restricted.

The analysis and discussion of appropriate policies for oil calls to mind related U.S. domestic policies of controlling the supply of basic commodities. Certainly in the present period of inflation this represents a most appropriate time for abolishing price support programs in connection with milk, sugar and rice. Restrictive and protective legislation and regulatory bodies in other areas such as transportation also clearly call for abandonment in any general program mounted against the inflationary problem.

IX. EXORCISM WILL NOT WORK

In summary, the broad brush approaches characterizing many proposals for economic policy need to be related more directly to the underlying conditions faced. In the effort to control inflation, we must recognize a distinction between policies to prevent inflation and what must be done to mitigate and eventually terminate a strong inflation that is already under way. The old-time religion is a sound policy prescription to avoid the onset of inflation. Would that it had been applied in 1966-68 and clearly continued in Phase III launched in 1973. But appeals to the old-time religion at the present juncture would represent exhortation in an attempt to cast out the inflation devil by exorcism.

Monetary policy probably has been pushed as far as feasible at the present juncture. Interest rates are at levels that produce great distortions, and inequities in the economy. The policy of accommodation adopted in late summer 1974 represents a movement toward the correct stance in monetary policy. Even if monetary policy were to have been held with extreme tightness, it would not have accomplished the present job needed. It would run the risk of unnecessarily threatening a liquidity crisis and bankruptcies without offsetting substantial gains.

At this juncture in our efforts to control inflation the relative emphasis must necessarily be on cost controls as of the highest priority as compared to the old time religion or even an incomes policy. Just as proponents of the old time religion are overgeneralizing in seeking the continuation of a very tight monetary and fiscal policy, their opponents are also guilty of overgeneralizing. It is clear that shortages and bottleneck industries exist in a number of parts of the economy. A general tax cut would aggravate the excess demand that exists in a number of sectors. A general tax increase would confront a long debate on equity considerations and place indefensible burdens on lower income groups.

Hence the policies in the fiscal area need to be more selective. The general purpose of the fiscal policies would be to secure the cooperation of labor leaders

in holding down wage increases in bargaining negotiations over the forthcoming year to levels based on an assumption of a 60 to 70% reduction in current inflation rates. In addition, on equity or incomes policy grounds, a number of revenue policies deserve consideration. A two-year surtax on corporate incomes would diminish the "ability to pay" arguments; tax credits for investment in priority, bottleneck industries would reduce the negative investment incentive effects of the corporate surtax. Personal income taxes on high brackets over \$30,000 would be increased, while tax rates on income of \$10,000 and below would be reduced.

Overall government spending programs need to be constrained further. Increases in the lending and guarantee programs of the Federal lending Agencies along with borrowing by State and Local governments (despite nominal surpluses) have resulted in substantial demands on the capital markets. Within a generally constrained fiscal program, selective revenue and spending programs could be used to achieve a social contract in which a wage-price spiraling reinforcement of the current inflation could be ameliorated at its origins. The emphasis is on wage-cost controls obtained through fiscal programs jointly directed at the root causes of inflation.

But domestic programs alone cannot solve the international dimensions of the inflation problem. Coordination and cooperation among the nations is required. Oil consumption patterns must be altered in the United States to recognize the new realities. But it is not enough for the U.S. to go it alone in dealing with the problems of the increased costs of oil and its balance of payments consequences. The international economic fabric between nations is too tightly knit to ignore the serious financial problems of other nations. This is the entire logic of the efforts to develop world financial institutions following World War II. The problems of international financial adjustments mechanisms will also have to be resolved before we are on the road to solution to the specters of both worldwide inflation and international instability.

Senator PROXMIER. Mr. Mueller, before you start, I might say that there is a live quorum in the Senate. I will have to leave to go over to the Senate during your presentation. I will be back before you finish. Also I have had a chance to review your prepared statement.

**STATEMENT OF WILLARD F. MUELLER, VILAS RESEARCH
PROFESSOR, UNIVERSITY OF WISCONSIN**

Mr. MUELLER. Thank you, Mr. Chairman.

RETURN TO OLDTIME RELIGION

In recent months it has become increasingly popular to call for a return to the oldtime religion in our battle against inflation. By this is meant a fundamentalist approach that assumes all inflation is caused solely by the twin devils of faulty monetary and fiscal policies.

But let us not forget that this approach is neither all that old, nor is the call for a return to it all that new. It was practiced with disastrous results in the 1950's when we had three recessions in 8 years. It was embraced again in January 1969, when President Nixon announced his "game plan" for reducing inflation without increasing unemployment. Some apparently have forgotten—or would have the public overlook—the costly lessons of that recent experiment, when our reward for relying solely on a restrictive monetary and fiscal policy was a rise in both unemployment and prices.

CANNOT RELY SOLELY ON MONETARY AND FISCAL POLICY

These unpleasant experiences should raise in everyone's mind serious questions about relying solely on the oldtime religion in fighting the devil of inflation. In my view, it has not worked in the past and will

not in the future because it rests on a false assumption; namely, that all prices are determined in competitive markets. But, alas, many modern industries are not competitively structured, with the result that firms have power to maintain or even increase prices in the face of falling demand. The result: Market power creates a serious inflationary bias in our economy.

I shall not attempt here to review all the evidence bearing on this subject. Although the evidence is mixed, empirical research and historical events warrant the following conclusions:

One, market power-induced inflationary pressures played a critical role in the poor performance of the economy of the 1950's.

Two, the change in public policy toward the use of market power as reflected in the guidepost policy initiated in 1962 played a significant role in permitting the noninflationary expansion of the economy during 1962-65.

Three, the price behavior of the concentrated industries during the period of restrictive monetary and fiscal policy of 1969-70 again demonstrated how business firms with market power may increase prices in the face of declining demand.

Today, we are in very much the same situation as in early 1969 when President Nixon announced his ill-fated anti-inflation "game plan" which relied solely on restrictive monetary and fiscal policies. But the problem has escalated considerably since then. Because of the tax increase in July 1969 the Government was running a surplus in 1969, indeed an \$8 billion surplus for the year. In January 1969, unemployment was only 3.4 percent. And inflation during 1968 had been only 4.2 percent. Yet, the game plan was a dismal failure as both unemployment and inflation accelerated in the face of the restrictive monetary and fiscal policies.

There are already danger signals that such policies will not work any better this time. Certainly General Motors' 10 percent increase in auto prices this year, despite an over 20 percent drop in purchases, illustrates once again how market power can be used to maintain or increase prices in the face of falling demand. This kind of behavior simply cannot be dismissed as catchup. GM already was making a return on investment of nearly 20 percent in 1973, and in the first 6 months of this year, during which period its sales were down over 20 percent, it earned \$426 million. Many others in the economy would like to be able to catch up under circumstances much less conducive to it than this, but they simply do not have the market power to do it.

Such behavior inevitably creates serious problems in fighting inflation solely through monetary and fiscal measures.

Because the advocates of the oldtime religion argue that there is no empirical support for the thesis that market power creates an inflationary bias, I feel obliged to comment briefly on some of the arguments.

ARGUMENTS ON INFLATIONARY IMPACT OF MARKET POWER

A common fallacy running through their arguments is the assumption that all inflation must be explained either by excess demand—demand-pull—or by market power—seller-push. This simplistic "either or" reasoning runs counter to the belief of those economists,

including myself, who believe much of recent inflation experienced by the United States and other Western nations involves a complicated interaction of demand-pull and market power forces.

My fellow panelist, Professor Weston, is guilty of the "either or" fallacy. His failure to recognize the possibility of multiple causes mars his entire discussion and renders meaningless his empirical studies, as well as leads him to interpret improperly the works of others. An example is his treatment of the period 1958-65, a period during which different inflationary forces were at work. During 1958-60, sole reliance was placed on monetary and fiscal policy. Certainly, if we want to induce a recession as we did in 1958 when during part of the year unemployment reached 7 percent, and in 1960-61 when unemployment again reached 7 percent, we can moderate prices. Of course, in the last part of the period, 1962-65, we had wage-and-price guideposts which had a significant impact on repressing price increases of some important sectors with market power. So the kind of evidence Professor Weston cites proves nothing with respect to the basic question of whether or not market power creates an inflationary bias.

Certainly, historically, demand-pull inflation caused by ill-advised monetary and fiscal policies frequently have been a major culprit. But we should also recognize that today the existence of excess market power makes it impossible to rely solely on monetary and fiscal policy in coping with inflation. The failure of concentrated industries to reduce prices as demand decreases renders obsolete policies relying solely on monetary and fiscal policy to manage the economy. Some economists take comfort from the fact that over long periods prices and wages in the administered price sectors may not diverge greatly from those in the competitor sectors. They would dismiss the problem by calling the aberrant behavior of administered price sectors "delayed inflation," or as merely involving a catchup process. But when prices are unresponsive to demand in the short run, monetary and fiscal policies may be frustrated. And we have learned, the short run turns out to be a fairly long duration at times.

First, officials may mistakenly interpret seller-push inflation as signaling the onset of demand-pull inflation, as apparently happened in the 1950's, when we choke off expansions prematurely because of the increases in prices at a time when we were still short of full employment and capacity utilization.

Second, price rigidities in concentrated industries during the early stages of demand-pull inflation may mislead officials into underestimating the true magnitude of demand-pull pressures, thereby delaying timely application of appropriate monetary and fiscal policies. Thus, at any given time inflationary pressures may involve a complicated admixture of seller-push and demand-pull forces that are difficult to combat, or even correctly identify.

To sum up, the presence of unrestrained market power creates an inflationary bias. And, significantly, such power creates inflationary pressures even in the absence of strong demand-pull forces. Perhaps the most vexing problem is that efforts to control seller- or cost-push inflation with monetary and fiscal policies, alone, inevitably end up with unacceptably high levels of unemployment or both unemployment and inflation. Hence, to achieve the twin goals of full employment and reasonable price stability requires that restraint be placed on the use of discretionary economic power.

METHODS OF DEALING WITH MARKET-POWER INDUCED INFLATION

What, then, are the alternative methods of dealing with the problem of market-power induced inflation? Although there are a number of alternatives, I would urge adoption of a comprehensive form of price and income policy complimented by a broad mix of measures designed to perfect the functioning of our market economy. In such a comprehensive price and income policy, I believe a first step should be to give it a clear legislative mandate. The Congress did this with the legislation establishing the Cost of Living Council on Wage and Price Stabilization, though I believe this legislation is defective in a number of respects.

A serious flaw in the guidepost policy of the 1960's was its single-minded emphasis on wages and prices. In the future, profits, salaries, and other professional income must also be considered. It is both inequitable and unrealistic to expect labor to go along with a program that ignores all but wage incomes. This, of course, raises questions regarding the redistribution of income. Obviously, something must be done to reform our inequitable tax structure. Laborers and other salaried employees will find unacceptable a policy that asks them to exercise restraint when so many others enjoy vast incomes on which they pay only small taxes. Relatedly, an incomes policy cannot work if concentrated industries enjoy persistently high profits and executives in these industries receive large salaries and lucrative fringe benefits, a subject to which I shall return shortly.

What sort of mechanism should be created to implement this policy? One possibility is an independent agency created by the Congress. Its members would be appointed by the President and confirmed by the Senate. The agency would systematically review wage and price decisions in those industries where labor and business have substantial discretionary power. I emphasize that the agency should not become involved in every wage and price decision in the country. Fortunately, most of the economy is still effectively competitive. The Congress should, therefore, spell out the areas to be mentioned by the agency, or the standards for identifying the areas.

It would probably be necessary to permit the agency to delay price and wage decisions in some cases but, hopefully, primary reliance could be placed on the power of publicity in encouraging responsible behavior. To carry out its task it would be imperative that the agency have legal authority to obtain from business the data necessary to evaluate proposed price and wage increases. Without such information the entire process may be an exercise in futility. How can the President's Council be expected to act correctly and responsibly unless it has the facts? Certainly, the absence of reliable facts was one of the Price Commission's greatest shortcomings. Moreover, it is unfortunate that the new Council intends to operate under the same cloak of secrecy as the Price Commission, which refused to disclose the facts upon which it based its price decisions, in flagrant disregard of the congressional mandate expressed in the Hathaway amendment that would have made many records public.

I find the present situation with regard to corporate secrecy ironic in the face of the many promises of a more open Government. Not only is the public entitled to know the basis for the Council's actions, but unless this is done the policy will again be unevenhanded, in that

the record of wage increases will be plain for all to see, whereas the underlying data supporting price increases will be kept secret. Clearly, the new Council promises to be a charade unless it is greatly strengthened. It is unfortunate that the efforts of Senator Nelson and others for a more open Council, and one which would have more capacity for gathering data were are not accepted.

What I have said about the need for a comprehensive price and incomes policy is not to imply that I believe primary reliance should be placed on price and incomes policy. Rather, the congressional mandate authorizing such a policy should make it manifestly clear that a coordinated approach should be pursued involving a panoply of complimentary programs which will improve the basic functions of our market economy.

Time does not permit elaboration of these complementary policies. Their primary thrust, however, is to make our market system work efficiently and thereby improve the tradeoff between unemployment and inflation. Procompetition policy plays a central role among these complementary policies. It cannot be emphasized too strongly that the extent of Government involvement in price and wage decisions is directly related to the extent that competition restrains the discretionary power of key decisionmakers. We therefore have a choice:

Either enlarge the area of competitive markets or enlarge the area of Government involvement in business pricing decisions. Moreover, the extent of market power in business bears directly on the extent and use of power by labor. Market power in business begets market power in labor, as well as encourages maximum use of that power. But perhaps even more importantly, where firms enjoy persistently exorbitant profits, as in the drug industry, such excess profits must be eliminated if we are to expect labor unions not to exercise their full power. It is not convincing to argue, as have some, that eliminating monopoly profits in a particular industry is not really very important because it will not improve significantly the allocation of resources or the distribution of income in the economy. The critical point missed by this argument is that it is unreasonable to expect some persons in the economy to exercise restraint in the use of discretionary market power unless we adopt an explicit national policy designed to place limits on market power in all segments of the economy. There is growing evidence, throughout the Western World, that much of the current behavior of those with market power involves a struggle over the distribution of income. Thus, increasing competition in an industry aids in the fight against inflation on two fronts: First, it diminishes the inflationary bias created by those with discretionary power. Second, by reducing excess profits it encourages others in the economy to behave responsibly in using their powers.

This immediately raises the question of how best we may increase competition in our problem industries. Our 80-plus years of experience with the enforcement of the Sherman Act makes clear that the traditional antitrust approach is not adequate to cope with the task before us. Indeed, there is a serious question whether the antitrust agencies have the capacity to do the job even if they have the will. If we are serious about increasing competition in certain industries, new approaches are needed. First, a new mandate from the Congress indicating that it does indeed support a public policy designed to improve the effectiveness of competition in the economy and second, a new

statute that permits both effective and expeditious means of accomplishing this end. It is for this reason that the Congress should take steps to perfect the proposals of Senator Hart and others that would establish legal standards going to the essence of the matter—the possession of monopoly power. The existing law focuses on issues of intent to monopolize, the abuse of monopoly power, and other aspects of conduct and business behavior, rather than market power as such. Too often the result is excessively lengthy lawsuits that exhaust the resources and will of the Justice Department.

If the Congress truly wishes to improve the competitive structure of American industry, it should and can enact legislation to correct the deficiencies in the existing law.

Thank you, Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Mueller.

[The prepared statement of Mr. Mueller follows:]

PREPARED STATEMENT OF WILLARD F. MUELLER

MARKET POWER AND THE INFLATION PROBLEM

In recent months it has become increasingly popular to call for a return to the old time religion in our battle against inflation. By this is meant a fundamentalist approach that assumes all inflation is caused solely by the twin devils of faulty monetary and fiscal policies.

But let us not forget that this approach is neither all that old, nor is the call for a return to it all that new. It was practiced with disastrous results in the 1950's when we had three recessions in eight years. It was embraced again in January 1969, when President Nixon announced his "game plan" for reducing inflation without increasing unemployment. Some apparently have forgotten—or would have the public overlook—the lessons of this most recent experiment, when our reward for embracing the old time religion was a rise in both unemployment and prices.

These unpleasant experiences should raise in everyone's mind serious questions about relying solely on the old time religion in fighting the devil of inflation. In my view, it has not worked in the past and will not in the future because it rests on a false assumption, namely that all prices are determined in competitive markets. But, alas, many modern industries are not competitively structured, with the result that firms have power to maintain or even increase prices in the face of falling demand. The result: market power creates a serious inflationary bias in our economy.

I shall not attempt here to review all the evidence bearing on this subject.¹ Although the evidence is mixed, empirical research and historical events warrant the following conclusions:

(1) Market power-induced inflationary pressures played a critical role in the poor performance of the economy of the 1950's.

(2) The change in public toward the use of market power as reflected in the guidpost policy initiated in 1962 played a significant role in permitting the noninflationary expansion of the economy during 1962–65.

(3) The price behavior of the concentrated industries during the period of restrictive monetary and fiscal policy of 1969–70 again demonstrated how business firms with market power may increase prices in the face of declining demand.

Today, we are in very much the same situation as in early 1969 when President Nixon announced his ill-fated anti-inflation "game plan" which relied solely on restrictive monetary and fiscal policies. There are already danger signals that such policies, alone, will not do the job. Certainly GM's 10 percent increase in auto prices this year, despite an over 20 percent drop in purchases, illustrates once again how raw market power can be used to maintain or increase prices in the face of falling demand. Such behavior inevitably creates serious problems in fighting inflation solely through monetary and fiscal measures.

¹ This evidence is reviewed in W. F. Mueller, "Market Power: An Important Inflationary Force," in *Industrial Concentration: The Economic Issues*, Columbia Law School, forthcoming.

Because the new advocates of the old time religion argue that there is no empirical support for the thesis that market power creates an inflationary bias, I shall comment briefly on their arguments.

A common fallacy running through their arguments is the assumption that all inflation must be explained *either* by excess demand (demand-pull) *or* by market power (seller-push). This simplistic "either or" reasoning runs counter to the belief of those economists, including myself, who believe much of recent inflation experienced by the United States and other western nations involves a complicated interaction of demand-pull and market power forces.²

My fellow panelist, Professor Weston, is guilty of the "either or" fallacy. His failure to recognize the possibility of multiple causes mars his entire discussion and renders meaningless his empirical studies, as well as leads him to interpret improperly the works of others. For example, the most comprehensive study of the relationship between concentration and price behavior was done by Professor Leonard Weiss.³ Whereas Weiss covered the period 1953-59, Weston reran the analysis for the entire period 1954-70, for which he finds concentration is not statistically significant.⁴ This analysis lumps together observations from periods in which market power factors were predominant (1953-59), periods in which guidepost policy was exerting a strong deterrent to the use of market power by powerful unions and firms (1962-65), and periods in which excess demand were predominant (1966-70). This approach inevitably biases the results toward statistical insignificance, since it fails to take into account the fact that different forces were at work during different parts of the period.

I emphasize the fallacy of taking an "either or" view of inflation to make explicit that market power is only one cause of a complicated multicausal problem. Certainly, historically demand-pull inflation caused by monetary and fiscal policies has been a major culprit. But we should also recognize that existence of excess market power makes it impossible to rely solely on monetary and fiscal policy in coping with inflation. The failure of concentrated industries to reduce prices as demand decreases renders obsolete policies relying solely on monetary and fiscal policy to manage the economy. Some economists take comfort from the fact that over long periods prices and wages in the administered price sectors may not diverge greatly from those in the competitor sectors. They would dismiss the problem by calling the aberrant behavior of administered price sectors "delayed inflation." But when prices are unresponsive to demand in the short run, monetary and fiscal policies may be frustrated. First, officials may mistakenly interpret seller-push inflation as signalling the onset of demand-pull inflation, as apparently happened in the 1950's. Second, price rigidities in concentrated industries during the early stages of demand-pull inflation may mislead officials into underestimating the true magnitude of demand-pull pressures, thereby delaying timely application of appropriate monetary and fiscal policies. Thus, at any given time inflationary pressures may involve a complicated admixture of seller-push and demand-pull forces that are difficult to combat, or even correctly identify. As a result, when traditional policies are applied to a demand-pull inflation, they simply do not work. I believe Sellekaerts and Lesage speak for most economists today when they concluded their empirical study of the effects of seller-inflation with the observation:

² For example, the British economist Sir Alec Cairncross observes that while at times inflation may be caused "predominantly by demand and price and at other times *predominantly* by wages and costs, there is a rather confusing mixture of the two, particularly in the neighborhood of full employment." A. Cairncross, "Incomes Policy: Retrospective and Prospect," in *The Three Banks Review*, published by National and Commercial Banking Group Ltd., London, December 1973, p. 15. Even President Nixon's Council of Economic Advisors recognized that the two sources of inflation "are not necessarily exclusive," observing, "It may be that the economic power structure, though it is not radically different from that of two decades ago and would not on its own cause persistent inflation, does tend to prolong a high rate of inflation, once such a movement is generated by excessive demand. Reduction in the rate of inflation would still be achievable in the face of that type of structure, but it would come faster if the economic system were more competitive." *Economic Report of the President*, February 1971, pp. 61-62, emphasis added. Peter Fortune of the Boston Federal Reserve states the problem succinctly: "Over long periods of time, the primary source of inflation is demand-pull, but over short periods both demand-pull and cost-push factors exist with the weights attached to each varying over time." P. Fortune, Federal Reserve Bank of Boston, *New England Economic Review*, January-February 1974, p. 4.

³ Weiss found a significant positive relationship between the level of concentration on price increase. L. W. Weiss, "Business Pricing Policies and Inflation Reconsidered," *Journal of Political Economy*, April 1966, pp. 177-87.

⁴ As reported in "Concentration and Inflation," *Industrial Concentration: The Economic Issues*, *op. cit.*

"Monetary and fiscal policy, designed to eliminate inflation by reducing aggregate demand below potential output will be relatively unsuccessful if, *in concentrated industries, prices continue to rise in the face of a 10 to 20% fall in all manufacturing capacity utilization.* The major consequence of a traditional anti-inflationary policy is an increase in the unemployment rate above what can be considered as socially and politically acceptable, rather than a fall in the rate of inflation."⁶

To sum up, the presence of unrestrained market power creates an inflationary bias. And, significantly, such power creates inflationary pressures even in the absence of strong demand-pull forces. Perhaps the most vexing problem is that efforts to control seller- or cost-push inflation with monetary and fiscal policies, alone, inevitably end up with unacceptably high levels of unemployment or both unemployment and inflation. Hence, to achieve the twin goals of full employment and reasonable price stability requires that restraint be placed on the use of discretionary economic power.

What, then, are the alternative methods of dealing with the problem of market power-induced inflation? Although there are a number of alternatives, I would urge adoption of a comprehensive form of prices and incomes policy complimented by a broad mix of measures designed to perfect the functioning of our market economy.

TOWARDS A COMPREHENSIVE PRICES AND INCOMES POLICY

To begin, an explicit legislative mandate should be given to any future public policy to influence the prices and incomes⁷ of those with market power. The Congress has done this with the legislation reestablishing the Cost of Living Council, though I believe that legislation is too weak.

A serious flaw in the guidepost policy of the 1960's was its single-minded emphasis on wages and prices. In the future, profits, salaries and other professional income must also be considered. It is both inequitable and unrealistic to expect labor to go along with a program that ignores all but wages incomes. This, of course, raises questions regarding the redistribution of income, a subject that received scant attention even in polite liberal circles during the 1960's. Something must be done to reform our inequitable tax structure. Laborers and other salaried employees will find unacceptable a policy that asks them to exercise restraint when so many others enjoy vast incomes on which they pay only small taxes. Relatedly, an incomes policy cannot work if concentrated industries enjoy persistently high profits, a subject to which we will return shortly.

What sort of mechanism should be created to implement this policy? Personally, I favor an independent agency created by the Congress. Its members would be appointed by the President and confirmed by the Senate. The agency would systematically review wage and price decisions in *those industries where labor and business have substantial discretionary power.* I emphasize that the agency should not become involved in every wage and price decision in the country. Fortunately, most of the economy is still effectively competitive. The Congress should, therefore, spell out the areas to be monitored by the agency, or the standards for identifying the areas.

It would probably be necessary to permit the agency to delay price and wage decisions in some cases but, hopefully, primary reliance could be placed on the power of publicity in encouraging responsible behavior. To carry out its task it would be imperative that the agency have legal authority to obtain from business the data necessary to evaluate proposed price and wage increases.

This is not to imply that sole, or even primary, reliance should be placed on a price and incomes policy. Rather, the Congressional mandate authorizing such a policy should also make it manifestly clear that a coordinated approach be pursued involving a panoply of complementary programs that will improve the basic functioning of our market economy.⁸

⁶ W. Sellekaerts and R. Lesage, "A Reformulation and Empirical Verification of the Administered Prices Inflation Hypothesis: The Canadian Case," *Southern Economic Journal*, June 1973, p. 356.

⁷ The term incomes is used rather than wages to emphasize the need for concern with other forms of income than wages, which had been the sole focus of the 1960 guideposts.

⁸ President Johnson's Cabinet Committee on Price Stability outlined some essential ingredients of such a complementary policy, including (1) manpower policies, (2) programs to promote competition (3) freer international trade, (4) close surveillance and coordination of government procurement programs to avoid unnecessary market disruptions, and (5) special programs to improve productivity and institutional arrangements that created an inflationary bias in particular industries, especially the construction and the health care fields. Cabinet Committee on Price Stability, *Report to the President on the Committee's Activities with Recommendations for Future Action*, December 28, 1968.

THE SPECIAL ROLE OF COMPETITION POLICY

Time does not permit elaboration of these complementary policies. Their primary thrust, however, is to make our market system work efficiently and thereby improve the trade-off between unemployment and inflation. Procompetition policy plays a central role among these complementary policies. It cannot be emphasized too strongly that the extent of government involvement in price and wage decisions is directly related to the extent that competition restrains the discretionary power of key decision makers. We therefore have a choice: Either enlarge the area of competitive markets or enlarge the area of government involvement in business pricing decisions. Moreover, the extent of market power is business bears directly on the extent and use of power by labor. Market power in business begets market power in labor, as well as encourages maximum use of that power. But perhaps even more importantly, where firms enjoy persistently exorbitant profits, as in the drug industry, such excess profits must be eliminated if we are to expect labor unions not to exercise their full power. It is not convincing to argue, as have some, that eliminating monopoly profits in a particular industry is not really very important because it will not improve significantly the allocation of resources or the distribution of income in the economy, much less have any effect on seller-push inflation. The critical point missed by this argument is that it is unreasonable to expect some persons in the economy to exercise restraint in the use of discretionary market power unless we adopt an explicit national policy designed to place limits on market power in all segments of the economy. There is growing evidence, throughout the western world, that much of the current behavior of those with market power involves a struggle over the distribution of income. Thus, increasing competition in an industry aids in the fight against inflation on two fronts: First, it diminishes the inflationary bias created by those with discretionary power. Second, by reducing excess profits it encourages others in the economy to behave responsibly in using their powers.

This immediately raises the question of how best we may increase competition in our problem industries. Our over eighty years of experience with the enforcement of the Sherman Act makes clear that the traditional antitrust approach is not adequate to cope with the task before us. Indeed, there is a serious question whether the antitrust agencies have the capacity to do the job even if they have the will. If we are serious about increasing competition in certain industries, new approaches are needed: (1) a new mandate from the Congress indicating that it does indeed support a public policy designed to improve the effectiveness of competition in the economy and (2) a new statute that permits both effective and expeditious means of accomplishing this end. It is for this reason that the Congress should take steps to perfect the proposals of Senator Hart and others that would establish legal standards going to the heart of the matter: the possession of monopoly power. The existing law focuses on issues of intent to monopolize, the abuse of monopoly power, and other aspects of conduct and business behavior rather than market power as such. Too often the result is excessively lengthy lawsuits that exhaust the resources and will of the Justice Department.

NO EXCESSIVE DEMAND

Senator PROXMIRE. Gentlemen, I think this is the most appropriate way to start our inflation hearings, because in my view, there is no more obvious area of inflationary behavior than in discretionary pricing power. The pricing decisions that have been made so far in some industries are just so conspicuous to me that it is a wonder that there has not been more attention focused on them.

Let us start with taking a look at what the situation is with respect to the usual conventional assumption as to what causes inflation. First, excessive demand. Now, in the last year if there is anything clear, it is that we have not had an excessive demand in our economy. The fact is that personal consumption has fallen off by a sharp amount, real retail sales are down 2.4 percent, which is probably the best measure of demand. Retail sales are off, at the same time our economy and population have been steadily growing.

So in the worst inflation in our history, demand is down.

Now, you may say that while overall demand may be down, in the specific areas where there have been terrific price increases, demand is up. No, it is not. It is down there also. For instance, there has been a very sharp drop in the demand for automobiles, and yet the price is up, and up sharply.

I mentioned steel, and the colossal 40-percent increase that we have had in the price of steel last year. But we are producing less steel. We have greater steel capacity, but we are producing much less steel. An article in the New York Times points out that in the first 8 months of this year, less steel was produced than during the same period last year.

The same thing in construction in general. Construction is down. It is true that there is an increase in investment in plant and equipment, but residential construction and overall construction is down.

In oil, which I think most people feel is certainly one of the most important elements in our current inflationary situation, we are producing less, not more. Demand is down and oil firms are selling less oil and oil products.

So that we cannot say that demand is the cause.

Now, let us take a look at cost. Is this a cost-push inflationary situation? Well, the wage costs have certainly gone up a whale of a lot less than prices have. Real wages are down, I should say; down, not up.

If we take the area of steel that I discussed, I was talking with some leaders in the steel industry not long ago, and they conceded the fact that wage costs are stable or down in the steel industry, not up. The productivity is sufficient to overcome a substantial increase in wage rates, and wage costs are down. So you are not having that enormous 40-percent increase in steel prices because wage costs are pushing up the price of steel.

In oil, I think all of us recognize that if there is anything simple about that industry, it is that the wage factor is not important in the oil industry, it is not a primary cost determinant.

So what is left? Now, you can argue that world inflation is a factor, and I presume it is. World inflation is a factor particularly in oil and steel because it has knocked out the foreign competition, which had been one of the elements that had given us some degree of price stability. What is left is a situation where sheer unadulterated economic power has been pushing up prices very sharply. I submit that if you take these areas of oil and steel and chemicals and nonferrous metals, you have identified the source of a large part of our current inflation.

Food is the third area. In food you have the most remarkable performance of all. For 5 consecutive months this year, farm prices dropped. In June we had parity at the lowest levels it had been in 10 years. The farmers have not been worse off since 1963 or 1964. In spite of that fact, the price to the consumer of food has been going up. Why? Because you have concentration in the processing and distributing industries.

So it seems to me that if there is any answer, you gentlemen should have it.

I would like to ask Mr. Scherer first, to respond to that general observation.

Mr. SCHERER. Well, Senator, there is very little that I can disagree with on what you have already said. Indeed, you are obviously more expert on what is happening in the U.S. economy than I am. I have been back in the country only for 6 weeks after living overseas for 2 years. My impression is exactly the same as yours. I have not got down to the root numbers that explain exactly where these price increases are being trapped. It is quite clear that profits are going up. I suspect that returns to people who own raw resources such as land, and especially land which has oil, coal, or what have you, under it, are gaining substantially in the income distribution struggle. I do not have the figures precisely to back up your analysis. I think, however, it is very close to the mark.

THE ROLE OF OIL

Senator PROXMIRE. Mr. Weston, your analysis is a most interesting one. You are a man of the greatest stature in your profession. You are esteemed by people who disagree with you, which I think is probably the best tribute that anyone can be paid. But you have given us a picture in which we cannot blame the concentrated industries. That is your analysis in general. And it has been so consistently over the years. What I find lacking in this is a definition of what is a concentrated industry and whether or not the concentration is actually a basis for a pricing power.

Let me just give you a quick example. I doubt very much if you would classify oil as a concentrated industry. There are 23 majors. And there are many thousands of other companies in the oil industry. I doubt if you could call the oil industry a concentrated industry under these circumstances. And yet, because of their vertical integration, and because there are some very large companies, and because of the tradition of international cooperation, perhaps, they have followed a policy of pricing which seems to be based on power rather than on supply and demand, inasmuch as they continue to maintain and to increase prices, while the supplies available and increasing should lower prices.

So my question is, How much do you justify just looking at the concentration ratio? You have a situation in which you call a concentrated industry one in which there are eight firms with 80 percent or more of the sales; is that right?

Mr. WESTON. No. My position is not one which attaches importance to a concentration measure. That is a burden I should not be asked to bear. My research has been to rebut the arguments of those who have used concentration ratios to try to establish that industries that are highly concentrated by the four firm concentration ratios or eight firm concentration ratios, which they have used, have some particular economic significance. My position has always been that more important than the mechanical ratio is looking at the economic processes that take place in the industry.

I think the overwhelming significance in the oil industry is the role of OPEC. Mr. Scherer in his prepared statement refers to the general proposition that Stigler made. "That monopoly or oligopoly cannot explain inflation." He says, "It is refuted by the oil situation." He says, "Ask an oil sheik about this."

But I think you have to recognize the very, very special characteristics of that situation. You have coordination among nations account-

ing for a very high percentage of the production of a national resource. So what you have here is not an individual firm or a group of individual firms in a given country like the United States, for example. But what you have is a group of nations acting in concert, and which found themselves with unexploited, unfully exploited cartel or monopoly power which they proceeded to exercise during a period when the quantity demanded for oil had increased greatly in part because oil had been underpriced at \$3 a barrel.

But their increase to \$12 a barrel did represent a monopoly exploitation. Although even there the impact on the quantity demanded was bringing oil prices down to between \$9 and \$10 a barrel. Then we have the recent decision that they are going to perhaps cut back on the supply even more to try to keep the prices of oil up. It seems to me that what is a more critical analysis of the structure of the U.S. petroleum industry in a circumstance like that where a group of nations have exercised hitherto, incompletely exercised, potential monopoly power—that is far different from the kind of situation we generally have in mind when we are talking about concentrated industries in the United States.

So that I would say, as a general point, that in terms of the whole series of industries that have been run through, just commenting very briefly—

Senator PROXMIRE. Let us just confine our remarks to oil for the time being. As I understand it, the oil companies had a great deal of crude oil available, more than they had last year at this time. But they were not refining it at the same rate in July and August as they did last year. They were restraining their production of gasoline. They had the supply available, and the price was enormously inviting. They could make a big profit at the price, but they restrained it. Why? So they could maintain and reinforce that enormously high price.

Now, do you deny that this is a fact? This was the observation of some of the oil experts who advised this committee. Are they wrong in that observation?

Mr. WESTON. I do not know those details on the facts of the oil industry. One hypothesis that occurs to me, if refining runs were down, was that the relative prices for other types of oil products had increased relative to the prices of gasoline. That would be a rational response. But I do not have these facts available. I would have to look at the facts.

Senator PROXMIRE. That was not the case in this instance, they had not switched over to the production of fuel oil, for example. So that that was not an explanation.

Mr. WESTON. I really cannot comment on that, because I do not know the facts.

Senator PROXMIRE. At least you would regard this as a matter worthy of inquiry and a matter of suspicion, that they had more crude oil available and they were not actually using their full refinery capacity, right?

Mr. WESTON. In these circumstances I would want to look into the facts to get an understanding of what was happening.

Senator PROXMIRE. Mr. Scherer.

Mr. SCHERER. Again, I have been out of the country and not in close touch with the facts on U.S. refining. I have been watching, however,

the development of prices in Europe for gasoline and crude oil products very carefully. Exactly the same kind of phenomenon has been going on there during the past year. The same companies are involved. About 6 months ago the European market had a severe surplus of gasoline. What did the companies do? First, they raised their prices in the face of excessive supply; and second, they then said, we must, because our prices are up, cut back our supplies of gasoline, our refinery runs, so that we do not develop a gasoline surplus at these high prices.

Senator PROXMIRE. You have said it much better than I could.

Mr. SCHERER. To me it all seems very bizarre, Senator.

Senator PROXMIRE. It is just a matter of sheer economic power. It has nothing to do with supply and demand, it is related to the fact that they have the power to get whatever price they want.

Mr. SCHERER. That is the case, I think.

Senator PROXMIRE. My time is up.

Congressman Conable.

NATURE AND ROLE OF CONGLOMERATES

Representative CONABLE. Mr. Scherer, we are told that Mobil has purchased Marcor, and Gulf is buying Ringling Brothers, Barnum and Bailey Circus. There obviously is a tendency toward conglomeration. Let me ask you, is conglomeration a good thing or a bad thing in relation to the administering of prices? Certainly, if it permits a high profit line of business to subsidize a competitive line of business, thus giving an unfair competitive advantage, you develop some degree of oligopoly. There is a greater potential for administering prices, and then reinvesting in or subsidizing a line of business where you have a much tougher competitive situation. The result can tend toward monopoly. Do you have any generalization about this impact of conglomeration?

Mr. SCHERER. My first generalization would be that economists observing the effects of conglomeration disagree violently.

The second observation is that the disagreement probably results from what is in fact a very complex reality. There seems to be evidence that on rare occasions conglomerates do cross subsidize their lines, and therefore may have somewhat more fighting power than a nonconglomerate firm.

There is also clear evidence that the profit performance of a conglomerate in any given line is very hard to detect because the data are all scrambled under one corporate roof.

But third, I think the general opinion of economists is that the enhancement of economic power from mere conglomerateness is not very great. That is to say, the social evils in a narrow economic sense from conglomerateness may not be very great. On the other hand, there seems to be little if any evidence that significant benefits come to society from conglomerateness.

Representative CONABLE. There is some benefit of stability, is there not, that if you diversify you become more stable? I can see that as a possible benefit. I think it may be outweighed by other factors.

Mr. Mueller had something he wanted to say on that.

Mr. MUELLER. I think, on the point you are raising, very clearly conglomeration makes it much more difficult to find out what is happening in the industry. If you are concerned with public policy issues.

in the case of the oil industry, which I think should be viewed as a quasi-public utility, the growing conglomeration of oil companies into coal, department stores and what have you, obscures the profit picture with respect to oil. So we really do not know what is going on. Generally, it will make it more difficult to have an effective public policy. Hopefully, the FTC will win its suit against those challenging its authority to collect information on line of business. We will then be getting more information, the public will, although unfortunately, it will not be made public to the degree it should be. But it will be helpful.

But I think there are other problems of conglomerates, but that is another matter.

Representative CONABLE. If I may say so, on the Ways and Means Committee, where we have been working on windfall tax bills, which then disappeared into limbo, we have been concerned about trying to encourage reinvestment in an area that has obviously got tremendous capital demands. And applying increased profit from oil sales into some other types of business instead is a somewhat discouraging development to the people who feel that we should be trying to force capital toward this very capital demanding area.

Mr. Weston, you had something to say about this.

Mr. WESTON. That ties in with the comments I made. And I agree with you, that I think a capital allocations committee would have a role to play here. I would agree with Mr. Mueller when he says that in the present situation in the United States that the oil industry has to be regarded as a quasi-public utility. And to transfer funds from selling petroleum products to the individual stockholders of Marcor, rather than to use those funds related to the most pressing problem of petroleum supplies in the United States, I think is properly something that a capital allocations committee and your Ways and Means Committee should be concerned about.

DEFINING A CONCENTRATED INDUSTRY

Representative CONABLE. I agree with you that it is not very rewarding to consider what constitutes a concentrated industry, that we get hung up on rigid definitions. But I am wondering if an industry may exhibit characteristics of a concentrated industry under some circumstances and not under others. For instance, if you assume that we have an oil shortage, you might much quicker come to the conclusion that oil is a concentrated industry than you would if we had an oil surplus, because the industry in circumstances of surplus may very well perform quite differently than it would in circumstances of shortage. The surplus might stimulate much greater competition than would be possible if you had a shortage. So I am not sure that the definition of what constitutes a concentrated industry is going to remain the same under different circumstances.

Mr. WESTON. As I indicated, I recognize the difference in the role of a concentrated industry on the wage determination side during a period of relative price stability as compared with a period when you are trying to wind down an inflation. But I think another comparison here is relevant. And that is, we have had two industries where shortages have caused considerable price increases, and in one the mechanism was the oil industry, and in another it was agriculture. Now,

prices in farm products, for example, between 1967 and October 1973 have gone up 88 percent. In 1973, per capita personal income in North Dakota rose faster than in any other State, 28 percent. One could argue from data like that, that the farmers in North Dakota are monopolists, or that agriculture is monopolized. Agricultural personal income was up 15 percent during the first 5 months of 1974. You have the parallel between the behavior of the cattle producers and the petroleum companies in Germany, as Mr. Scherer has referred to, and the refining activity that Senator Proxmire has referred to. Initially, in the shortage period, point No. 1, the shortage as such does not mean that the industry must be concentrated, because clearly, that was not true in agriculture.

Point No. 2, when the shortage occurred and prices rose sharply, they rose sharply both in agricultural products and in petroleum products.

Point No. 3, efforts were made as prices went up sharply to augment supply. And that occurred in agriculture by more cattle going into the feedlots and getting them out as quickly as possible. Refining activity was increased in petroleum, and refining operating capacity.

And then you had a period where the high prices reduced the quantity demanded. And the thousands of cattle producers went to Congress and asked for direct forms of relief—and they got them—so that they could withhold supplies from the market.

A relatively small number of petroleum producers, as the quantity demanded dropped, urged filling stations to be open 24 hours a day and on weekends. Within that framework I can see where refining activity would drop down, given that the quantity demanded fell off. I do not see that as market power any more than the comparable and parallel situation among the thousands of cattle producers. I do not think it is true or accurate to say that only those farm prices have come down since their peak of August 1973—and they have, of course, from an index of 213 down to 169 in June 1974 before rising to 180 in July 1974. Nevertheless, it is true also that the prices of processed foods have also come down from a peak reached in the same month of August 1973 of 166 down to 157.4, through June 1974, rising to 167.6 in July 1974.

WORLD MARKETS AND THE STEEL INDUSTRY

Representative CONABLE. I expect that your colleagues may want to comment on your answer to that.

But I would like to ask one additional question. We legislate here for the United States. To what extent must we concern ourselves in any legislative approach to the problem of the concentrated industry and the administered price with what is happening abroad in an industry, let us say, like the steel industry, where you have very substantial subsidy, and an obviously administered price, and an artificial capital investment as the result of policy decisions made in the nationalized industry for political purposes? If we are pretty tough with our industry in an effort to try to maintain market conditions here, are we not closing ourselves to very real problems of survival as long as we have in our world increasing pressures or liberalized trade? I think the steel industry is planning to spend something like \$7 billion in increased capacity. Should we not, as policymakers, concern our-

selves with this as well as with the problem of what goes on right in our own country?

Mr. WESTON. Yes; it seems to me that that underscores my point, that concentration numbers for the United States is a mechanical approach. Many of our industries have now become international industries.

The steel industry, which you just described, is a good case in point. The worldwide steel industry as a whole is experiencing strong demand, excess demand at prices that had been prevailing until recently. The dramatic thing is that you had the spectacle, up until a couple of years ago, of ingot steel at something like \$200 a ton, with the Japanese coming in and selling at something like \$160, \$180 a ton, undercutting in the United States. Whether it is dumping or not is a complex subject, depending upon how you treat the allocation of fixed costs as between domestic and international.

Representative CONABLE. We cannot even define what dumping is.

Mr. WESTON. Right. It is very complex. But nevertheless, you had import controls in foreign countries and various forms of direct and indirect subsidies by Japan and many European countries. Now, in recent months you had the spectacle of steel prices moving up, yes. But again, U.S. steel prices moved up relatively slowly, so that you had the Japanese, who had been coming in and selling below U.S. prices, coming in and selling steel at above U.S. prices. Because of the general atmosphere of moral suasion on the steel industry, U.S. steel prices had not moved up to market clearing prices, so the Japanese have been coming in and selling at a premium. Then in part at least it appears, using part of that premium, that they are selling steel at below-market prices in their domestic markets, which in turn provides relatively lower cost steel for the industries that use steel as a raw material in Japan.

So that illustrates the complexities involved when you deal with industries that are truly international markets. And this is increasingly the case for a large number of those industries that are capital intensive and also by conventional measures relatively concentrated.

Representative CONABLE. I am sorry, my time is up, Mr. Scherer. Maybe Senator Proxmire would like you to continue.

Senator PROXMIRE. Yes, indeed.

Mr. SCHERER. I wonder if I could elaborate a bit on Professor Weston's analysis of the world steel industry.

It is true that prices have been going up rather rapidly of world steel markets. Historically, however, there is a big difference between the pricing behavior of, say, the European and the Japanese steel producers on the one hand, and the pricing behavior of the U.S. producers on the other hand. In the U.S. steel industry, prices go only in one direction, up. In Europe and Japan, on the other hand, there are substantial price fluctuations over the business cycle. Yes; prices of Japanese steel and European steel today are very high. I suspect, however, that in a couple of years they will have fallen by 20 or 30 percent. Then the U.S. producers who have in the past 8 months raised their prices by 40 percent will once again find themselves priced out of world markets. Not only that, but they will find themselves vulnerable to low-price steel coming in from abroad, and will be scrambling to Congress next December 31 or earlier for continuing protection from foreign import threats.

SUBSIDIZATION OF STEEL INDUSTRY

Representative CONABLE. But to what extent is that the result of subsidization?

Mr. SCHERER. That would be my second point. There is subsidization of steel industry abroad. I think, however, you will find it inversely proportional to the efficiency of the industries abroad. The Japanese producers, to the best of my knowledge, receive at best very modest subsidies from their government. They are now unquestionably the most efficient steelmakers in the world. I do not have the latest figures. I suspect, however, that their output per worker now exceeds that of the United States, which used to lead the world in steel productivity.

Similarly, the toughest European exporters are the Germans, where you will find almost no subsidies, and the Dutch, who do not in general subsidize their steel industries.

The British industry has in the past been hopelessly inefficient, and therefore there have been massive governmental subsidies.

Similarly, the Italians have been subsidizing their industry strongly. And so have the French. Once again, you will find in those industries massive inefficiencies.

Representative CONABLE. Mr. Mueller.

Mr. MUELLER. Even admitting the possibility of subsidization by some foreign governments, I think it would be a great mistake to argue that we should not be concerned with the nature of competition in the industries affected in this country. It is easy to argue that we must be big, our companies must be big, in order to compete with foreign competition. The fact of the matter is that in industry after industry even our medium-sized companies often are larger than their leading foreign competitors. But certainly, what empirical evidence we have indicates that the largest companies in many industries are by no means necessarily the most efficient. The steel industry is a classic example. Study after study has shown that United States Steel has been a laggard, as well as the other industry leaders. Consequently, working toward a policy of bringing about more competition in industries through some deconcentration is likely to make our industries more competitive whatever the nature of foreign competition.

FUTURE OF PRICES

Senator PROXMIRE. Gentlemen, I would like to start off my round by first asking you if you would tell me what you expect price behavior to be in the coming year, say, in the next 12 months. I will start with Mr. Weston and move across the table that way.

Mr. WESTON. Senator Proxmire, are you referring to price behavior?

Senator PROXMIRE. I am talking about consumer prices, overall consumer prices.

Mr. WESTON. Overall?

Senator PROXMIRE. Yes, sir.

Mr. WESTON. I think that given the strength of the inflationary rates in recent months, that our policies should be geared not to attempting to stop inflation in its tracks in the sense of getting back to 1 percent a year or 2 percent a year. But that given that workers' real income has indeed fallen, as you have stated, that realistically, it makes sense to attempt to ratchet downward the inflationary pressures. In return for

the kinds of, for example, financial controls and policies that I outlined in my original presentation, to attempt to work out a program of statesmanship in the key large industries of wage increases that would be only moderately above labor productivity increases for the coming year. So that if we could wind down from the present two-digit rates of inflation to something in the region of 7 to 9 percent—

Senator PROXMIRE. Then, do you think that prices will be at the rate of 7- to 9-percent increase 12 months from now, roughly?

Mr. WESTON. At least if we can manage the situation well.

Senator PROXMIRE. If we manage the situation well they will be at least that high?

Mr. WESTON. Yes, sir.

Senator PROXMIRE. Now, Mr. Scherer.

Mr. SCHERER. I would like to engage in wishful thinking and believe they will not be that high. If the rate of inflation for the next year continues to be that high it will be a national catastrophe. So I would hope that we could wind down the inflation to about 5 percent. We will not be able to do that without vigorous Government action on a variety of fronts. It is hard now to tell whether we will indeed take such action. If we do not take such action, I would agree with Professor Weston, we will have inflation on the order of 10 percent.

I think also that we will observe in the next year the rate of inflation to be more rapid in those industries where substantial power exists than in those industries where prices tend to be set by the free play of supply and demand forces. There is of course, one major exception to this generalization. And that is the agricultural sector. If I understand the situation correctly, the drought conditions in the Midwest are likely to restrict supply in such a way as to lead to continuing double digit inflation of basic farm commodity prices.

Senator PROXMIRE. Mr. Mueller.

Mr. MUELLER. Given the dismal record of the expert forecasters, I will not be so presumptuous as to make a prediction.

But I am very fearful of increasing unemployment. The people I have the greatest respect for as forecasters of unemployment and inflation, such as Otto Eckstein, are predicting that we must have unemployment go to 8 percent to 2 years under the present kind of monetary and fiscal policy, in order to get inflation down to 5 or 6 percent. I think this is a very critical factor—certainly, it is as important as public enemy No. 1, inflation. What happens to unemployment?

Senator PROXMIRE. You say you have great respect for Otto Eckstein. Do you accept the idea that unemployment is going to have to go to 8 percent before we get inflation under control?

Mr. MUELLER. If we are going to rely solely on monetary and fiscal policy, I do.

Senator PROXMIRE. Do you see this administration as likely to do anything else?

Mr. MUELLER. I just do not know at this stage. Apparently the President is open minded. But certainly, the present Price Council which does not have any teeth, will not do the job.

PROGRAMS AGAINST INFLATION

Senator PROXMIRE. I want to start back the other way and ask you gentlemen to give me what you can do in the short run, in the next

12 months, to have an effective action against inflation? Give me three or four of your most important recommendations.

Mr. MUELLER. Certainly it assumes that we will have a monetary fiscal policy that is not expansionary. But even assuming that, I think the key matter is to have a prices and incomes policy that does focus in on the key sectors of the economy.

Senator PROXMIRE. By that you mean before the prices could be increased there would be a waiting period, as Mr. Burns has suggested, and the administration could focus on that by holding hearings? That kind of action would take legislation.

Mr. MUELLER. Yes, sir.

Senator PROXMIRE. Do you think that should be done?

Mr. MUELLER. I think that is essential.

Senator PROXMIRE. How about antitrust policy, how important is that?

Mr. MUELLER. I think antitrust is really a longrun matter; it is going to require long-range initiatives. In the shortrun, antitrust is not an effective tool.

Senator PROXMIRE. Why is it not an effective shortrun tool?

Mr. MUELLER. Because you cannot make a tough antitrust policy that is going to have an immediate impact across all the concentrated industries. But my own view, unless we can persuade labor and others in the economy who have discretionary power that we have policies that are at least on the way to reducing the excess incomes and profits of some concentrated sectors of the economy, it is just a lot of nonsense, and the height of irresponsibility to ask labor to continue to be statesmen and exercise restraint. And consequently, I think we should get a strong antitrust policy underway and demonstrate that we are finally going to make the market system work more effectively.

Senator PROXMIRE. Would you provide for rollback power on the part of the President? This is something that was not in the Stevenson-Muskie amendment or the budget recommendation, but it would permit in specific cases excessive price increases to be rolled back. Yet it is not an over form of price controls. Would you favor that?

Mr. MUELLER. I think so. As I mentioned in my oral statement, the way in which automobile prices have been increased in the face of this drastic drop in consumption is blatantly irresponsible. And in cases like that—and I think there may be others—some kind of a rollback is warranted.

Senator PROXMIRE. Mr. Scherer, will you give us your shortrun prescription as to what should be done?

Mr. SCHERER. First, on the fiscal front, I do think that we need a tightening up, even though from a full-employment budget standpoint we are running a government surplus.

Senator PROXMIRE. I strongly favor that, too. But I must say that I am somewhat weakened in that view by the fact that demand and sales are down sharply and yet prices continue to go up. If demand is down and prices are going up, how would further restriction of demand help us?

There is one area I can see—if the Federal Government can balance the budget they are out of the capital market on a net basis, and the pressure on interest rates would ease, but this is only one phase.

Mr. SCHERER. Let me say, Senator, that I advocate this position more from income than from classical stabilization grounds. That is,

I think the tightening should take place with respect to corporate profits and income taxes in the higher tax brackets. I would advocate something like what was done in the Federal Republic of Germany over the past 18 months or so, that is, to impose a tax surcharge only for incomes above a certain threshold.

Senator PROXMIRE. That is very interesting. They have the best inflation performance of any major country. But was this an important factor in it? It seems to me that a tax increase of that kind now, once again with demand so shaky, would hardly be a good method for getting prices down.

Mr. SCHERER. That may have played a minor role in their superior price performance. The major role is more a historical kind of thing, simply that labor in Germany has been very patient, and has not pushed hard for high wage increases. That discipline has broken in the past year, and Germany is experiencing its problems. I do think, however, that tightening should be selective rather than across the board. The latter policy largely hits the little guy, restricting his consumption and making it difficult for him to buy a house. So there is one point.

The second point is that I would move toward very total jawboning, imposing, among other things the hot glare of publicity and detailed investigation upon those power groups that attempt to raise prices and/or wages at high rates.

Third, this implies that the new Council on Wage and Price Stability needs the subpoena power in order to get out the kind of information permitting it to inform the public on what is going on in these high price increase industries.

Senator PROXMIRE. Along that same line, product line disclosure of the kind Mr. Mueller has been urging, and some of us in the Congress have been fighting for?

Mr. SCHERER. Yes, indeed, sir, that is very important.

Finally, because the critical problem here is one of expectations. I believe there must be a strong moral leadership from the Presidency. And that is a rather—

Senator PROXMIRE. Tell us what it means. What does the President do to provide moral leadership with respect to inflation?

Mr. SCHERER. Across the board, beginning in the White House, I think he needs to tighten up and say, let us hold the line. Now, that has some macroeconomic implications in terms of multipliers. The key thing, however, is not the multiplier effect, it is the expectational effect.

Senator PROXMIRE. What do you mean in the White House? Turn off the lights?

Mr. SCHERER. Things like that, little things, cutbacks in staff and amenities.

Representative CONABLE. Congress has already done that with respect to White House staff during earlier administrations.

Mr. SCHERER. Yes; I know it is difficult, but that kind of leadership must be exercised and communicated throughout the country.

Senator PROXMIRE. You would come down hardest, however, in the same area that Mr. Mueller would in incomes policy and antitrust action and restraining price increases; is that right?

Mr. SCHERER. I do not think we are going to crack the problem without a very strong effort on that front.

Senator PROXMIRE. Mr. Weston.

Mr. WESTON. I want to begin by making it clear that the oldtime religion is not enough, that the oldtime religion has been carried pretty far now, as indicated by full employment, budget surplus, and the rate of monetary increase in recent months down to 4 to 5 percent per year. That is not going to solve the problem alone. The oldtime religion is important for avoiding the sin of getting inflation started. It cannot do the job alone after the sinning has been underway for a number of years. Nor, on the other hand, do I believe in the devil theory, that by exorcising some devils you are going to solve the problem either. And I would move on a broad front.

I would make a distinction between an incomes policy which redistributes and a cost control policy which keeps costs down in the wage determination. Much comment has been made about automobile prices in recent months. The whole history of the automobile industry represents an attempt to keep automobile prices relatively lower than other items in the consumer expenditure budget. I see no reason why they would depart from that policy in the present circumstances.

In the least concentrated of all possible industries, when you have substantial increases in costs, you cannot look at demand alone. Sure, the demand curve can shift to the left, demand can fall off. But if supply shifts even further, that is, if costs have gone up, that will produce a price increase under the least concentrated of industries. And while again I have not studied the facts in detail in the automobile industry, I think that it is dangerous to generalize on the basis of looking at demand alone.

But more generally in the short run, clearly in two areas on oil I think the oil-consuming countries have to meet and have to agree to present a united front to achieve at least a bilateral monopoly in this situation. From the standpoint of the United States, we have to increase domestic supplies on an accelerated program. I think we have to recognize also that when something has increased in price fourfold, that we have to do more in the way of changing our way of life and developing ways of using less oil in the United States.

With regard to agricultural commodities, it is clear that a major cause of our problem there is that we were so concerned with a number of years of large stockpiles that we got them down too low, so that we were not in a position to ride out a period of increased demand abroad, or bad weather. I think clearly this is an opportunity to get rid of price supports in a number of areas, milk, sugar—clearly they make no sense in this kind of environment. This is the time to do that.

Therefore, I would say that we should be in a position now to even moderate in the oldtime religion areas the monetary and fiscal policies, and move along these more specific directions. Particularly in order to give labor a reasonable basis for their continuing good record, I think, of statesmanship, we need a financial program in the tax area. This is where I would then come into the incomes policy. In addition to a freeze on dividends, I think it does make sense to move on corporate tax rates and perhaps offset to some degree with an investment tax credit, supplemented by capital allocation. So we are improving resource allocation overall.

Senator PROXMIRE. Would you freeze dividends, increase the corporate income tax, and permit an increase in the investment tax credit?

Mr. WESTON. In the investment tax credit. At the same time, I would couple that with a surtax on personal incomes above a designated income level, again as a basis for distributing the burden equitably. With 400-percent excise tax on oil, with worldwide crop shortages, having shot billions into the area in Southeast Asia, in some sense our real resources have been reduced, and all of us have to adjust. And clearly, from this standpoint if at the same time you levy a surtax on personal incomes above \$30,000 to \$40,000 that is not going to have a great impact on aggregate demand. As you point out properly, with retail sales down, consumer spending down, you are not going to be hurting spending where it actually occurs in the lower income groups. In fact, on the income side I think it makes sense to reduce the tax on wages, social security, and unemployment taxes, on incomes below a certain level. I think détente really ought to be buying us some ability to reduce military expenditures abroad. That money could be used, then, for employment programs. With the rising unemployment, I think you have got to have direct programs to take care of the terribly high unemployment rates among certain groups that just cannot be justified on equity grounds.

So that is what I would argue.

Senator PROXMIRE. Senator JAVITS.

ANTITRUST APPROACH SLOW

Senator JAVITS. Gentlemen, I am impressed with the theories that you have espoused.

Is it not a fact that an effort to break down the system through the antitrust laws is going to be extremely slow? However, you may disagree, perhaps you would agree on the point that we have not very much time to right the ship of state.

Mr. Mueller.

Mr. MUELLER. I could not agree more. This cannot be done rapidly. The argument that antitrust is slow has been made, though, for so many years that we just never get around to doing anything substantial. On the other hand, the fact that it does take so long I think is a powerful argument to those in the Congress and elsewhere that the antitrust laws should be changed so that it is possible to bring about an industrial restructuring within a lifetime. Now it develops into such an enormous legal battle that I question whether the Justice Department can take on an IBM. Control Data's settlement with IBM in a case similar to the Justice Department case involved legal fees as part of the settlement of \$15 million, presumably covering Control Data's costs up to that point in the case. They were not nearly finished. That amount is equal to the total annual budget of the Antitrust Division.

So I think new approaches have to be taken. I am a firm believer in a market economy. But I think a strong antitrust approach is really a life insurance policy for it.

Senator JAVITS. By a strong antitrust approach you do not necessarily mean the enforcement of the Sherman antitrust laws in sequels, unless I am mistaken, but the espousals and standardization of an antitrust policy which by statute could be more than the case-by-case method of the Department of Justice. Do I read you correctly?

Mr. MUELLER. Yes. Of course, I do urge that we do as much as we can under the existing law. The Supreme Court has not been given an opportunity to rule on a big antitrust case recently, so we do not know how much authority we really have. But the main point is, I think, that steps should be taken to speed up the process.

Senator JAVITS. Mr. Scherer, would you care to speak to that?

Mr. SCHERER. I largely agree with what Mr. Mueller has said. First, there are substantial lags in the antitrust process. But second, we do have a number of major cases in the works. They will probably provide important precedents. We do not know yet how those cases are going to come out. If we get beaten, we will surely be coming to Congress and asking for help. I think, however, Congress should independently be considering about ways of strengthening the antitrust laws for the long-run fight against inflation.

A third factor that should be mentioned is that we are doing a number of novel things both in the antitrust area and in the consumer protection area at the Federal Trade Commission. Some are going to be politically unpopular. We have, for example, some things going on in the retail drug industry which I am sure are going to be very unpopular. We have an action now in the soft drink industry against which legislative measures are being considered.

We need help from Congress here, too. If Congress passes legislation exempting powerful interest groups from antitrust actions, then our efforts are indeed not going to be very effective. We ought, in other words, to be plugging some of these loopholes, and surely not creating new loopholes from the antitrust laws.

Senator JAVITS. Mr. Weston.

Mr. WESTON. The theme that I had been developing is that there are a broad range of policies that I would give much higher priority to than I listed in my previous comment. I too believe in free markets in a competitive economy. I believe that we should have strong antitrust laws and effective enforcement. Where I disagree with my colleagues on the panel is in the interpretation of the behavior of industries that they would refer to as concentrated industries. I believe that in the case of many most concentrated industries that they are concentrated because of underlying technological managerial considerations interacting, and that I would not equate concentrated with lack of competitive behavior.

NEED TO INCREASE PRODUCTIVITY

Senator JAVITS. Gentlemen, I just want the record to show that for years I have had in for a long time, with Wayne Morse, now very unhappily deceased, a measure to revise the antitrust laws, which I consider to be a central American structural problem, just so the record has a reference to the fact that there is legislation pending on that score.

Now, I have just one other question, Mr. Chairman, if I may, without intruding on the time of my colleagues.

We hear a lot about the increase in productivity as being essential. I am very much devoted to that myself. I agree with you gentlemen on the whole respecting an incomes policy. I think the monitoring board is very weak, and that the President is going to come to us himself and

ask to give it subpoena power and a cooling off period. We probably ought to have guidelines too. I have little doubt that that is right in the offing. Even though the White House may not think so, they may not think they are going to do something, but somebody else looking at it from a different vantage point knows very well that we will have to.

How does productivity in your view—and that is the only question I would like to ask—tie in with this question of stagflation, of prices going up and demand, as Senator Proxmire properly pointed out, going down?

Would you gentlemen give us your views as to how productivity would tie in with the approach which you respectfully suggested?

Could you start, Mr. Mueller? Then I will not have any other questions.

Mr. MUELLER. Although I did not spell it out, I believe there should be a whole variety of complimentary policies designed to improve the efficiency of our system. I am concerned directly because of my own experience with improving the market system, the competitive process.

I think the other side of that is to try to increase the productivity of the system—and this means within government, working at programs, whether it is in our regulatory agencies or what have you. It does tie in to the inflation problem, although like antitrust it does not offer anything overnight. It is not all that dramatic. To increase annual productivity suddenly by one-half of 1 percent over what it would otherwise be would be a tremendous accomplishment. But that is slow in coming.

Senator JAVITS. Mr. Scherer.

Mr. SCHERER. I agree with you, Senator Javits, that stimulating productivity is extremely important. One cannot, however, stimulate it artificially. It is particularly difficult to increase productivity from here in Washington. That is like pushing on a string. Rather, it seems to me the most effective way to spur productivity is to bring to bear the spur of competition. I do not say this simply from an ideological standpoint. I say it on the basis of fairly careful empirical analysis.

During the past 4 years I have been doing a comparative study of 12 industries across 6 nations. My observation is that the U.S. industries among those 12 with the poorest productivity records compared to other nations are, in order of badness: First of all, cement; second, steel; and third, antifriction bearings. Cement had been cartelized for decades. Its low productivity reflects the hangover of that cartelization. Steel has had a history of parallel and not vigorously competitive pricing. That price cushion has delayed adjustment of the U.S. steel industry to the kind of productivity increasing measures that are needed. Finally, in the bearings industry, we have a high degree of concentration and weak price competition. It seems fairly clear that this weak competition has led to slowness in implementing the kinds of productivity increases that could take place. It was only when the Japanese began invading our steel markets and our bearing markets that one saw really vigorous efforts to increase productivity.

Senator JAVITS. The Chair has allowed me to let you answer the question too, Mr. Weston. My time is up.

Mr. WESTON. Thank you.

In the long run labor productivity is increased most by increased capital investment and by increases in innovation and knowledge. In the short run the greatest productivity improvement comes with increases in volume. That is why I would agree that at this juncture, particularly with your realistic assessment of guidelines, that we push monetary and fiscal policy pretty far, and we cannot run the risk of slowing the rate of real growth in the economy too much. Guidelines, coupled to productivity increases would need a period of expansion in order to get in the short run realistic increases in labor productivity.

I would have to disagree with the implications of the last comment made by Mr. Scherer, because if you look at the data in table 1 of my prepared statement, over extended periods of time, on the average most concentrated industries have the best record in labor productivity increases.

Senator JAVITS. Congressman Conable.

NATURE AND FUTURE OF CONCENTRATION

Representative CONABLE. Is there any real disagreement that concentration is going on, and that it is likely to accelerate during periods of economic disruption such as resulting from double-digit inflation over a period of time? In the past 20 or 23 years there has been at least an American assumption that small business was disappearing, that excessive government regulation, such as the sort of thing that is implicit in an incomes policy, would also result in further concentration of power in the hands of those who can afford the staffing necessary to respond to the increasing demands of government for information and other things. Do you see ahead increased problems of administering prices? Do you see any problems arising out of the possibility that one of the alternatives to administered prices on the part of oligopolies is administered prices on the part of the Government? Do you not assume that the Government can do a better job of administering prices than can the modest diversity involved in oligopoly?

I do not know. We make a lot of assumptions here. And maybe they are good assumptions, and maybe they are not. But I wonder, just from a general viewpoint, if you could deal with some of these questions. First of all, has there been real concentration going on during the past 20 or 30 years, or is there enough vitality in the system so that as some businesses fail, others come to take their place, or alternatives develop?

Second of all, can we expect this concentration to continue and to accelerate? Is that acceleration likely to come before as a result of economic distress, or as a result of Government intervention?

And third of all, would the result be likely to be more efficient through Government-administered prices than an economy which involves administration by oligopolies in concentrated industries?

I do not care who starts.

Mr. MUELLER. I will start.

The main problem is not, in my judgment, one of ever-increasing concentration. We have simply got too much of it now in some sectors of the economy, somewhere between a quarter and a third of manufacturing is excessively concentrated. I think Professor Scherer's measurements in other industry issues have come to a similar conclusion.

The facts which I reviewed recently indicate that perhaps since 1958, market concentration has risen modestly on an average. But the dramatic area of increasing concentration in the whole postwar period is in consumer goods industries which lend themselves to extensive advertising. This is an especially difficult area. There are consumer product industries where concentration and profit rates are extremely high. Many of these are in the food industry, the beverage industry, and so on.

In my own judgment—again economists differ on this—the increasing conglomeration of American industry has added a new dimension to market power that has tended to make the system somewhat more rigid. But this is a debatable subject.

As to the future, I think fortunately, except in these consumer goods areas where advertising is a powerful force promoting concentration, there are basic economic forces on the side of more competition—most important is the size of our economy. It is now so large that it will sustain a very substantial number of efficient smaller sized firms. There is some tendency for concentration to erode in highly concentrated industries, but very, very slowly.

So I think that with a Government policy that is concerned more with increasing competition than with the reverse, the process of bringing about greater competition need not be all that painful. It will not go away by itself, however. That is why I think some changes in public policy are needed to restructure industry.

As to whether the Government can do a better job of administering the prices than the oligopolies, based on all of our experience with regulation in relative simple industries such as the utilities, I am naturally very reluctant to favor such things as incomes policy.

But the unhappy fact is that until such time that these oligopolistic industries are subject to greater competitive pressures, they create this problem, this inflationary bias. So we have few options. This is the dilemma. We must choose to either have more Government controls with all the problems that they involve, or greater competition.

I think Government controls can work more effectively, and can be effective to a greater degree than has been demonstrated, than say, by the Price Commission's experience. Those guys just were not that interested. It was sort of like putting a Christian Scientist in charge of a hospital, something no self-respecting Christian Scientist would do. But apparently Chicago school economists do not have similar scruples.

So I am not completely pessimistic about having Government intervene. The point is that prices are not now reflecting competitive levels so the Government does not necessarily bring about greater distortions. We have an unfortunate dilemma.

Representative CONABLE. Mr. Scherer.

Mr. SCHERER. Two points. Mr. Mueller has said most of the things that need saying.

First of all, about the problem of small business. Historically, small businesses have done relatively well and flourished in booms and done relatively badly in slumps. What the present unprecedented situation will bring is hard to predict. I suspect it will be catastrophic for small business, not so much because of the slump aspects, but because money is so difficult to obtain for these small businessmen. So I think it will

be very, very hard on small businesses, and they will lose part of their share in the economy.

Second, on the question of whether the Government can do a better job administering prices than oligopolies, I think our general answer to that is clear. The Government does not do a very good job administering prices. It is precisely for this reason that we have the anti-trust policy. That is to say, our antitrust policy reflects a fundamental judgment that we would rather have prices set by freely competitive market forces than by Government intervention. The dilemma, however, is the one that Mr. Mueller has suggested—how in the short run do we crack out of the present spiral. Like Mr. Mueller, I see no alternative to Government meddling if we are to achieve a breakthrough.

Representative CONABLE. Mr. Weston.

Mr. WESTON. I agree, and had in my notes that small business is hurt in a period of tight money. I would include that as an item of importance for a capital allocations committee.

I agree with my colleagues that Government does not have a good record in administering prices. In one sense—then going to the question of, will prices be administered more in the future or less—this depends certainly on your definition of administered prices. In one sense all prices are administered in that the group can have some influence on them. The farmer in choosing his crop mix, or the retail store, even. On the other hand, in another sense no prices are administered in the sense that the results cannot avoid the inexorable consequences of the marketplace. What I was proposing is that you can have a cost control policy on wages via some form of guidelines without interjecting the Government into individual bargaining decisions. You need in conjunction with a cost controls policy the type of fiscal policy in terms of short-term corporate surtax rates coupled to increased investment tax credits, a surtax on personal incomes above a certain level, as well as tax reductions for incomes below a certain level and unemployment incomes supplements, et cetera, along those lines. You really cannot look at the solution in terms of one policy alone. But I think that a guidelines policy that would be effective in cost control would have to be supplemented with these other income policies in order to make a guidelines policy a reasonable and meaningful one from a labor standpoint.

Representative CONABLE. Thank you.

Senator PROXMIRE. Gentlemen, I have a couple of additional questions. I do not think that we have sufficiently focused on the arbitrary increase in prices that is reflected in some colossal price increases. Note the fact that between 1970 and 1971 total corporate profits went up 13 percent. From 1971 to 1972 they went up 18 percent. From 1972 to 1973 they went up 14 percent.

Then when we compared the profits for some industries in the second quarter of 1974 with the same period in 1973, we really have what seems to be a ripoff if ever there was one. Chemicals up 62 percent, although one of their major inputs is oil.

Containers up 29 percent, although the price of the paper and metals they use have gone up sharply.

Metals and mining up 91 percent.

Fuel up 83 percent, and, of course, last year was a great year for them.

Oil service and supply up 58 percent, although they have to pay more for their oil.

Food retailing up 61 percent, in spite of the fact that the farm prices are down for the last year.

Service industries up 34 percent.

Steel up 84 percent.

Trucking up 36 percent.

I just wonder if this does not indicate what seems to be a pretty sharp, stark and unjustified exhibition of power that just cannot be explained on any grounds. We have gone over the fact that in many of these industries demand is not up. Obviously, the prices have increased faster than costs.

So how about it, Mr. Weston? I think you are the one who can best reply.

Mr. WESTON. I think it is very dangerous to generalize. Where costs have gone up, where materials and labor costs particularly have gone up in individual industries. You would find in a period such as this, you would expect to find a positive correlation between nominally reported profits and the size of the labor and material cost components, particularly if the industry is using FIFO rather than LIFO accounting, because you will have inventory valuation profits in there. I think, as I indicated, the best measure of that is that between the fourth quarter of 1973 and the first quarter of 1974 nominal profits overall increased 10 percent. But just making the inventory valuation adjustment alone, profits are down 2 or 3 percent.

Senator PROXMIRE. I just wonder if a LIFO, last in first out, accounting system can account for profits of this kind. I can see that they could account for some substantial profit increases. But when you get a 91-percent increase in metals and mining, when you get a fuels increase of 83 percent, and steel 80 percent, I just wonder if you can account for all of that on the basis of inventory.

Mr. WESTON. In that alone there are always a combination of factors affecting the profit. I always think you have to look at your base. In some of these industries I think you were starting from quite a depressed base. So if an industry was making a very low profit and increases profits at all the percentage may be very high.

Senator PROXMIRE. Mr. Burns used that, and I was not prepared for it when he did, but I thought about it later, and what I think Mr. Burns failed to account for was the fact that inventory profits are profit, they are profits like any other profits. All you are saying is that that price increase is never going to occur again. If you say you are going to discount inventory profits, if you get another 40 percent increase next year you get a further profit of another kind, and those are the same things. Those are profits. The fact that they are inventory profits may explain the fact that you were able to produce them at a lower cost and sell them at a higher cost, and then if you want to replace them you have to replace them at a cost which may be considerably higher. But if your price is continuing to rise you are going to make an inventory profit year after year, are you not?

Mr. WESTON. Well, you are correct, that there are at least two sides to this argument. If you postulate that prices continue to rise, then in some sense the seller is always ahead of the game, except that in terms of anyone realizing those profits in the form of income that can be spent, they are not profits, that is, for a going concern—

Senator PROXMIRE. If you have a cash flow problem, you have a very serious problem there. When you take something like food retailing, when the inventory averages about 6 weeks for a turnover, you cannot explain that 61-percent increase from the second quarter of 1973 to the second quarter of 1974 on the ground of inventory profits and have a very satisfactory resolution of it, can you?

Mr. WESTON. No. I hope my position will not be interpreted as saying that any profit increase is justifiable. The point I am trying to make is that profits are extremely volatile, that in a period such as the one that we have recently experienced, and particularly with price increases of raw material inputs into a firm, that its nominal prices and its nominal profits will increase in ways that may be exaggeration of what their real profits are. As I said, profits are very volatile. In our concern, with large percentage profit increases, would we have the same concern when in a period of economic downturn profits dropped by very, very large percentages and become negative? You can always find a number of industries where profit decreases have been very great. All that I am saying is that looking at percentage profit increases alone is not a complete and reliable guide to policy.

Senator PROXMIRE. We have to take it with a lot of other things.

Mr. WESTON. Right.

CHANCES FOR DEPRESSION

Senator PROXMIRE. The final question, which I have been asking off and on, and I have always been answered with assurance, probably wrongful, is one that troubles many people. Would you distinguished economists give us your opinion as to whether there is any real prospect of another 1930's style depression? Many people are really concerned about that. I have been asked that again and again. The indications are that many informed and educated people feel the possibility of a 1930-style depression. But one indication of the possibility is the stock market. If you recognize the fact that the prices have been going up at an enormous rate at the time that stock prices have been going down, and adjust for that, you will find that the real drop in common stock prices is not far from what happened in the disaster of 1929 to 1933, when the stock prices dropped about 82 percent. This time they have dropped by 79 percent, if you allow for the fact that between 1969 and the present that other prices have been going up. As you recall, in the 1929 to 1933 period consumer prices were dropping sharply. Now, recognizing the stock market as an uncertain indicator of our future, but having a fair track record, looking at all the other things, I would like to ask each of you gentlemen to comment briefly—the hour is late—whether there is any real possibility of a depression.

Mr. MUELLER. As far as the stock market is concerned, I think it probably has the dubious distinction of predicting five of the last three

recessions. It certainly is a leading indicator. But I do not think it is a very reliable one. As to whether we can expect a disaster depression, my view is that it is just inconceivable that we would permit a depression of the magnitude of the 1930's. We may not know how to solve the inflation problem today, but we have learned enough to prevent the kind of depression we had back in the 1930's. Macropolicy can be used effectively, I think to prevent that.

Senator PROXMIRE. We cannot avoid inflation, we are not sure we can at least. But you are positive that we can avoid a depression like that of the thirties; is that right?

Mr. MUELLER. That is my judgment.

Senator PROXMIRE. Mr. Scherer.

Mr. SCHERER. I am not quite so sanguine. I do not think the present behavior of the stock market has a great deal to say about whether or not we will have a severe depression. The experience of the late twenties was different. What we have now is a fall in stock market values largely due to a rise in interest rates reflecting anticipated inflation, not deflation as in 1929. So from that I do not see a great danger.

I do, however, see a significant danger in the possible collapse of international trade. That could happen. Many major nations in the world are now in very serious trouble, largely because of their oil balance-of-payments problem. That could lead to severe international trade breakdowns which might conceivably trigger a worldwide recession. The United States is perhaps in better shape to withstand such a breakdown because it is not as trade dependent as, say, Japan or most of the European countries. It would, however, require excellent fiscal management in the United States to ward off the adverse effect of an international trade breakdown. Otherwise, with reasonably good fiscal management we can avoid anything like the magnitude of the early 1930's depression.

Senator PROXMIRE. Mr. Weston.

Mr. WESTON. Some years ago I wrote an article in the *Financial Analyst's Journal* arguing that even if we were able to achieve greater stability in our economic activity, I would indicate that fluctuations in the stock market might be even greater for a number of reasons. Certainly, in the current situation the rise in nominal interest rates means that the capitalization factor has increased which reduces the multiplier. Professor Nordhaus in the Brookings paper No. 1 for 1974 points out that the real rate of return on capital investment has been declining. That would be a factor in the decline in stock market prices.

So that the collapse of stock prices is not a good indicator as to what is going on in the economy as a whole, and cannot be used as a predictor of a return to 1929-32 generally.

I agree with Mr. Scherer that the big risk is in the international area because of the tremendous dislocations caused by \$60 to \$80 billion a year and up shifting to the oil producing countries. However, even here I would argue that this is a basis for greater optimism than in 1929 to 1932 when individual country domestic policies aggravated the international dislocation. For example, our monetary policy, and even our fiscal policy in the United States were depressive in their effect. We understand these things better, and we would be removed from this aggravating factor so that I think even though the risk of inter-

national dislocations are still high, our better understanding of domestic policy mitigates that risk, and makes the probability of a repetition of 1929-32 occurring much lower.

Senator PROXMIRE. Gentlemen, thank you very much. You have been a most distinguished and helpful panel. Just excellent. We have got our hearings off to a fine start.

We will reconvene on Monday, September 9, in the same room, to hear Thomas E. Kauper, assistant attorney general, Antitrust Division, Justice Department; Joel Dirlam, University of Rhode Island; and Senator Howard Metzenbaum.

[Whereupon, at 12:45 p.m., the committee recessed, to reconvene at 10 a.m., Monday, September 9, 1974.]

INFLATIONARY IMPACT OF PRICING BY CONCENTRATED INDUSTRIES

MONDAY, SEPTEMBER 9, 1974

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (vice chairman of the committee) presiding.

Present: Senator Proxmire and Representative Conable.

Also present: Richard F. Kaufman, general counsel; Michael J. Runde, administrative assistant; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. The committee will come to order. Last week a number of economists appeared before the President and others at the White House, and while they disagreed on many things, they agreed unanimously on the need to change laws and regulations which limit competition and help push up prices. It was agreed that this practice is inflationary.

OUTRAGEOUS PRICE AND PROFIT INCREASES IN CONCENTRATED INDUSTRIES

What I think are outrageous price increases in some concentrated industries will result in the American consumer paying higher prices for years to come. There is no cost justification for most of these increases other than the use of pure market power to increase profits, and the corporations have certainly been more successful in increasing their profits.

The pretax profit rate on stockholders' equity was about 14 percent in the petroleum industry during the 1960's and early 1970's. For the first quarter of 1974, the return on stockholders' equity has risen by more than two-thirds to 25.4 percent. In primary metals the average return in the past decade was about 14 percent. The figure for the first quarter of 1974 was one-half again as large, rising to 21.2 percent. The chemical industry has increased its return on equity from the 1970 through 1972 average of 21 percent up to a whopping 30 percent for the first quarter of 1974.

While costs have indeed increased in all these industries, it is clear that prices have increased even faster in order to achieve these incredible profit rates. The indications are that when all the profit figures are in for the second quarter of 1974, the first quarter figures will be just the beginning of the bonanza. For anyone who wonders where all of

the money is going in this inflation, and who wonders who is getting rich when so many are getting poorer, these profits are a substantial part of the answer.

The Wall Street Journal of Friday, September 6, reported on a study of the salaries of top corporate executives. Last year the top executives of major companies enjoyed their largest gain in total compensation in 5 years. Why? As the report showed, there is a strong correlation between changes in executive pay and changes in company profits and 1973 was a good year for profits.

It appears that 1974 will be a very good year for profits and corporate executives, and a very bad one for workers and consumers.

I am pleased to welcome our witnesses for today, each of whom is well equipped to give this committee some important insights in the nature of the private price-fixing phase of this inflation, and what policies this government can follow to reduce the inflationary impact of this type of pricing behavior.

Our first witness is Senator Howard Metzenbaum. I am delighted to see my good friend and colleague, who had a very successful career in business before he came to the U.S. Senate. He has impressed all of us in the Senate with his grasp of business matters and economic matters.

These are capabilities, Senator, which are too rare in the Senate. This is a haven for lawyers and others who achieve most of their experience outside of the tough competitive world of private business. But you are one who did achieve it in that area. And you have already enlightened us in the Senate greatly on the anatomy of this inflation and some of the very serious problems it represents. And we are most honored to have you here this morning. Please proceed.

STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. I am delighted to accept your invitation to participate, Senator Proxmire. I truly wish to commend you for day in and day out addressing yourself to the challenge of the problems of our economy, and providing not only speeches but positive action as to how we may deal with some of those problems in the economy. I have noted that almost with no exception that the legislative proposals that you have made truly tend to cope with the challenge that we face in our Nation. Although you did not come from the business world, you certainly have come up with the right answers as a U.S. Senator.

Senator PROXMIRE. I had a worm's eye view of it at first. I started out with J. P. Morgan at \$25 a week. That was not exactly the top salary. I did have that experience. And I had my own printing business, but did not achieve the kind of smashing success you have.

Senator METZENBAUM. That J. P. Morgan was an up-and-coming company. You might well have stayed with them a bit.

I wish to commend you, Mr. Chairman, for convening these hearings on the state of the economy, and I am honored that you have invited me to participate.

Certainly, I agree with President Ford that inflation is the Nation's major problem.

As you pointed out in your opening statement last week, consumer prices have risen by more than 40 percent during the last 5 years, in-

creasing by 12 percent in the last year alone. Wholesale prices, as you pointed out, have risen by more than 50 percent during the last 5 years, increasing by more than 20 percent in the last year.

Of all the inflationary price increases, perhaps none has been felt so acutely by the consumer, directly as well as indirectly, as the skyrocketing cost of fuel in the wake of last winter's energy shortage. Let me mention just a few examples. Over the past year the price of regular gasoline has increased by more than 40 percent, and the price of home heating oil has jumped by almost 70 percent. I remember just a few months ago when I was back in Ohio traveling around, conducting meetings, and listening to people as to what was on their minds, I was sitting in Toledo with a group of middle-class Americans. And there was a lady there with tears streaming down her face telling me that she does not know how she is going to pay for the fuel that year, an additional \$100. And there was another lady with two little children, newly married. I have never seen such pathos from a group of people, who were middle class and who were just saying, what do we do about it, Senator? We do not have the answers.

I regret to admit that I did not have the answer either.

Every time a motorist drives up to the gas pump, every time a homeowner purchases fuel to heat his house, he, too, agrees with President Ford that inflation is the Nation's No. 1 problem.

But what the average citizen may not be sensitive to is the contagiously inflationary nature of increases in the price of fuel. A price increase for any basic commodity is likely to spread to other industries, and you have a pyramiding kind of effect. And that is particularly true with respect to oil, which is the energy resource at the very heart of our economy. Higher oil prices affect virtually everything else, from food prices to utilities, to transportation prices, to the cost of essential public services. Just over the weekend somebody told me about the fact that their utility bill, the electric bill, the bill was something like \$35, and there was an additional item of \$10.40 for additional fuel costs, an incredible amount, an incredible add-on.

As James Kilpatrick, a distinguished columnist, wrote recently—and I want to remind the Senator about James Kilpatrick, he is the one who also wrote in such glowing terms about your leadership in the Senate, and talked about the emphasis that you had given in the Senate about what is good about America. James Kilpatrick and I may not always agree on political matters, but I agreed with his articles on Senator Proxmire. I also agree when he said that:

Higher costs of fuel now affect just about everything that is grown or manufactured or transported. Inflation, as President Ford remarked, is public enemy No. 1, but energy is playing the Godfather's role.

Moreover, the same oil companies which have perpetrated these disastrous price increases on the American public are now moving to gain control of other energy sources—coal, nuclear and solar energy—as well as sectors of the economy totally unrelated to energy.

OIL PRICE ROLLBACK ESSENTIAL TO CONTROLLING INFLATION

Mr. Vice Chairman, I submit that we cannot bring inflation under control until we roll back the price of oil and until we insure that the Nation shall have ample energy supplies at reasonable prices in the

future. Let me just say parenthetically at this point that there has been a failure of leadership with respect to Project Independence. Mr. Sawhill has not provided the kind of leadership or the dispatch of the sense of urgency in seeing to it that we do have ample energy in the future. I think Project Independence is moving at a snail's pace, and I think the blame has to be laid at the doorstep of Mr. Sawhill. And that is true whether it is solar energy, whether it is geothermal energy, or whether it is conversion of coal into a form that can be used for the elimination of sulphur content. Things are just not happening at the rapid pace that the people of America have a right to expect of their Government.

But as a direct result of the energy shortage, the oil corporations are amassing enormous profits. As you have previously stated, and as you recognized, I am a businessman, I am not against profits. I know that businesses and corporations have to make profits or they cannot stay in business. But the unbelievable kinds of profits that the oil companies have been making in recent months are truly unconscionable, and I must speak out against them.

During the second quarter of this year, 14 major oil companies reported profit increases ranging from a low of 18 percent to a high of 292 percent over the same period of last year. For the first half of this year, the profit increases ranged from 21 percent to 402 percent.

Mr. Vice Chairman, I offer a table for the record on recent oil company profits. As you go through that list you truly see what one of the major contributors to the inflation that we are now living in is. It is the oil companies' profits which are far and above what they should be if they have the national interest at heart.

[The table referred to follows:]

SELECTED OIL COMPANY PROFITS

| Company | 2d quarter 1974 (millions of dollars) | Change from 1973 (percent plus) | 1st half 1974 (millions of dollars) | Change from 1973 (percent plus) |
|-----------------------------|---|------------------------------------|---|------------------------------------|
| Ashland Oil..... | 32 | 40 | 186 | 41 |
| Cities Service..... | 54 | 76 | 123 | 82 |
| Continental Oil..... | 100 | 94 | 210 | 111 |
| Exxon..... | 850 | 67 | 1,500 | 53 |
| Gulf Oil..... | 250 | 28 | 540 | 50 |
| Marathon Oil..... | 50 | 90 | 81 | 98 |
| Mobil Oil..... | 367 | 99 | 626 | 84 |
| Occidental Petroleum..... | 99 | 292 | 160 | 402 |
| Phillips Petroleum..... | 124 | 166 | 205 | 127 |
| Shell Oil..... | 124 | 39 | 246 | 45 |
| Standard Oil (Indiana)..... | 280 | 130 | 499 | 105 |
| Standard Oil (Ohio)..... | 50 | 18 | 73 | 21 |
| Sun Oil..... | 127 | 163 | 218 | 124 |
| Texaco..... | 460 | 72 | 1,049 | 98 |

¹ Last 9 months.

Senator METZENBAUM. The average profit increase by these 14 companies for the second quarter comes to 98 percent. The enormity of this harvest is demonstrated by the fact that, as reported by the First National City Bank recently, the second-quarter profits of major U.S. corporations were not bad, they were excellent, they rose by only 27

percent over the same period last year, as compared to the 98 percent increase as the average prices of the 14 oil companies.

For the first half of this year, these 14 oil companies amassed in excess of \$5.8 billion—on top of the industry's already huge resources. The massive wealth of the petroleum industry is most strikingly demonstrated when it is measured against the rest of American industry.

Of the world's 15 largest manufacturing companies, almost half, 7, are oil companies, and 5 of these are based in the United States. During the last quarter of 1973—the most recent period for which such a comparison is available—31 domestic petroleum companies reaped \$2.5 billion in profits; this represented almost 60 percent of the total profits earned by the remaining 572 major manufacturing concerns in the United States. That is just an unbelievable reality of life in this country. In 1973, the net worth of 108 domestic petroleum companies surpassed \$60 billion, more than 3 times as great as the next largest industry.

Furthermore, oil is a highly concentrated industry. According to data gathered by the Federal Trade Commission in 1971, half of all domestic oil production is accounted for by just 20 firms, even though there are more than 8,000 in the business. Not surprisingly, the largest producers are also the largest refiners. The top eight producers and refiners are the same. All of the top 16 producers are among the 20 largest refiners. Because of this interrelationship, an FTC report last year charged that the major oil companies "continually engage in common courses of action of their common benefit."

We talk about monopolies. The oil industry truly has a monopoly, as well as a stranglehold on the economy of this Nation.

Traditionally, oil companies have used their profits to finance growth within their own industry. But in most recent years, the oil giants have moved aggressively to acquire control of such alternative sources of energy as coal, nuclear power, and solar power. Some day the American people are going to awaken to the fact that the other sources of energy no longer are distributed generally in this country, but they are all concentrated in the petroleum companies of this Nation.

OIL COMPANIES MOVE INTO ALTERNATE ENERGY SOURCES

Going back to 1963, Gulf acquired the Pittsburgh & Midway Coal Mining Co., major oil companies developed a substantial stake in the coal industry. In the past 10 years, six petroleum firms have acquired coal companies which together account for more than 20 percent of current domestic coal production. Not alone do they control with respect to the production of coal, but the oil companies have insured their future hold on the coal industry by securing control over more than 20 percent of the known coal reserves.

Mr. Vice Chairman, I offer a table for the record on the takeover of the coal industry by the oil companies.

[The table referred to follows:]

OIL INDUSTRY CONTROL OF COAL PRODUCTION

| Acquiring firm | Acquired firm | Acquired firm percent of market | Date of acquisition |
|---------------------------|-------------------------------|---------------------------------|---------------------|
| Gulf Oil..... | Pittsburgh & Midway Coal..... | 1.3 | 1963 |
| Continental Oil..... | Consolidation Coal..... | 9.9 | 1966 |
| Occidental Petroleum..... | Island Creek Coal..... | 4.1 | 1968 |
| Standard Oil (Ohio)..... | Old Ben Coal..... | 1.9 | 1968 |
| Ashland Oil..... | Arch Mineral..... | 1.1 | 1968 |
| Eastern Gas and Fuel..... | Eastern Associated Coal..... | 2.1 | 1969-70 |
| Total..... | | 20.4 | |

Source: Small Business Committee, 92d Congress. Production data from Keystone Coal Industry Manual.

Senator METZENBAUM. Petroleum firms have also sought to dominate the nuclear energy market and they have been very successful. Kerr-McGee now controls 27 percent of domestic uranium production, and Humble Oil is planning a mill with capacity equal to 8 percent of domestic. Other oil firms also are planning to invade the production of uranium. The Bureau of Mines estimates that the industry now controls—and this figure is almost unbelievable—about 80 percent of domestic uranium reserves, and the Oil & Gas Journal reports that the “oil industry is moving more and more into coal and uranium.” In addition, that one new energy source that we all talk about developing, solar energy, is an area which the oil companies have given their attention to. They have begun to move into that solar energy research on a large scale.

The Exxon Corp. recently purchased Solar Power Corp.; Shell now controls Solar Energy Systems; Gulf conducts solar research through one of its subsidiaries, and other firms have also begun work in this area. By the time solar energy is commercially feasible, the oil industry will have built up a substantial stake in solar power. And, if my guess is right, they will have control of the industry.

As I have already suggested, however, the oil giants have not devoted their attention to energy exclusively. Although their representatives have repeatedly come before the Senate Interior Committee, of which I am privileged to be a member, to plead that they need enormous profits to finance further development of our energy resources, it has become evident that the oil barons are using some of these incredible profits to invade sectors of the American economy totally unrelated to energy.

OIL COMPANIES INVADE OTHER INDUSTRIES

Many oil companies, for example, have made significant investments in real estate. Arco began acquiring property in downtown Los Angeles 2 years ago. Gulf Oil real estate has been involved in new communities such as Reston, Va., and is currently developing a 2,700-acre site in Florida for residential and commercial use. Gulf attempted to expand its real estate holdings last year by acquiring the CNA Financial Corp. I remember so well when I myself was developing Holiday Inns, for each Holiday Inn we were expected to find a location for a Gulf Oil station. Why had that come about? Because some years earlier Gulf Oil Corp. had loaned Holiday Inns of America \$40 million, and that was part of the package deal.

Now, the oil companies are reaching beyond real estate. Mobil Oil is in the process of purchasing a controlling interest—a \$350 million deal at least—in Marcor Corp., the parent company of Montgomery Ward and Container Corporation of America.

These are but a few of the many instances in which the oil companies are using their tremendous resources to move into other industries.

Besides their own vast economic power, the oil companies also have been able to establish intimate relationships with the Nation's major financial institutions—relationships that the Federal Trade Commission has announced it will investigate.

To mention just a few examples from a 1972 study by the Ruttenberg consulting firm at that time, Exxon shares two directors with Chemical Bank of New York, one director with Chase Manhattan and one with Morgan Guaranty. Gulf shares three directors with Mellon National. Shell has one director on the board of First National City Bank of New York.

A more recent study by the office of my distinguished colleague from South Dakota, Senator Abourezk, updates the Ruttenberg analysis. I want to point out, Mr. Vice Chairman, that when an oil company ties up with a major financial institution in this country we are talking about using the tentacles of the oil petroleum company's financial power to extend that power beyond the oil industry through the banks and into a host of other industries as well.

I offer a table based on the Abourezk study for the record. I think this is a fact of life that has to be most disturbing to all.

[The table referred to follows:]

INTERLOCKING DIRECTORATES BETWEEN SELECTED OIL COMPANIES AND FINANCIAL INSTITUTIONS

| Oil company | Banks |
|---------------------------------|--|
| Amerada Hess | Chemical |
| Arco | Chase Manhattan |
| Continental | Morgan Guaranty Trust |
| | Mellon National |
| Cities Service | Morgan Guaranty Trust |
| Exxon | First National City |
| | Chase Manhattan |
| | First City Bank Corp. (Texas) |
| Gulf | Mellon National (5) ¹ |
| Marathon | Chemical |
| Mobil | First National City |
| Phillips | First National City |
| Shell | Charter New York |
| Standard Oil (California) | First National City (2) ¹ |
| Standard Oil (Indiana) | Chase Manhattan |
| Standard Oil (Ohio) | Cleveland Trust (2) ¹ |
| Superior | First City Bank Corp (Texas) |

¹ The figure in parenthesis is the number of interlocking directorates, if more than 1.

Senator METZENBAUM. How is the oil industry responding to President Ford's proclamation that inflation is the Nation's No. 1 problem? Despite its record profits—the industry has launched an extensive public relations campaign to convince the public that its return on investment is less than that of other industries. In effect, the oil corporations are pleading poverty, but the facts on which their case is based are, at best, open to question. Interestingly, when the oil industry explains its financial position to the American public, it consistently omits an important detail. When the vast majority of American indus-

trial corporations, report their earnings, they report with reference to equity capital—those dollars which the corporation earned as related to the net worth of the company. In other words, if an oil corporation is reporting its earnings, it reports based upon not only equity capital, but its earnings based upon equity capital and borrowed capital. The rest of American industries report its earnings based upon a return on equity capital.

Now, what does that really mean, and what are we talking about? If an average businessman invests \$10,000 in his business, and he earns \$44,000, he has had a 50 percent return. If he borrows another \$10,000 and pays the current price rate of 12 percent, he would pay on the additional \$10,000, \$1,200, and his profits instead of being \$5,000 would be \$3,800. He would then have a \$3,800 profit on a \$10,000 investment, for a 30 percent return.

But what does the oil industry do? Say that he has a \$3,800 profit on a \$20,000 return. They have combined invested capital plus borrowed capital. And I have searched far and wide to find whether any other industries follow a similar procedure. And I point out to the vice chairman that, although I cannot claim that I have made an exhaustive research study on the subject, I do know that the general rule of American industries is to report profits on invested equity capital and not profits based upon invested capital plus borrowed capital and claim that as being a normal return.

It is something to hear the oil company executives plead poverty in a period of unprecedented prosperity for the oil industry, but the negative impact which those profits have caused in the total American economic picture is even more shocking.

Until such time as this Government accepts its proper responsibility and forces the oil companies to roll back their unnecessarily high oil prices, we will be unable to cope with the continued inflationary spiral. One cent a gallon in increased gallon list prices means an additional billion dollars out of the American consuming public's purchasing dollar. And it means an additional billion dollars in profits for the oil industry.

I believe the time has come to place the interest of the American people above the greedy self-interest of the oil industry.

Thank you, Mr. Vice Chairman.

Senator PROXMIER. Thank you for a most impressive statement, Senator Metzenbaum. I think you have made a devastating case about the very rapid increase in the profitability of the oil industry. But I think that there is a problem here with respect to whether or not this is the result of price fixing in the usual sense.

We had a distinguished panel of economists here last week. Mr. Weston, who is recognized as one of the outstanding economists, classified the degree of monopoly or oligopoly on the basis of the number of firms which dominated the industry. He found that four firms with more than 80 percent of the business would be considered to be a concentrated industry. The automobile industry is an example of that. We have had three firms that are almost the entire automobile business. In this industry, the oil industry, you have 23 majors, and you say, Senator Metzenbaum, there are a large number, 20 or 23, that have half the business. Even though all these are very, very large firms, as you point out, and although the industry is vertically inte-

grated, how is it that this relatively larger number than you have in some other industries is able to establish monopolistic prices?

Senator METZENBAUM. I think they have a pretty good club of their own. I think that they really have no desire to drive down prices.

Now, in all fairness, in the past there were competitive price wars in the oil industry. As soon as they saw some shortage, by reason of the Arab embargo, they immediately exploited that situation. Each one was willing to follow the other, because it served their own financial interests particularly well. And one added on to the other. In fact, some even exceeded the normal price.

And beyond that point I think it should be pointed out that there are tie-ins which exist with respect to the major national banks of the country. No major business can function today without having good banking relationships. We have all thought about conspiracy. We have thought that men sat down together and said, we agree that we will not raise prices, or we will raise prices, whatever the case will be. I do not think they had to do that in this country. It is quite obvious that they have not had to do that. The supply was limited. They exploited a shortage that was not really as great as it was claimed to be. The American public paid through the nose. It also has had an unbelievable impact upon the total economy. There has been no sense of concerns for what is happening to the Nation as a whole.

Senator PROXMIRE. How they do it there does seem to be a prima facie case, in view of the fact that there does seem to be a large amount of oil, especially crude oil, available for refining, and yet the oil companies are able to maintain a price which is so much higher than it was last year, and thereby obtain immense profits. There is quite a bit of evidence that in July and August they were not refining gasoline, though they had excess capacity, as they should if they were proceeding strictly on the basis of maximizing the profits of each individual firm. Is that not correct?

Senator METZENBAUM. That is absolutely correct. As a matter of fact, it was public information that they were holding back on the refining of petroleum products. The information was so blatant and so well admitted by the American Petroleum Institute that I had conversations with the Attorney General of the United States about it as well as sending him a communication urging that they convene a grand jury in order to investigate whether there truly had not been a violation of law and a conspiracy to hold back production in order to keep up prices.

I noted that there were indictments in the New York area just recently of some of the major oil companies. I would hope that Mr. Saxbe's investigation would be productive enough to indict, if there is a legal basis to do so. But certainly, they made no bones about the fact that they were cutting back production in order to keep up prices.

NATURE AND NEED FOR HIGH OIL COMPANY PROFITS

Senator PROXMIRE. How do you answer the claim of the oil industry that these profits are needed for the following purposes: To limit demand in an energy-short economy, and to ration the available supply in the most efficient way?

Senator METZENBAUM. I think that that is about as much hocus as they could possibly put out. What they are really saying is, let us just keep raising the prices, and we will be limiting the demand. Yet, in Ohio I know they are forcing their gasoline dealers to keep open 7 days a week and all hours of the day, even though the independent gasoline dealers do not want to do so. There is a contradiction in terms. When it comes to a question of selling more gasoline products they force them to do so. When it comes to a question of trying to get more money from the American consumer, then they claim that they are doing so in the national interest in order to limit consumer demand. I think that is hocus—or probably a synonym for that is baloney.

Senator PROXMIER. There is another argument that they use that all of us have been exposed to in the saturation TV ads that the oil companies have had on—they have had a tremendous amount of institutional advertising. They argue that to elicit the additional supply of oil, to make it more profitable to explore, as well as to build the equipment necessary to transport and refine and distribute gasoline and oil, they have to have these high profits. You have answered that in part, a very large part, I think, by pointing out that they are using a great part of this additional cash flow for other purposes that have nothing to do with the oil industry.

Senator METZENBAUM. Correct. But beyond that point the best evidence against the oil companies on that subject is their own statements that were made in 1973 when they were saying to the American Petroleum Industry Institute, as well as something called something like the National Petroleum Council that was dominated by the petroleum industry, that they needed to get their price up by 1975 or 1980 to something like \$4.15 or \$4.25. That is when prices were back around \$3 and something. Now the price is up well over \$10, almost around \$11. They are saying, oh, no, we need all these dollars in order to assure further production. I remember that when there was a witness before the Interior Committee I inquired of him exactly at what point can the American people be assured that we are going to get an adequate supply, where do we have to peg the price of oil in order to assure that?

And he said, we have not made that study yet.

And, of course, they just reach up in the sky. Of course, if the price went to \$20 they would say they need \$20 in order to have further production.

I think the price could be rolled back far below the price that it is at at the moment, although nobody talks about it, I think it still could go back to \$5 and some odd cents.

I might say that if that meant that we could not import some oil from some of the oil-producing nations of the world, so be it. Then maybe we would have to tighten our belts and get along with a little bit less oil. I think the problem was not as great as we made it out to be the last time around.

Senator PROXMIER. Is it not true that the statistics that you have available, the only ones you had to work with, may well understate, and substantially understate, the actual profits these oil companies have received because, as I understand it, they have provided for a very, very large reserve—in the case of Exxon, for instance, of a couple of hundred million dollars at least—to provide for a drop in the price of oil, and also to provide for retroactive action on the part of Con-

gress to reduce their present tax privileges? So that if these, I think, quite extreme assumptions do not materialize, their profits really are a lot bigger than they stated here, as big as those profits are; is that not correct?

Senator METZENBAUM. I think that is absolutely correct. They have done one other thing, if I might point it out to the vice chairman, they have played around with a thing like LIFO, FIFO, which has to do with how you evaluate your inventory.

Senator PROXMIRE. Last in, first out, first in, first out.

Senator METZENBAUM. Correct. The major companies in Ohio, which dominate the Ohio market, have just switched their whole method, and as a consequence were able to change their profit figures something like—I forget the figures I used, but something like \$100 million. You are playing with big dollars if you can change your inventory. The Standard Oil of Ohio is a much smaller company than Exxon and Standard Oil of California and some of the others.

IMPACT OF OIL PRICES ON INFLATION

Senator PROXMIRE. I think that your contribution here this morning has been tremendously useful, especially the fact that as you point out, this permeates so much of the rest of the energy field. I think that the conference we had on inflation was very good. I think it was a most useful exercise, and it was good to have conflicting viewpoints. But I was quite distressed at the lack of concentration on areas like this, and an enormous contribution, the oil industry has made to inflation. It enters, as you say, into everything.

Take food. You have to consider the fact that the farmer has to spend money on the gasoline to run his tractors, on the electricity, which is costing a lot more because the oil which goes into producing that electricity on his farm, and to transport what he produces to market. In addition, higher oil related costs affect the processor and distributor of food.

The energy cost must be substantial in many other industries where none of us think of it as a big cost. In every industry you can name—the clothing that we wear, all the construction that we have in this country depend enormously on oil.

So this is one of the big elements that is responsible for the present inflation; is that correct?

Senator METZENBAUM. There is just no question about it. There is one, I am sure, that the vice chairman was thinking of and did not mention, and that is fertilizer, because the fertilizer prices have gone to an astronomical price, up 400 or 500 percent, if you can get it. That has had such a tremendous impact upon the cost of food. You cannot look at any industry without seeing this pyramiding effect that the increased oil costs have had, to the point that some industries such as the public utilities industries—some of the public utilities companies came before a Senate committee the other day on which I was sitting and pleaded that they are really in distress, and they are not certain how they can make out, they cannot borrow money, and their costs are going way up.

I believe that either we deal with the increased price of oil and we roll it back, or we will never get a handle on the whole question of inflation in this country.

We can do lots of things with respect to the cost of money, we can do lots of things with respect to new housing starts and various other things, but until we deal with this particular problem we will be kidding ourselves and we will not be successful.

Senator PROXMIRE. The law is on the books. The Energy Act permits the administration to roll back the price of old oil, for example, and when they do that it will have no effect on production, because it is oil that we already have. It is not a matter of discouraging new explorations.

Certainly, that aspect of oil pricing can be done without further legislation; is that right?

Senator METZENBAUM. That is correct. But we need new legislation if we are going to roll back some of the present prices. Some of the profits—if you really are to do the job, you recognize that we passed through the Senate, passed through the House, legislation which rolled back the price of oil to something like, as I remember it, \$5 or \$7 a barrel, I forget the exact figure. You remember that President Nixon vetoed that legislation, and we did not have the vote to pass it over the veto.

Senator PROXMIRE. We want to mandate it, that is true. But is not that discretionary authority in the hands of the President or not? Can he not do so if he wishes to?

Senator METZENBAUM. I think there is discretionary authority to deal with old oil, and I think they are holding that now—

Senator PROXMIRE. Holding it at \$5.25, which is very hard to justify.

Senator METZENBAUM. That is right. Then there is that \$1 a barrel increase that the administration permitted which nobody has ever provided an answer for.

So that there are mechanisms where we can roll it back in part at this point. But I think that we need leadership from the White House for a total rollback in this area.

Senator PROXMIRE. Thank you very, very much, Senator Metzenbaum. You have been a most helpful witness.

Senator METZENBAUM. Thank you.

Senator PROXMIRE. I would like to ask the next two witnesses to appear together. We have Mr. Kauper, Assistant Attorney General, the Antitrust Division, Department of Justice, and we have also Mr. Joel Dirlam, professor at the University of Rhode Island, a specialist and expert in the steel industry and in administered prices and pricing in the steel industry.

And Mr. Hay, the Director of Economics at the Department of Justice.

We are honored to have you gentlemen. You have distinguished attainments; I do not think we need a further buildup.

We are very interested in the statements you have made recently Mr. Kauper. We certainly welcome them on the sad contribution that price fixing, corporate price fixing has made to inflation.

Gentlemen, we would appreciate it if you could confine your remarks to 10 minutes or so, and then we will put your prepared statement in the record. Then we can engage in questioning.

Mr. Hay, did you have a statement you would like to make, too?

Mr. HAY. No, Senator. I am accompanying Mr. Kauper.

Senator PROXMIRE. Mr. Kauper, why don't you go right ahead?

STATEMENT OF HON. THOMAS E. KAUPER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE, ACCOMPANIED BY GEORGE A. HAY, DIRECTOR OF ECONOMICS

Mr. KAUPER. I will summarize parts of my prepared statement as I go along and try to reduce its length.

The purpose of the committee's inquiry, as I understand it, is to ascertain the role of so-called administered pricing as either a cause of or a substantial contributor to current inflation in this economy, and if indeed, administered pricing bears a causal relationship to inflation, to identify possible solutions to the problem.

CONFLICTING VIEWS ON IMPACT OF ADMINISTRATION PRICING ON INFLATION

As my testimony will indicate, I believe that the relationship of the enforcement of the antitrust laws to inflation is somewhat broader than administered pricing, although the impact or lack of impact of administered pricing is certainly a matter of concern in a severe inflationary period such as we are suffering through today. We recognize that there are conflicting views of the effect of concentration on prices in particular industries and the economy as a whole. From the standpoint of the Department of Justice, however, we believe that antitrust enforcement can play a significant role in alleviating inflationary pressures in concentrated industries as well as in other areas of the economy. In addition, as advocates for regulatory reform designed to allow competition to play a greater role in regulated industries, we believe that immediate gains in the fight against inflation could be achieved by eliminating a myriad of Federal and State governmental restraints on free competition.

The original economic argument against administered pricing has been that prices in concentrated industries did not fall rapidly enough over a period of inadequate demand to avoid widespread unemployment. In recent years the focus of the argument has been shifted. The issue today is whether prices on occasion have been forced up too rapidly in concentrated industries so as to cause or exacerbate general inflation. As you know, Mr. Vice Chairman, economists have differed on this issue.

In 1970, the Antitrust Division took the position before this committee that there was no significant correlation between concentration and price changes for the period running from 1963 to 1968, when prices were relatively stable. Assistant Attorney General Richard McLaren also observed that in the more inflationary years 1967 through 1969, prices appeared to have risen a good deal less in concentrated industries than in the more competitive sectors.

Unfortunately, not only is inflation a complex phenomenon, but it also seems clear that no two episodes of inflation are precisely alike, so that it has been impossible to achieve a consensus on the role of concentration generally in fostering cost-push inflation, as the testimony of this committee's previous witnesses has demonstrated rather sharply. Therefore, it does seem clear that the inflation which we now experience is in large part due to factors unrelated to market power. But this committee's inquiry—and the Department's inquiry as well—cannot, on this alone, rule out possible anticompetitive arrangements and structures which may contribute to inflation.

I cannot say whether industrial concentration is the primary cause of our dilemma. I will say that I believe antitrust enforcement can make a substantial contribution in the battle against continuing inflation and that resources devoted to antitrust will have a payoff far in excess of cost, even in relatively shortrun terms.

It is not essential to antitrust enforcement whether prices on the average are rising faster, more slowly, or at the same rate in concentrated industries vis-a-vis unconcentrated markets. Antitrust enforcement is concerned not with the average industry, but with specific products in specific markets. It is the responsibility of the Antitrust Division to identify price rises which have not been compelled by increases in labor or material costs and to then investigate whether those unexplainable price rises are a product of collusion.

In competitive markets, prices are presumed by economists normally to approximate costs. When costs rise, prices rise, and there is no discretion or choice on the part of the individual firms involved. Borrowing from the administered pricing theory, in concentrated industries prices are frequently above costs so that when costs rise it is not inevitable that prices must follow at least to the same extent that costs go up. Thus, when prices do increase by this much or more, it may be the result not of impersonal market forces but of conscious decisions by the firms involved.

Pricing decisions of this nature can arise basically in two ways. They may be made through a series of independent decisions by firms in the industry who realize that because of the industry structure each firm is in some respects interdependent with the other. In dealing with pricing in this context, antitrust can be effective primarily over a longer period through challenging acquisitions under the Clayton Act which would further concentrate an industry and by seeking to eliminate existing concentration under the monopolization provisions of the Sherman Act. Whether such action is desirable or necessary will depend on the industry involved.

There is a second form of pricing above cost, however, which the antitrust laws will reach in the short run. Pricing decisions in a concentrated industry can arise through outright collusion with respect to the timing or amount of the increase. I am not convinced that all the price increases we have seen over the past 6 months have occurred as a result of independent decisions by each firm in an oligopolistic market. This history of antitrust enforcement indicates that concentration may be the ideal environment for price conspiracy—the electrical equipment case and the plumbing fixtures case are examples. While conspiracy may not always be necessary to achieve high profit margins in a concentrated industry, it may be resorted to as a guarantee for profits.

In discussing concentrated industries, I should stress that I include within that framework not only national markets such as steel or automobiles, but also local manufacturing and service industries. These markets may also be dominated by a few firms which engage in collusive and anticompetitive conduct. The service area is increasingly important in our economy with estimates that services represent 40 percent of our gross national product. When prices for these services are raised to artificial and monopolistic levels, the consumer is directly affected.

DIRECTING ANTITRUST ENFORCEMENT TOWARD CONCENTRATED INDUSTRIES

This would suggest that antitrust enforcement be directed toward concentrated industries on both a national and a local level and that the service industries be given particular scrutiny. We are attempting to gear our antitrust program with these principles in mind. The various litigating sections of the Division, both in Washington and the seven field offices, will be directed to canvass the competitive performance and prices of concentrated and other significant industries, and to institute grand jury investigations where appropriate. A team of professional economists will also be assigned to assist the litigating sections to employ tools of economic analysis in order to identify industries in which particular price levels suggest the existence of anticompetitive conduct.

In addition, to increased attempts to identify price fixing and the like, the Division will step up investigations which might ultimately result in structural changes in a particular industry. These include enforcement of section 2 of the Sherman Act to reduce the instance of monopoly in the economy and suits under section 7 of the Clayton Act to oppose mergers and acquisitions.

Mr. Vice Chairman, I have another 10 or 12 pages of this prepared statement which deal with a somewhat different subject, and if I might, may I spend a minute or so to talk about it?

Senator PROXMIRE. Fine. All of your prepared statement will be printed in the record at the end of your oral statement.

PROBLEMS OF REGULATED INDUSTRIES

Mr. KAUPER. The second and third portions of the prepared statement deal with another aspect of the economy with which we have also been concerned, and that is the area commonly characterized as regulated industries. In the prepared statement, we attempt to point out that, with the percentage of gross national product which is represented by those industries, this too is an area where some considerable change might be necessary.

The Antitrust Division, as I think you probably know, Mr. Vice Chairman, has devoted a good part of its resources to this area. We have, in a number of appearances, urged that competitive policies be taken into account in decisions made by our regulatory agencies. However, it is our view, and I think the view of a good many others, that a good deal more may be necessary. More particularly, the time has come for a reevaluation of the basic statutory schemes under which some of these industries are regulated, either with an eye toward deregulation, or perhaps at a minimum an increasing role of competition within the regulatory framework.

I have tried to spell that out in more detail in the prepared statement. I think that, rather than going through it, because as you have indicated, time is limited, I will simply submit the prepared statement for the record, Mr. Vice Chairman.

Senator PROXMIRE. Thank you very much.

[The prepared Statement of Mr. Kauper follows:]

PREPARED STATEMENT OF HON. THOMAS E. KAUPER

Mr. Vice Chairman and Members of the Committee, I appreciate the opportunity to testify before you in these hearings. The purpose of the Committee's inquiry, as I understand it, is to ascertain the role of so-called administered pricing as either a cause of or a substantial contributor to current inflation in this economy, and if indeed administered pricing bears a causal relationship to inflation, to identify possible solutions to the problem.

Administered pricing is generally defined as price inflexibility in certain sectors of the economy, largely those sectors which are characterized by high concentration.¹

As my testimony will indicate, I believe that the relationship of the enforcement of the antitrust laws to inflation is somewhat broader than administered pricing, although the impact or lack of impact of administered pricing is certainly a matter of concern in a severe inflationary period such as we are suffering through today. We recognize that there are conflicting views of the effect of concentration on prices in particular industries and the economy as a whole. From the standpoint of the Department of Justice, however, we believe that antitrust enforcement can play a significant role in alleviating inflationary pressures in concentrated industries as well as in other areas of the economy. In addition, as advocates for regulatory reform designed to allow competition to play a greater role in regulated industries, we believe that immediate gains in the fight against inflation could be achieved by eliminating a myriad of Federal and State governmental restraints on free competition.

The original economic argument against administered pricing has been that prices in concentrated industries did not fall rapidly enough over a period of inadequate demand to avoid widespread unemployment. In recent years the focus of the argument has been shifted. The issue today is whether prices on occasion have been forced up too rapidly in concentrated industries so as to cause or exacerbate general inflation. Economists have differed on this issue.

In 1970, the Antitrust Division took the position before this Committee that there was no significant correlation between concentration and price changes for the period running from 1963 to 1968, when prices were relatively stable. Assistant Attorney General Richard McLaren also observed that in the more inflationary years 1967 through 1969, prices appeared to have risen a good deal less in concentrated industries than in the more competitive sectors.

Unfortunately, not only is inflation a complex phenomenon, but it also seems clear that no two episodes of inflation are precisely alike, so that it has been impossible to achieve a consensus on the role of concentration generally in fostering cost-push inflation, as the testimony of this Committee's previous witnesses has demonstrated rather sharply. A number of unusual and significant events have occurred over the past two years which have adversely affected this nation's economy—the energy crisis is perhaps the most obvious factor. Moreover, perhaps in part related to these phenomena, the United States is not alone among the nations of the world in feeling the pains of sharply rising prices. Surely even the most fervent proponents of the cost-push theory would recognize that the American experience is not unrelated to inflationary conditions outside the United States. Therefore, it seems clear that the inflation which we now experience is in large part due to factors unrelated to market power. But this Committee's inquiry—and the Department's inquiry as well—cannot on this alone rule out possible anticompetitive arrangements and structures which may contribute to inflation.

I cannot say whether industrial concentration is the primary cause of our dilemma. I will say that I believe antitrust enforcement can make a substantial contribution in the battle against continuing inflation and that resources devoted to antitrust will have a payoff far in excess of cost, even in relatively short-run terms.

It is not essential to antitrust enforcement whether prices on the average are rising faster, more slowly, or at the same rate in concentrated industries vis-à-vis unconcentrated markets. Antitrust enforcement is concerned not with the average industry, but with specific products in specific markets. It is the responsibility of the Antitrust Division to identify price rises which have not been compelled by increases in labor or material costs and to then investigate whether those unexplainable price rises are a product of collusion.

¹ 74th Cong., 1st Sess., S. Doc. 13, Gardiner Means *Industrial Prices and Their Relative Inflexibility*.

In competitive markets, prices are presumed by economists normally to approximate costs. When costs rise, prices rise, and there is no discretion or choice on the part of the individual firms involved. Borrowing from the administered pricing theory, in concentrated industries prices are frequently above costs so that when costs rise it is not *inevitable* that prices must follow at least to the same extent that costs go up. Thus when prices do increase by this much or more it may be the result not of impersonal market forces but of conscious decisions by the firms involved.

Pricing decisions of this nature can arise basically in two ways. They may be made through a series of independent decisions by firms in the industry who realize that because of the industry structure each firm is in some respects interdependent with the other. These pricing decisions are generally called "parallel pricing." In dealing with pricing in this context, antitrust can be effective primarily over a longer period through challenging acquisitions under the Clayton Act which would further concentrate an industry and by seeking to eliminate existing concentration under the monopolization provisions of the Sherman Act. Whether such action is desirable or necessary will depend on the industry involved.

There is a second form of pricing above cost, however, which the antitrust laws will reach in the short run. Pricing decisions in a concentrated industry can arise through outright collusion with respect to the timing or amount of the increase. I am not convinced that all the price increases we have seen over the past six months have occurred as a result of independent decisions by each firm in an oligopolistic market. The history of antitrust enforcement indicates that concentration may be the ideal environment for price conspiracy—the Electrical Equipment case and the Plumbing Fixtures case are examples.² And, while conspiracy may not always be necessary to achieve high profit margins in a concentrated industry it may be restored to as a guarantee for profits.

In discussing concentrated industries I should stress that I include within that framework not only national markets such as steel or automobiles, but also local manufacturing and service industries. These markets may also be dominated by a few firms which engage in collusive and anticompetitive conduct. The service area is increasingly important in our economy with estimates that services represent 40% of our Gross National Product.³ When prices for these services are raised to artificial and monopolistic levels the consumer is directly affected.

This would suggest that antitrust enforcement be directed toward concentration industries on both a national and a local level and that the service industries be given particular scrutiny. We are attempting to gear our antitrust program with these principles in mind. The various litigating sections of the Division, both in Washington and the seven field offices, will be directed to canvass the competitive performance and prices of concentrated and other significant industries, and to institute grand jury investigations where appropriate. A team of professional economists will also be assigned to assist the litigating sections to employ tools of economic analysis in order to identify industries in which particular price levels suggest the existence of anticompetitive conduct.

In addition to increased attempts to identify price fixing and the like, the Division will step up investigations which might ultimately result in structural changes in a particular industry. These include enforcement of Section 2 of the Sherman Act to reduce the instance of monopoly in the economy and suits under Section 7 of the Clayton Act to oppose mergers and acquisitions which tend to increase concentration and impair competition in particular markets.

As another tool against inflation, the Department has attempted to limit Government interference with the free market system. Many federal and state agencies engage in activities which eliminate, modify, or restrain the workings of the free market in pursuit of Congressionally mandated programs to promote some other specific and desirable national interest. For many years the Antitrust Division has urged these agencies to eliminate key impediments to competition; we have stressed the economic costs of such restraints, and explained how Congress' purpose could be achieved without unnecessarily impairing competition.

The industries concerned are basic to the nation's welfare. Prices of their goods and services are critically important to the overall price structure. In such fields as air, rail, truck, bus and water transportation, electric power, petroleum

² See for example George Hay and Daniel Kelley, "An Empirical Survey of Price Fixing Conspiracies," *The Journal of Law and Economics*, April 1974.

³ 1974 Report of the Council of Economic Advisers.

and petroleum products, telephone, radio, television and telecommunications services, securities, banking, finance and related industries, the Antitrust Division has argued for policies which would ease barriers to entry, limit mergers, and reduce restrictive practices. For many years it has participated in adjudicatory hearings and rulemaking activities before practically every regulatory agency in Washington.

Increased Antitrust Division activity in these proceedings has been supported by recent reports to the President including repeated reports of the Council of Economic Advisers, the Stigler Task Force and the Neal Task Force. The President and the Council of Economic Advisers have continually stressed the importance of relaxing restraints upon free market forces in these industries, and have pointed out that in these industries as in others, competition is essential to the fight against inflation. The regulated sector of the economy account for over 10 percent of this nation's Gross National Product and involves some of the more basic and important national industries. The products of these industries, transportation, finance, communications and power, for example, contribute heavily to the costs of innumerable other products. Every additional dollar devoted to maintaining the influence of competition as an essential ingredient of regulation promises to make a substantial contribution to the longer run battle against inflation.

Advocacy by the Department of Justice in particular proceedings is not enough.

The Congress, and state legislatures, should take a major role in eliminating state and federal regulatory schemes which breed inefficiency and waste. There are without doubt regulatory statutes on the books which contribute significantly to inflation.

Traditionally, comprehensive economic regulation of the public-utility nature has been imposed by state and federal legislatures in order to counteract the power of "natural monopolies," such as the local distributors of electricity or phone service, where economies of scale are believed to be so pervasive that competition would impose wasteful duplication.

Regulation has also been imposed on industries where some argued that unsupervised competition would also be wasteful, and not in the public interest. Such industries may include trucking, banking, broadcasting, air transportation, or various kinds of intercity communications.

In recent years, the Administration has become concerned with the cost to society of these artificial restrictions on competition; this Committee has also expressed its concern. Certain economic regulation discourages innovation, preserves inefficient operations, reduces services to the public, and maintains artificially high prices.

In a competitive situation, the skilled and innovative entrepreneur is rewarded; success comes to the firm which provides what the public wants and thinks worth paying for, while the inefficient producer, or the one who fails to recognize changing demand in the marketplace, is swiftly penalized. Governmental regulation, on the other hand, has frequently been a "cost-plus" operation under which even the most mediocre, the most inefficient firm is sheltered. Economic regulation encourages second-guessing by the regulator in Washington or state capitals. It substitutes bureaucratic judgments for consumer choices and the skill and judgment of the entrepreneur.

The transportation industry provides some indication of the possible costs of regulation. The ICC-administered Motor Carrier Act of 1935 requires that all interstate common carriers by truck receive a certificate of public convenience and necessity for a specific route or area and for a specific commodity from the ICC before it can commence operations. Once a carrier has been permitted to enter into service, it is subject to extensive rate regulation by the ICC. Rates are fixed by the carriers in rate bureaus with antitrust immunity. It is not surprising then, that ICC limitations on entry and innovation, along with the rate-fixing which results from these provisions have led to higher truck rates and decreased flexibility and convenience of service.

As could be expected, the cost of these policies is rather high. One analysis of the extra costs to society resulting from too high rates, goods carried on other than the lowest cost mode, lost incentive for innovation due to delays in getting approval of new services and inefficiency due to restrictions on routes, commodities, etc., concluded that these extra costs amounted to between \$4 billion and \$9 billion in 1968 alone.⁴ One may quarrel with the precise figures. It is clear,

⁴ Moore, *The Feasibility of Deregulating Surface Transportation*, in *Hearings on Surface Transportation Legislation Before the Subcommittee on Surface Transportation of the Senate Commerce Committee*, 92d Cong., 2d Sess., pt. 3, at 1082, 1091 (1972).

however, that we pay a dear price for this kind of regulation, and that those increased costs are heavy contributors to our current inflation.

The airline industry provides another example of how regulation can increase costs to the public—and provide poor service at the same time. Under the Federal Aviation Act, the Civil Aeronautics Board regulates entry of new carriers and controls the awarding of new routes to existing carriers. It also passes on requests for changes to airline tariffs and has the power to suspend, reject or modify them. The CAB, however, has no power to control schedules other than to require a minimum level of service. The Board's administration of the Act, currently symbolized by a moratorium on hearings for new route awards, has been characterized by limitations on entry. Thus, over the past two decades, there has been virtually no entry of new scheduled certificated airlines into the domestic market, and the number of competitors in many markets has been limited by CAB regulation.

This fact, combined with the inhibitions to rate cutting imposed by the regulatory process—all changes must be announced in advance and are subject to challenge from competitors—has led to a situation in which airlines do not compete on the basis of price. Instead they "compete" by increasing schedules and in-flight services, the only unregulated portion of their operations. While such "improved" service initially seems to be the public good, it may in fact be economically wasteful, because it leads to a level of service above that which the public would be willing to pay for in the marketplace and deprives the public of the option of purchasing less service at a lower cost.

In fact, a 1965 study by the staff of the CAB found that, in the Los Angeles-San Francisco market, in which certified carriers were faced with competition from an intrastate airline, not subject to minimum rate regulation, fares were lower, service was more flexible, and traffic growth was greater than in comparable markets served only by regulated airlines.⁵ Based on the California experience, one economist has estimated that regulated airlines in 1972 had rates as much as 48% to 84% higher than would be the case in a non-regulated environment.⁶

Again, the validity of these precise figures is not the key question. Rather the question is whether the conclusion they suggest—that regulation in this area has significant costs—is an accurate one. There is considerable evidence supporting the conclusion. In April, 1967, a supplemental air carrier proposed to enter the California/East Coast market at a rate almost one-half less than the lowest regularly available fare. The CAB never acted on this proposal. Similarly, a British airline has applied for authority to operate a non-reserved U.S.-U.K. "Sky-train" service at \$250 a round trip, which is substantially below the \$665 regular economy fare. The application is currently pending before the CAB, but an Administrative Law Judge has recommended the imposition of terms giving the CAB greater power to reject low fares (which power is more limited in international cases). The CAB has also taken steps to insure increased fares in the previously unregulated international charter market. First, it has approved discussions among charter carriers to fix charter fares. It should be noted that Board approval of a discussion or subsequent agreement immunizes it from the operation of the antitrust laws. Second, the Board has proposed a rule which would make *prima facie* unlawful any charter rates (even those agreed to by an intercarrier conference), which fell below a specified formula. If adopted, this rule would result in an increase in charter fares of about 30% in the lowest, off-season charter fares for high-capacity equipment.⁷ The Department of Justice is opposing this action before the Board.

The purpose of these examples is really not to single out particular agencies, who frequently are simply carrying out particular statutory mandates. Rather, it is simply to illustrate that there are indeed significant costs resulting from regulation which is either unnecessary, more cumbersome than necessary, or in some cases even positively counter-productive. There can be no question that these costs play a significant role in the creation of inflationary pressures. Perhaps more importantly, the regulatory structure itself in many instances eliminates or severely limits the ability of companies in important sectors of our economy to fight inflationary pressures by competing vigorously.

⁵ Bureau of Accounts and Statistics, Civil Aeronautics Board, Traffic Fares and Competition: Los Angeles/San Francisco Air Travel Corridor.

⁶ Keeler, *Airline Regulation and Market Performance*, Bell J. Econ. & Man. Sci. 399 (1972).

⁷ Docket 25875, PSDR-37, Proposed Policy Statement; *id.*, World Airways Exhibit WOA-201 (appended to Comments of World Airways, Nov. 2, 1973) (compilation of CAB tariff data).

It seems to me that it is past time to look at existing regulatory structures and to ask whether those structures are indeed meeting today's needs or, whether they are instead part of today's problem. It is past time to examine both federal and state regulatory schemes to see whether they can be remodeled in particular instances to directly serve the avowed purposes of regulation in ways which do not unnecessarily limit or eliminate competition and the ability of firms to compete. There are undoubtedly some few areas in which regulation is essential; there are undoubtedly other areas in which some regulation is desirable. But it is time we examined the economy and determined what specific kinds of regulation are either necessary or desirable today.

Let me touch on some of the things which could be done. First, of course, direct economic regulation of industries other than those few which are natural monopolies could simply be ended. That possibility is greeted with alarm, even by some observers outside the industries themselves. It is interesting to note in this regard a study prepared by the Council of Economic Advisors in 1971, which analyzed the deregulation of surface transportation in Australia and Britain, as well as partial deregulation in Canada, and concluded that such conditions generally resulted in better service and lower rates without the chaos frequently predicted.⁹ The only substantive problem discovered by the Council was the result of the sudden end of regulation in Australia when that country's regulation scheme was declared unconstitutional. The Australian experience merely teaches what ought to be an obvious lesson; deregulation ought not to be instantaneous. Rather it should be approached on an open basis with input by all parties and a well publicized timetable for change.

Another alternative, less dramatic but potentially capable of a significant impact, would be changes in various regulatory schemes done with an eye to achieving "workable regulation" by allowing competitive forces much greater opportunity to function within the regulatory framework. The Administration's 1971 proposal, known as the Transportation Regulatory Modernization Act, was a step in this direction.⁹ While continuing prohibitions on "prejudicial" or "discriminatory" rates for carriers under ICC jurisdiction, that legislation would have declared as *per se* reasonable all rates above variable cost and, in the case of a carrier monopoly, below 150% of fully allocated costs. Thus a "zone of reasonableness" would have been created. Entry restraints would have substantially lessened and the power of rate bureaus would have been decreased.

The bill was not reported out of either the House or Senate. Currently, a modified form of the 1971 legislation—restricted mainly to railroads—is before the Congress. That bill also contains innovative reforms designed to reduce procedural delays involved in processing rate changes, so as to encourage proposals for lower rates.

The Departments of Justice and Transportation have also supported the concept of a "zone of reasonableness" before the CAB. This proposal, which received the backing of a major airline, would have allowed carriers to file tariffs 15% above or below the CAB approved rate, without the necessity of costly investigation and hearing. This proposal was rejected by the CAB last March in the final phase of its Domestic Fare Investigation.

Finally, the legislative standards which govern regulatory agencies could, and we believe should, be analyzed with an eye to their effect on competition and competition policy. Many regulatory agencies operate under very general "public interest" standards and some have the power to immunize particular activities from the antitrust laws. The ability of agencies operating under such standards to severely limit the beneficial impact of free market incentives under their control is enormous. If the history of economic regulation in this country proves one thing, it must be the danger of the establishment of a regulatory scheme on the supposition that those making the ultimate regulatory decisions are always wise, always objective and always removed from the political process.

Considering the possible adverse impact a regulatory structure can have, it must be structured so that it can be administered by less wise or industry-oriented appointees who may—from time to time—be called on to administer it. Obviously, it is past time to examine regulatory standards to determine whether they should be amended to give affirmative guidance to the regulatory agencies on how they are to weigh competitive interests. The courts have imposed upon regulatory

⁹ See *Chaos Will Not Occur*, in *Hearings on the Transportation Act of 1972 Before the Subcommittee on Transportation and Aeronautics of the House Committee on Interstate and Foreign Commerce*, 92d Cong. 2d Sess., pt. 1, at 238 (1972); see also B. Bayliss, *The Road Haulage Industry Since 1968* (1973).

* H.R. 11826, S. 2842, 92d Cong., 1st Sess. (1971).

agencies a duty to consider antitrust issues,¹⁰ but there is no sure way outside of affirmative legislative direction to compel agencies to give competitive values the weight they deserve in policy formulation.

There are a number of industries, heavily regulated, but subject to more specific direction from the Congress to the regulatory agencies as to the weight of competitive factors and without the benefit of a grant of immunity from the antitrust laws, in which there has been a thoughtful accommodation between regulatory interests and antitrust interests. In the energy, financial or communications industries, the interplay of these often opposing forces has not resulted in chaos. Rather the presence of the antitrust issue, whether presented by the Antitrust Division or raised by the parties affected, has been most helpful in delineating the competitive impact of particular decisions and preventing in some cases the implementation of procedures or decisions unjustified in comparison to their competitive impact.

These are questions which many regulated companies—and some regulators—do not even want to hear, much less answer, but these are the kinds of questions that must be asked if we are serious about removing significant inflationary pressures, not only in the short run but on the longer term as well. Clearly antitrust and competitive policy, even if fully applied and followed throughout our economy, cannot guarantee the absence of times of inflation in the future. But just as clearly, effective antitrust enforcement against private conduct and anti-competitive industry structure, and strong governmental action to remove unnecessary and unwarranted public restraints on competition, would be major steps in doing something about the inflationary pressures that are within this nation's control.

Senator PROXMIRE. Mr. Dirlam, please proceed.

**STATEMENT OF JOEL B. DIRLAM, PROFESSOR OF ECONOMICS,
UNIVERSITY OF RHODE ISLAND**

Mr. DIRLAM. Senator Proxmire, in presenting my statement I will attempt to ask myself the most difficult questions, and proceed from the general down to the particular. I will read the questions, and then summarize the answers, or at least a discussion that I prepared with respect to each question.

First—and this is generally, I believe, within the purpose of the committee's activities—I did not have an opportunity to read your resolution until I got here this morning, but I see we are thinking along much the same line—why is it necessary to examine individual industries in order to devise a workable anti-inflationary policy?

In highly developed economic systems such as that of the United States, the interactions among institutions usually make it impossible to rely on a single macroeconomic device to combat inflation. Simple remedies, such as reducing the money supply or raising taxes, are politically intolerable or counterproductive—higher interest rates are absorbed into costs, and higher income taxes lead to intensified pressure for higher wages. Hence, tight money and higher taxes can intensify inflation. Cutting Government spending sufficiently to create prolonged high-level unemployment can scarcely be regarded as a civilized policy in 1974. On the other hand, there is good reason to believe that the pricing goals and habitual market behavior of some firms and industries have fueled much of recent inflation. The fact that large firms have discretionary power in pricing decisions in well-disciplined industries suggests that an analysis of the industry behavior could be helpful in shaping a viable anti-inflationary policy. Steel of course, still remains by far the most important industrial material, three times as large in industrial production as all other

¹⁰ *E.g., Gulf States Utilities Co. v. Federal Power Commission*, 411 U.S. 747, 760 (1973).

metals combined. It is an important material input, accounting for more than 5 percent of the inputs in 20 of the 52 manufacturing industries, including, for example, 1½ percent in autos, 9 to 15 percent in machinery industries, and 44 percent in metal containers.

Its value weight in the wholesale price index changes from time to time, but it is approximately 5 percent, and the indirect effect from the wholesale price index is about twice as large.

Ever since World War II the steel industry, regarded as an inflationary bellwether, has been subject to special investigation and sporadic controls. Because they appeared to intensify an upward price movement, the steel price increases of December 1949, were investigated by the Joint Committee on the Economic Report. In a report to the same committee in 1959, Professor Eckstein and Gary Fromm held the steel industry responsible for a major share of the rise in wholesale prices in the postwar period, taking into account direct and indirect price effects. The confrontation between Mr. Blough and President Kennedy in April 1962 resulted in a rollback of an across-the-board increase that threatened the bastion of the administration's wage-price guidelines. By 1965, however, a report of the Council of Economic Advisers on steel prices complimented the industry on its "great contribution to the economy's excellent price record" in the expansion of 1960-65. When this record was darkened by a sharp increase in steel prices from 1968 to 1970, another high-level committee, chaired by a member of the Council of Economic Advisers, attempted to assess the causes and consequences of the increase. Although the committee did not employ the sophisticated input-output techniques of Eckstein and Fromm, it concluded that "the indirect effect, or influence, or rising steel prices is likely to be larger" than its direct effect. Advances in steel prices, according to the committee, "tend to trigger a general reexamination of costs by users * * * [and] the justification for an increase in [their] price is often attributed to increased steel prices."

The discretionary power vested in leading firms in the industry, which can more or less determine the extent and timing of price increases, has made price changes a function of the ritual of profit and cost estimates by just a few centers of decisionmaking.

Even though an official basing point system has been abandoned price leadership assures price uniformity. "Price levels," Prof. Walter Adams wrote in 1971, "are geared to a break-even point of 50 percent or less of capacity, and only remotely influenced by market forces. The industry leader sets prices like a public utility, aiming for a predetermined profit target—after taxes—and the other firms usually follow in lockstep." Vertical integration further insulates pricing behavior from direct influence of the market, since the large firms must take into account the effect on a vertical pricing structure of changes they might make in the price of a semifinished product.

In short, steel pricing illustrates par excellence, the theory of administered pricing as expounded by Mr. Gardner Means. Sometimes the price administrators seem to defy market pressures, as they did when they increased prices during the 1957-58 recession; at other times, price does seem to reflect, to a degree, changes in demand, but it never functions as a market-clearing institution.

How, in general, has the industry's overall performance contributed to inflation in the long run?

STEEL INDUSTRY AND INFLATION

Any attempt to generalize about performance is dangerous. But it seems safe to say that certain characteristic practices of the steel industry strengthen inflationary pressures. For one thing, the industry, eventually joined by the United Steelworkers of America, has lobbied intensively for restrictions on imports. In the 1960's, when capacity was said to be underutilized, quotas were advocated in order to protect domestic profits and jobs. Today, although U.S. mills enjoy a 6- to 8-month backlog, and the 50 million ton excess world capacity reported by industry's experts in 1968 has been replaced by an even larger capacity shortage, quotas are advocated in order to permit the industry to expand.

And yet only after the quotas were imposed did steel prices begin to move upward once more after a period of stability. But why should the industry continue to support a quota system, for instance, as embodied in the administration's trade bill, when a 20 percent devaluation and booming world demand had lifted the prices of most imported steel far above domestic quotas, and import volume is far below its 1971 peak? Evidently the domestic industry wants to be sure that at no future date will it be exposed to competition that it cannot control.

Insulation from foreign competition would also relieve the industry from pressure to innovate. The oxygen converter—the major technological breakthrough in basic steelmaking of the past 70 years—was “invented and innovated by the miniscule Austrian steel industry in 1950.” In the United States it was first installed by tiny McLouth in 1954. It was not until late in 1963 that United States Steel used its first converter. There is reason to believe that large U.S. producers have lagged, too, in introducing continuous casting. But, as the imports expanded year after year, the industry came to place more emphasis on developing and installing new techniques, such as Q-BOP, a German-invented improvement on the oxygen converter which reduces energy inputs and avoids air pollution.

Industry support for import limitations is the more remarkable when devaluation plus wage increases in leading European countries has brought their unit labor costs close to our own while we maintain our superiority in output per man-hour. Productivity in Japan, however, continues to improve at a rate we seem unable to duplicate. In fact, given our relative independence in supplies of coal, and the proximity of taconite, and of high grade iron in Quebec, there seems to be no reason why American steel could not compete effectively in export markets as it did 20 years ago. Some industry analysts have concluded that, a *Business Week* says, “the current cost structure favors U.S. competitiveness in world markets.” Nevertheless, the American Iron and Steel Institute has taken the position, in February 1974, that it cannot compete on an equal footing with either the Japanese or the Europeans, in part because “steel industry facilities * * * are definitely much older than those in Europe.”

Has current behavior of the steel industry intensified inflation?

Compared with the rapid rise in price of refined products, vegetable oils, woodpulp, or crude oil, in the past year, steel price increases for the year ending July 1974 may appear to be moderate. Yet, United States Steel, followed by others, has announced three distinct general price increases since controls ended on April 30, 1974. If one includes

the 6 percent increase allowed in January 1974, its quoted prices have gone up roughly 30 percent; the corporation says it does not intend to announce any further increases this year. According to the National Association of Purchasing Agents, prices of finished steel products have registered a 30 to 40 percent increase in the past year. And the BLS index for iron and steel was 40 percent higher in July 1974 than in July 1973.

The industry takes the position that during the years subsequent to the August 1971 freeze it had been prevented from increasing prices and is now, therefore, entitled to recoupment of substantial amounts. Ignoring for the moment, however, questions of equity, price rises of this magnitude were not allowed under the rules of the Price Commission of the Cost of Living Council because of their inflationary consequences.

Are price increases necessary to stimulate expansion of capacity?

EXPANSION OF CAPACITY AND PROFITS IN THE STEEL INDUSTRY

According to spokesmen for the steel industry, higher prices for steel will generate the cash flow to finance the capacity required to take care of present and anticipated demand.

The industry apparently does not pause to ask whether, in fact, it will be able to check increases in its wage and materials costs that may result from an increase in the price of steel. If costs of these inputs rise, the profits will be temporary, and still further increases in prices will be required.

It is impossible to resolve this plea on its merits. The problem is not whether we shall let the industry increase its prices so as to have available a certain level of capacity at some future date. Depending on one's assumptions, one might arrive at a variety of estimates of how much capacity is needed, and where it is to be constructed. If a classical free market ruled, the decision would be made by market forces. Perhaps the capacity would be built in Japan, Spain, Brazil, South Africa, or Australia, rather than in the United States. Again, should the industry modify its attitudes toward exporting, the additions to capacity might be used to supply foreign markets. It is far from a free market solution for the problem to permit the industry to raise its prices as far as it thinks desirable in order to plan for the expansion level it favors, while at the same time severely limiting imports.

Actually, the industry is proposing that it be regarded as a public utility, but it wants itself to determine the fairness of the fair return.

If prices are to be linked to specific rates of return, however, we need to know much more than we do now about the details of the steel companies' costs and finances. Are all of the assets reflected in net worth "used and useful in the public interest"? Low rates of return in some past years may have resulted from carrying on the books still undepreciated, but nevertheless obsolescent steelmaking plant. Indeed, spokesmen for U.S. Steel have said that they refrained from replacing outmoded open-hearth facilities by oxygen converters because they had not yet fully amortized the plant in use. Recent revisions of capacity estimates for the steel industry have disclosed that until as late as 1972 there were millions of tons of antiquated facilities still numbered among potentially useable plants. Questions would arise regarding depreciation, taxes, and many other charges against income.

Information should be available to permit analysis of rates of return on nonsteelmaking activities for each company. Finally, there would have to be a determination of the cost of capital.

Given current monetary policy, and the state of security markets, the successful flotation of new common stock issues would necessitate prices for steel products far above current levels. What would the industry regard as its current cost of capital? This question can scarcely be resolved here, but it indicates what would be involved if we were to accept the industry's position that it be allowed to earn a fair rate of return, as opposed to one determined by a competitive market. But competitive markets could be created only by changing the structure of the industry, by eliminating restriction on imports, and by involvement of U.S. producers in export competition.

Should steel prices be controlled in a period of stagnation?

Many signs point toward a prolonged recession accompanied by rising unemployment and by rising prices. The recession, however, has clearly been caused by wrong-headed economic policy prevailing for the past 3 years. Convinced that price and income controls were not only immoral, but unsound because in conflict with principles of a free market, high officials of the Government undermined public support for phase II, and then for phase III, by promising a quick return to the status quo ante. We are now living with the consequences—that is to say, prices are being determined not by a price commission or by a free market but according to the bargaining strength of a few economic power centers. The only alternative would seem to be to adopt an anti-inflationary program that will come to grips with current economic reality. Those industries that are highly concentrated and where competition is feeble should be brought under direct price control—not merely monitoring or exhorting. Steel is one of these industries—but there are others, as Senator Metzenbaum has so clearly shown. At the same time, there must be some form of incomes, not merely wage control. It does not make sense either politically or economically to set ceilings to wages when there are such huge disparities in personal incomes. We must also prepare for an eventual ordered abandonment of Government controls by providing the structural and behavioral requisites of competition, and again not only in the steel industry.

Thank you.

Senator PROXMIRE. Thank you very much, Mr. Dirlam.

[The prepared statement of Mr. Dirlam follows:]

PREPARED STATEMENT OF JOEL B. DIRLAM

1. Why is it necessary to examine individual industries in order to devise a workable anti-inflationary policy?

In highly developed economic systems such as that of the United States the interactions among institutions usually make it impossible to rely on a single macroeconomic device to combat inflation. Simple remedies, such as reducing the money supply or raising taxes, are politically intolerable or counterproductive—higher interest rates are absorbed into costs, and higher income taxes lead to intensified pressure for higher wages. Hence tight money and higher taxes can intensify inflation. Cutting government spending sufficiently to create prolonged high-level unemployment can scarcely be regarded as a civilized policy in 1974. On the other hand, there is good reason to believe that the pricing goals and habitual market behavior of some firms and industries have fueled much of recent inflation. The fact that large firms have discretionary power in pricing decisions in well-disciplined industries suggests that an analysis of the industry behavior could be helpful in shaping a viable anti-inflationary policy. Of course

one must recognize that any attempt to find a single origin for such a complex phenomenon is unlikely to be successful.

2. Why should the steel industry be singled out for attention?

Ever since World War II the steel industry, regarded as an inflationary bell-wether, has been subject to special investigation and sporadic controls. Because they appeared to intensify an upward price movement, the steel price increases of December 1949 were investigated by the Joint Committee on the Economic Report.¹ In a report to the same committee in 1959, Professor Eckstein and Gary Fromm held the steel industry responsible for a major share of the rise in wholesale prices in the postwar period, taking into account direct and indirect price effects.² The confrontation between Mr. Blough and President Kennedy in April 1962 resulted in a roll-back of an across-the-board increase that threatened the bastion of the Administration's wage-price guidelines.³ By 1965, however, a report of the Council of Economic Advisers on Steel Prices complimented the industry on its "great contribution to the economy's excellent price record" in the expansion of 1960-1965.⁴

When this record was darkened by a sharp increase in steel prices from 1968 to 1970, another high-level committee, chaired by a member of the Council of Economic Advisers, attempted to assess the causes and consequences of the increase. Although the committee did not employ the sophisticated input-output techniques of Eckstein and Fromm, it concluded that "the indirect effect, or influence, of rising steel prices is likely to be larger "than its direct effect. Advances in steel prices, according to the committee, "tend to trigger a general re-examination of costs by users . . . [and] the justification for an increase in [their] price is often attributed to increased steel prices."⁵

The steel industry has been of continuous concern not merely because steel is a widely used and strategic material, but also because of its concentrated structure and its long history of conscious parallelism. Although U.S. Steel's dominance has declined, the four largest producers still accounted for 53.7 percent of shipments in 1973, with U.S. Steel's share at 23.4 percent. The discretionary power vested in leading firms in the industry, which can more or less determine the extent and timing of price increases, has made price changes a function of the ritual of profit and cost estimates by just a few centers of decision-making.

From time to time we have been given glimpses of the bases for these crucial moves as industry representatives have testified before Congressional committees, but we are far from knowing the complete story. Some of the material was pieced together in the Brookings study published in 1958.⁶ But the analysis of pricing badly needs updating.

We do know something about the mechanism. Even though an official basing point system has been abandoned price leadership assures price uniformity. The spirit of the basing point system lingers on. "Price levels," Professor Walter Adams wrote in 1971, "are geared to a break-even point of 50 percent or less of capacity, and only remotely influenced by market forces. The industry leader sets prices like a public utility, aiming for a predetermined profit target (after taxes), and the other firms usually follow in lockstep."⁷ Vertical integration further insulates pricing behavior from direct influence of the market, since the large firms must take into account the effect on a vertical pricing structure of changes they might make in the price of semi-finished product.⁸

In short, steel pricing illustrates *par excellence* the theory of administered pricing as expounded by Dr. Gardner Means. Sometimes the price administrators seem to defy market pressures, as they did when they increased prices during the 1957-1958 recession; at other times, price does seem to reflect, to a degree, changes in demand, but it never functions as a market-clearing institution.⁹

3. Has the industry's over-all performance contributed to inflation?

¹ *December 1949 Steel Price Increases*, Hearings before the Joint Committee on the Economic Report, 81 Cong. 2 Sess. (1950).

² Eckstein and Fromm, *Steel and the Postwar Inflation*, Study Paper No. 2, Study of Employment, Growth, and Price Levels, Joint Economic Committee (1959).

³ Roy Hoopes, *The Steel Crisis* (New York, 1963).

⁴ Council of Economic Advisers, *Report to the President on Steel Prices*, April, 1965, p. 64.

⁵ Cabinet Committee on Price Policy, *Report to the President*, July 6, 1971, p. 54.

⁶ Kaplan, Dirlam and Lanzillotti, *Pricing in Big Business: A Case Approach* (Washington, 1958), pp. 166-175.

⁷ "The Steel Industry", in Adams, ed. *The Structure of American Industry* (New York, 4th ed., 1971), p. 109.

⁸ Adams and Dirlam, "Steel Imports and Vertical Oligopoly Power", *American Economic Review*, Sept. 1964, p. 626.

⁹ *Pricing Power and the Public Interest* (New York, 1962), *passim*.

Any attempt to generalize about performance is dangerous. But it seems safe to say that certain characteristic practices of the steel industry strengthen inflationary pressures. For one thing, the industry, eventually joined by the United Steelworkers of America, has lobbied intensively for restrictions on imports. In the 1960's when capacity was said to be underutilized, quotas were advocated in order to protect domestic profits and jobs. Today, although U.S. mills enjoy a six to eight month backlog, and the 50 million ton "excess" world capacity reported by industry's experts in 1968 has been replaced by an even larger capacity shortage, quotas are advocated in order to permit the industry to expand.¹⁰

That imports did impose a degree of pricing and efficiency discipline on the industry prior to the adoption of the "voluntary" quota plan in 1969 seems indisputable. Only after the quotas were imposed did steel prices begin to move upward once more.¹¹ But why should the industry continue to support a quota system, for instance as embodied in the Administration's Trade Bill, when a 20 percent devaluation and booming world demand had lifted the price of most imported steel far above domestic quotas, and import volume is far below its 1971 peak? Evidently the domestic industry wants to be sure that at no future date will it be exposed to competition that it can not control.

Insulation from foreign competition would also relieve the industry from pressure to innovate. The oxygen converter—the major technological breakthrough in basic steel making of the past seventy years—was "invented and innovated by the miniscule Austrian steel industry in 1950."¹² In the United States it was first installed by tiny McLouth in 1954. It was not until late in 1963 that U.S. Steel used its first converter. "As of September 1963 the largest steel companies, operating more than 50 percent of basic steel capacity, had not installed a single LD furnace. . . ."¹³

In 1972, Japan was still ahead of the United States in the proportion of steel produced by the oxygen process. There is reason to believe that large United States producers have lagged, too, in introducing continuous casting.¹⁴ But, as the imports expanded year after year, the industry came to place more emphasis on developing and installing new techniques, such as Q-BOP, a German-invented improvement on the oxygen converter which reduces energy inputs and avoids air pollution.

Industry support for import limitations is the more remarkable when devaluation plus wage increases in leading European countries has brought their unit labor costs close to our own while we maintain our superiority in output per man hour. Productivity in Japan, however, continues to improve at a rate we seem unable to duplicate. In fact, given our relative independence in supplies of coal, and the proximity of taconite, and of high grade iron in Quebec, there seems to be no reason why American steel could not compete effectively in export markets as it did twenty years ago.

Some industry analysts have concluded that, As *Business Week* says, "the current cost structure favors U.S. competitiveness in world markets."¹⁵ Nevertheless, the American Iron and Steel Institute has taken the position, in February 1974, that it cannot compete on an equal footing with either the Japanese or the Europeans, in part because "steel industry facilities . . . are definitely much older than those in Europe."¹⁶

4. Has current behavior of the steel industry intensified inflation?

¹⁰ Statement on Trade Legislation by Steward S. Cort, Chairman, American Iron and Steel Institute before the Senate Finance Committee, March 26, 1974. To Mr. Cort, the level of steel imports of 15 million tons in 1973—less than 14% of shipments—was "astounding".

¹¹ See Chart A, testimony of J. Dirlam, Tariff and Trade Proposals, Hearings before House Ways and Means Committee, 91st Cong., 2d. Sess. (1970)—Pt. 6, p. 1852, and Comptroller General of the United States, "Economic and Foreign Policy Effects of Voluntary Restraint Agreements on Textiles and Steel", March 21, 1974, p. 24. As the Comptroller points out, the effect of the VRA program was to strengthen anticompetitive behavior in Japan.

¹² Adams, *op. cit.*, p. 105.

¹³ *Ibid.*

¹⁴ Ault, "The Continued deterioration of the Competitive Ability of the U.S. Steel Industry: The Development of Continuous Casting", *Western Economic Journal*, March 1973, p. 8; Huetter, "The Development of Continuous Casting in the U.S. Steel Industry: Comment", *Economic Inquiry*, June 1974; p. 265; Ault, "The Development of Continuous Casting in the U.S. Steel Industry: Reply", *Economic Inquiry*, June 1974, p. 271. According to Huetter, the earliest commercial continuous casting unit was installed in the U.S. by Roanoke Steel Co. in 1963; U.S. Steel was the 11th to install such a unit, in 1967. Huetter, *op. cit.*, p. 268.

¹⁵ "The New Economics of World Steelmaking," August 3, 1974, p. 39.

¹⁶ *Steel Industry Economics and Federal Tax Policy*, p. 17.

Compared with the rapid rise in price of refined products, vegetable oils, wood pulp, or crude oil, in the past year, steel price increases for the year ending July 1974 may appear to be moderate. Data are not available to enable one to arrive at a precise percentage increase in the prices paid by customers. Yet U.S. Steel, followed by others, has announced three distinct general price increases since controls ended on April 30, 1974. If one includes the 6 percent increase allowed in January, 1974, its quoted prices have gone up roughly 30 percent; the Corporation says it does not intend to announce any further increases this year.¹⁷

According to the National Association of Purchasing Agents, prices of finished steel products have registered a 30 to 40 percent increase in the past year.¹⁸ And the BLS index for iron and steel was 40 percent higher in July 1974 than in July 1973. There is no question that steel prices have risen more than the average of wholesale prices, and more than the industrial commodities wholesale price index during the past year.

The industry takes the position that during the years subsequent to the August 1971 freeze it had been prevented from increasing prices and is now, therefore, entitled to recoupment of substantial amounts.¹⁹ Ignoring for the moment however questions of equity, price rises of this magnitude were not allowed under the rules of the Price Commission of the Cost of Living Council because of their inflationary consequences. Some highly concentrated industries, such as automobiles, have already embedded the higher steel cost into their prices. In other more competitive areas, such as appliances, the effect may be postponed, but the ultimate effect will be the same.

5. Are price increases necessary to stimulate expansion of capacity?

According to spokesmen for the steel industry, higher prices for steel will generate the cash flow to finance the capacity required to take care of present and anticipated demand.

An allied argument emphasizes the low level of recorded profit rates in the steel industry prior to 1973; margins on sales and on net worth had declined, it is said, since the 1950's to a level where it was impossible to sell new common stock, while high interest rates make borrowing extremely costly. With higher prices, the companies will realize the higher profits that will justify and finance new investment. The industry, apparently does not pause to ask whether, in fact, it will be able to check increases in its wage and materials costs that may result from an increase in the price of steel. If costs of these inputs rise, the profits will be temporary, and still further increases in prices will be required.

It is impossible to resolve this plea on its merits. The problem is not whether we shall let the industry increase its prices so as to have available a certain level of capacity at some future date. Depending on one's assumption, one might arrive at a variety of estimates of how much capacity is needed, and where it is to be constructed. If a classical free market ruled, the decision would be made by market forces. Perhaps the capacity would be built in Japan, Spain, Brazil, South Africa or Australia rather than in the United States. Again, should the industry modify its attitudes toward exporting, the additions to capacity might be used to supply foreign markets. It is far from a free market solution for the problem to permit the industry to raise its prices as far as it thinks desirable in order to plan for the expansion level it favors, while at the same time severely limiting imports.

Actually, the industry is proposing that it be regarded as a public utility, but it wants itself to determine the fairness of the fair return. As we know, the steel industry registered substantial profit gains in 1973; the First National City Bank tabulation lists iron and steel companies' return on net worth as 9.8 percent in 1973, against 8.9 percent in 1972.²⁰ The margin on sales went up

¹⁷ *Metal Bulletin*, July 19, 1974, p. 33.

¹⁸ *Metal Bulletin*, August 9, 1974, p. 32.

¹⁹ AISI, *Steel Industry Economics and Federal Income Tax Policy*, p. 19; Mr. E. B. Speer, Chairman, *U.S. Steel Corp.*, quoted in *New York Times*, July 31, 1974, p. 41.

²⁰ First National City Bank, *Monthly Economic Letter*, April 1974, p. 8.

from 3.2 percent to 4.2 percent. In the first half of 1974, U.S. Steel's margin on sales rose to 6.6 percent. From the industry's point of view what is important is not the rate of climb from 1972 to 1973, or from 1973 to 1974, but rather the absolute level of the percentage return. Only in the early 1950's, according to industry leaders, was a reasonable profit realized. Republic Steel's Annual Report for 1974 prominently displays a chart that shows return on stockholders' equity from 1950 through 1973. In 1950 the company had earned 18 percent; in 1955, 16 percent, compared with 8 percent in 1973.²¹

If prices are to be linked to specific rates of return, however, we need to know much more than we do now about the details of the steel companies' costs and finances. Are all of the assets reflected in net worth "used and useful in the public interest"? Low rates of return in some past years may have resulted from carrying on the book, still undepreciated, but nevertheless obsolescent steelmaking plant. Indeed, spokesmen for U.S. Steel have said that they refrained from replacing outmoded open-hearth facilities by oxygen converters because they had not yet fully amortized the plant in use.²²

Recent revisions of capacity estimates for the steel industry have disclosed that until as late as 1972 there were millions of tons of antiquated facilities still numbered among potentially useable plants.²³ Questions would arise regarding depreciation, taxes and many other charges against income. Information should be available to permit analysis of rates of return on non-steel-making activities for each company. Finally there would have to be a determination of the cost of capital.

Given current monetary policy, and the state of security markets, the successful notation of new common stock issues would necessitate prices for steel products far above current levels. What would the industry regard as its current cost of capital? This question can scarcely be resolved here, but it indicates what would be involved if we were to accept the industry's position that it be allowed to earn a fair rate of return, as opposed to one determined by a competitive market. But competitive markets could be created only by changing the structure of the industry, by eliminating restriction on imports, and by involvement of United States producers in export competition.

6. Should steel prices be controlled in a period of stagflation?

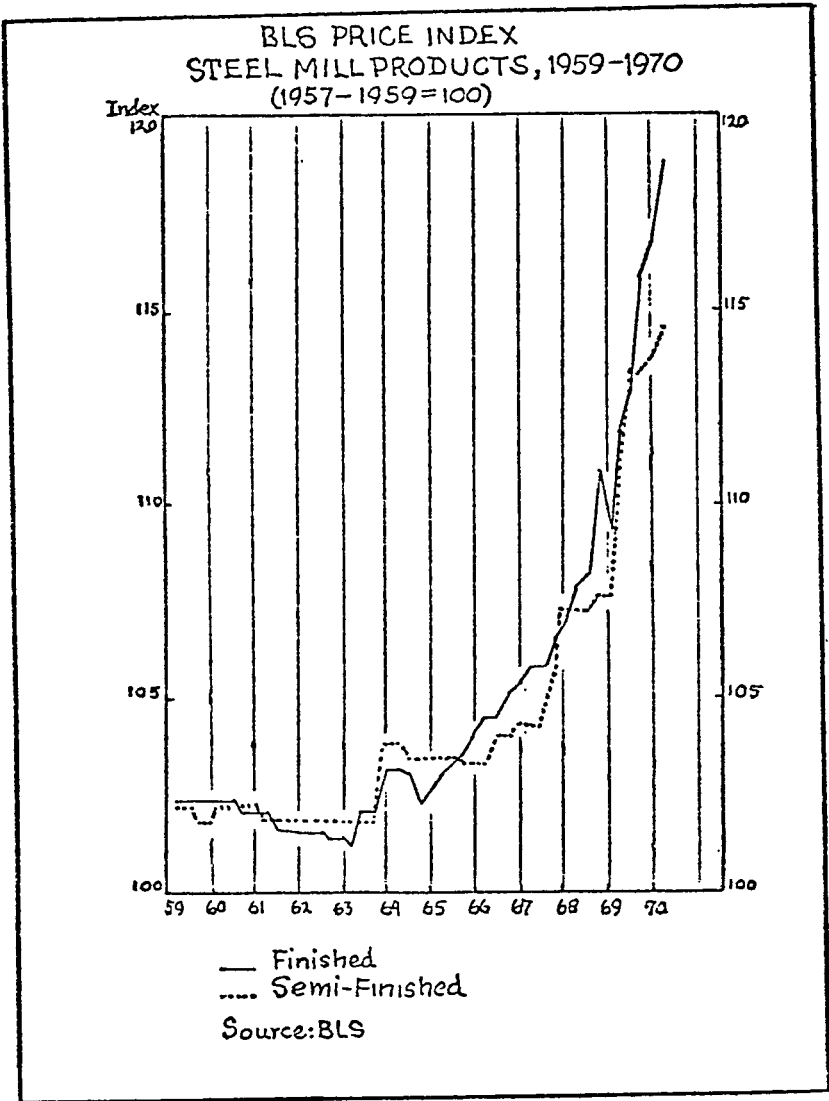
Many signs point toward a prolonged recession accompanied by rising unemployment and by rising prices. The recession, however, has clearly been caused by wrong-headed economic policy prevailing for the past three years. Convinced that price and income controls were not only immoral, but unsound because in conflict with principles of a free market, high officials of the government undermined public support for Phase II, and then for Phase III, by promising a quick return to the *status quo ante*. This procedure was supposed eventually to promote an optimum allocation of resources, if combined with continued monetary stringency. We are now living with the consequences—that is to say, prices are being determined not by a price commission or by a free market but according to the bargaining strength of a few economic power centers. The only alternative would seem to be to adopt an anti-inflationary program that will come to grips with current economic reality. Those industries that are highly concentrated and where competition is feeble should be brought under direct price control—not merely monitoring or exhorting. Steel is one of these industries—but there are others. At the same time, there must be some form of incomes, not merely wage control. It does not make sense either politically or economically to set ceilings to wages when there are such huge disparities in personal incomes. We must also prepare for an eventual ordered abandonment of government controls by providing the structural and behavioral requisites of competition, and again not only in the steel industry.

²¹ P. 5.

²² Adams and Dirlam, "Oxygen Steelmaking—The Phantasmagoria of Innovative Giantism". *Iron and Steel Engineer*, July 1968, p. 97.

²³ Wall Street Journal, Feb. 28, 1973, p. 32.

CHART A



Senator PROXMIRE. I have several very, very crude charts to illustrate a point that I would like to make.

I might say, incidentally, Mr. Dirlam, that your remarks about the inflationary impact of the steel industry were most welcome, and they brought home the fact that last spring I spent a full day working in a pea-packing plant in Wisconsin. I was told the shocking fact that this September, this month, they expect to increase the price of canned peas 20 percent. Now, a principal reason for this is the cost of the can. They point out that the cost of the can empty today is higher than the cost of the can full a few years ago, because of the colossal increase in

the price of steel. So this is another element in the price of food, along with the oil we were talking about a while ago, and indicates that the kind of contribution the concentrated industry makes, aside from the processing, which is somewhat concentrated, and the distribution, which is certainly more concentrated than it is on the farm.

I have here a chart which shows what has happened to the spread between what the farmer gets, raw foodstuffs, and consumer food prices—last August—when, remember, farm prices were so enormously high, and the housewife was campaigning against the high price of food. You notice that the farm prices have dropped very sharply, they have come up a little in the last month. But the spread is really tremendous compared to the situation where there was no spread in August 1973. It is a spread of some 50 points at the present time.

So what has happened is that while farm prices have dropped very, very sharply, to some degree because of concentration in the food industry, you had no drop at all in the consumer food prices, in fact, they have gone up somewhat. We expect food prices to go up again if farm prices go up next year.

Turning to the steel industry, you will notice that iron and steel wholesale prices were fairly stable from 1964 to 1970 and then they just went right through the roof, an index of a hundred to an index of 190.4, with almost all of the increase coming in the last year or so.

Chemical prices were fairly constant until 1973, and then skyrocketed up at a tremendous rate.

The same thing is true of the performance on the part of non-ferrous metals and fuels.

In all these cases we do not get the 10- to 12-percent inflation that we are suffering, we get a 40 percent or a 60 percent, or in the case of fuels, an 80-percent increase in prices in the past year.

Now, I submit that these industries have such a widespread and dispersed effect throughout our economy that a very, very large part of the explanation for the enormous inflation we are suffering right now is right here. It is in oil, it is in steel, it is in chemicals, it is in non-ferrous metals, and the explosion of price increases here. This is why it seems to me, that the kind of action by you, Mr. Kauper, and your Department, can be very, very helpful to us.

I read your prepared statement carefully, looking for concrete evidence that the Antitrust Division is moving against violations of the antitrust laws. You say in your prepared statement that effective antitrust enforcement against private conduct would be a major step in doing something about the inflationary pressures that are within the Nation's control. But nowhere in your prepared statement do I find an example of what you are doing. There are several statements about what will be done. What have you done? That is the question.

Mr. KAUPER. I think we did not try to go through the catalog, Mr. Vice Chairman. I think we did supply you with information on cases, as to why we take some of the industries we talk about, concentrated industries in general. We do have a series of indictments in the steel industry, as you probably are aware. These are price fixing indictments, but I would not want to leave you with the impression that they involve major national price fixing. They involve regional price fixing of re-bar steel.

We have filed two major cases in the replacement tire industry, seeking divestiture on the part of two major tire manufacturers. We do have a price fixing case presently under submission against two of the major automobile companies.

We have a major investigation ongoing in the oil industry. As I am sure you are aware, a major deconcentration case, if it may be called that, is presently proceeding in the Federal Trade Commission.

We are also looking toward trial of a very large case, in what I suppose would be regarded as a highly concentrated industry, the IBM case.

We have a number of other major investigations ongoing which have not yet led to litigation.

I think if you examine the figures over the past year you will find that we have shifted the emphasis somewhat into the type of conduct which has been commonly prosecuted by the criminal process. I think the figures—I do not have them right in front of me—but I think last year for the first time the statistics show that we returned more criminal indictments than civil cases, which tends to indicate that we are moving more of our resources into the question of price fixing. Some of those are local cases, and some of them are perhaps not terribly dramatic, except that I have a rather simple notion that price fixing is a crime and ought to be prosecuted. But I think that the overall caseload has been somewhat higher.

Senator PROXMIRE. Can you name one successful prosecution of a major corporation in the last 6 years?

Mr. KAUPER. You mean a criminal prosecution.

Senator PROXMIRE. Any kind of a prosecution that would get results and relief from the inflationary problem.

Mr. KAUPER. I think you can point to a number of price-fixing cases.

Senator PROXMIRE. Let us hear them.

Mr. KAUPER. I do not have a list of cases in front of me. But we have concluded a number of price-fixing cases.

Senator PROXMIRE. I see there were a number of antitrust cases pending on June 30, 1974. We come down to toilet seats and that is about the only one that seems substantial. While that is fundamental if you are going to get to the bottom of this—

Mr. KAUPER. It certainly is, I will agree with that. But in terms of major cases and major firms, we have price-fixing cases pending now involving such firms as Armco, Bethlehem, United States Gypsum.

Senator PROXMIRE. They are pending, but I mean concluded.

Mr. KAUPER. I think the list you were looking at—I thought what you gave me was a list of pending cases.

Senator PROXMIRE. I have pending cases here.

Mr. KAUPER. I would have to have a list in front of me to point to, because I do not keep a catalog in my mind.

Senator PROXMIRE. Will you put that in the record?

Mr. KAUPER. Sure.

Mr. DIRLAM. What about the Autolite cases?

Mr. KAUPER. If you want to talk in terms of merger cases, we completed a case keeping Texaco from taking over the Coastal States Refining Co. in Texas. I thought you were talking in terms of price fixing in particular. I do not have a list right in front of me, but I will be glad

to supply you with a list of cases that have been terminated in the last few years.

[The following information was subsequently supplied for the record:]

CIVIL, FISCAL 1972

- United States v. Sybron Corporation (formerly Ritter Pfaudler Corporation).*
United States v. Ford Motor Company, The Electric Autolite Company.
United States v. Eaton Yale & Towne, Inc.
United States v. Navajo Freight Lines, Inc., United Transportation Investment Co., Navajo Terminals, Inc., Garrett Freightliners, Inc., F. J. Arsenault, L. F. Mattingly.
United States v. Reynolds Metals Company.
United States v. Florida Power Corporation, Tampa Electric Company.
United States v. Combustion Engineering, Inc.
United States v. Kansas City Music Operators Association, B & G Amusement Company, B & G Cigarette Vending Company, Paramount Music Company, Inc., Charles W. Bengmina, Nicholas Evola.
United States v. International Telephone and Telegraph Corporation.
United States v. International Telephone and Telegraph Corporation, Grinnell Corporation.
United States v. International Telephone and Telegraph Corporation, The Hartford Fire Insurance Company.
United States v. Work Wear Corporation.
United States v. Asiatic Petroleum Corporation, C. H. Sprague & Son Company, Sprague Associates, Inc.
United States v. The Higbee Company.
United States v. Yoder Brothers, Inc., Yoder Brothers of California, Inc., BGA International, Inc.
United States v. Tandy Corporation, Radio Corporation.
United States v. The American Oil Company, The Atlantic Refining Company, Cities Service Oil Company, Cities Service Company, Gulf Oil Corporation, Humble Oil & Refining Company, Sinclair Refining Company, Socony Mobil Oil Company, Inc.
United States v. Tidewater Marine Service, Inc., Twenty Grand Marine Service, Inc., Tideex, Inc., Pan Marine Service, Inc.
United States v. Toro Manufacturing Corporation.
United States v. The Atlanta Real Estate Board.
United States v. The Owensboro National Bank, M. Jackson Mitchell, Raymond A. Alexander, Edward B. Curtis.
United States v. Metro Denver Concrete Association, Pre-Mix Concrete, Inc., Walt Flanagan and Company, Ready Mixed Concrete Co., Jefferson Transit Mix Co., Mobile Concrete, Inc., Suburan Reddi-Mix Co.
United States v. W. R. Grace & Co.
United States v. Jackson's Atlanta Ready Mix Concrete Company, Inc., Jackson's East Point Ready Mix Concrete Company, Inc., Citizens Bank of Hapeville.
United States v. Owens-Illinois, Incorporated.
United States v. Venice Work Vessels, Inc.
United States v. Martin Marietta Corporation.
United States v. H. K. Porter Company, Inc.
United States v. Beatrice Foods Co., Federated Dairy Farms, Inc., Ht-Land Dairyman's Association.
United States v. American Society of Civil Engineers.
United States v. Wayne Corporation.
United States v. Darling-Delaware, Inc., Herman Isacs, Inc., Lincoln Farm Products, Inc., The New Jersey Soap, Co., Inc., Pinkas-Fischer & Co., Inc., Quaker Soap Co., Inc., Rencoa, Inc., I. Schonwalter & Co., Inc., The Standard Tallo Company, Swift & Company, The Theobald Industries, Wilson Pharmaceutical & Chemical Corporation.
United States v. The Overhead Door Distributors Association of Greater Delaware Valley.
United States v. American Institute of Certified Public Accountants, Inc.
United States v. Heyward Allen Motor Company, Inc., J. Swanton Ivy, Inc., Trussell Ford, Inc., Davidson Pontiac-Buick, Inc., Clarke County Motors, Inc., Silvey Motor Company, Inc., Phillips Body and Paint Shop, Inc., Patton Broth-

ers, Inc., Carney's Body & Paint Shop, Inc., Athens Automobile Dealers Association, Independent Garage Owners of Athens.
 United States v. Washington Bancshares, Inc., Old National Bank of Washington, Oroville State Bank.
 United States v. First National Bancorporation, Inc., The Exchange National Bank of Colorado Springs.
 United States v. Trust Company of Georgia, Peachtree Bank and Trust Company.
 United States v. United Banks of Colorado, Inc., The Colorado Springs National Bank.
 United States v. White Consolidated Industries, Inc., White Motor Corporation.
 United States v. Seattle-First National Bank, First National Bank of Ferndale.
 United States v. National Bank of Georgia, Bank of Fulton County.
 United States v. First National Bank of Atlanta, First National Bank of Glenwood, First National Bank of Tucker, Alfred D. Kennedy, Emory L. Cooke.
 United States v. Interpace Corporation, Gano, Inc., Motel, Inc., Ayer, Inc.

CIVIL, FISCAL 1973

United States v. County National Bank of Bennington, Catamount National Bank.
 United States v. El Paso Natural Gas Company, Pacific Northwest Pipeline Corp.
 United States v. Associated Credit Bureaus, Inc., John L. Spafford, William B. Price, James E. Simmermon, Kenneth L. Hooper, Frank M. Blenkhorn, Walter Kurth, T. Monty Skiles, Ray Swan, Donald Sharp, William J. Welch, Jr., William Henderson.
 United States v. County National Bancorporation, Bid Bend Bank.
 United States v. First National Bancorporation, The First National Bank of Greeley.
 United States v. United Virginia Bankshares Incorporated, The Peoples National Bank of Manassas, Manassas Bank, N.A.
 United States v. Trans Texas Bancorporation, Inc., El Paso National Bank, First State Bank, Northgate National Bank of El Paso, Border City Bank.
 United States v. American Institute of Certified Public Accountants, Inc.
 United States v. Wolverine World Wide, Inc.
 United States v. The Cleveland Real Estate Board.
 United States v. Harvey Hubbell, Incorporated.
 United States v. Memphis Board of Realtors.
 United States v. Bird Corporation, Instrumentation Associates, Inc.
 United States v. T.I.M.E.-D.C. Inc.
 United States v. Long Island Board of Realtors, Inc.
 United States v. Westinghouse Electric Corporation.
 United States v. Uniroyal, Inc.
 United States v. Converse Rubber Corporation, Eltra Corporation, The B. F. Goodrich Company.
 United States v. The Wachovia Bank and Trust Company, N.A.
 United States v. The American Society of Mechanical Engineers, Inc., The National Board of Boiler and Vessel Inspectors.
 United States v. Bally Manufacturing Corporation.
 United States v. Tulsa Bottlers Association, Lake Country Beverage, Inc., Beverage Products Corporation, Coca-Cola Bottling Company of Tulsa, Inc.
 United States v. Richter Concrete Corporation, Hilltop Concrete Corporation.
 United States v. KDI Corporation, KDI Aqua Systems, Inc., JHO Dissolution Co.
 United States v. Sweetheart Bakers, Inc., The E. H. Koester Bakery Company, The Hauswald Bakery.
 United States v. The E. H. Koester Bakery Company, Schmidt Baking Company, Incorporated, The Hauswald Bakery.
 United States v. Safety First Products Corporation.
 United States v. American Ship Building, Litton Systems, Inc.
 United States v. Southeastern Peanut Association.
 United States v. Southwestern Peanut Shellers Association.
 United States v. Nissan Motor Corporation in U.S.A.
 United States v. Crane Company.
 United States v. Yellow Freight Systems, Inc.
 United States v. Los Angeles Realty Board, Los Angeles Realty Board, Southwest Branch, Hollywood-Wilshire Division, Pacific Palisades Division, Westwood Division.

United States v. The Material Handling Institute, Inc., Hoist Manufacturers Institute, The Industrial Trust Association, Rock Manufacturers Institute, Crane Manufacturers Association of America, Inc., Monorail Manufacturers Association.

United States v. Arden-Mayfair, Inc., Carnation Company, Consolidated Dairy Products Company, Foremost-McKesson, Inc.

United States v. Capital Glass & Trim Co., Dunn Glass Company, Inc., Nelson-Brantley Glass Co., Inc., Norment Glass Company, Inc., Wagon Auto Parts, Inc., Oscar Lee d/ba Lee Glass Company.

United States v. Ross Trucking, Inc., Standard Fruit and Steamship Company, Castle & Cook.

United States v. Greater Pittsburgh Board of Realtors, East Suburban Multilist Real Estate Brokers, Inc., South Hills Multilist, Inc., North Suburban Multilist, Greater Pittsburgh Multilist Council.

United States v. United Foam Corporation.

United States v. United Aircraft Corporation.

United States v. The Wachovia Corporation, Wachovia Bank & Trust Company, N.A., Bank of Granite.

United States v. Multiple Listing Service, Portland Board of Realtors, Washington County Board of Realtors, Clackamas County Board of Realtors.

United States v. Wells Fargo Bank, National Association, First Western Bank & Trust Company, Wells Fargo & Company, Worldamerica Investors Corp.

United States v. Marathon Enterprises, Inc., Sabrett Food Products Corp.

United States v. The First National Bank of Platteville, Mound City Bank.

United States v. American Television and Communications Corporation, Cox Cable Communications, Inc.

United States v. The Fort Worth National Corporation, Mutual Savings and Loan Association.

United States v. Grinnell Corporation, American District Telegraph Company, Holmes Electric Protective Company, Automatic Fire Alarm Company of Delaware.

United States v. First National Bancorporation, The Security State Bank of Sterling.

CIVIL, FISCAL 1974

United States v. Standard Oil Company of California.

United States v. Topco Associates, Inc.

United States v. Greater Buffalo Press, Incorporated, Dixie Color Printing Corporation, The International Color Printing Company, Newspaper Enterprise Association, Inc., Southwest Color Printing Corporation, The Hearst Corporation.

United States v. General Electric Company.

United States v. Wohl Shoe Company, Nordstrom's Albuquerque, Inc., Paris Shoe Stores, Penobscot Shoe Company.

United States v. Otter Tail Power Company.

United States v. Greyhound Corporation, Greyhound Lines, Inc., R. F. Shaffer, J. L. Kerrigan, F. L. Nageotte.

United States v. Crowell Collier, Macmillan, Inc.

United States v. Jackson Hole Service Station Association, Philip C. Begley, Noble A. Franzen, John Farrell Hill, Kenneth E. Gayhart, Cecil E. Lynch, James Max May, Dale R. Rhodes, Robert L. Shervin, Charles Tice, Mike G. Wilmoth.

United States v. General Dynamics Corporation, The United Electric Coal Companies, Freeman Coal Mining Corporation.

United States v. Hercules Incorporated, Mitsui Petrochemical Industries, Ltd., Mitsui Petrochemical Industries (USA) Inc.

United States v. G. Heileman Brewing Co., Inc., Associated Brewing Company.

United States v. General Cinema Corporation.

United States v. Ed. Phillips & Sons Co.

United States v. Technical Tape, Inc., Technical Tape Corporation, Steadley Company, Inc., Nachman Corporation.

United States v. The Standard Oil Company (Ohio).

United States v. Clark Mechanical Contractors, Inc., Hussung Mechanical Contractors, Inc., Paul Jeanes, Jr., Plumbing, Inc., Koenig Corporation, Raymond M. Meyer Company, Inc., James E. Smith & Sons, Inc., Coleman L. Waltrip Co. Inc., Ward Engineering Company, Inc.

- United States v. Greater Portland Convention Association, Inc., Hilton Hotels Corporation, ITT Sheraton Corporation of America, Western International Hotels Company, Cosmopolitan Investment, Inc.*
United States v. St. Petersburg Automobile Dealers Association.
United States v. A. Levy & J. Zentner Co., John H. Burrows, Inc.
United States v. Bankers Trust of South Carolina, Peoples National Bank.
United States v. Swift Instruments, Inc.
United States v. United Scientific Co., Inc.
United States v. Garage Door Manufacturers Association, Inc., Calder Manufacturing Company, The Commander Door, Inc., General Doors Corporation, Howell Manufacturing Company, Irv Snyder Doors, Inc., Ridge Nassau Corporation.
United States v. Odom Company, Anchorage Cold Storage Co., Inc., Alaska Distributors Company.
United States v. Roofing Metal and Heating Associates, Inc.
United States v. Estate Board of Metropolitan St. Louis.
United States v. Teaco, Inc., Coastal States Gas Producing Company.
United States v. Amateur Softball Association of America, Athlone Industries, Inc., H. Harwood & Sons, Inc.
United States v. Insilco Corporation.
United States v. Aviation Specialties Co., Inc., Clark's Aerial Service, Inc., Dathan Aviation Corporation Incorporated, Ralco, Inc.
United States v. The New York Times Company, New York Times Sales, Inc., Field Enterprises, Inc.
United States v. Professional Petroleum Merchants Association.
United States v. Central Michigan Gasoline Dealers Association.
United States v. Baker Commodities, Inc., Peterson Manufacturing Co., Inc.
United States v. Brownell & Co., Inc., Indian Head, Inc., Newton Line Co., Nylon Net Company, Wellington Puritan Mills, Inc.
United States v. United Parcel Service of America, Inc.
United States v. First Washington Net Factory, Inc., FNT Industries, Inc., Indian Head, Inc.
United States v. Greater Los Angeles Solid Wastes Management Association, Los Angeles Solid Wastes Management Association, San Fernando Valley Refuse Removal Association, Inc., West Los Angeles Refuse Removal Association, South Los Angeles Refuse Removal Association.
United States v. Len Harris Wholesale Meats, Inc., Blue Ribbon Meat Company, Sierra Meat & Provision Company, Inc., Silver State Meat Company, Calvin D. Hemphill d/b/a Peerless Meat Company.
United States v. Glazo Group Limited, Imperial Chemical Industries Limited.
United States v. Movielab, Inc.
United States v. Ampress Brick Company, Inc., American Brick Company, E. L. Ramm Company, Chicago Block Co., Inc., Illinois Brick Company, Heights Block, Inc., SGM Corporation, Northfield Block Co., Valley Block & Supply Company, Joliet Concrete Products, Inc., Joseph Metz & Sons, Inc.
United States v. Board of Trade of the City of Chicago, Inc.
United States v. Pacific Southwest Airlines, Air California, Inc., Westgate-California Corporation.
United States v. Combustion Engineering, Inc.
United States v. Northwest Industries, Inc., The B. F. Goodrich Company.
United States v. Colley Enterprises, Inc., d/b/a Triangle Package Stores, Jabo's Centennial Package Store, Inc., The Scotchman, Inc., d/b/a The Scotchman and The Oasis, Warehouse Cut Rate Stores, Inc., J and J Liquor Store, Billy Dicorte d/b/a Dicorte Liquor Store, Johnnie M. Fadal d/b/a Fadal's Cut Rate Liquor Store, J. B. Zeller d/b/a J. B. Zeller's Silver Dollar and J. B. Zeller's Silver Dollar No. 2.

CRIMINAL, FISCAL 1972

- United States v. Darling-Delaware, Inc., Herman Isacs, Inc., Lincoln Farm Products Corp., The New Jersey Soap Co., Inc., Pinkas-Fischer & Co., Inc., Quaker Soap Co., Inc., Rencoa, Inc., I. Schonwalter & Co., Inc., The Standard Tallo Company, Swift & Company, The Theobald Industries, Wilson Pharmaceutical & Chemical Corporation, Irving Block, Irvin Frisch, Charles L. Hausermann, Jr., Herman Isacs, III, John Lee Isacs, Robert E. Kohn, Albert Mosthof, William J. Rosenberg, Melvin M. Sachs, George J. Schaming, H. Clay Stahler, Harry Theobald.*

- United States v. Arden-Mayfair, Carnation Company, Consolidated Dairy Products Company, Foremost-McKesson, Inc., Joseph A. Witham, Jr., Henry C. Weber, Richard Izzard.*
- United States v. Air Conditioning and Refrigeration Wholesalers, Franklyn Y. Carter, Thomas E. Muir.*
- United States v. Baker Commodities, Inc., Peterson Manufacturing Co. Inc., Frank S. Jerome, Stephen F. Shultz, Robert N. Peterson, Donald E. Heddleston.*
- United States v. Richter Concrete Corporation, Hilltop Concrete Corporation, Eddie K. Wilson.*
- United States v. Independent Garage Owners of Athens, Athens Automobile Dealers Association.*
- United States v. Odom Company, Anchorage Cold Storage Co., Inc., Alaska Distributors Company, M. W. Odom, Alex Shulman.*
- United States v. Sweetheart Bakers, Inc., The E. H. Koester Bakery Company, The Hauswald Bakery.*
- United States v. Wohl Shoe Company, Nordstrom's Albuquerque, Inc., Paris Shoe Stores.*
- United States v. The E. H. Koester Bakery Company, Schmidt Baking Company Incorporated, The Hauswald Bakery, Richard Koester, John Hauswald.*
- United States v. The Overhead Door Distributors' Association of Greater Delaware Valley.*
- United States v. Frito-Lay, Inc., BFF Liquidating, Inc., Granny Goose Foods, Inc., Pet Incorporated.*

CRIMINAL, FISCAL 1973

- United States v. Manufacturers' Association of the Relocatable Building Industry, Modulux, Inc., Vinnell Steel Corporation, Speedspace Corporation, Designed Facilities Leasing Co.*
- United States v. Airfreight Transportation Corp., Air-Freight Trucking Service, Inc., Teterboro Air Freight, Henry Bono, Jr., Howard Wofsy.*
- United States v. Colley Enterprises, Inc., d/b/a Triangle Package Store, Jabo's Centennial Package Store, Inc., The Scotchman, Inc. d/b/a The Scotchman and The Oasis, Warehouse Cut Rate Stores, Inc., J and J liquor Store, G. B. Clifton, Woodrow Colley, Zelyma Dekle, Billy Dicorte d/b/a Dicorte Liquor Store, Johnnie M. Fadal d/b/a Fatal's Cut Rate Liquor Store, J. B. Zeller d/b/a J. B. Zeller's Silver Dollar and J. B. Zeller's Silver Dollar No. 2, Roy L. Power.*
- United States v. Empire Gas Corporation, Plaster, Robert W. Smith.*
- United States v. Garage Door Manufacturers Association, Inc., Calder Manufacturing Company, The Commander Door, Inc., General Doors Corporation, Howell Manufacturing Company, Irv Snyder Doors, Inc., Ridge Nassau Corporation, Calder, Jr., William H., Cain, George P., Snyder, Irv, Weinstein, Herb.*
- United States v. A. Levy & J. Zentner Co., John H. Burrows, Inc., Eugene Bell, John H. Burrows.*
- United States v. American Bakeries Company, General Host Corporation, ITT Continental Baking Company, Ward Foods, Inc.*
- United States v. Dunn Glass Company, Inc., Nelson-Brantley Glass Co., Inc., Norment Gass Company, Inc., Wagon Auto Parts, Inc., Genuine Auto Parts Co., Inc., Oscar Lee d/b/a Lee Glass Company.*
- United States v. Blue Ribbon Meat Company, Len Harris Wholesale Meats, Inc., Sierra Meat & Provision Company, Inc., Silver State Meat Company, Leonard H. Harris, Calvin D. Hemphill d/b/a Peerless Meat Company.*
- United States v. Clark Mechanical Contractors, Inc., Hussung Mechanical Contractors, Inc., Paul Jeanes, Jr., Plumbing, Inc., Koenig Corporation, Raymond M. Meyer Company, Inc., James E. Smith & Sons, Inc., Coleman L. Waltrip Co., Inc., Ward Engineering Company, Inc., Richard F. Clark, Paul Jeanes, Jr., Charles M. ("Buddy") Koenig, James E. Smith, Jr., Coleman L. Waltrip, William R. Ward.*
- United States v. St. Petersburg Automobile Dealers Association.*
- United States v. Hilton Hotels Corporation, ITT Sheraton Corporation of America, Western International Hotels Company, Cosmopolitan Investment, Inc., Greater Portland Convention Association, Inc., Ford W. Montgomery, Ross T. Bell, Jr., Basil Miaullis, Evans R. Bargmann, Murray W. McBride.*
- United States v. Colorado Milling & Elevator Company, Fisher Mills, Inc., California Milling Corporation, VWR United Corporation, J. Lawson Cook, Kenneth R. Fisher, Dugald A. McGregor.*

- United States v. Champaign Asphalt Company, Shoemaker Bridge Company, O'Neil Brothers Construction Company, LaNeil Construction Company, A. J. Walker Construction Company, J. L. Simmons & Company, Inc., Cuderson Construction Company, Inc., Neal Lentz Construction, Inc., Shappert Engineering Company, E. J. LaBanbe, Donald Walker, Lee H. Sentman, Jr., Frank M. Shappert.*
- United States v. First Washington Net Factory, Inc., FNT Industries, Inc., Indian Head, Inc., Karl Koring, Murray Grabowsky.*
- United States v. Brownell & Co., Inc., Indian Head, Inc., Newton Line Co., Nylon Net Company, Wellington Puritan Mills, Inc., Howard Losea, Robert E. O'Connell, Harry K. Babcock, William R. O'Dell, Bennie Sacharin.*
- United States v. Bayside Net & Twine Co., Inc., FNT Industries, Inc., Indian Head, Inc., Nylon Net Company, Murray Grabowsky, Bennie Sacharin.*
- United States v. Atomic Fire Equipment Co., Fire Equipment Associates, Inc., Fire Safety Co., Inc., L & L Fire Fighting Equipment Co., S. R. Smith Company, Inc., John W. Bower, Michael R. Lukich, Joseph J. Pines, Joseph V. Rattay, Harold Siebert, Lester W. Stark, Warren L. Vodak.*
- United States v. Swift Instruments, Inc.*
- United States v. The AAV Companies, ARA Services, Inc., Western Vending Machine Company.*
- United States v. Kelsey-Hayes Company, Motor Wheels Corporation, The Bud Company, Gerald E. Doherty, Anson D. Grimes.*

CRIMINAL, FISCAL 1974

- United States v. Jackson Hole Service Station Association.*
- United States v. Chas. Pfizer & Co., Inc., American Cyanamid Co., Bristol-Myers Co., John E. McKeen, Wilbur G. Malcolm, Frederick N. Schwartz.*
- United States v. General Motors Corporation, Ford Motor Company.*
- United States v. United Scientific Co., Inc.*
- United States v. Gonnella Baking Co., Torino Baking Co., Marcucci, Louis L., Marcucci, George D., Marcucci, Lawrence L.*
- United States v. Austin Steel Co., Inc., Continental Steel Company, Huffhines Steel Company, The Lofland Company, Texsteel Mfg. Co., Inc., Roger Montgomery, Allen Huffhines, Oscie H. Kirkland, Nash L. Kelley.*
- United States v. Jahncke Service, Incorporated, Jimco, Inc., Radcliff Materials, Inc., Texas Industries, Inc., Frank T. Dooley, Herbert G. Jahncke, Sr., Edward N. Lennox.*
- United States v. United Parcel Service of America, Inc.*
- United States v. American Metal Products Corporation, Dura Vent Corporation, Hart & Colley Mfg. Co., General Products Co., Inc., Metal-Fab, Inc.*
- United States v. Eagle Fuel Oil Company, Lionetti Fuel Company, Inc.*
- United States v. Combustion Engineering, Inc., American Colloid Company, Charles H. Gehret.*
- United States v. Ampress Brick Company, Inc., American Brick Company, E. L. Ramm Company, Chicago Block Co., Inc., Illinois Brick Company, Heights Block, Inc., SGM Corporation, Northfield Block Co., Valley Block and Supply Company, Joliet Concrete Products, Inc., Joseph Metz & Sons, Inc., Hale W. Olson, Robert F. Carey, Jr., James Gillstrom, Harry J. Bevigiani, Norman Lunde, Dale C. Wright, Arnold Check*
- United States v. Aviation Specialties Co., Inc., Clarke's Aerial Service, Inc., Dothan Aviation Corporation, Incorporated, Ralco, Inc.*
- United States v. Interstate Gopher News, Inc., Galveston News Agency, Inc.*
- United States v. Georgia Automatic Merchandising Council, Inc., ARA Services, Inc., Central Vending Service, Old Fashion Foods, Inc., Sands and Company, Incorporated, Servomation of Atlanta, Inc., The Macke Company of Georgia, Shamrock System, Inc., John M. Darden, III, Wade H. Dennis, George R. Oscar, Jr., Ivan D. Potts, Sheldon E. Smith, Seymour Weiss.*
- United States v. Austin Steel Co., Inc., Confederate Steel Corp., Peden Industries, Inc., Whitlow Steel Company, Inc., Royal Alexander, Lewis Tubb, Ivan B. Nevill, Jr.*
- United States v. R & G Sloane Manufacturing Company, Inc., The Susquehanna Corporation, Celanese Corporation, Borg-Warner Corporation, Plastiline, Incorporated, Glenn Sloane, Thomas L. Rourke.*
- United States v. Rainbo Baking Company of Phoenix, Rainbo Baking Company of Tucson, Holsum Bakery, Inc., Baird's Bread Company, C. J. Patterson Com-*

pany, I. H. Dailey, Virgil L. Glaze, Clark Rorbach, L. E. Eisele, Jr., Roland W. Baird, Jr., Arnold Guiner.

Senator PROXMIRE. Congressman Conable.

SIZE OF THE ANTITRUST DIVISION'S BUDGET

Representative CONABLE. Could you tell me something about the Antitrust Division's budget in recent years? What is happening to staffing?

Mr. KAUPER. The Antitrust Division has been running its fully authorized staff positions, so we are not talking about a shortfall over our authorized budget division. The budget of the Division has remained essentially stable over, I guess, the last 4 or 5 years. In fact, I think the figures would show that in terms of the number of authorized positions, the budget has been less than it was in 1950. We have pending now, I think, before the Senate Appropriations Committee a request for a rather substantial increase which would add approximately 83 positions, and I think somewhere around 50 of those are professional positions. So that we are seeking increases at the moment in order to make some of these programs somewhat more effective.

But I think it is true that the Division's budget has over the past 4½ years remained relatively stable, although that has been stability at a level well above what it was, for example, in the late fifties and early sixties when there were substantial cutbacks.

Representative CONABLE. How does the budget and staffing of your Division compare to other Justice Department divisions?

Mr. KAUPER. I am not an expert on the total Justice Department budget. But I think among the litigating divisions we are probably now the largest. Some others are close, but I think we are the largest. That includes, of course, our seven field offices.

Representative CONABLE. To summarize, then, your budget has been normal, it has been flat. But it has not been reduced in any substantial way?

Mr. KAUPER. That is right. It has not been reduced in recent years.

Representative CONABLE. Your staffing has been at an authorized level that was consistent with the kind of activity you were having; is that right?

Mr. KAUPER. Yes, although I think in the past year or year and a half we have begun to feel a very heavy push, because we have a number of major cases now heading into litigation. The *IBM* case, the tire cases, and the cases we have in the gypsum industry, all appear to be headed for trial. So we have a very heavy trial burden at the moment.

Representative CONABLE. Thank you, Mr. Vice Chairman. I am sorry to interrupt.

Senator PROXMIRE. That is all right.

If you use the Pentagon's formula of computing real costs and real prices, you have suffered about a 30-percent cut?

Mr. KAUPER. Yes.

Senator PROXMIRE. You have considered the changes since 1958, and you say your staff has been about the same since then.

On this list of antitrust cases the only one I find in the oil industry is the *Phillips* case that goes back to 1966, 8 years ago. The attorney gen-

eral of the State of New York has a number of cases against the oil and gas industry. Why are you not doing more?

Mr. KAUPER. Mr. Vice Chairman, we are trying to do a number of things. We do have an investigation into the question of shortage. As I indicated, we have recently successfully terminated a case against Texaco involving the acquisition of Coastal States, a large independent refinery in Texas. But I think we have to recognize that, in the oil industry, what has been viewed as the major case is being conducted by the Federal Trade Commission. I do not want to be in a position of commenting on that case other than to say that we are trying to structure what we are doing so that we do not interfere with the FTC proceeding, which I think is terribly important.

Senator PROXMIRE. You are well aware, I am sure, of former President Nixon's hostile attitude toward enforcement of the antitrust laws and the steps he took to undermine enforcement.

Do you want me to document it?

Representative CONABLE. No; but I am not sure that he is willing to assent to that fully.

Senator PROXMIRE. Let me complete my question and see.

Unfortunately, that attitude is shared by several members of the present administration, most notably by OMB Director Roy Ash, who believes that the present laws ought to be scrapped. In your opinion, does this kind of hostility from high Government officials hurt or retard antitrust enforcement and does it have a harmful effect on the morale within your agency?

Mr. KAUPER. You put a couple of questions together there.

I do not think that the attitude, which I take it is the evidence which you find in the released tapes, among other things—

Senator PROXMIRE. That is right.

Mr. KAUPER [continuing]. Has affected our operations particularly. I do not think, among other things, it was ever really communicated.

Senator PROXMIRE. It must have been communicated to McLaren.

Mr. KAUPER. I was about to give you my own experience, Mr. Vice Chairman, which is perhaps influenced by the timing of when I came. I told others that I had been the loneliest man in Washington, and I think that probably is true. This kind of communication has not come down. I am not sure that one can really interpret it as that much of a hostility toward the antitrust enforcement. There were remarks made as to particular matters. Mr. Ash's statement, as I understand it, was a call for a review of overall antitrust policy. I have not interpreted that, and I do not think the Department has interpreted it, in such a way as to have a particular negative effect on antitrust enforcement.

So far as the morale of the staff of the Antitrust Division, I suppose if I were honest I would have to say that it has a rather perverse effect; yes.

Senator PROXMIRE. That is good to hear.

Mr. KAUPER. Probably it tends to be viewed as something of a badge of honor.

Senator PROXMIRE. Has President Ford done anything or said anything to you personally to encourage you to believe that there is no longer any White House hostility toward antitrust enforcement?

Mr. KAUPER. No, he has not said anything to me one way or the other.

Senator PROXMIRE. My time is up.

I will be back.

Congressman Conable.

Representative CONABLE. As far as you are concerned, the operation of your Division has been normal, and has been pressed with vigor; is that not correct?

Mr. KAUFER. Oh, yes.

CONCENTRATION IN THE FOOD INDUSTRY

Representative CONABLE. Now, what about concentration in the food industry? That is a matter of some concern. We obviously have a market economy for farmers and not for consumers. Is there anything going forward there?

Mr. KAUFER. So far as concentration in the food industry in general, I think most of us have noted concentration at the farm level, at least among farmers themselves, does not appear to be that great, although there is a growing concern over the situation of many of the Nation's farmer cooperatives, which can all at some point achieve a level of concentration in local markets which is considerable.

Representative CONABLE. Excuse me. May I interrupt there? Is that not an effort by the farmers to generate some competition to the big foodpackers so that they can have some access to markets? If the farmers had their way, would they not want to have a market in processed food as well as in farm commodities generally?

Mr. KAUFER. I would suppose so. My only point is that there is a danger that the farm cooperatives, just as any organization, can attain a monopoly in whatever industry one is talking about. As you know, we have been pressing three cases against the Nation's three largest milk cooperatives. There has been a concern about the kind of power which they may currently have, as well as a concern about how that power was obtained.

Representative CONABLE. There are some special privileges relating to farm cooperatively, are there not, that excludes them from the antitrust laws?

Mr. KAUFER. The Capper-Volstead Act does provide certain exemptions from the antitrust laws for agricultural cooperatives.

Representative CONABLE. As a matter of fact, if you applied the antitrust laws directly to farm cooperatives it would be impossible for farmers to try to stand up to the food processors they deal with; would it not?

Mr. KAUFER. I do not mean to say that you should not be concerned that farmers would not be able to negotiate or bargain. The law permits that. I was simply trying to catalog where there might be some concentration. I think there is at least some degree of concentration in some processing lines—not for the most part as high as we have in some other basic industries, but it does exist in some.

Representative CONABLE. May I ask you, though, is it not true that the farm cooperatives represent a tiny portion of the food processing business?

Mr. KAUFER. Oh, yes. And when I say food cooperatives—

Representative CONABLE. I am concerned about this, because you immediately start talking about price fixing with farm cooperatives, and I think they are a tiny portion of the total problem.

Mr. KAUPER. I guess I was starting at the bottom and working my way up.

Representative CONABLE. I want to be sure that that is what you are doing.

Mr. KAUPER. So far as the retailing of the foods are concerned, of course, you are talking about concentration at a somewhat different level, because retailing is a peculiarly local activity. In some local markets, we have a high degree of concentration in food marketing, and in others we did not. So I think you cannot generalize in terms of food marketing as such on a nationwide basis. There really is no nationwide retail market for food as such.

Therefore, when one talks about the effects of concentration in the food market, or the food business as such, while there are perhaps some processing areas where we have a significant degree of concentration, we are not talking about the kind of concentration generally which is used by economists to support the proposition that concentrated industries behave necessarily in an anticompetitive manner, at least not as a general proposition. I do not think one can make the kinds of generalizations about food processing that at least some economists try to do with some other industry.

STEEL AND IMPORTS

Representative CONABLE. Professor Dirlam, I am interested in your comments about the steel industry. As a member of the Ways and Means Committee I have been aware of pressure from the steel industry, and trade generally, and I quite acknowledge that they are one of the most protectionist elements in our economy. I understand that your interest in that is based primarily on the feeling that steel is much more important as material, as a basic material, than the other metals. Are the facts that you have brought forth in your very interesting statement peculiar to the steel industry, or can they be paralleled to some extent in the other metals, aluminum and copper, for instance? And let me ask you if steel is subject to the same cartel threat that some of the other basic materials are, because of their origins in a limited number of countries?

Mr. DIRLAM. As far as that final question is concerned, no. Obviously, there are many sources at least for fabricated and basic steel. Perhaps the sources for iron ore are somewhat more limited, as some of the steel producing countries like Japan realize. But what the domestic steel industry has attempted to do, it seems to me, by excluding imports, or attempting to limit them severely, is to set up the basis for what amounts to a domestic cartel, that is, a shelter within which they can function pretty much as they have been accustomed to in the past, during the period when they did not have to worry about import competition, that is, prior to 1959.

Representative CONABLE. Are there peculiar problems with the steel industry in the extensive nationalization of other steel industries which permit some subsidization of imports into this country or dumping on the world market below a cost because of tax subsidy? Is that an aggravation of the international trade in steel that might be somewhat a mitigating factor in the effort to set up quotas?

Mr. DIRLAM. I think that to the extent that there is dumping, that is, to the extent that steel is actually being sold here at prices less than

it is being sold in the country of origin, then recourse should be had to the normal antidumping procedures. And certainly, I am not in favor of dumping. Competition should be on a fair basis.

Representative CONABLE. But is there not a degree of subsidy implicit in nationalized steel generally?

Mr. DIRLAM. One would have to examine each particular steel industry in some detail to determine whether or not there was a subsidy, and second, perhaps more important from our standpoint, to know whether it is the nationalized steel which has provided the most intense competition for our own. I think, generalizing from what little I do know about some of the dumping cases, and some of the steel which has provided the most severe competition for our own, it has come from countries where there was no nationalization, such as Belgium and Japan. I think that these two countries perhaps have caused more worry to domestic producers than some of the others. And, of course, in France the industry is not nationalized. The British steel industry is nationalized, but it has never been much of a threat to American industry because it is so inefficient. The British steel productivity level is about half of our own per man-hour.

Representative CONABLE. As I recall, we used to have a situation in the steel industry where the largest, United States Steel, was twice as big as the next, which was twice as big as the next, which was twice as big as the next, and so forth. Does that still obtain? Is that still the condition?

Mr. DIRLAM. That ratio has declined to some extent. United States Steel now has about 23 or 24 percent of total shipments. And the next largest, Bethlehem, has 14 or 15 percent. The proportion of United States Steel to the next largest has declined.

Representative CONABLE. This is the reason that you feel that price leadership is so easily achieved in the steel industry, is that right, because of this degree of size disparity in American steel industry?

Mr. DIRLAM. I think price leadership is accounted for by perhaps several factors. In the first place, during the period that United States Steel was so dominant, it set the stage for the institutions for introducing price leadership, which then became habit in the industry. Eventually the industry followed the same procedures, even though United States Steel did not have the dominating power that it did prior to World War II, let us say. Beginning in 1962, of course, with the confrontation between President Kennedy and United States Steel, the industry, instead of following a pattern of having usually United States Steel and sometimes some other company which was a leader in a particular product always make the price change, the industry adopted the so-called selective price leadership system by which from time to time one of the small firms was given the option of increasing prices. But the pattern is that essentially one firm announcing an increase and the others following remains pretty much the same. Since the industry feels pretty much closely knit, the policy has remained much the same.

There is a little indication that Bethlehem wants to be regarded as the leader, and there have been a couple of instances in the past 3 or 4 years where Bethlehem has taken the bit into its teeth and actually challenged United States Steel. But these are exceptions.

Representative CONABLE. I want to thank you for your statement. It is very helpful. I am really quite interested in it.

Mr. DIRLAM. Thank you.

Senator PROXMIRE. I would like to follow up on that.

According to Armco Steel's own research bulletin, shortages of steel worldwide will disappear in the next year or two. The steel industry economists point out that much of the demand for steel is the result of increased steel inventories which have been held by consumers of steel-mill products. In the light of their own numbers, does it make sense to raise prices as they are doing today? The Wall Street Journal as you may have noticed, reported this morning—after you had prepared your prepared statement for us, and after you had indicated, as I understand in your prepared statement, that the steel industry would not raise prices again this year—it reported this morning that Bethlehem Steel and several other steelmakers have joined in raising prices on some types of steel by as much as 10 percent. I guess they must have done that this last Friday. Would you comment on that action, Mr. Dirlam?

Mr. DIRLAM. I am happy that I covered myself in my prepared statement by saying that United States Steel had announced that it would no longer increase prices this year. I did not forecast that the industry would not.

Senator PROXMIRE. Do you stand on your prepared statement in view of this increase by much of the rest of the steel industry?

Mr. DIRLAM. As I read this particular increase by Bethlehem, it represents a reversal of a discount that Bethlehem itself had taken earlier in the year, and hence, may simply mean that Bethlehem is now coming up to United States Steel's level. I normally keep a chronology of each price increase that goes on. Unfortunately, I was not in the country in July, so that I do not know the circumstances. I would imagine, however, that this does represent no more than Bethlehem's coming up with the current level. I would not anticipate that United States Steel would also go ahead with structural price increases.

Senator PROXMIRE. Do you think that these increases that we have had, this latest increase that we have, will result in steel finding itself behind the other steel-producing nations, and will again ask for import quotas?

Mr. DIRLAM. I think that the industry is presently asking for import quotas, and will continue to press for them.

With regard to this question of capacity and demand, I would be very skeptical of a diminution of world demand within the next year or so. If it occurs, however, there is no indication from past behavior that the U.S. steel industry is going to cut prices.

Finally—and I just touched on this in my oral presentation—the U.S. steel industry, having lost its export market after 1959, has seemed to be somewhat loathe to go out and compete in world markets even in situations where the prices are extremely favorable, as they are now in Europe. Our exports have risen in 1973 above 1972, but they are still at a very low level, they are only about 5 million tons.

Senator PROXMIRE. What shocks me is that you have this perfectly enormous price increase. I went back, and I could not find a year in which you had a price increase of more than 22 percent, and that was in 1946 or 1947, right after World War II. But this year, there is

a 40-percent price increase. You have that tremendous increase which you could argue, someone might theoretically argue, is because demand is sucking up the price. Yet, when you look at the production, it is less this year, less in the 12 months ending August of this year, than it was last year, greater capacity, but less production. They argue that to some extent this was because they had semifinished steel available last year, but that does not ring much of a bell with me.

Mr. DIRLAM. Shipments last year were high because the producers were drawing down inventory by about 4 million tons. This enabled them to reach a record level on shipments. They say they cannot draw down their inventories any longer, hence, shipments—

Senator PROXMIRE. Do they not have more capacity now?

Mr. DIRLAM. Capacity should have gone up this year. They claim, however, that they were running at such a high rate last year that they now have to shut down for maintenance.

Senator PROXMIRE. Supposing there was successful antitrust enforcement, and supposing the Antitrust Division was able to break up the vertical integration of the steel companies, do you believe that this would result in lower prices and more efficient production or not?

Mr. DIRLAM. I think that a horizontal disintegration would be beneficial—whether there should be vertical disintegration too I am not so sure. But it probably would help.

Senator PROXMIRE. But you have no doubt about horizontal—

Mr. DIRLAM. Beginning with United States Steel, which has announced, I would say, perhaps seven times since 1938 that it was engaging in a full-scale reorganization to improve its efficiency—each time these reorganizations were announced we are assured that they are going to cut the 18 levels through which investment proposals have to pass but they get to the top level management. It is perfectly obvious that United States Steel is not efficient, otherwise it would not need to be reorganized so often.

So, if we could divide it in separate plants, probably we would increase its efficiency. Whether we would increase its competitiveness would depend on the subsequent behavior of those units. While I am far from having a complete confidence in the relationship between structure and behavior, it does seem to me that this would set up a condition in which you might have more mavericks and independent action in the industry.

Senator PROXMIRE. On the basis of the enormous worldwide demand for steel and the failure to expand production this year when it appears likely capacity has been increased, it seems to me there is almost a prima facie case that they achieved this colossal price increase on the basis of some kind of concerted action, whether you call it conspiracy or not may be something else.

Let me ask you this, Mr. Kauper. Many people charge that antitrust has been a dismal failure, that with a few exceptions the giant corporations have been left alone, that if legal bottlenecks do not defeat efforts at enforcement, political pressures will, and that in effect, the Antitrust Division has become an ally and a protector of the largest corporations in the most concentrated industries. What is your response to these charges? What is your answer to the critics who have been saying for years that antitrust is a charade?

EFFECTIVENESS OF ANTITRUST ACTION

Mr. KAUPER. I think in large part whether you think it is effective or whether you think it is ineffective depends on what you think it is capable of accomplishing. Obviously, if one believes that the antitrust laws should achieve a major deconcentration of American industry, then one would have to say they have not been successful. On the other hand, it seems to me that one can argue quite plausibly that the kind of vigilance which has been exerted since 1950, with the amendments to section 7 of the Clayton Act, has been highly successful in preventing additional concentration. That weapon really did not exist prior to that time. In addition, I think that antitrust enforcement has been quite successful in dealing with some kinds of price fixing. Granted, it has to be shown that there was some kind of conspiratorial, collusive behavior. That kind of evidence is not always easily come by. The evidentiary rules may make prosecution of some of these cases rather difficult. But I have no question in my own mind that antitrust enforcement has been successful in a number of things it was designed to do. I think the real disagreement, perhaps, is on the question of what should it be designed to do.

Senator PROXMIRE. The best evidence that antitrust has been ineffective in the past is that your Agency has not in the past gone after the industrial giants in such areas as automobiles, steel, chemicals, drugs, and energy. What is your explanation of the Antitrust Division's ineffectiveness?

Mr. KAUPER. I do not agree that they have been ineffective. We have cases pending in virtually all of these industries that you have just listed. There is no immunity for a major corporation.

Senator PROXMIRE. I have given these examples of these perfectly enormous increases in prices in steel and oil and nonferrous metals, they have just gone right through the roof, and in almost every case they are producing less than they were last year. You cannot explain it on the basis of demand. And you certainly cannot explain it on the basis of cost.

Mr. KAUPER. I am not sure, Senator, that that is the result of an antitrust violation. It seems to me that that is a conclusion you are coming to. That, of course, is a matter of proof as to whether or not there has been that kind of violation or not. We have investigations in a number of these areas. And whether we are going to find that this is a result of price fixing is quite a different question; we cannot simply indict on the basis of a degree of suspicion, obviously. We do have cases pending, in one form or another, some of them price fixing cases, in many of those industries. Some of them have been lost. The case against the major drug manufacturers of tetracycline was lost; the case was brought, but it was lost.

The same is true with the case brought against General Motors and Ford. It resulted in acquittal by a jury.

These are not easy cases to bring and they are hard to win. But I do not agree with the proposition that somehow these companies are immune. That is just not the case. I think it is true that some of these companies are undoubtedly more sophisticated than others. This does not necessarily mean that all companies are engaged in price fixing. A lot of companies are well counseled, and they understand exactly what the law is. It is not surprising to me that some of these companies do

not engage in the kind of violations that perhaps some smaller, less well-counseled companies do engage in.

Senator PROXMIRE. What you are saying is that they have got lawyers who are smart enough to get their conspiracies around the law—we clumsy fellows in Congress have made the law, and they are able to work out a system that is technically legal, and yet they are able to rig prices at a level which is hard to justify and seems to be highly inflationary?

Mr. KAUPER. Senator, that is not quite what I said. What I said was that they comply with the law. Some of them obviously do not. We did return indictments several weeks ago against the major chemical companies with respect to analine dyes. But I think my point was that what you are referring to as a rigging of prices may not be what legally is viewed as a conspiracy to raise prices.

Senator PROXMIRE. No doubt about that.

Mr. KAUPER. If that is so, then it seems to me we really are coming back to the subject of these hearings, which is the question of administered pricing, and whether or not this kind of pricing is the necessary result of the structure of a particular industry, or whether it is carried out in some other way.

Senator PROXMIRE. Let's get back to whether or not we might change the law to make it possible to act against price behavior which is obviously against the public interest.

Mr. KAUPER. I think that is really the question.

Senator PROXMIRE. But which is not arrived at by the present law. Congressman Conable.

Representative CONABLE. I understand a lot of your dilemmas in antitrust, Mr. Kauper. Of course, the end product of competition is monopoly. You cannot just suppose that successful competition will eventually result in the elimination of the unsuccessful competitor. You cannot just go after these people because they happen to be survivors. How much of your time is directed toward the problems of conglomeration as opposed to the problems of concentration?

Mr. KAUPER. Do you want to define conglomeration? Do you mean total size?

Representative CONABLE. An accumulation of economic power in some unrelated field through merger rather than in a related field.

Mr. KAUPER. The major area of concern in which that directly interests us is in the merger area, where we do spend a good deal of time worrying about mergers that can be put into that kind of category, although they may have demonstrable market impact. I would suppose that the bulk of the mergers we look at today are not straight horizontal mergers. I do not think you will find that with the possible exception of a firm that is virtually on the verge of bankruptcy, you do not find direct mergers between major competitors any more. I think that is the result of the amendment of section 7 of the Clayton Act of 1950.

Representative CONABLE. Do you concern yourself with the use of the corporate divisions of a conglomerate, where administered prices are possible, to increase the profit margin so that they can subsidize competitive areas for the purpose of driving out competition in the competitive areas?

Mr. KAUPER. Yes, this is frequently an observed pattern of conduct. Obviously, in part you may be talking about the Robinson-Patman Act, which is largely enforced by the Federal Trade Commission. But in

addition to that, you may find the use of a particular profitable line to, in one way or another, serve as a war chest for the takeover of some other line. I do not think it occurs commonly, but it certainly is possible.

Representative CONABLE. Have you concerned yourself at all with the acquisition of Marcor by Mobil Oil?

Mr. KAUPER. Yes, we have a pending investigation.

Representative CONABLE. I am somewhat sympathetic to Mobil Oil in one way. It may be that they are unable to plow back the very substantial increased profits they are making in oil into oil as long as there are shortages of drilling materials and things of that sort, and yet they do not want to put it out in increased dividends to their stockholders, or they will get in trouble on that, so what is left for them? They can go ahead and conglomerate. On the other hand, I think this is something that the Congress must concern itself with generally, where we are hopeful that increased cash flow will go back into an expansion of the supply of petroleum. So I am glad to hear that you are making some investigation of that.

Mr. KAUPER. You have raised an interesting question. It may be that acquisitions of that type raise some kinds of questions that I am not really sure can fairly be characterized as antitrust questions. If there is a Federal policy in favor of where particular earnings are to be put, it seems to me that is not really directly an antitrust issue.

Representative CONABLE. We have been trying to deal with that in the Ways and Means Committee, but we have got into an internal struggle in the House which makes it impossible to get the bill over to the Senate here.

You are right, there is a serious question that antitrust applies here. I am not sure what the directions to the Antitrust Division are relating to conglomeration in particular. That is a matter of some interest to me.

I guess that is all.

IBM CASE

Senator PROXMIRE. The International Business Machine case is an example of the failure of antitrust. The Government filed its suit 4 years ago, and you are still in the pretrial stage. I understand that one of the problems there has been that you have to examine about 40 million documents turned over to the Government by IBM.

I also understand that when Control Data Corp. settled its civil suit against IBM, part of the settlement was Control Data's agreement to destroy an index that it constructed of the 40 million documents. Can you tell us whether the Antitrust Division was successful in getting Control Data to turn over the index to the Government, and why the Government was not able to make its own index of the evidence?

Mr. KAUPER. Mr. Vice Chairman, I think I am going to have to not answer that question. I am under an outstanding pretrial order in that case which prohibits me from making any public comment on it. I would be glad to discuss some parts of it with you individually. But I think I ought not, given the court's pretrial order, make any comment on it.

Senator PROXMIRE. All right, that is fair enough.

Will you get the pretrial order for us—that is a public document—so that we can make it a part of the record?

Mr. KAUPER. I would be glad to.
[The following information was subsequently supplied for the record:]

United States District Court, Southern District of New York

69 Civ. 200

UNITED STATES OF AMERICA, PLAINTIFF

v.

INTERNATIONAL BUSINESS MACHINES CORPORATION, DEFENDANT

PRETRIAL ORDER NO. 4 AS AMENDED

The parties having been heard and the Court being duly advised, in the interest of justice and accurate, objective, dispassionate and fair comment and news reporting of the proceedings in this action, it is hereby

ORDERED that plaintiff and defendant are restricted from disseminating news of any proceedings before this Court or of any matters relating to this action by press release, press conference or interview with the press without the consent of the Court, except insofar as it is necessary to keep the public informed as to the progress of the case, as to the scheduling of proceedings before the Court and the existence of documents and transcripts on file with the Court, and except as convenience may suggest that quoting from the record is appropriate.

All proceedings before this Court in this action, unless otherwise ordered upon written motion for good cause shown, shall be open to any member of the news media and any member of the public. All information emanating from such proceedings shall be obtained by representatives of the press or by the public by attendance at such proceedings or from the documents and transcripts of the proceedings on file in the office of the Clerk of this Court.

Plaintiff and defendant may make available to the press or to the public a copy of any document, or permit the inspection of any transcript, which is on file with this Court, and may advise the press or public of the existence of such materials, but are prohibited from commenting on or characterizing such documents or transcripts, or the information contained therein, without the permission of the Court. It is the intent of this provision that the documents and transcripts on file in the office of the Clerk of this Court shall speak for themselves with respect to all proceedings in this action, and it is also the intent of this provision that neither party shall initiate contacts with the press or volunteer information with respect to this action, except insofar as it may be necessary to keep the public informed as to the progress of the case, the scheduling of proceedings before the Court and the existence of documents and transcripts on file with the Court, and except as convenience may suggest that quoting from the record is appropriate.

Except in unusual circumstances, it shall be the responsibility of each party to file with the Clerk of the Court an agenda of the principal matters it intends to discuss at any scheduled pretrial conference. With respect to deposition notices, the parties shall periodically file with the Clerk of the Court a list of persons they expect to depose in the forthcoming period. A telephone contact shall be designated by Department of Justice and by IBM, from whom any representative of the press may obtain answers to question as to deposition schedules and schedule changes, and places of such depositions.

The provisions and prohibitions of this Order shall apply to all persons who have responsibility for, or who are in any way involved in, the handling of this action, including all potential witnesses employed by either party and all consultants employed by either party.

It is further provided that nothing contained herein shall prohibit the disclosure of any information required to be disclosed pursuant to the provisions of the Freedom of Information Act (5 U.S.C. Section 552).

OCTOBER 16, 1972.

DAVID N. EDELSTEIN,
Chief Judge.

SALE TO LOCKHEED OF SURPLUS PLANT

Senator PROXMIRE. Earlier this year I made a Senate speech in which I said that the sale of Air Force Plant No. 14 to Lockheed Aircraft Corp. was improper and possibly in violation of the antitrust laws. Lockheed was the only firm allowed to bid for a very valuable property in a sale which was repeatedly objected to by the Justice Department on grounds that it would increase concentration in the aircraft industry and tend to be inconsistent with the antitrust laws. In March I wrote to Attorney General Saxbe asking him to investigate the sale and set it aside if that was the proper action to take. My question is, why did not the Antitrust Division move against the sale to prevent it from being consummated?

Mr. KAUPER. You are talking about the surplus property disposal?

Senator PROXMIRE. Yes, sir.

Mr. KAUPER. It is not clear to me we could move against it, Senator, because of the form of the acquisition. The acquisition was made from the Federal Government. Section 7 of the Clayton Act does not apply to acquisitions from the Federal Government. We did object on antitrust policy grounds, as I think you are aware.

Senator PROXMIRE. If you object on antitrust grounds, why can you not move on antitrust grounds?

Mr. KAUPER. We objected on antitrust policy grounds.

Senator PROXMIRE. What does that mean?

Mr. KAUPER. The statute requires us to give antitrust policy advice to the Administrator of GSA, which we did. That policy, it seems to me, is a procompetitive policy. We are not required to, nor did we, conclude that the proposed acquisition would violate a particular antitrust statute. That is the posture of it. I have not reviewed that record before coming up here.

Senator PROXMIRE. Let me read to you what the Attorney General said with respect to the sale: "Would increased concentration in the aircraft industry, and, therefore, such sale would tend to create or maintain a situation inconsistent with the antitrust laws."

He did not say it was a bad policy; he said it was inconsistent with the law.

Mr. KAUPER. I am familiar with that. When we say inconsistent, this is the same advice we give in other circumstances. I am simply suggesting to you that the statement which was made was in terms of what we normally think of antitrust policy as being. So far as section 7 of the Clayton Act is concerned, it is concerned only with acquiring all or part of the assets from any corporation engaged in commerce. The Federal Government is not a corporation engaged in commerce.

Representative CONABLE. What you are saying, then, is that it is bad policy, but not illegal under that section of the Clayton Act which exempts acquisitions from the Federal Government from illegality; is that right?

Mr. KAUPER. We certainly did not think it was wise policy; that is correct.

Representative CONABLE. And, therefore, you objected as a matter of policy, but had no legal ground on which to follow up your objection; is that correct?

Mr. KAUPER. I think given the approval of the GSA administrator under that statute, and because of the fact that section 7 applies only

to acquisitions from corporate concerns, we could not proceed under section 7.

Senator PROXMIRE. My question is, what have you done since March when I wrote to the Attorney General and asked for an investigation, and asked that it be set aside if that was the proper action to take?

Mr. KAUPER. Senator, we investigated that matter at great length. We have had a number of letters prior to these letters. We know what the issues are, but we do not have authority to set that sale aside as far as I know. At least, I am not aware of any such authority in terms of the Antitrust Division.

Senator PROXMIRE. We did not get a response on this. That is why I wanted to know.

Mr. KAUPER. Have you not had a response to that letter, Senator?

Senator PROXMIRE. Not a final response; no, sir.

Mr. Buzhardt, the General Counsel of the Defense Department in 1970, said the following:

We are of the opinion that there is no existing disposal authority that is adequate to support a defense program that seeks to dispose of Government-owned industry equipment on a negotiated basis to the contractor who is in possession of the property, and in whose plant the property is located.

He indicated that there is no legal basis.

Mr. KAUPER. Let me make clear what I am saying in terms of the Antitrust Division.

It seems to me you are now raising a somewhat different issue, which is whether there is legal authority under the Surplus Disposal Act to dispose of this property on this sale basis at all. That is not really an antitrust issue. I cannot tell you what has occurred with that. That was not a problem which would normally have been ours. I can inquire as to what the status of your letter to General Saxbe is.

Senator PROXMIRE. I understand that you have previously stated that you believe that you do not have the resources to invest in a full-scale investigation of the international petroleum industry. Yet, you devoted a large part of your staff to such matters as the wooden toilet seat conspiracy and the mink cartel. How do you justify that allocation of resources?

Mr. KAUPER. I do not believe, Senator; that I made the statement that we did not have the resources to investigate it.

Senator PROXMIRE. Not this morning you have not, but you have previously stated it.

Mr. KAUPER. We have put a substantial amount of resources into that, and that investigation is ongoing. I would not think I would say to you that we do not have that kind of resources. We are pooling our resources on it now.

In terms of resources expended on other cases, Senator, I have what I suppose has to be characterized as a rather simple-minded view that price fixing is a crime. If we are informed that price fixing has occurred we will prosecute in those cases. That is true whether you are talking about toilet seats or any other product. Many of these cases do not call for the expenditure of a great deal of resources, and yet there is a considerable beneficial impact from those prosecutions. We do bring them, and we will continue to bring them, even though they do require some resources.

Senator PROXMIRE. All that is true. But you see, my problem is that with the staff that has not grown in 25 years, it seems to me that you are going after things that are relatively peanuts compared to the big operations that really affect the economy, and especially now when we have such a very, very serious inflation problem.

Mr. KAUPER. I think that judgment rests on some notion of how we allocate resources. In terms of the resources which we are allocating now, most of those resources, I think, are in major industries. The problem that we have, Senator—it is an acute problem for any law enforcement agency—is what one does when competitor *x* comes in the front door, and he asks to see a lawyer, and he says, here is the evidence of price fixing, and now what do you do? You say to him, I am sorry, our resources are not geared to consider that. I do not think we can ignore those situations.

Senator PROXMIRE. That is a very revealing response. I do not mean to be critical of you at all. But it indicates a problem that, we have in this society and in this Government when you have an industry in which you have got competitors that are likely to do that who come in the front door and say, we have this problem and we want and expect action. But, where you have an industry like steel or some of these others, where you have a most complacent operation, where everybody is taken care of, and everybody gets their cuts, and the little consumer is the one that ultimately gets hurt, you are less likely to get a complaint from a member of that industry.

Mr. KAUPER. I have deliberately used the illustration of a competitor and not a customer, because a competitor is usually a disgruntled member of the industry, and he comes in with some evidence. I was deliberately trying to use one in which it was not a question of our devoting resources to do investigation. The evidence walks in the front door, typically in the firm of a participant. We will continue to bring those cases.

Now, as to whether we are looking for price fixing in those areas, whether we will gear up our resources to search for price fixing in the case of, to use your example, toilet seats, the answer is no. Those are not the major areas we are examining on our own initiative. But those cases do arise, and they will continue to arise.

Senator PROXMIRE. About half of your statement concerns regulatory agencies of the Federal and State Governments. We are concerned about these kinds of anticompetitive practices too, but do you not agree that your primary responsibility should be to enforce the criminal provisions of the antitrust laws, and does it not dilute your resources even further to spread them out into regulatory policy? Or is this a way for the Antitrust Division to look busy without doing its main job?

Mr. KAUPER. It does, I suppose, use our resources to some degree. I do not agree that it is simply to make us look busy. I think we have accomplished a great deal, and we will continue to put on resources on the regulatory front. There is at the moment really no voice for competition appearing before those agencies. I think it is very important that a voice for competition be heard. The Department has had a major role, for example, with respect to the issue of fixed stock commission rates. We have had a major role before the FCC with respect to telephone services, as well as a variety of other things which it seems to me as equally important to the American consumer.

Senator PROXMIRE. If we can pass this consumer advocate law, perhaps we can provide some of that.

STRENGTHENING THE ANTITRUST LAWS

You have recently been quoted, Mr. Kauper, as saying that you would like to see a tightening of the antitrust laws and increased penalties for their violation. Your statement today does not indicate a great deal on this. Would you spell out how you would change the law and why you believe stiff penalties are necessary?

Mr. KAUPER. I think the question of penalties is the immediate issue. Really, we have reached a point where—when the maximum fine to a corporation is \$50,000—you are talking about a very small license to steal. I think it is imperative that that fine be increased.

Senator PROXMIRE. Incidentally, you might be interested to know that when I asked Mr. Burns, the Chairman of the Federal Reserve Board, about this, he was with you 100 percent, he thought penalties ought to be sharply increased. He said, this is a slap on the wrist, it is ridiculous to expect to enforce antitrust laws with penalties that are that feeble.

Mr. KAUPER. I think that is true. Of course, the monetary fine is the only penalty we can impose on the corporation as such. Now, we can put officials in jail, and we have had jail sentences this year in some cases. But the fact of the matter is that, to really deter the corporate defendant, the fine must be more substantial.

Now, it is also true that we do have another significant deterrent. In any discussion of penalties you do have to keep in mind that there is a treble damage deterrent which can be very considerable. Whenever I talk with lawyers I discover that the major fear is not that the corporation will be sued and convicted by the Government, but rather that they will be sued for treble damages.

Senator PROXMIRE. What would you do to change the law, not just the penalties, but the law, to make this more effective and make it work?

Mr. KAUPER. I think in terms of changes in the law, no very significant changes are needed, with one exception. If we are to undertake a major deconcentration program—and by major I mean 10, 12, or 15 cases a year to deconcentrate major industries—then I believe we do need legislation for several reasons. First, it is not altogether clear that the law now even can be applied to the situation where you do not have conspiratorial behavior, and you do not have single monopoly. The burden of proof under the existing law, in addition, is difficult.

I think, Senator, for quite a different reason, new legislation would be desirable. If we are going to have that kind of a program, it is a significant political issue, and it should be viewed initially as a political issue. Such a deconcentrational program would cause considerable disruption. There would be costs. I think there should be a full-scale political debate over that issue, and I mean political now in the best sense, and not the worse sense. In terms of the adequacy of the existing law, there is something to be said for viewing that as a political issue.

There are some other procedural changes. We have legislation now submitted as an administration proposal to amend our civil investigative demand authority which would give us considerably broader investigative powers. I believe that is a very important piece of legisla-

tion, probably the most important piece we have pending at the moment, with the possible exception of the penalty legislation.

Senator PROXMIRE. Do you think the steel industry should be exempted from the treble damages provision as the Senate Finance Committee has recommended in the trade bill?

Mr. KAUPER. You are talking about from the voluntary steel case. That is obviously a debatable issue. I think in terms of antitrust policy that is a very difficult question to answer. There is an argument in favor of exempting such arrangements from liability. I am thinking now, particularly in terms of the foreign concerns involved, that it really ought to be based on what your expectations are.

Senator PROXMIRE. Do you agree with that, Mr. Dirlam?

Mr. DIRLAM. I do not think there should be an exemption.

Mr. KAUPER. Let me be clear. I am not talking simply in terms of whether we should exempt such arrangements from the antitrust laws.

Senator PROXMIRE. That was my question.

Mr. KAUPER. I do not believe any such exemption should be created. But I think the proposal that you have been talking about involves the—

Senator PROXMIRE. The treble damages provision?

Mr. KAUPER. The liability for past conduct. Maybe I am wrong about that.

Senator PROXMIRE. Is that what the Senate finance provision goes to?

Mr. KAUPER. That is my impression.

That, it seems to me, raises a somewhat different question. The courts, in examining the issue before, have been concerned with whether the President was authorized in what he did. You are dealing with the expectations of the companies, involved and it seems to me there may be an equities issue that may be quite different. That was the only point I was trying to make.

Senator PROXMIRE. Is not part of your problem that you have to prove predatory intent on the part of a private firm, rather than simply monopoly power and the ability to interfere with normal market forces, and is not this an argument for changing the law to provide for divestiture or other remedies where there is excessive concentration? Do you support the deconcentration approach based on a rebuttable presumption of excessive concentration?

Mr. KAUPER. I am not sure I do. That is probably the best basis for raising the presumption, if there is to be one. The real question, it seems to me, comes back to the one which you have been discussing before this committee. If there is one exception, for example, in the view of Professor Weston, then it seems to me that there is a very serious issue raised. I am not an economist, so I am a little at a loss for some of this. Nevertheless, the basic question is, is there really a basis for a presumption? Given a certain level of concentration, can you say that the effects are so generalized that you can create a general presumption? I am very frank to say, Senator, with all the economic evidence I have looked at—some of which I do not understand totally—I am not altogether sure what the answer to that question is. I think Mr. Scherer, whom I have discussed this week many

times, finally said at one point in his appearance here last week that he found it very confusing. I agree with that.

Senator PROXMIRE. Mr. Dirlam, do you have a view on that?

Mr. DIRLAM. My view has changed somewhat over the years. I used to be more in agreement with Mr. Kauper than I am now. I would, I think, go along with this rebuttable presumption of excessive concentration in certain industries where industry studies, which combine historical analysis and analysis of behavior, have pretty clearly demonstrated that these industries are not competitive, and if the industries justify remaining concentrated on such ground as the costs of breaking them up, then let them show what those costs would be in terms of loss perhaps of economies and scale. I think that the consequences of concentration are pretty evident in terms not only of price increases, but of the power to reshape vast segments of the economy. Such has been the case with the automobile industry. I think it is about time to begin to take some action.

Senator PROXMIRE. I would like to ask each of you gentlemen in conclusion to tell me what two or three things you think would be most important for us to do to be able to make progress in the inflation area with respect to price fixing or the inflationary behavior of concentrated industries.

Mr. KAUPER. I think, Senator, one can distinguish between the long and short run. In the long run, it seems to me the Congress is going to have to make some decisions with respect to concentration in terms of new legislation. But you are talking about a very long-range proposition.

Senator PROXMIRE. When you make decisions, you give us your recommendations as to what we ought to do. You are the expert in this area.

Mr. KAUPER. I am not an economist.

Senator PROXMIRE. I know, but you are the top Government expert in antitrust. You have an eminent economic assistant at your side, a former distinguished professor and outstanding expert, and if he would like to join you I would very much like to hear what you recommend that we do.

Mr. KAUPER. I am not quarreling with the proposition that concentration can have some kind of effect. I think the question of how one creates the criteria to determine presumptions is quite different. Professor Dirlam said he supported the idea—

Senator PROXMIRE. I am not confining it to that. I said the two or three actions which would be most effective.

Mr. KAUPER. All right, as an immediate thing, the Division's budget should be increased, and we should be given additional authority with respect to investigations. You are asking, I assume, what Congress can do.

Senator PROXMIRE. I think that a budget increase is not inconsistent, in spite of the fact that I have been very much opposed to increased spending. The investment here, which would be very small, would mean a very consequential increase in the staff of the Antitrust Division, and really effective action, provided that is what you did with the staff.

Mr. KAUPER. I believe in this context you have raised another issue which I think is very important, which is that we get a major increase in the kind of penalties over what we have now.

Senator PROXMIRE. What additional investigative authority do you need?

Mr. KAUPER. We basically use our own investigational resources. When we talk about hiring attorneys, we are in large part talking about adding investigators. It is true we will probably be trying to make some additional use of FBI investigators as well, but that is not so much a question of your budget as being able to better utilize those people. But when you talk about adding personnel, you are also talking about adding economic capability. And the economists that we will be adding will be trying to use much more advanced economic tools.

Senator PROXMIRE. You want additional capability rather than authority?

Mr. KAUPER. That is right. It is not so much a question of authority as the capability of carrying out what we have now.

Senator PROXMIRE. So you would say the most important action you can get in the short run is to be able to increase your staff so that you could take advantage of it with respect to these investigations? Do you think if you did have an increased staff you could have a significant effect on pricing in these inflationary industries?

Mr. KAUPER. Yes, I think we can.

Again, let me go back. I am not talking at this point about short-run deconcentration. But my belief—and certainly we see it is a number of industries—is that when they do have price fixing going on, our job is to try to find it and prosecute it. That is our biggest single mission.

Senator PROXMIRE. Mr. Dirlam.

Mr. DIRLAM. I do not know that I can come up with anything that has not been proposed—my priority would begin with giving an increased budget to the Antitrust Division. And secondly, I would hope that the Division would use a little more imagination than it has in the past with regard to such practices as conscious parallelism, which has been pretty much forgotten, it seems to me, recently. That is, there are some precedents. Perhaps one might look to a recent decision by the European Economic Community which found a violation of section 85 when there was parallel action by dyestuffs companies. Here, after launching some cases a good many years ago against conscious parallelism, we seem to have neglected it. And I wonder whether it would not be possible to move against some of these industries.

Senator PROXMIRE. Not just parallelism as when you have Bethlehem and U.S. Steel increasing their prices at the same time and by the same amount for the same product.

Mr. DIRLAM. That would be a good summary of it. When an industry knows that it behaves in such a way that everybody ends up with a uniform price—

Senator PROXMIRE. And they increase it to about the fourth decimal point. It is very precise.

Mr. DIRLAM. This happens under the basing point system. One might try to extend the frontiers a little bit with regard to that.

And secondly, when an industry does behave uniformly in order to try to keep out imports, as not only the steel industry has done, but

certain other industries, I wonder whether they may not be subject to some sort of action under section 1 of the Sherman Act as it now stands.

Now, I would agree that you cannot deconcentrate very effectively perhaps under section 2, but I do recall a decision against the Du Pont acquisition of General Motors stock, which was launched a great many years after that acquisition. At the time that decision was handed down many people thought that section 7 of the Clayton Act might be used to roll back acquisitions which had taken place in the past. Again, there does not seem to have been any further action along those lines. But assuming that the lawyers say that this cannot be done, then probably some sort of amendment to the law would be necessary along the lines, perhaps of Senator Hart's Industrial Reorganization Act to deconcentrate.

Senator PROXMIRE. Thank you.

I have the budget of the United States here in my hands, Mr. Kauper. It is impossible to find the budget of the Department of Justice, at least, I cannot find it.

Mr. KAUPER. Would you like some figures?

Senator PROXMIRE. Of the Antitrust Division.

Mr. KAUPER. I think there is now a consolidated budget.

Senator PROXMIRE. Would you break that out for us and tell us how much you request and how much more you need?

Mr. KAUPER. We will supply that to you.

[The following information was subsequently supplied for the record:]

Senator Proxmire requested a break-out of Antitrust Division budget figures from the consolidated budget of the Department of Justice. The specific figures have been compiled by the Subcommittee on Departments of State, Justice, Commerce, the Judiciary, and related agencies of the House Appropriations Committee and included in the printed record of hearings before that Subcommittee. More precisely, they can be found at pp. 970-978, and 1021. Other information and testimony can be found at pp. 1086-1101 and 1129-1131.

Senator PROXMIRE. Why did they consolidate that? Would it not be helpful as a matter of policy for us to know?

Mr. KAUPER. I am not quite sure, Senator. When it comes to questions like that I am afraid I am something of a neophyte. What the reason for consolidation was, I do not know.

Senator PROXMIRE. Do you not know what your own budget is and what you are asking for this year?

Mr. KAUPER. Yes. But I do not have the figures with me. In terms of an increase it is about \$1.5 million over what we had recently, somewhere in the range of \$13 million. The total increase is more there because there is an uncontrolled increase in there as well. It is a total of 83 positions over our existing authorization now.

Senator PROXMIRE. What percentage increase in positions now?

Mr. KAUPER. The total position increase is about 14 percent, or somewhere around there.

Senator PROXMIRE. In the antitrust?

Mr. KAUPER. That is right.

Senator PROXMIRE. Is that about a 14-percent increase in professional staff?

Mr. KAUPER. I think it would be about—I use the two gross figures, but I think they come out about the same amount of professionals. In terms of total professionals it would be about that same percentage.

Senator PROXMIRE. Is that enough?

Mr. KAUPER. I think in part it is a question of how many you can assimilate intelligently in 1 year. Whether we are going to need additional funding for another year is something that we are looking at now. I do not think we could probably bring in 200 new professionals and really use them effectively in the course of an 8- or 9-month period between the time of passing the budget and what is left in that year.

Senator PROXMIRE. So it would be about—what is it, somewhere between one ten-thousandth, and one three-thousandth of the budget, something like that?

Mr. KAUPER. It is very small.

Senator PROXMIRE. Microscopic?

Mr. KAUPER. Yes.

Senator PROXMIRE. But very effective in the results that might be achieved in terms of the hard-pressed consumer?

Mr. KAUPER. We would hope so.

Senator PROXMIRE. About a thousand to one benefit-cost ratio, I would hope. That would not be out of line, would it?

Mr. KAUPER. Some of these cases involved large sums. The tetracycline case, as you know, involves settlements already over a \$100 million. The payoff can be very good.

Senator PROXMIRE. Gentlemen, thank you very much. I appreciate very much the contribution you have made.

The committee will stand in adjournment, subject to the call of the Chair.

[Whereupon, at 12:25 p.m., the committee adjourned, subject to the call of the Chair.]

INFLATIONARY IMPACT OF PRICING BY CONCENTRATED INDUSTRIES

MONDAY, OCTOBER 7, 1974

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (vice chairman of the committee) presiding.

Present: Senators Proxmire and Sparkman.

Also present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; William A. Cox, Jerry J. Jasinowski, and L. Douglas Lee, professional staff members; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. The committee will come to order. I believe the Joint Economic Committee during the conduct of its emergency study of economic conditions must confront the issue of price fixing by sheer corporate power and inflation resulting from huge price increases in a few massive industries.

We have seen a series of colossal and unprecedented price and profit increases in industries in which power is concentrated in a few very large corporations. For example, the three companies represented here today produce almost one-half of all the raw steel made in the United States.

Prices in the steel industry have skyrocketed. They have not just increased more rapidly than ever before. They have—and think of this—increased twice as rapidly as in any prior year in history. This massive increase in steel prices constitutes a major element in our present inflation. In fact, the increases in the price of steel and similarly administered explosions in the prices of nonferrous metals, of industrial chemicals and of petroleum constitute the basis for most of the inflation in the wholesale price index.

It appears on the basis of the analysis by the staff of this committee that there is no cost basis for this huge inflationary pressure from steel prices. I am convinced that the supply-demand situation cannot warrant such an inflationary rip-off. The explanation seems to be the sheer, unrestrained economic power of the industry and a pricing system which for years has been noncompetitive. The industry

has traditionally fixed prices. But they have never before come close to fixing them in such a highly inflationary way.

In the 6 months from February to August 1974, the wholesale price of steelmill products increased at an annual rate that has continued throughout the year, which exceeded 70 percent. During the same period the overall wholesale price index rose at an annual rate of 24 percent and the Consumer Price Index at an annual rate of 12.2 percent.

It is ironic to note that in April 1962 there was a furor over an announcement by United States Steel that it intended to increase its prices by an average of \$6 a ton. In the last 6 months the price of steel per ton has actually risen 10 times as much as the 1962 planned increase and there is hardly a murmur.

The significance of these increases in steel prices in terms of fueling inflation appears to be very substantial.

I have had the staff of the Joint Economic Committee study the available information on the costs, profits, and cash flows of the steel industry and they have come up with the following results.

In terms of costs, we have estimated that during the last year the average costs of inputs to the industry such as labor, ore, and energy rose by about 22 percent. So prices rose more than 50 percent faster than did costs. This resulted in very large increases in both profit and cash flows to the steel industry.

Beginning in 1972 there has been a decided improvement in profits of the industry, with the 1973 rate of return on stockholders' equity being the highest since 1966. But when we compare 1973 steel profits to the industry's most recent profit rates, we get "eye-popping" results. The net profits after taxes as percent of stockholders' equity in the second quarter of 1974 reached an amazing 18.5 percent. The figure is almost double the 9.5 percent return achieved during 1973. This record high level of profits came even before the additional 15-percent price increase during the third quarter became effective. Experts tell my staff the second-half year profit rate after taxes may approach 25 percent.

Of course the steel industry needs to expand its capacity over the next 5 years. But the amount and cost of the expansion are somewhat uncertain. Even steelmakers themselves disagree. Some argue for the need to produce an additional 30 million tons of steel a year by 1980 and say that the expansion will cost as much as \$600 per ton or even more. In fact, I think one witness this morning indicates it could cost \$800 a ton.

Other steelmakers talk in terms of 20 million tons at a cost of as little as \$350 per ton. The committee would like to receive from the steel industry a detailed analysis of their present capacity and estimates of future needs and costs.

My staff and the JEC staff have estimated that the present price structure will yield a total cash flow which will allow for meeting the replacement, modernization, and pollution outlays of the industry as well as providing for expansion of production by 20 to 25 million tons by 1980. In addition, there should be more than enough money to increase the dividends paid to the stockholders of the steel industry by an extremely generous 50 percent. Gentlemen, you are in a strong position to help us win the fight against inflation.

I am hopeful that this hearing can accomplish a specific goal in the fight against inflation. That goal is that, on the basis of the towering increases in prices and profits that you have put into effect in the past year, there should be no further big price increases for this bellwether of our economy for years to come. Such price stability in steel followed by similar stability in other industries whose prices have gone through the roof—that is, oil, chemicals, and nonferrous metals—would mark the beginning of our getting inflation under control.

We have invited three distinguished leaders of American steel companies to appear before us today and to answer questions about what appears to be wholly unjustified and highly inflationary pricing policies.

You gentlemen who will testify today have all indicated your proper sensitivity to any presentation at today's hearing that might give the appearance of your acting in concert or joining together on pricing, production, or any other matter. I very much appreciate that proper sensitivity on your part.

In response, let me say that you are here at the express and direct invitation of the Joint Economic Committee, not on your volition, either joint or several.

You are appearing in a manner and according to a procedure that I have insisted on, despite a protest on your part. You have expressly said that you wish to appear entirely separately.

You are appearing as I have requested only to accommodate the committee. I have just this morning spoken to Mr. Thomas Kauper, the chief of Antitrust Division of the Department of Justice, and he has informed me that he sees no objection to your appearing in public testimony at the request of this committee.

Our first witness is Mr. Frederic W. West, president of the Bethlehem Steel Corp.

Mr. West, please proceed.

MR. WEST. Good morning.

Senator PROXMIRE. I apologize for taking so long in my opening statement. May I say I do hope you gentlemen can limit your oral presentations as much as possible. The entire prepared statement will be printed in full in the record and made available to the other members of the committee and the Congress, but if you could confine your oral statement to 10 minutes, if possible, we would appreciate that very much.

STATEMENT OF FREDERIC W. WEST, JR., PRESIDENT, BETHLEHEM STEEL CORP., ACCOMPANIED BY CHARLES W. GANZEL, SENIOR VICE PRESIDENT, COMMERCIAL; BRUCE E. HASLETT, ASSISTANT VICE PRESIDENT, ACCOUNTING, AND ASSISTANT COMPTROLLER; AND CURTIS H. BARNETTE, ASSISTANT GENERAL COUNSEL AND ASSISTANT SECRETARY

MR. WEST. My name is Frederic W. West, Jr. I am president of Bethlehem Steel Corp.

The gentlemen with me are Charles W. Ganzel, senior vice president, commercial; Bruce E. Haslett, assistant vice president, accounting, and assistant comptroller; and Curtis H. Barnette, assistant general counsel and assistant secretary.

I was invited to appear before this committee in the words of the letter we received from Senator Proxmire—and I quote—“to testify * * * concerning steel prices and the commercial health of the steel industry.”

In discussions with members of the committee staff, we were advised that you are particularly interested in a long list of subjects. For example:

The current and projected future demand for our products; our plans for and problems incurred with respect to expansion of productive capacity; and, the situation with respect to steel imports.

Those subjects and others are discussed in the prepared statement submitted for the record.

I would like to take my allotted time to call your attention to some items of special importance.

To begin with, we fully acknowledge the deadly seriousness of the problem of inflation. At Bethlehem Steel, we know what inflation means. We have seen our costs escalating day after day.

The very nature of our business makes us doubly susceptible to the inroads of inflation. We are a labor-intensive company, and rising employment costs have a severe impact on the economics of our business.

But we also have to make enormous capital expenditures. And the impact of steeply rising capital costs hits us very hard, especially in view of our determination to expand to help avoid steel shortages in the future.

We want to expand—and we intend to do it—but rising capital costs are straining our resources to the very limit.

Most of our other operating costs—notably energy and raw materials—are sky high.

What are we doing about it? We are fighting on two fronts: First, we are fighting to control our costs; and second, we are fighting to put every pound of steel we can into the hands of our customers—and build the productive capability to keep our customers fully supplied as their needs grow in the years ahead.

Those are the two subjects I am going to talk about for the next 10 minutes or so: Helping ourselves by controlling costs and helping our customers by gearing up to make all the steel they need.

EFFORTS TO CONTAIN COST INCREASES

Keeping a sharp eye on costs is not anything new at my company. It is our way of life. But nowadays we have to be sharper than ever before. And to show you what I mean, just listen to this:

The actual dollar cost of purchased raw materials—including energy—per ton of rolled steel products we made during July and August of this year—increased 69 percent over our average cost per ton during 1973.

That is a 69-percent increase in our costs this year just for purchased raw materials. But our cost crunch did not start last year. It started years ago. And then we got locked into price controls. Here are some figures that make the point:

Since 1970—just before controls—our cost per ton of steel for purchased energy has gone up 230 percent; our cost for steel scrap has

gone up 165 percent; our cost for fuel oil has gone up 320 percent; and our cost for purchased coal has gone up 240 percent.

And, gentlemen, the cost of coal is bound to increase even more as a result of the contract negotiations that are going on right now.

I strongly hope that a settlement can be reached without a strike because a coal strike would cause a curtailment of steel operations within a very short period of time, and that would be devastating to the economy.

So we know what it means to have your costs go right through the roof.

Let us look at another big item—employment costs.

It has been said right here in this room, that improved productivity has more than made up for rising labor costs—and that was true—last year.

That is because our surge in volume in 1973 gave productivity a big shot in the arm. But productivity has flattened out since then, while employment costs have kept going up.

Wages have increased more than 13 percent since December—so, our unit labor costs are rising, and there is no end in sight.

The picture is not any better with capital costs. And the most dramatic evidence I can think of is the story of our Burns Harbor plant in northern Indiana. We built Burns Harbor between 1963 and 1971, at a cost of about \$1 billion. Today it would cost twice that much to build the same plant.

What are we doing to control our costs? We are doing a lot. We have had an intensive cost-reduction program for years. We have scrutinized every opportunity for controlling our costs; we have gone over all our operations with a fine tooth comb; and with special attention to conserving energy.

We have reduced manpower, mainly through attrition. We have about 15,000 fewer employees than we had in 1966, our previous record year for production.

We have made every possible effort and we will keep on doing it, to control our costs and improve the efficiency of all our operations.

PRODUCTION CAPACITY AND ITS LIMITATIONS

Now, I will turn to my second subject—meeting our customers' needs today and in the years ahead.

Some people cannot seem to understand why we are not able to make all the steel our customers are asking for. Those same people cannot seem to realize that last year we broke all records for steel production and shipments—and that is true of my company as well as the industry as a whole.

And yet, I have heard accusations that we have been deliberately holding back production.

Mr. Vice Chairman, that charge is just not true.

The fact is, my company is making every pound of steel we are humanly able to make—within the constraints imposed by pollution control requirements, availability of raw materials, and delivery of equipment.

So, why are we not able to make enough steel to fully meet the demands of the marketplace?

The basic reason is that for a dozen years or more, low-priced steel imports from foreign producers—supported by their governments—skimmed most of the growth off the market. At their peak, imports accounted for 18 percent of U.S. steel consumption.

During those same years our profitability was shockingly low. We were at the bottom of the First National City Bank's list of manufacturing industries by return on stockholder's equity.

But even so, we spent a bundle to modernize and stay competitive. My company spent \$3½ billion in capital expenditures since 1963, and that is a lot of money.

It was because of all those improvements that we were able to break all existing records for production and shipments last year—we shipped 15 percent more tonnage in 1973 than we did in our previous record year.

Why could we not make even more steel after that big spending program? A major factor was the impact of pollution control requirements.

Because of those requirements, we retired production equipment that was and still is usable.

When a piece of equipment is nearing the end of its useful life, you simply cannot justify adding on very expensive pollution abatement equipment.

The net result is that my company has only a little more production capability than we had in the early 1960's.

Now let us take a look into the future.

Based on industrywide estimates of domestic steel demands in 1980, we figure that my company will have to spend \$525 million a year—and that is just to maintain our historical position in the industry. That \$525 million is needed to add new capacity, replace existing equipment that has to be retired, and install pollution control equipment.

Let us think that over for a moment. That is \$525 million a year for capital expenditures—in terms of 1973 dollars.

And, incidentally, about \$80 million of that spending every year will have to be put into non-income-producing pollution control equipment.

Now, let us see how far our so-called "enormous" earnings will go toward providing that kind of money.

At the rate we have generated internal cash flow in 1973 and the first half of 1974—that is retained earnings plus depreciation—we will have \$330 million a year.

That is a short fall of about \$200 million a year—or a total of almost \$1½ billion between now and 1980.

That is why it is so clear that our earnings have to improve—not only to provide capital funds, but also to support the necessary borrowing to make up the shortfall.

With all those things in mind, I do not see how anyone could be surprised at what has happened to domestic steel prices this year.

First, when controls ended, our selling values had to go up to recover our increased costs. And I can assure you that all of my company's announced price changes in May were entirely consistent with the Cost of Living Council regulations, even though they had expired.

Second, since May my company made further cost-justifiable increases, and took its first step toward improving our profit margins.

It was a modest step, but it had to be made. We have got to improve our earnings in order to raise the capital funds so badly needed for expansion.

SUMMARY AND RECOMMENDATIONS

In summary, Mr. Vice Chairman, I think I have made it clear that the present level of the selling values of my company's products is the result of inflation rather than a contributing cause.

I have shown the heavy impact of steeply rising costs of materials and services, employment, and capital programs on our overall costs of doing business. We were not able to recover all of the increases in those costs while our prices were strictly controlled by the Cost of Living Council.

I have shown that our announced increases in selling values since the end of controls have been fully related to past, current, and projected increases in our costs over the next few months. Also—very recently—we added a moderate factor for long-overdue, increased profitability.

I have shown why my company's productive capability has not increased in the past—in spite of enormous capital expenditures, and why we are committed to future expansion. The primary concern of our customers is an adequate supply of steel, and we intend to serve them.

I have shown that the burden of pollution abatement has impaired our ability to maintain and increase productive capability and will continue to do so unless some relief is forthcoming.

I have shown what we have done to solve our own problems, through unrelenting efforts to control all our costs and improve our productivity—our production efficiency.

But in spite of all our efforts, our profitability has been inadequate in the past. And although our earnings have improved, they still are not satisfactory.

I strongly recommend, therefore, that no arbitrary constraints be put on our right to establish the selling values of our products. I believe that controls have been demonstrated to be both ineffective and inequitable.

I further recommend that the Congress consider significant improvement in depreciation allowances and the immediate writeoff of the cost of pollution control facilities.

Finally, I urge a study of the adverse economic impact of existing pollution abatement requirements, with the objective of easing our burdens in a manner that properly balances the physical and economic health and well-being of the people of this country.

These recommendations are intended to help us generate sufficient capital funds.

Inflation and shortages are current facts of life. By alleviating shortages, we can help alleviate inflationary pressures. My company wants to do its part to help relieve the present steel shortage—and we intend to do it.

Mr. Vice Chairman, I agree wholeheartedly that inflation is "domestic public enemy No. 1." It deserves careful, rational, and intensive study. I can assure you that my company will support the Congress in its efforts to restore the economic good health of our Nation.

Thank you.

Senator PROXMIRE. Thank you very much, Mr. West.
[The prepared statement of Mr. West follows:]

PREPARED STATEMENT OF FREDERIC W. WEST, JR.

INTRODUCTION

By joint resolution of the House of Representatives and the Senate of the Congress of the United States (S. Con. Res. 93), August 7, 1974, the Joint Economic Committee was called upon to undertake "an emergency study of the current state of the economy and of the problems relating thereto, with special reference to inflation."

Part of the charge to the Committee was "to provide the Congress with specific recommendations for legislation to remedy the existing ills and improve the performance of the economy."

Speaking for Bethlehem Steel Corporation, I heartily endorse the purposes of this study. I believe, and am firmly on record as having stated publicly, that inflation is indeed "domestic public enemy No. 1." It deserves careful, rational, and intensive study, and I can assure you that my company will support the Congress in its efforts to "remedy the existing ills and improve the performance of the economy."

I say this because, in addition to the harmful effects of inflation on all of us as individuals, and our humane concern for those Americans who are especially hard-hit by escalating prices of many consumer needs, my company has been suffering severely during the current era of double-digit inflation, and for two distinct reasons.

First (and this is reason enough for intense concern), inflation has had a disastrous impact on our cost of doing business. And, in turn, these steeply rising and extremely burdensome cost increases have forced us to raise our selling values.

Our second reason for concern is perhaps exemplified by the turn that has been taken by these hearings. We find companies such as mine, by name or by implication, pilloried and castigated for being among the chief villains—for being major contributors to the very ailment that afflicts us so severely.

And this brings me to an awareness of more sharply defined reasons why I have been invited to testify in these hearings. In his letter to me dated September 25, 1974, Senator Proxmire stated his expectation that I would testify "concerning steel prices and the commercial health of the steel industry." I am prepared to do so.

He went on to mention the "exceptionally large price boosts for steel over the past year," increases that he described as being "a cause of great concern to those attempting to formulate policies to subdue inflation."

On the following pages I will show that the recent rises in prices of steel mill products are, in fact, the result of many factors.

I. INFLATION AND BETHLEHEM STEEL CORPORATION

A. *The Impact of Inflation on Costs and Facility Planning.* My company is described in our SEC Form 10-K report as an integrated steel producer engaged in the manufacture, fabrication, and sale of steel and steel products, including the erection of steel for buildings, bridges, and other structures. It is the second largest steel producer in the United States. It is also engaged in marine construction, including the building and repairing of ships and the building of offshore oil drilling platforms. Incidental to its steel business, Bethlehem is engaged in the mining of ore and coal and the quarrying of limestone.

There's no need to go on with a comprehensive recital of our activities: I've noted the primary ones. The significance of that listing is that it illustrates the fact that all our major activities are labor intensive *and* have extensive capital requirements. Such a condition might well be described as creating "the worst of all possible worlds" in a highly inflationary period.

All through the current inflationary era we have experienced a major impact on our costs of labor, materials, and services. The costs of current, planned, and proposed capital projects have escalated dramatically and there's no end in sight. An impressive example of this is our Burns Harbor Plant, which cost roughly \$1 billion in the period from 1963 to 1971. We think it would cost \$2 billion to duplicate this plant today.

This inflationary situation—as it relates to the cost of capital projects and the availability of investment funds—has been and is severely aggravated by the inability of present depreciation methods, as provided under Federal income tax laws, to adequately recover the cost of capital facilities. Because depreciation methods recover only the historic cost over a protracted period, rather than the current cost for the use of the asset, actual dollars recovered by these depreciation methods are worth substantially less than the dollars originally spent. In the case of Burns Harbor, the recovery dollars today would be approximately half of what is needed for replacement of the assets.

I have said inflation hurts us badly. It even distorts our earnings. While all other costs of doing business are charged to earnings at current-year cost, depreciation is charged at historical cost; therefore, our costs are understated and our earnings overstated.

B. *Bethlehem's Contributions in Dealing With Inflation.* We feel that there are two obvious contributions we've made and will continue to make. The first of these is to *control costs*; to exert every possible effort to reduce the inflationary pressures that are forcing our costs upward. The second is to *maximize production*; to make every possible effort to increase our output so as to help alleviate the current shortage of steel products.

C. *Bethlehem's Plans for Capital Expansion.* Over a period of some years, and culminating in Fall of 1973, Bethlehem completed the first major stage of an ongoing study we call Strategic Planning—1985. The recommendations of the Study group for a first phase of a massive capital spending program were approved by the Board of Directors late in October, 1973, and its decision was announced to the public in our news release dated November 1, 1973 (Attachment A).

In brief, the program involves a commitment to spend over \$2 billion in the period 1974-1977, approximately \$500 million of which is for facilities specifically identified in the release.

The commitment was, however, a conditional one. The salient conditions are stated in the following excerpts from the official news release:

"Mr. Cort emphasized that Bethlehem's latest action is being taken on the assumption that steel prices will in the near future be permitted to be governed by commercial considerations rather than continue, as they have for most of the past decade, subject to governmental price controls or other restrictions. . . . 'Otherwise,' he explained, 'we cannot justify either our initial program or any further efforts to ease the long-range steel shortages predicted for our own and foreign markets'. . . . 'We repeatedly have made clear,' he continued, 'the need for substantial price relief to achieve even average economic performance. Our commitment to this initial capital program is made on the basis of our belief that the Federal Government will soon perceive the necessity of providing such relief while controls remain, as well as promptly removing the controls themselves to permit the free interplay of supply and demand in the marketplace.'"

In effect, Mr. Cort said, "If our earnings permit, we'll do it!" And that is a commitment that I reaffirm today.

Steelmaking facilities have astronomical price tags, as illustrated by the earlier reference to our Burns Harbor Plant.

Furthermore, in contrast to many other large investment activities, our decisions to spend capital are based on our own appraisal of the marketplace and prospects for adequate financial return *without* the guarantee of long-term contractual commitments that are common in many other industries making investments of comparable magnitude. For example, we undertook construction of the Burns Harbor Plant *without having a guaranteed order on hand for a single ton of steel to be produced when the plant went into operation!*

The following sections of this statement will explain the background of my company's present problems, discuss the short- and long-term demand for our products, and cover some of the basic economics of our business.

II. THE BACKGROUND OF BETHLEHEM'S PROBLEMS

A. *Bethlehem's Performance in the 1960s.* Over the past decade Bethlehem has been greatly concerned with its financial performance and its inability to expand capacity to meet the nation's future need for steel products.

In the mid-1950s, Bethlehem's production and capacity increased significantly and its return on stockholders' equity compared favorably with the average for all manufacturing (First National City Bank Survey). But in the years 1960-1973, Bethlehem's return on stockholders' equity dropped substantially below the average for all manufacturing (Attachment B).

There were a number of reasons for this situation, the most important of which were these:

(1) *Pressure of Rising Costs.* Rising employment costs and prices of purchased goods and services increased faster than steel prices, thereby putting pressure on profitability.

(2) *Unsatisfactory Growth in Demand.* Because steel is a mature industry, demand and supply do not grow quite as rapidly as real Gross National Product (i.e., in constant dollars). As indicated in the following trend comparison between 1955-1970: real GNP increased 3.6% per year; steel consumption increased 2.1% per year; and steel shipments by domestic producers increased only 1.0% per year.

During this period steel imports took a rising proportion of total consumption. They increased from 5% in 1960 to 18% in 1968 and in 1971, with the effect shown on domestic steel producers' shipments. Accordingly, in the face of a somewhat sluggish economy in the 1960s, imports deprived the steel industry of a high proportion of even the modest growth that occurred in steel demand.

(3) *Relatively Low Utilization of Facilities.* The result of the relatively slow growth in domestic steel shipments was a low rate of utilization of facilities. This obviously had a depressing effect on steel industry profitability.

B. *Expansion of Production Capability.* As a result of the unsatisfactory level of shipments and profitability, neither the steel industry nor Bethlehem was able to increase steelmaking capability significantly during the decade of the 1960s.

In spite of total capital expenditures in excess of \$3.5 billion since 1963—part to help relieve the present steel shortage, and we intend to do it. In this and plant at Burns Harbor, with peak output in excess of 4 million net tons per year—Bethlehem's present production capability is little more than it was in 1963, before construction of Burns Harbor.

One reason for little or no increase in steelmaking capability was the shut-down of obsolete facilities at a number of plants. A second reason was that we could not economically justify the cost of equipping certain other facilities with pollution-control equipment, even though they are still capable of producing steel. Nor have we been able to justify replacing them with new facilities.

The fact is that since April of 1973 my company has been making every pound of steel we have been humanly able to make within the constraints imposed by pollution-control requirements. In addition, we continue to be plagued with shortages of raw materials and extended deliveries on equipment, both of which hamper our ability to reach maximum production.

Having reviewed our production capability, we'll now turn to the demand situation.

III. SHORT- AND LONG-TERM STEEL DEMAND

The extraordinary surge in steel demand, both in the U.S. and overseas, starting early in 1973 and continuing into 1974—accelerated by the energy "crisis"—and the prospect for improved growth of steel shipments in the 1975-1985 period have improved the prospects for Bethlehem and the steel industry. The new situation, reflecting greater demand for steel in a highly inflationary environment, will require additional steel capacity and a capital expenditure program well in excess of historical experience.

It is helpful to review the reasons for the increase in demand in both the 1973-1974 and 1975-1985 periods, the capacity required on the basis of this demand, and the capital costs if demand in the U.S. is to be met largely by domestic producers.

A. *Demand Surge, 1973-1974.* The boom in global demand for steel during 1973 and 1974 surprised experts throughout the world. There are many contributing reasons for this unexpected surge—all of which have been strongly influenced by actions arising from the petroleum crisis. The following, in my opinion, are the most important developments:

A substantial expansion in World Industrial Production (+18% for 1971-1973):

Insufficient capacity in many of the world's industries (due to an unsatisfactory investment climate for these industries in the 1960s):

Resulting capacity shortages and low stocks in many industries, including basic materials, foodstuffs, and—most importantly—energy;

Raw material shortages in many industries;

An investment boom (triggered by the expansion in requirements and the shortages); and

A speculative commodity inflation.

The result of these forces, insofar as steel is concerned, was a 20% increase in world steel production from 1971-1973 (+25% in the U.S.). Due to capacity limitations, world steel production in 1974 is unlikely to be much larger than 1973 (8 months, +2%), even if demand holds up throughout the year.

B. Steel Requirements, 1975-1985. Even prior to the 1973-1974 surge in demand, steel analysts in this country had been projecting a substantial growth in steel production for the U.S. and also for the world.

At Bethlehem we have projected that domestic steel consumption will grow from 104 million net product tons in the five-year period 1968-1972 to in excess of 145 million net tons in 1985—an annual rate of increase of about 2.5%. This assumes that the American economy will grow at somewhat over 3.5% per year and that durable goods expenditures continue their recent trend of increase (when they have been a substantially higher proportion of GNP than in the 1960s).

We would judge that imports will be no higher than their recent share of total consumption (1968-1972=16%), with the real possibility, as others have suggested, that they might be considerably lower.

On these assumptions, as many industry spokesmen have pointed out (including Bethlehem's previous Chairman, Mr. Cort, before the Cost of Living Council on August 30, 1973), the industry will need additional capacity by 1980 of at least 25 million net tons of raw steel, and probably a like increase between 1980 and 1985. If imports become less of a factor in the future, these requirements would be increased. In addition, obsolescence and retirement of existing equipment during the intervening years will require virtually an equal tonnage of replacement capacity.

Taking both the 25 million net tons of additional capacity by 1980 and replacement requirements into account, we estimate the cost of this capacity to be in the order of \$3.5 billion to \$4 billion a year (in 1973 dollars), more than twice the industry average capital expenditures in the previous decade, and higher than previous estimates due to inflation. Bethlehem's picture is covered later in this statement.

The following section explains how inflation poses problems with respect to costs.

IV. COST AND PRICE TRENDS, AND EARNINGS

A. Cost Trends. The devastating effects of unprecedented increases in our costs of doing business have been referred to earlier in this paper. Their severe impact is more fully described in the following discussions:

1. *Trends in Costs of Materials and Services.* The meteoric rise in costs of purchased goods and services—despite our most diligent efforts to economize—are apparent from the following comments and the supporting data (Attachment C). These increases are unprecedented in our experience, whether viewed in terms of 1970 as the base year or viewing only more recent developments.

An indication of the heavy impact of these cost increases can be expressed this way: *the actual dollar cost of purchased raw materials (including energy) per ton of rolled steel products we produced during July and August of 1974 increased 69% over our average cost per ton during 1973.*

Using 1970 as the base year, the index of our costs of all purchased energy rose from 100 to 330; for purchased raw materials excluding energy the index reached 177; for steel scrap it reached 265; and for purchased bituminous coal it reached 341.¹ During the same period the index of our selling values rose from 100 to only 168.

All of these cost increases are in excess of the rise in selling values, and some of them obviously exceeded it by several orders of magnitude.

2. *Employment Costs.* Over a long span of years employment cost increases in the domestic steel industry have been rising at a rate two or three times faster than gains in productivity (Attachment D).²

¹The cost of coal is bound to increase even more as a result of the contract negotiations that are now in progress. We are hopeful of a peaceful settlement, because a coal strike would shut down our steel plants within a matter of days, and that would be devastating to the economy.

²Productivity of U.S. steelmakers (man-hours per ton shipped) has historically been much better than that of foreign competitors (Attachment E). Employment costs, however, have negated our productivity advantage (Attachment F) resulting in unit labor costs which continue to be highest in the United States despite our productivity which remains superior to all other world industries with the exception of Japan.

That trend was interrupted temporarily in 1973, which probably explains a statement made before this Committee on September 4, 1974, that "wage costs are stable or down in the steel industry, not up. The productivity is sufficient to overcome a substantial increase in wage rates, and wage costs are down."

The fact is that a significant portion of the productivity increase for the domestic steel industry in 1973 over 1972 was the result of increased utilization of facilities (i.e., higher volume). The output per manhour increased 10.8% and the employment cost per hour increased 8.6%. This resulted in a lower employment cost per ton in 1973 than in 1972.

This is not, however, true in 1974. A much smaller productivity increase is expected in 1974, and wage costs are increasing much more rapidly. For example, wage rates have increased more than 13% since December, 1973.

The 2.3% average annual increase in productivity may be a reasonable expectation for productivity gains assuming sufficient funds are available to improve and expand our facilities.

3. *Trends in Costs of Capital Expenditures.* Following is an index showing the rising trend in capital construction costs:

| | | | |
|------------|-----|-------------------|-----|
| 1967 ----- | 100 | 1971 ----- | 130 |
| 1968 ----- | 105 | 1972 ----- | 139 |
| 1969 ----- | 114 | 1973 ----- | 152 |
| 1970 ----- | 122 | 1974 (July) ----- | 171 |

Source: U.S. Department of Commerce Construction Cost Index.

As a further indication of increases in construction costs for steelmaking facilities, let's look at a specific example. In the mid-1960s we built our Burns Harbor Plant, the last major integrated "greenfield site" steel plant to be built in the United States. The approximate original cost of capacity at Burns Harbor was about \$250 per net ton of annual raw steel capacity, or about \$350 per net ton of annual finished products. Today we estimate that it would cost about \$500 per net ton of annual raw steel capacity, or about \$700 per net ton of annual finished products—if we wanted to duplicate that same plant. That's a 100% increase in only a 10-year period.

4. *Controlling Costs.* Bethlehem's management has always made diligent efforts to control our costs. Even more strenuous efforts were spurred by the severe decline in profitability in the years 1970 and 1971, with only a partial come-back in 1972. This condition was industry-wide. Net income for the entire steel industry in 1970 and 1971 was barely one-half of income in each of the years 1965 and 1966.

As for my company, our net income averaged \$152 million in the period 1964–1969, inclusive, then plunged to \$90 million in 1970. Our earnings improved during the two following years, but not to the earlier levels.³ My point is that it didn't take an upsurge of inflation to motivate us; the force of necessity caused us to clamp down on costs in recent years, harder than ever before.

During this entire period we've scrutinized every opportunity for cost-reduction; we've gone over our operations with a fine-tooth comb. We've made substantial reductions in our work force⁴ and cut costs in many areas. We've initiated continuing procedures whereby all operating and capital expenditures are subjected to the closest scrutiny. Every effort has been made, and will continue to be made, to improve the efficiency of all our operations.

B. *Steel Price Trends.* Bureau of Labor Statistics figures show a composite finished steel price rise of 40% from December, 1973, to August, 1974.

It is no consolation to the Purchasing Department of my company, any more than it is to other buyers, to acknowledge that the prices of many other products have risen faster and higher.

But we believe that a brief review of the background facts will show very clearly that Bethlehem has followed a policy of moderation and restraint in pricing its products, and this statement applies with equal force to all price actions taken this year after the cessation of controls on April 30.

³ Bethlehem Steel's net income was \$139.2 million and \$134.6 million in 1971 and 1972, respectively.

⁴ In 1957, Bethlehem's record year for shipments prior to 1966, and earnings prior to 1973, we had a monthly average of 167,000 employees; in 1966, our previous record year for shipments, we had 133,000 employees; in 1973, during a period when we shipped about 15% more steel than in 1966, we had only 118,000 employees.

Certainly the flood of low-priced foreign steel starting in 1959 was a major factor in depressing the domestic steel price level. So was the practice of governmental "jawboning" beginning in 1962 and continuing through the 1960s. These factors were decisive in condemning my company and industry to low profitability, and they deterred the expansion that was needed to keep pace with the growth of the economy.

Wage and price controls were set up in August, 1971, before any correction could take place, and controls continued in effect through April of this year. Under controls, price increases granted by the Cost of Living Council were limited to recovery of costs, usually with a costly time lag, and in the case of my company, cost-recovery was only partial. In the final months of controls our costs escalated even more rapidly than before, so there was a significant build-up of unrecovered costs when controls expired.

C. *Bethlehem's Price Actions After April 30, 1974.* On May 3, Bethlehem increased base prices on rolled steel products and also announced revisions of extras for a number of products. Cost justification for the increases was entirely consistent with Cost of Living Council regulations, even though they had already expired, and the objective was therefore limited to recovery of actual cost increases incurred through May 1.

Since May we have increased prices for many basic steel mill products. The advances, which were substantial, covered actual cost increases, plus clearly identified additional increases forthcoming over the next few months. They also constituted a long-delayed step toward improved earnings margins.

Bethlehem has long recognized the importance of establishing fair prices, and using moderation when change is imperative. This is of vital importance to the customers who make our business possible. We have a basic obligation, however, to our stockholders, employees, and above all to our customers to maintain a healthy and progressive company, capable of expansion to satisfy the growing needs of the marketplace. For this a reasonable profit is absolutely essential. Therefore we have taken the only course open to us in the inflationary climate of 1974: that is, price adjustments as required to offset rapidly escalating costs.

Under the present inflationary condition of our economy, it is premature to judge the extent to which our earnings level based on present profit margins will in fact support future expansion of capacity, but we do feel that an essential step toward meeting the conditions necessary for expansion has been taken.

D. *Bethlehem's Earnings and Capital Requirements.* As has been mentioned earlier in our testimony, Bethlehem's earnings performance compared with that of all manufacturing has been very unsatisfactory indeed. In 1973, our record year for production and shipments, and again in the first half of 1974, we have averaged only 10% return on net worth, substantially below the average for manufacturing industries in general.

Bethlehem's concern with respect to such a disappointing earnings performance is closely related to our ability to maintain competitive facilities and to expand. The study prepared by the American Iron and Steel Institute in February of this year, "Steel Industry Economics and Federal Income Tax Policy," portrayed a capital need for the industry for the period 1974-1980 of \$3.5 billion per year—which includes \$400 million annually for pollution abatement. This average annual requirement is in terms of 1973 dollars and does not reflect the impact of future inflation on these capital requirements. Bethlehem's historical position in the industry would indicate a capital requirement for us of about \$525 million per year, a figure very close to our own expectations.

In the preceding 7-year period, 1967-1973, Bethlehem's average capital spending was \$342 million per year and our internal cash flow from retained earnings plus depreciation was \$269 million per year. The difference over the period was made up largely by an increase in our long-term debt.

Looking forward to the period 1974-1980, assuming capital expenditures averaging \$525 million per year, our 1973 and first-half 1974 levels of internal cash generation (retained earnings plus depreciation) would provide only \$330 million of this amount, an aggregate short-fall over the period of almost \$1.5 billion. Improvements in our earnings picture are absolutely essential, not only to increase our earnings capability, but also to provide an earnings performance that would allow the additional necessary borrowing to carry out expansion programs.

Environmental pollution control requirements contribute heavily to our problems by demanding substantial expenditures that make no contribution to our productivity or earnings—in fact, their economic effects are negative. Yet we

expect to spend upwards of \$400 million for pollution-abatement equipment during the next five years.

To help generate funds needed for capital investment, we wholeheartedly support the recent proposals by members of Congress representing both major political parties that would modify existing tax laws to provide for more rapid methods of capital recovery.

More rapid write-off of the capital cost of manufacturing facilities and the immediate write-off of non-productive pollution control facilities are essential for the industry to provide necessary new productive capacity. Those write-offs would bring the United States cost recovery rates more in line with foreign rates. More rapid capital recovery allowances would not decrease a corporation's over-all Federal tax burden. They would merely accelerate the timing of those deductions and permit the cost of capital investment to be recovered in dollars closer to their value at the time they were spent. Furthermore, prompt enactment of such a capital recovery system would provide those dollars *now*, when they are sorely needed to meet our capital requirements.

It also is essential that the 7% investment tax credit be retained as a permanent part of the tax law.

CONCLUSIONS AND RECOMMENDATIONS

I think I've made it clear that the present level of the selling values of my company's products is the *result* of inflation rather than a contributing cause.

I have shown the heavy impact of steeply rising costs of materials and services, employment, and capital programs on our over-all costs of doing business. We were unable to recover all of the increases in those costs while our prices were strictly controlled by the Cost of Living Council.

I have shown that our announced increases in selling values since the cessation of controls have been scrupulously related to past, current, and projected increases in our costs, plus only very recently a moderate factor for long-overdue increased profitability.

I have shown why my company's productive capability has not increased in the past despite enormous capital expenditures, and why we are committed to future expansion. The primary concern of our customers is an adequate supply of steel, and we intend to serve them.

I have shown that the burden of pollution-abatement has impaired our ability to maintain and increase productive capability and will continue to do so unless some relief is forthcoming.

I have shown what we've done to solve our own problems, through unrelenting efforts to control all our costs and improve our productivity—our production efficiency.

But in spite of all our efforts, our profitability has been inadequate in the past. And, although our earnings have improved, they are still not satisfactory.

I strongly recommend, therefore, that no arbitrary constraints be put on our right to establish selling values of our products, since such controls have been demonstrated to be both ineffective and inequitable.

I further recommend that the Congress consider significant improvement in depreciation allowances and the immediate write-off of the cost of pollution-control facilities.

Finally, I urge a study of the adverse economic impact of existing pollution-abatement requirements, with the objective of easing our burdens in a manner that properly balances the physical and *economic* health and well-being of the people of this country.

All those recommendations are intended to help us generate sufficient capital funds.

Mr. Chairman, inflation and shortages are facts of life. By alleviating shortages, we can help alleviate inflationary pressures. My company wants to do its part to help relieve the present steel shortage, and we intend to do it. In this and in many other matters, if business and government work together, we'll restore the economic good health of our nation.

ATTACHMENT A

BETHLEHEM, PA.—An integrated program to modernize and expand steel-making and finishing capacity, involving the expenditure of nearly a half-billion dollars during the period 1974-1977, was announced today by Stewart S. Cort,

chairman and chief executive of Bethlehem Steel Corporation, the nation's second largest steel producer.

Mr. Cort described the program as the initial step in the implementation of the results of a long and intensive study undertaken to determine Bethlehem's capital program in the decade 1975-1985.

He pointed out that the program will be Bethlehem's second major expansion undertaken in the past decade, its Burns Harbor plant in the Chicago area having been started in 1963.

Mr. Cort emphasized that Bethlehem's latest action is being taken on the assumption that steel prices will in the near future be permitted to be governed by commercial considerations rather than continue, as they have for most of the past decade, subject to governmental price controls or other restrictions.

"Otherwise," he explained, "we cannot justify either our initial program or any further efforts to ease the long-range steel shortages predicted for our own and foreign markets."

"We repeatedly have made clear," he continued, "the need for substantial price relief to achieve even average economic performance. Our commitment to this initial capital program is made on the basis of our belief that the Federal Government will soon perceive the necessity of providing such relief while controls remain, as well as promptly removing the controls themselves to permit the free interplay of supply and demand in the marketplace."

Major features of the program are:

At the Burns Harbor, Ind., Plant

A third BOF vessel and a scrap melter to provide 1,000,000 annual tons of new steelmaking capacity.

A new 110-inch sheared plate mill.

New light flat-rolled facilities, including a 54-inch tandem mill, a galvanizing line, and annealing facilities.

At the Sparrows Point, Md., Plant

A new blast furnace, rated at 8,000 tons of pig iron per day, to replace four small furnaces of substantially equivalent aggregate capacity which would otherwise require substantial expenditures for maintenance and pollution control.

At the Lackawanna, N.Y., Plant

New steelmaking capacity of 600,000 annual tons.

ATTACHMENT B
RETURNS ON STOCKHOLDER'S EQUITY

| | Return on stockholder's equity ¹ (percent) | | |
|----------------------|---|---------------------------------|--------------------------------|
| | Bethlehem | All iron and steel ² | All manufacturing ² |
| 1955..... | 16.7 | 15.2 | 14.9 |
| 1956..... | 13.6 | 13.9 | 13.8 |
| 1957..... | 14.4 | 13.2 | 12.9 |
| 1958..... | 8.7 | 8.2 | 9.8 |
| 1959..... | 7.2 | 8.4 | 11.7 |
| 1960..... | 7.4 | 7.8 | 10.6 |
| 1961..... | 7.4 | 6.4 | 9.9 |
| 1962..... | 5.4 | 5.4 | 10.9 |
| 1963..... | 6.2 | 7.3 | 11.6 |
| 1964..... | 8.9 | 9.9 | 12.6 |
| 1965..... | 9.3 | 9.6 | 13.9 |
| 1966..... | 10.0 | 9.4 | 14.2 |
| 1967..... | 7.3 | 7.4 | 12.6 |
| 1968..... | 8.6 | 8.5 | 13.3 |
| 1969..... | 8.3 | 7.4 | 12.4 |
| 1970..... | 4.6 | 4.6 | 10.1 |
| 1971..... | 7.1 | 4.6 | 10.8 |
| 1972..... | 6.5 | 6.2 | 12.1 |
| 1973..... | 9.7 | 9.4 | 14.8 |
| 1974 (6 months)..... | 10.1 | NA | NA |

¹Sum of capital stock and surplus at beginning of year.

²As published by The First National City Bank of New York.

ATTACHMENT C

BETHLEHEM STEEL CORPORATION INDEX OF INCREASED SELLING VALUES AND COSTS PER UNIT FOR MAJOR ELEMENTS OF COST

[Index Base—1970=100]

| | Per net ton of rolled steel products | | |
|----------------------|--------------------------------------|-------------------------------|--------------------------------------|
| | Selling value | Purchased energy ¹ | Purchased raw materials ² |
| 1970..... | 100 | 100 | 100 |
| 1971..... | 107 | 134 | 94 |
| 1972..... | 113 | 131 | 94 |
| 1973..... | 116 | 170 | 112 |
| 1974 (6 months)..... | 133 | 266 | 144 |
| December 1973..... | 118 | 209 | 122 |
| August 1974..... | 168 | 330 | 177 |

| Basis | Purchased bituminous coal per net ton of coal | Fuel oil per gallon | Purchased electric power per MkwH | Steel scrap per net ton of scrap |
|----------------------|---|---------------------|-----------------------------------|----------------------------------|
| 1970..... | 100 | 100 | 100 | 100 |
| 1971..... | 121 | 132 | 118 | 85 |
| 1972..... | 128 | 121 | 125 | 86 |
| 1973..... | 140 | 171 | 130 | 129 |
| 1974 (6 months)..... | 234 | 386 | 175 | 227 |
| December 1973..... | 171 | 308 | 133 | 159 |
| August 1974..... | 341 | 420 | 191 | 265 |

¹ Includes purchased coal, purchased electricity, fuel oil, natural gas, and purchased coke. In August these energy costs represented about 10 percent of the total cost of rolled steel products. If coal produced by Bethlehem's mining operations were included the percentage would be much higher.

² Includes virtually all purchased raw materials (excluding energy items). This index, of course, is influenced by the mix of raw materials purchased during each period as well as the proportion of purchased metallics (scrap and iron ore) to our own.

ATTACHMENT D

[This chart indicates the long-term increase in output per man-hour in the steel industry as published in the Annual Statistical Report of the AISI for 1973, and an index of wage employment costs per hour.]

| Year | Index of output per man hour ¹ | Index of wage employee employment cost per hour |
|------|---|---|
| 1957 | 84.3 | 67.6 |
| 1958 | 77.9 | 73.8 |
| 1959 | 87.5 | 79.8 |
| 1960 | 82.3 | 80.3 |
| 1961 | 84.9 | 83.8 |
| 1962 | 89.2 | 87.3 |
| 1963 | 93.2 | 89.3 |
| 1964 | 97.2 | 91.5 |
| 1965 | 101.1 | 94.1 |
| 1966 | 103.2 | 97.4 |
| 1967 | 100.0 | 100.0 |
| 1968 | 104.2 | 105.8 |
| 1969 | 104.8 | 113.0 |
| 1970 | 101.9 | 119.3 |
| 1971 | 105.6 | 131.6 |
| 1972 | ² 111.8 | 148.7 |
| 1973 | ³ 133.9 | 161.4 |
| 1974 | NA | 191.1 (July) |

¹ Bureau of Labor Statistics—index of output per man-hour in steel industry (1967=100).

² Index of wage employees AIS-1 industry rates per hour (1957=100).

³ Preliminary.

Average Annual Increase—2.3 percent.

ATTACHMENT E

STEEL INDUSTRY MAN-HOURS PER TON SHIPPED IN SELECTED COUNTRIES 1955-73

| | United States | West Germany | France | United Kingdom | Japan |
|------|---------------|-------------------|--------|----------------|-------|
| 1955 | 14.1 | 33.6 | 33.0 | 32.7 | 62.8 |
| 1956 | 14.3 | 32.5 | 32.6 | 33.1 | 60.7 |
| 1957 | 14.6 | 29.9 | 32.3 | 32.8 | 55.3 |
| 1958 | 15.8 | 28.7 | 29.4 | 32.9 | 57.0 |
| 1959 | 14.1 | 26.2 | 27.9 | 30.6 | 49.3 |
| 1960 | 15.0 | 24.3 | 26.7 | 29.0 | 44.2 |
| 1961 | 14.6 | 25.1 | 27.6 | 29.3 | 38.6 |
| 1962 | 13.9 | 24.5 | 27.4 | 29.9 | 40.7 |
| 1963 | 13.3 | 24.9 | 27.5 | 29.0 | 34.5 |
| 1964 | 12.7 | 21.6 | 25.6 | 26.3 | 29.8 |
| 1965 | 12.2 | 21.7 | 24.4 | 25.0 | 28.5 |
| 1966 | 12.0 | 21.1 | 22.8 | 25.6 | 23.8 |
| 1967 | 12.4 | 19.2 | 21.7 | 25.6 | 19.8 |
| 1968 | 11.9 | 16.9 | 19.7 | 23.8 | 17.7 |
| 1969 | 11.8 | 15.3 | 17.6 | 23.3 | 14.5 |
| 1970 | 12.2 | 15.5 | 17.0 | 22.2 | 12.6 |
| 1971 | 11.7 | 15.8 | 17.1 | 24.8 | 12.6 |
| 1972 | 11.1 | 14.2 | 16.0 | 22.6 | 10.9 |
| 1973 | 10.0 | ¹ 13.3 | N.A. | N.A. | 19.0 |

¹ Estimated.

Source: Calculated from U.S. Bureau of Labor Statistics data.

ATTACHMENT F

STEEL INDUSTRY EMPLOYMENT COSTS PER MANHOUR IN SELECTED COUNTRIES

[Wage employees only—United States dollars]

| Year | United States | West Germany | Disparity United States versus West Germany | France | Disparity United States versus France | United Kingdom | Disparity United States versus United Kingdom | Japan | Disparity United States versus Japan |
|----------------|---------------|--------------|--|--------|--|----------------|--|-------|---|
| 1955 | 2.72 | .83 | 1.89 | .85 | 1.87 | NA | NA | .43 | 2.29 |
| 1956 | 2.95 | .90 | 2.05 | .96 | 1.99 | NA | NA | .48 | 2.47 |
| 1957 | 3.22 | 1.01 | 2.21 | .86 | 2.36 | NA | NA | .54 | 2.68 |
| 1958 | 3.51 | 1.06 | 2.45 | .85 | 2.66 | NA | NA | .54 | 2.97 |
| 1959 | 3.80 | 1.12 | 2.68 | .91 | 2.89 | NA | NA | .57 | 3.23 |
| 1960 | 3.82 | 1.21 | 2.61 | .99 | 2.83 | NA | NA | .62 | 3.20 |
| 1961 | 3.99 | 1.37 | 2.62 | 1.11 | 2.88 | NA | NA | .68 | 3.31 |
| 1962 | 4.16 | 1.51 | 2.65 | 1.21 | 2.95 | NA | NA | .74 | 3.42 |
| 1963 | 4.25 | 1.59 | 2.66 | 1.30 | 2.95 | NA | NA | .80 | 3.45 |
| 1964 | 4.36 | 1.66 | 2.70 | 1.40 | 2.96 | 1.53 | 2.83 | .88 | 3.48 |
| 1965 | 4.48 | 1.75 | 2.73 | 1.48 | 3.00 | 1.65 | 2.83 | .97 | 3.51 |
| 1966 | 4.63 | 1.89 | 2.74 | 1.56 | 3.07 | 1.76 | 2.87 | 1.08 | 3.55 |
| 1967 | 4.76 | 1.95 | 2.81 | 1.66 | 3.10 | 1.73 | 3.03 | 1.22 | 3.54 |
| 1968 | 5.03 | 2.08 | 2.95 | 1.84 | 3.19 | 1.64 | 3.39 | 1.40 | 3.63 |
| 1969 | 5.38 | 2.32 | 3.06 | 1.96 | 3.42 | 1.83 | 3.55 | 1.67 | 3.71 |
| 1970 | 5.68 | 3.29 | 2.39 | 2.08 | 3.60 | 2.04 | 3.64 | 2.03 | 3.65 |
| 1971 | 6.26 | 3.72 | 2.54 | 2.41 | 3.85 | 2.32 | 3.94 | 2.36 | 3.90 |
| 1972 | 7.08 | 4.20 | 2.88 | 3.06 | 4.02 | 2.75 | 4.33 | 3.00 | 4.08 |
| 1973 (revised) | 7.68 | 5.69 | 1.99 | 4.04 | 3.64 | 3.10 | 4.58 | 4.19 | 3.49 |

Sources: AISI, U.S. Bureau of Labor Statistics, European Economic Community, and Japanese Ministry of Labor. Earlier years, Iron Age, Apr. 6, 1967.

Senator PROXMIRE. Our next witness is the chairman of the Board of Inland Steel, Mr. Jaicks.

STATEMENT OF FREDERICK G. JAICKS, CHAIRMAN, INLAND STEEL CO., CHICAGO, ILL.

Mr. JAICKS. Thank you. My name is Frederick Jaicks. It is a pleasure to appear before you in my capacity as chairman and chief executive of the Inland Steel Co. of Chicago, sixth largest domestic steel producer and the only major company headquartered in the Nation's second largest city. As you may know, our steel-making complex, the Indiana Harbor Works, is located along the Lake Michigan shoreline at East Chicago, Ind., some 25 miles southeast of Chicago.

I would like to emphasize at the outset that, while I am currently serving as chairman of the American Iron & Steel Institute, I appear here today solely in my capacity as chairman of Inland Steel Co. and not as a representative of the American Iron & Steel Institute. Information regarding the steel industry which I may refer to in my presentation is from sources available to the public.

Unlike our major competitors, all of Inland's steel manufacturing facilities are located at one plant location, which for each of the past 3 years has shipped more steel than any other single steel installation in this country. Our plant has been operating at capacity during this period. Our shipment total was just under 6 million tons in 1973 and is likely to slightly exceed 6 million tons for 1974.

We are here this morning to discuss a problem which is also being debated by your colleagues and mine in other forums all over the country—inflation. It need not be said, I hope, that what the President has described as public enemy No. 1 is also the foremost enemy of our industry and that a search for its solution is critical to the planning of my company and others. I hope today to describe very briefly the effect of inflation on Inland Steel Co. and our plans for dealing with one of the situations which may be contributing to our domestic inflation. It might be helpful in my testimony if you would separate the charts¹ from the statement, so you can observe and follow the text of my statement, if you wish.

ORIGIN OF THE STEEL SHORTAGE

The question posed by Senator Proxmire in his correspondence and press releases has its origin in the situation that has existed in the steel industry since the early 1960's. Over that period, the domestic industry has been subjected to extreme financial strains and very low rates of return. Without price increases and the restoration of workable margins, the steel industry will not be able to expand to meet future needs of the economy. The shortages of the past 2 years did not exist 10 years ago. The domestic industry could and did supply the needs of American industry, including provision of reserve capacity for periods of peak demand. But, starting in 1963—if you will refer to chart 1, you will note this—imported steel offered at cutrate prices, began to absorb virtually all of the growth in the American steel market.

¹ See charts, beginning on p. 143.

As shown in chart 2, the investment programs undertaken in the 1960's required the commitment of all of the industry's available cash flow and considerable new debt.

The money was well spent in terms of the modernization of plant and improvement in technology—benefits which, in a very large part, accrued to customers in the form of better service and higher quality products. But because of the foreign steel invasion, the programs were not good business investments in the sense that they did not provide a satisfactory return on invested capital.

As can be seen in chart 3, returns on equity became unsatisfactory, whether compared with other manufacturing industries or with the going rate on fixed yield securities. The return on new investment is not easily isolated but was clearly much lower.

Steel continued to pour into the country; and, with its market growth stunted and its margins so low that new projects were unjustified, total domestic industry investment began to plummet. By 1972, capital expenditures were virtually back to the level of 1963, nearly a decade earlier. I need not remind you that on a constant dollar basis our investment was well under the level of real investment 10 years before.

It is difficult to assess the impact of underinvestment, but we can demonstrate that we do not now have the capacity to meet America's needs. If we are to continue to produce at maximum capability as we did for the 12 months ending June 1974, we would still fall short of the country's needs by 9.4 million tons, as shown in chart 4.

We can demonstrate that the situation in Japan was quite different, as shown in chart 5, where investment continued at a phenomenal pace and steel production grew proportionately. Much of that investment was directed toward displacing potential new capacity in the United States.

The situation in American steel markets began to change in 1972 with the emergence of a worldwide capital goods investment boom. Steel consumption in the United States increased by nearly 9 percent in 1972 and another 7 percent in 1973. Overseas, the 2-year gain was even greater. We note these developments on chart 6.

In the midst of a boom in steel demand, foreign steel suppliers began pulling back from American markets in favor of what they viewed as more lucrative markets at home or elsewhere in the world. These market developments coincided with the abandonment of fixed exchange rates. Artificial exchange rates had kept imported steel prices lower than they would have been in a free exchange market. With their abandonment, true foreign costs were transmitted to the American market as markedly higher prices for steel.

Despite the sizable price increases of recent months, American steel is selling at bargain basement prices compared to quotations from foreign steel. I can demonstrate this point on chart 7 most tellingly by comparing Inland Steel Co. and import prices for typical, large volume, steelmill products. Inland's prices are quoted for October delivery at dockside in Chicago, which is a comparable basis in the eyes of Chicago regional steel buyers.

The import price premiums range from 107 percent on carbon steel plates down to 20 percent on galvanized steel. Chicago area steel users are paying these higher prices not because of any product superiority or supplier loyalty, but simply because Inland and other domestic pro-

ducers do not have the capacity to supply their needs. I think that our experience parallels the market situation that exists all over the country. Plants have been pushed to their ultimate capacities, and current production has been supplemented by shipments from inventories. Since December 1972, industry inventories have been reduced by 8.5 million tons or nearly 40 percent. These sales from inventory resulted in shipments actually exceeding industry capacity in 1973. In Inland's case, inventories are at an irreducible level and cannot be relied upon as an additional supply source.

INLAND'S EXPERIENCE UNDER PRICE CONTROLS

To bring perspective to the 1974 pricing actions, it is necessary to examine the steel industry situation that existed at the start of controls in 1971. The continued heavy influx of foreign steel and the feast, famine of steelmill operations that were identified with steelworker contract negotiations brought the 1971 earnings to such a level that the only way to go was up. The earnings performance for that base year is compared with other years in the following table:

Inland earnings performance for selected years: 1971, return on sales, 3.8 percent; 1968, 7.2 percent; and 1955, 8.0 percent. Return on net worth, 1971, 6.1 percent; 1968, 10.9 percent; and 1955, 15.8 percent. Return on invested capital, 1971, 5.1 percent; 1968, 8.8 percent; and 1955, 9.3 percent.

These calculations shows that the return on net worth in 1971 was 6.1 percent. Therefore, Inland began the period under price controls at a depressingly low-profit margin and ROI level in relation to prior periods, as well as to other manufacturing industries. In effect, Inland and the industry went into controls at an earnings level which, if continued, could have brought bankruptcy to a most vital element of our Nation's economy.

Using July 1971 as the base period, chart 8 shows the increase in Inland's costs and net realizing prices at important mileposts along the way. The data supporting these charts is compatible with the data reported to the Cost of Living Council during the control period. These data give due recognition to gains from improved productivity and efficiency. The chart shows that cost increases exceeded increases in realizing prices throughout all four phases of price and wage controls.

By the end of December 1973, costs had outrun price increases by 3 to 1 (29.5 and 10.13 percent, respectively). At the steel hearings in December 1973, the CLC recognized inequities of the steel pricing situation and allowed an increase in sheet prices that had been requested 9 months previously. A cost passthrough provision was introduced solely to offset the soaring price of scrap.

By April 30, 1974, the end of formal price controls, Inland had incurred cost increases of 34 percent but had only increased prices 24.2 percent. Most of the price increases occurred in the first quarter of 1974, the last period of controls.

Since May 1, 1974, Inland has been able to obtain prices that reflect substantially the same percentage increase over July 1971 prices as the percentage increase in costs since that time. This has finally brought our return on net worth back to the level that prevailed at Inland in

1955, and only slightly above the average of all manufacturing companies in 1973, an important factor in the competition for funds in the capital markets.

CURRENT PROFITABILITY

For 1973, steel industry profits as a percentage of net worth were 9.5 percent compared with 14.8 percent for all manufacturing companies, as reported by the First National City Bank of New York. This relationship means that our industry's return was only 64 percent of the average, and, as a result, steel ranked 36 out of the total of 40 industries. On the same basis, Inland earned 10.2 percent, or 69 percent of the average.

Comparable steel industry data for the first half of 1974 indicates a 13.5 percent return on net worth. Failure to equal last year's average for all manufacturing, despite all-out production and record earnings, is particularly disturbing. Inland's return on net worth for the first half of 1974 was 15.8 percent. It is important to understand, however, that this figure substantially overstates the true profitability of the company during a period of prolonged inflation.

During periods of high inflation, generally accepted depreciation accounting methods provide inadequate recoveries for replacement of wornout facilities, a situation which is especially pronounced in capital intensive industries such as steel. Since depreciation is based on original costs rather than current replacement costs, reported net income and return on invested capital tend to be greatly overstated.

A recent engineering study indicates that it would cost more than \$6 billion at September 1974 construction price levels to replace our present steelplant facilities and raw material operations. Those same assets are shown on our balance sheet at less than \$2 billion before allowance for depreciation.

By substituting the \$6 billion replacement costs for the original cost of fixed assets, Inland's return on invested capital (net assets less current liabilities) fell below 2.5 percent. This hypothetical analysis illustrates the magnitude of the problem of inadequate capital recovery in the highly capital intensive steel industry.

ECONOMICS OF NEW INVESTMENT

For the period 1974 through 1980, average capital expenditure requirements for the steel industry are estimated at \$4.8 billion per year in 1974 dollars. This expenditure is required to maintain present productive capacity, to provide 25 million tons of additional capacity to meet projected growth in demand, to meet environmental requirements, and for other purposes. Estimates of average annual cash flows for the same period, also in 1974 dollars, would be around \$3 billion.

After careful study, Inland Steel Co. announced 10 days ago a major program to expand our steelmaking and finishing capacity. Under this program, our annual raw steel capacity will be increased 2.1 million tons or 24 percent, and our annual capacity of finished mill products will also be increased 24 percent of 1.6 million tons.

This massive program is estimated to cost a minimum of \$1.3 billion. This is an investment of more than \$800 per additional ton of annual finished product capacity. Our cash flow projections indicate that after providing the funds needed to maintain existing productive capacity,

at least 50 percent of the cost of this expansion program will have to come from external sources even if the company's profitability continues at its present rate. Both internal and external financing, of course, require an adequate rate of return on the sale of steel.

In seeking to achieve such an adequate return we fully expect to benefit from improvements in productivity and effectiveness from the new facilities. However, during the past decade such gains have been far outstripped by increases in depreciation and taxes on the new facilities, plus the soaring cost increases in raw materials, energy, employment and virtually all purchased goods and services and amortization of debt. If net costs do increase, the price of steel will also inevitably increase. Indeed, because amortization of the new facilities will cost so much more than amortization of our present facilities, we could not justify building this new capacity at present cost levels if its output had to be sold at the present price of steel.

NEED OF THE NATION FOR IMPROVED CAPITAL RECOVERY IN STEEL

In the long run, expansion of productive capacity for items in short supply such as steel is necessary to decrease inflationary pressures caused by shortages. The price of imported steel compared with the price of domestic steel indicates quite clearly that there is a shortage of steel in this country. This shortage has an inflationary impact, both because too many dollars are chasing too few tons of steel and because of inefficiencies induced in the economy by shortage. But the only cure for this inflationary impact is the expansion of capacity so that supply is adequate to meet demand. The creation of this capacity cannot be accomplished overnight. As I have noted above, it will take both time and money to create that capacity. The money must come ultimately from an adequate return on the sale of steel. However, there are a number of steps the Government can take to facilitate the result, and to reduce its short-range impact on the economy.

To alleviate our heavy dependence on the mechanism of prices to attain profit margin levels that will attract the required investment funds, this committee and the entire Congress should give serious consideration to other means. One alternative in addition to maintaining the investment tax credit, is to amend the Federal income tax laws to provide for immediate writeoff of expenditures on antipollution equipment, suggested by Mr. West. Such expenditures provide no additional earnings and, in fact, generally entail added operating expense, thus reducing earnings and cash flow. Immediate recovery of these capital expenditures would free these funds for investment in productive facilities.

Real encouragement to expansion of capacity would also be provided by improvement in capital recovery allowances. To repeat what I said earlier, inflation has substantially eroded the investment dollars recovered via depreciation. Adoption of a more flexible capital recovery system, permitting the cost of all productive industrial investment to be recovered over a period as short as 5 years, as is done in many other industrialized countries, would reduce the effect of inflation and further lessen dependence on the price mechanism to provide funds for expansion. It should be recognized that while shorter depreciation periods improve short-term cash flows, there is no long-range tax savings to corporations.

SUMMARY

In conclusion, I have attempted in my testimony to describe how the recent pricing actions of the steel industry had their origins in economic and political forces of the early 1960's. These forces suppressed logical pricing actions that were needed more than a decade ago. The combination of informal price controls and foreign steel invasion persisted until the imposition of the formal controls program in 1971. As a result, Inland and the steel industry entered the control period at an earnings performance level that not only stifled expansion but, had it continued, would have invited corporate bankruptcy, or forced us into other business activities. The situation was aggravated throughout the controls period, and, with their expiration, there was an acute shortage of the capacity to serve the Nation's needs.

Since the end of price controls, normal economic forces have again been operating, and my company has increased its prices. We have done so, acting as responsible business managers who are responding to the needs of the marketplace. These price increases will provide revenues which should permit us to build new facilities and help us to attract capital. Through the market mechanism of increased demand, our customers have told us that they need more steel. The realistic prices that they pay for that steel today will assure them a greater supply of steel in the future. And a greater future supply of steel and other materials can only serve to moderate the inflation that is the common enemy of us all.

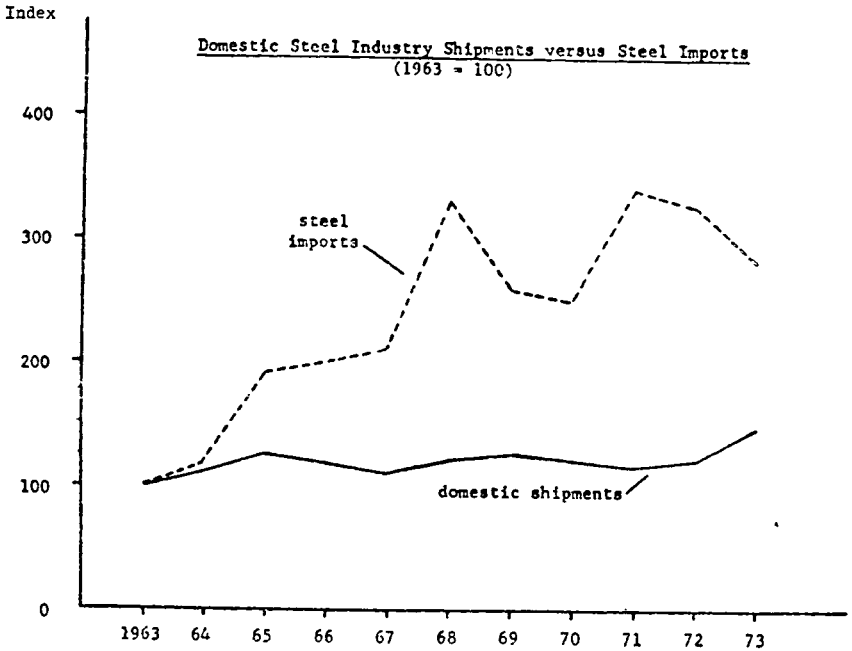
Thank you, Mr. Vice Chairman.

Senator PROXMIRE. Thank you, Mr. Jaicks.

[The charts referred to in Mr. Jaicks' statement follow:]

CHART 1

IMPORTS TOOK MOST OF THE
GROWTH IN THE U. S. MARKET

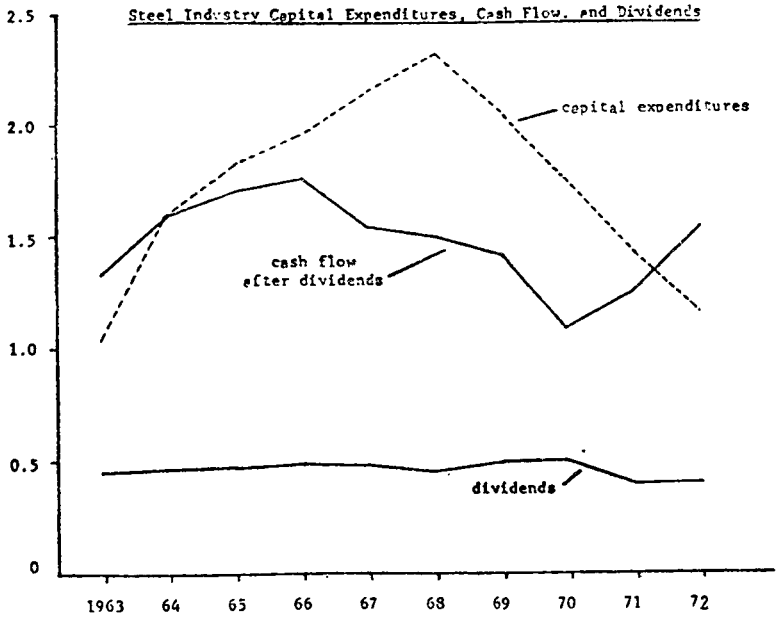


Source: United States Department of Commerce.

CHART 2

STEEL CAPITAL EXPENDITURES
EXCEEDED CASH FLOW

\$ Billions



Source: United States Department of Commerce.

CHART 3

**STEEL INDUSTRY
COMPARATIVE PROFITABILITY
PERCENT RETURN ON NET WORTH**

| | IRON & STEEL | <u>ALL MANUFACTURING</u> | IRON & STEEL RANK |
|-------------|-----------------------------|-------------------------------------|----------------------------------|
| 1955 | 15.2 | 15.0 | 14 |
| 1960 | 7.8 | 10.5 | 30 |
| 1965 | 9.6 | 13.8 | 37 |
| 1966 | 9.4 | 14.1 | 37 |
| 1967 | 7.4 | 12.1 | 39 |
| 1968 | 8.5 | 13.1 | 38 |
| 1969 | 7.4 | 12.5 | 39 |
| 1970 | 4.6 | 10.1 | 41 |
| 1971 | 4.6 | 10.8 | 41 |
| 1972 | 6.1 | 12.1 | 40 |
| 1973 | 9.4 | 14.8 | 36 |

Source: First National City Bank

CHART 4

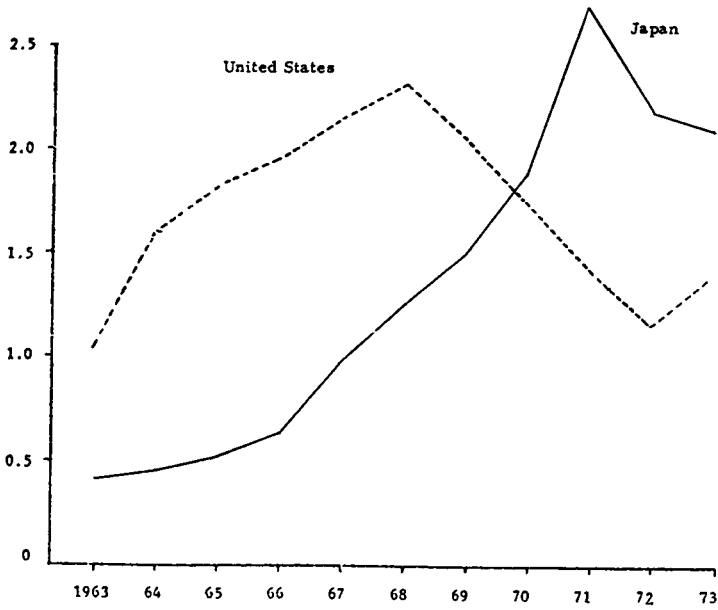
CONSUMPTION OF STEEL
COMPARED WITH
ALL-OUT PRODUCTION
(Millions of Finished Tons)

| | <u>Twelve Months Ending June, 1974</u> |
|---------------------|--|
| Consumption | 117.6 |
| Current Production* | <u>108.2</u> |
| Shortfall | 9.4 |

* Shipments less Change in Mill Inventory.

Source: American Iron and Steel Institute, and
United States Department of Commerce

CHART 5

STEEL INDUSTRY CAPITAL EXPENDITURES
UNITED STATES VS. JAPAN
(Billions of Dollars)

Source: American Iron and Steel Institute, and Japanese Ministry of International Trade and Industry

CHART 6

APPARENT WORLD
STEEL CONSUMPTION
(Million Metric Raw Steel Tons)

| | <u>World</u> | <u>U.S.</u> | <u>World Excl. U.S.</u> |
|--------|--------------|-------------|-------------------------|
| 1969 | 574 | 139 | 435 |
| 1970 | 595 | 128 | 467 |
| 1971 | 582) | 129) | 453) |
| 1972 | 629) +19.1% | 140) +16.3% | 489) +19.9% |
| 1973 | 693) | 150) | 543) |
| 1974 E | 721 | 148 | 573 |

Source: American Iron and Steel Institute

CHART 7

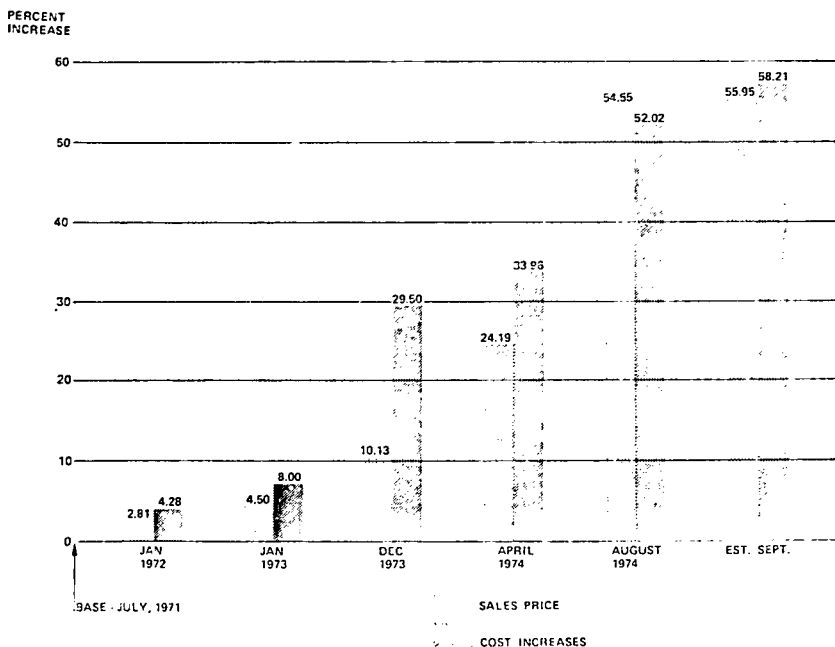
INLAND VS. IMPORTED STEEL PRICES
SIX MAJOR PRODUCTS
OCTOBER 1974
(\$/Ton)

| | <u>INLAND</u> | <u>IMPORTS*</u> | <u>DIFFERENCE</u> |
|---------------------------|---------------|-----------------|-------------------|
| Hot Rolled Sheets, Coils | 220 | 360 | + 64% |
| Cold Rolled Sheets, Coils | 260 | 380 | + 46% |
| Galvanized Sheets, 22 Ga. | 367 | 440 | + 20% |
| Hot Rolled Bars | 240 | 300 | + 25% |
| Structural Angles | 265 | 340 | + 28% |
| Plates, Carbon | 227 | 470 | +107% |

* Imports prices are duty paid, all dockside charges paid.

CHART 8

STEEL SALES PRICE AND COST INCREASES
Since July, 1971



Senator PROXMIRE. Our final witness is the chairman of the board of United States Steel Corp., Mr. Speer.

**STATEMENT OF EDGAR B. SPEER, CHAIRMAN OF THE BOARD,
UNITED STATES STEEL CORP., ACCOMPANIED BY DAVID M.
RODERICK, CHAIRMAN, FINANCE COMMITTEE, AND M. G. HEAT-
WOLE, GENERAL COUNSEL**

Mr. SPEER. Thank you, Senator Proxmire. My name is Edgar B. Speer. I am chairman of United States Steel Corp., and with me today are several of my associates—David M. Roderick, chairman of United States Steel's finance committee; and M. G. Heatwole, our general counsel.

We are pleased to participate in these hearings of the Joint Economic Committee and have this opportunity to present our views on the commercial health of the steel industry and its future. We have already submitted to this committee a very detailed prepared state-

ment on this subject—a prepared statement that I believe fully supports three important conclusions.

First, a financially strong, healthy and expanding domestic steel industry is vital to increasing the Nation's industrial growth and supply to curb inflation. This requires more capital formation and investment in the steel industry, as well as industry generally, to step up the overall output of goods and services, which is the only means of sustaining a rising standard of living.

Second, substantial steel price increases over the past year were necessary to cover the unprecedented cost increases in recent years. More funds for needed investment are being generated from record volume of production and shipments, and attendant short-term productivity gains, although profit margins are still at modest levels.

Third, contrary to assertions made in prior hearings of this committee that pricing practices in the steel industry have been a cause of inflation, steel company prices have responded individually and independently to cost and market conditions. The largest producer—United States Steel—generally has the lowest prices, and the smaller producers have higher prices, which should put to rest the repeated charges that steel prices behave in some arbitrary fashion, regardless of market conditions, and, therefore, require some form of Government supervision or restraint.

Senator Proxmire, before proceeding further with my statement, I must take issue with the assertion in your opening statement that the steel industry has traditionally fixed prices. This is simply not so.

EXPANSION OF U.S. STEELMAKING CAPACITY

A very critical problem in this country—and throughout the world—is the question of future steel supply. Demand for steel in this country and abroad not only exceeds the supply today, but it is growing at a rate of 2½ to 3 percent a year here at home and nearly 5 percent elsewhere in the world.

Current world trade prices for capital goods indicate that we have a clear advantage in this country in constructing integrated steel capacity. It is my belief, moreover, that steel produced here will cost less than steel produced in almost any other country in the world for sale in U.S. markets.

So, as I see it, the place to produce low-cost steel for America's needs in the future, as today, is right here in this country. Do it, I say, in American-built plants, operated by American steelworkers, using American technology that is second to none in the world.

Moreover, America's steelmills are the only dependable source of supply for the steel needed in this country to achieve industrial growth and to increase the supply of goods and services to the American people. This has become abundantly clear as rapidly growing steel demand abroad has caused foreign producers to withdraw substantially from the American market.

Now, what about America's future steel needs? Well, assuming that imports continue to supply about 13 percent of our domestic needs, as they did in 1973 and this can only be an assumption—I believe at least 30 million tons of new raw steel output will have to be added by the American steel industry by 1980. This, of course, is over and

above the substantial replacement of existing facilities that is constantly necessary to maintain our maximum present capability.

Steel companies have already announced plans to obtain, through roundout, some 17 million tons of additional production from existing domestic mills. Obtaining this tonnage will be costly. But further expansion must include totally new integrated steelplants and that cost will be staggering. So the steel industry's capital spending for expansion, replacement and for such nonproductive facilities as pollution controls will have to be at an average annual rate of nearly \$5 billion during the 1975-80 period.

That is nearly triple the level of capital expenditures made by the industry in recent years. And, gentlemen, to me that is the primary reason why the turnaround in steel company profits that is now becoming evident must be continued. American steel producers must be able to provide and attract the huge amounts of capital necessary to maintain and expand this country's job-creating domestic supply of steel. And they must be able to do it not only now, but in the future as well.

It will do this Nation little good to plan for self-sufficiency in oil and other essential needs, if at the same time our domestic steel companies are financially handcuffed in their efforts to supply the growing volume of steel needed to achieve those goals.

INDUSTRY RETURN ON SALES SINCE 1954

The shortfall in steel supply today is not a contrived situation. Profits and the prospect for profits among steel companies in recent years were totally inadequate to justify the large investments necessary for major expansion programs. Why? Well, let us take a look.

Going back 20 years, the average return on the sales dollar for steel companies, taken in 5-year periods, was 7 cents from 1954 through 1958. In the next 5-year period, 1959 through 1963, that average dropped to 5.2 cents. It rose ever so slightly to 5.6 cents on the sales dollar for 1964 through 1968. And then it plunged down to an average 3.7 cents for the past 5 years.

Last year, the industry shipped some 17 million tons more steel than it had shipped in any previous year in its entire history. If I understand the theory, record shipments are supposed to produce record returns. But the average return on the sales dollar among steel companies was less than a nickel—only 4.5 cents.

Perhaps I can put this in better perspective by relating what we have been experiencing in United States Steel. For the past 10 years, United States Steel's profits have ranged from a low of 2.9 cents on the sales dollar to a high of 6.2 cents—for an average of 4.5 cents during that period.

The highest earnings rate, however, did not occur last year when our shipments were at an alltime high. Rather, it was in 1965, when we shipped about 14 percent less steel, but earned more on each sales dollar that we took in.

Over this same period of time, productivity—or output per man-hour—rose at an annual rate of around 2 percent. The only valid rate of productivity measurement is one that covers a long period of time, since productivity is closely related to volume, which is rarely a constant thing in the steel business.

For example, from 1965 through 1970, when there was virtually no improvement in our volume of production, output per man-hour went up at a rate of only four-tenths of 1 percent a year. Since 1970, volume has increased rapidly, and output per man-hour has gone up at better than 6 percent annually. With record volume and shipments of steel out of inventory last year, the rate was inflated up to better than 10 percent.

But all of that 10-year gain in output per man-hour has been more than wiped out by steadily rising costs. Our only recourse has been to raise the prices of our steel to cover the gap, although those increases were still not enough to prevent a serious squeeze on our profits during the past few years.

EXPERIENCE UNDER PRICE CONTROLS

Now, the real rub is what happened in the last 3 years which cover the period of Government controls. Our cost increases during this 3-year period were of a magnitude of that, quite frankly, we have never experienced before in our company.

From July of 1971 through August 1974, hourly employment costs rose 51 percent. The prices of purchased goods and services increased 57 percent, with two-thirds of this occurring just in 1974. There were huge increases in the prices of many world market commodities—zinc up 126 percent; fuel oil up 172 percent; coal up 205 percent; steel scrap up 247 percent. And all of these materials are essential in the production of steel.

Over the total period of controls, and even taking into effect long-term productivity gains, our unit costs of production increased some 28 percent. But our prices rose only 15 percent, because we were not permitted to fully recover all of those higher costs. In fact, it was not until July of this year that our rate of price increases equaled our rate of cost increases—and even then, we had not obtained any margin for added costs.

So with soaring cost increases, our steel prices have been raised 40 percent from August of 1973 through August of this year. These increases have been absolutely imperative not only to cover rapidly rising costs, but to recover the margin percentage lost during the period of controls and to put us in a position to expand and help meet this Nation's growing need for steel.

The general short supply of steel worldwide has produced several results in the area of prices. One is the premium of \$50 to \$150 per ton—over and above domestic price levels—that is being charged for imported steel in this country today. The other is the so-called "multi-tier" prices of domestic producers. That is, with the excess of steel demand over supply, the prices charged by the various steel producers in this country have not been forced down to the level of the lowest prices in the market. And for the past year, domestic steel users buying from United States Steel are buying the lowest priced steel available in the United States from any place in the world.

With no let up in the very high demand for steel, we are producing every ton of raw steel we can in United States Steel—and striving to operate in the best interests of the Nation, our customers and our employees and stockholders. During the first half of 1974, United States Steel shipped an all-time record amount of steel, but once

again, our earnings fell far short of setting any kind of record. In fact, United States Steel's earnings on sales for the first 6 months of the year were 5.7 cents—much below the 10.1 cents that we earned in the first 6 months of 1959, also a period of very high shipments.

Measured in dollars, our first half profits this year were \$249.8 million, compared with income of \$134 million in the same period of 1973. This is an encouraging improvement and indicates that a level of return is finally emerging that will hopefully enable us to compete for the new capital we need to expand our steelmaking operations.

NEEDS FOR INVESTMENT CAPITAL

With the capital needs of all industry expected to be greater during the next 5 or 10 years than at any previous time in our Nation's history, the competition for new investment funds is going to be intense. The years 1973 and 1974 have been peak years in steel, and we would expect our earnings to be good. But looking to the years ahead—the good ones and the bad—we will have to earn an average return at least equal to that of other manufacturing industries. Otherwise, we will not be able to compete for the new capital we will need.

We expect to see continued gains in productivity, of course. But we also expect that cost increases in excess of sustainable increases in productivity will have to be covered by price increases when market conditions permit.

Despite the inadequate profits of the past, United States Steel has made substantial investments over the last 10 years—actually, some \$4.8 billion—indicating not only our faith in steel as a business, but our recognition of a responsibility to help supply the steel that is so vital to the growth of the American economy.

In all candor, however, this level of spending was beyond United States Steel's capability for generating the cash that we used. Our debt load was increased and had reached, by the end of last year, a high ratio of debt to total capitalization of over 27 percent. There has also been a 20-percent reduction in the dividend paid to the hundreds of thousands of Americans who own our stock.

From past spending, we did gain a complement of steelmaking facilities that is among the most modern and technologically advanced anywhere in the world. We now have greater flexibility to meet today's shifting markets for steel. And we have made tremendous progress in meeting the strict—I might even say unnecessarily strict—pollution standards that exist everywhere that we manufacture steel.

But that large amount of capital spending did not produce any noticeable increase in our steelmaking capability, and we now face an even higher level of capital spending to help meet future steel demand. The projects that our people are drawing up and reviewing for authorization this year, for example, will require an annual capital outlay of some \$800 to \$900 million—nearly triple the amounts authorized in recent years—just to increase steel availability from facilities already in place.

To expand beyond this will get us into building a fully integrated steelplant, and frankly, I shudder to think of the staggering amount of capital that such a facility will require. It would have to turn out no less than 4 million tons of raw steel annually. And that means a minimum capital investment of some \$2½ billion—or about half the

total investment we have made in all of our facilities during the past 10 years.

At the same time, we have to maintain our ongoing schedule of replacing our existing facilities as they wear out—an expensive process in itself. We face the expenditure of other vast sums, more or less mandated by the Environmental Protection Agency and those who are administering the Occupational Safety and Health Act.

It is going to be a difficult job. But if our steel operations can generate the higher levels of earnings that will provide a reasonable share of the capital and permit us to compete for new investment funds, I know our people in United States Steel have the experience and ability to use that capital wisely and efficiently.

At the same time, I do not think they can do the job singlehandedly. They are going to need a sizable amount of cooperation from both the executive and congressional branches of government in the form of sincere efforts to increase the rate of capital formation and investment in this country.

Less of our gross national product must be spent by Government. More must go toward expanding the industrial base in order to produce the goods and services needed by the American people. The share of GNP going to capital formation in this Nation last year was less than 16 percent, compared to 37 percent in Japan, 28 percent in France, and 26 percent in West Germany.

It is no longer a question of this country waiting for the rest of the world to catch up. We have got to run a little harder just to stay even. The primary elements in this worldwide economic race, of course, center about industrial production. Only with a strong industrial base can any nation—whatever its form of government—create the material and financial base to achieve its social goals.

And that is why I believe that whatever detracts from the ability of American industry to produce ever larger quantities of goods and services, with ever-increasing efficiency, detracts also from the future growth of America.

We need to continue and strengthen the free market system. We need to have faith in the millions of people all across this country who are part of this system. They are the builders of America through their talents, their efforts, their dreams, and their willingness to work, and save, and invest for a better tomorrow.

Thank you for allowing me to express these thoughts here today. I understand that my full prepared statement will be entered into the hearing record. If you have any questions at this time, I will be pleased to try to answer them.

Senator PROXMIRE. Thank you very much, Mr. Speer, for your testimony, your prepared statement will be printed at this point in the hearing record. And thank you, Mr. Jaicks and Mr. West, for excellent statements and for a most persuasive presentation in defense of your position.

MR. SPEER. Thank you, Mr. Vice Chairman.

[The prepared statement of Mr. Speer follows:]

PREPARED STATEMENT OF EDGAR B. SPEER

My name is Edgar B. Speer. I am Chairman of United States Steel Corporation. I am pleased to have the opportunity to participate in these hearings of the Joint Economic Committee and to present this statement on the "Commercial Health of the Steel Industry and Its Future."

I believe that this statement fully supports the following conclusions:

1. A financially strong, healthy and expanding domestic Steel Industry is vital to increasing the nation's industrial growth and supply to curb inflation.

This requires more capital formation and investment in the Steel Industry, as well as industry generally, to step up the overall output of goods and services, which is the only means of sustaining a rising standard of living.

2. Substantial steel price increases over the past year were necessary to cover the unprecedented cost increases in recent years.

More funds for needed investment are being generated from record volume of production and shipments and attendant short-term productivity gains, although profit margins are still at modest levels.

3. Contrary to assertions made in prior hearings of this Committee that pricing practices in the Steel Industry have been a cause of inflation, steel company prices have responded individually and independently to cost and market conditions.

The largest producer, U.S. Steel, generally has the lowest prices and the smaller producers have higher prices, which should put to rest the repeated charges that steel prices behave in some arbitrary fashion, regardless of market conditions, and therefore require some form of governmental supervision or restraint.

While these observations and conclusions about the Steel Industry are clearly borne out by the facts in the matter, I am sure that you gentlemen recognize that I cannot speak with authority or precision as to the varying pricing situations, actions or views of the many individual companies comprising the American Steel Industry. All told, there are nearly 250 American steel companies operating some 450 plants in thirty-eight states. More than 80 of these companies, large and small, produce their own raw steel and process it into a wide variety of steel mill products such as sheets, bars, pipe, plates, shapes and wire.

THE NATION'S STEEL SUPPLY

From the standpoint of the nation's total steel supply, about 70% of the tonnage is produced by the 12 largest American steel companies. More than 17% of the nation's steel supply was imported in three of the last six years. In this connection, it may be a somewhat surprising fact that of the 12 largest steel companies in the free world today, only three are American. Four are Japanese and the other five are in the European Common Market countries.

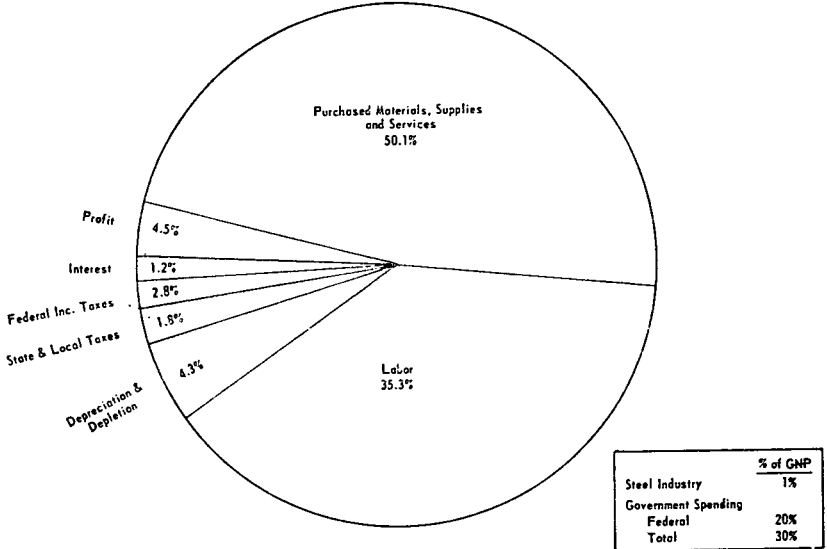
With worldwide steel demand surpassing supply over the past two years, the foreign producers have elected to increase their sales in foreign markets at the higher prices obtainable there, which has reduced the supply to this country. This clearly demonstrated the well-known fact that this country cannot safely rely upon foreign sources for sustained availability of steel products—or of any other material that is basic to the economic health of this country, as dramatically illustrated by the recent oil crunch.

So now this country has an urgent need to assure that its supplies will henceforth be adequate—particularly the supply of steel, which is basic to the needed growth of this country's overall industrial output.

THE AMERICAN STEEL INDUSTRY

Is the Steel Industry presently in good enough shape to do the job? Let us first consider where the domestic steel sales dollar went in 1973. This is shown in Chart 1.

CHART 1

DISTRIBUTION OF SALES DOLLAR
Steel Industry
1973

Source: American Iron & Steel Institute

Of the total Steel Industry revenues, 35.3% went to cover the cost of labor. Another 60.2% went for purchased materials, depreciation, interest and taxes. After deducting these costs, there remained only four and a half cents profit from each sales dollar—hardly an impressive rate of return by any reasonable standard—so it must improve, and it is improving, as I will come to shortly.

In 1973, the Steel Industry contribution to GNP, that is, the "Value Added in Manufacture", was approximately \$14.5 billion, or only 1.1% of our nation's \$1.3 trillion economy. For perspective, government spending at all levels amounted to more than 30% of the total GNP, with Federal spending in 1973 amounting to \$264 billion, or 20% of the country's total GNP. The widely diffused Steel Industry, aggregating only 1% of GNP, is clearly relatively tiny compared to the huge government sector.

Pruning of the Federal Budget to the presently targeted \$300 billion for the current fiscal year will still leave a huge increase of Federal spending over prior levels. But unlike the Federal government, the Steel Industry's full output—presently more than two million tons of finished steel products every week—must be substantially increased, not cut back, to keep this country's industrial economy moving ahead. The nation's steel producers, however, haven't earned the money necessary to enable them to provide the capacity needed to meet the nation's burgeoning demands for steel, and nowhere near enough is abuilding for the increased future needs of a growing economy.

Before considering the prognosis for recovery from this latent iron-anemia of the nation's economy, I think we should, all understand what brought it about. In the Steel Industry, as in other basic industries requiring heavy capital investment, long lead times of several years or more are necessary for major new installations of increased capacity. Thus, the reason for the shortage of steel capacity today is simple. The steel companies' profit returns and prospects for profits in recent years were inadequate to warrant or support the large capital investment programs necessary for any major expansion of steel capacity.

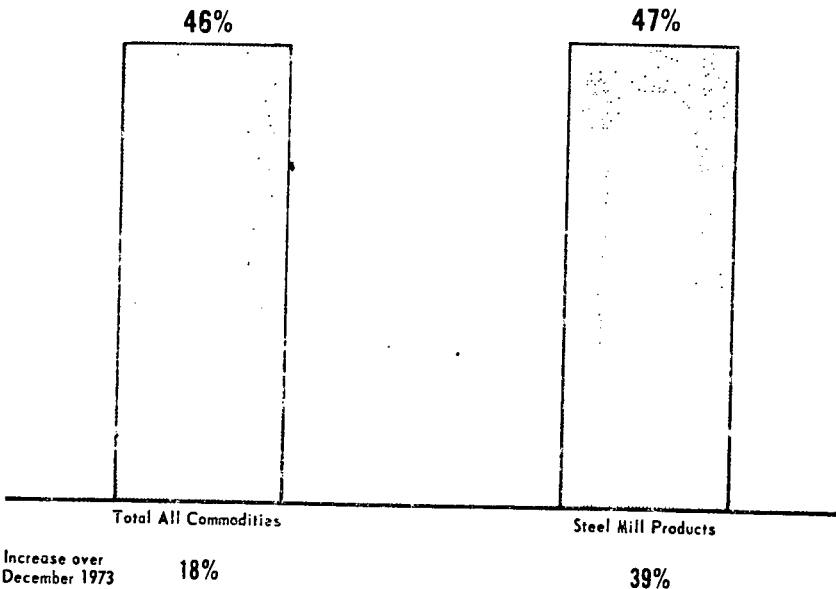
While many companies have recently announced plans for increases in capacity of nearly 17 million tons within the next few years, this is generally rounding out existing complements of facilities. The necessary expansion beyond this phase will take much longer time and much larger investments.

THE IMPACT OF CONTROLS

The past 2½ years of wage-price control was not entirely responsible for the accumulated capacity deficiency, but it certainly injected a massive dose of bad medicine. Despite government controls, and in part because of them, rapidly rising costs and prices have been working their way through the economy from a variety of sources—some international in origin, such as rampant inflation abroad and the Arab squeeze play on oil. Steel prices were tightly held down, however, while the prices in many other sectors such as imported materials, and imported materials like coal and scrap used in steelmaking, couldn't practically be controlled at all.

The government's simplistic solution to its own deficit-inspired inflation was to squeeze industrial cost-price relationships, such as for steel, within and below the depressed levels immediately preceding the controls period. The program was obviously no solution to the basic need for generally increased capacity and growth of supply to meet rising demand. The inevitable results are with us today—greatly increased wholesale prices across the entire economy, as well as pressing needs for the industrial expansion that was deferred by controls. Much of what you see now is the bulge in prices that was inevitable due to the deferrals of cost passthrough that should have occurred during the controls program. Wholesale price increases for steel and for all commodities over the last three years are shown on Chart 2.

CHART 2

INCREASES IN WHOLESALE PRICE INDEXES
August 1971 to August 1974

Source: U.S. Department of Labor

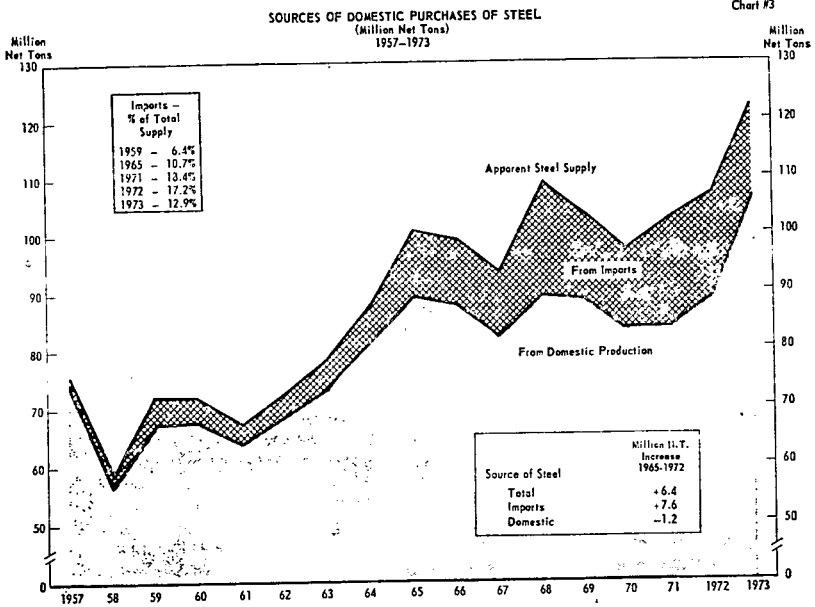
The BLS Wholesale Price Index for all commodities increased 46% over the three-year period from the beginning of controls in August 1971 through August 1974. The year's steel price increase of 39% over year-end 1973 brings

steel to only about the same total increase over the three-year period as the overall increase in wholesale prices, which for the most part was experienced during the controls period. The bulge in steel price increases this year primarily reflects the fact that steel price increases were held far below other price increases—and below the cost increases to steel—during the period of controls. Thus, over the three-year period, the total increase in steel prices is generally in line with the overall increase in wholesale prices.

THE IMPACT OF IMPORTS

In the years preceding controls there was also insignificant growth of steel capacity. A major factor in this slow-growth period was the rapidly rising tide of foreign steel coming into this country. Actually, steel consumption in this country increased substantially during the 1960's, as shown in Chart 3.

CHART 3



Imports supplied only 6.4% of the nation's steel needs in 1959; but by 1965 imports were up to 10.7%. The impact was even more severe after 1965. By 1971, imports reached the record annual high of 18.4% of total steel supply. They were only slightly lower in 1968 and 1972. In 1973, imports dropped 2½ million tons; however the total payments for imports was more than in 1972 with the advent of premiums for imported steel as availability was reduced. The average price of imported steel in 1973 was 18% higher than in 1972, while the tonnage was down 14%.

From 1965 to 1972, annual steel purchases in the economy increased 6.4 million tons while imports rose 7.6 million, with steel from domestic suppliers actually declining 1.2 million tons. Thus, over the 7-year period imports took all the growth in consumption—and then some. The intense competition of domestic and foreign producers for the domestic market was also a losing battle for the do-

mestic produces financially. As imports increased, profit margins deteriorated with the efforts of domestic producers to maintain volume in the face of foreign government support of predatorily and unfairly priced imports while labor and other costs continued rising.

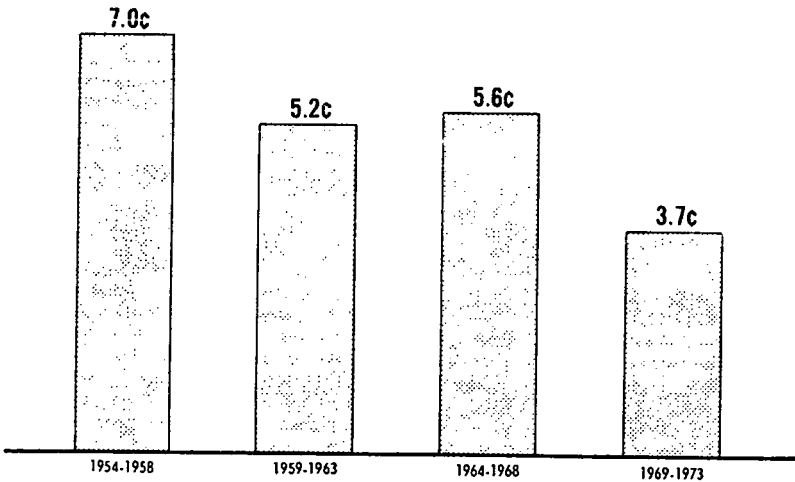
STEEL INDUSTRY EARNINGS

The loss of ability to provide or attract the heavy capital investment necessary to maintain and increase this country's supply of steel is indicated by the history of the steel companies' profits over the past twenty years, as shown in Chart 4.

CHART 4

STEEL INDUSTRY PROFITS
RETURN ON SALES DOLLAR
1953 - 1973

During the latest five-year period,
the profit rate was only about half
that of 1954-1958.



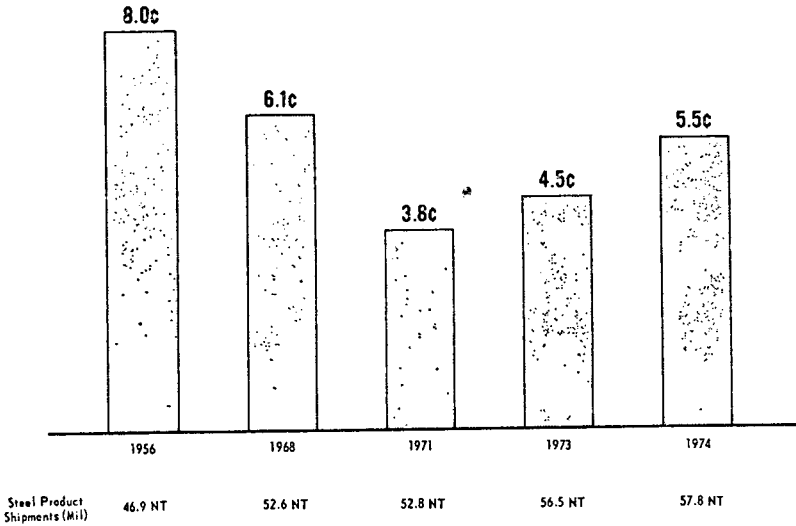
Source: American Iron and Steel Institute

In successive 5-year periods, profits in terms of cents per sales dollar were: 1954 through 1958—7.0¢; 1959 through 1963—5.2¢; 1964 through 1968—5.6¢; and 1969 through 1973—3.7¢. The last year in the entire period 1973, was up to the rate of 4½¢ on the sales dollar that I previously mentioned. But this was only with record volume, which should have produced record returns. Instead, it was well below even the lackluster margins of the mid-1960's. The controls beginning in 1971 had locked steel into the worst cost-price squeeze experienced since World War II.

Now, let's consider how much the Steel Industry's earnings recovered in the first half of 1974. This is shown in Chart 5.

CHART 5

STEEL INDUSTRY PROFITS
RETURN ON SALES DOLLAR
First 6 Months of High Volume Years



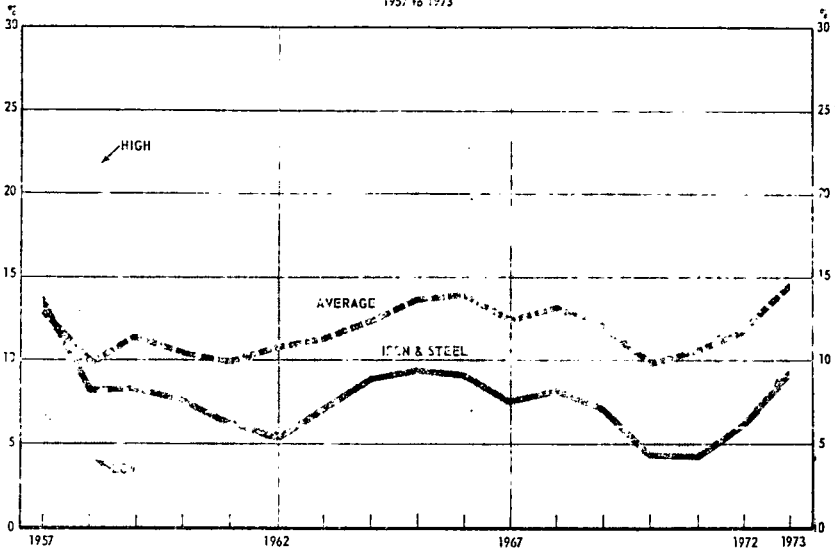
Production and shipments were "all-out" as they were for most of 1973, with shipments reflecting a substantial drain of inventories beyond the maximum effort to produce steel. Profits allegedly "soared"—but only up to $5\frac{1}{2}\phi$ on the sales dollar, or 1ϕ over the aforementioned $4\frac{1}{2}\phi$ in 1973. The first half of 1971, which generally established cost-price relationships for the controls period, had produced profits for that period at the dismal level of 3.8ϕ on the sales dollar, even though the shipment level was only about 10% below the first half of 1974. By 1971, increased labor and other costs had severely squeezed steel company profits. The last prior year at a roughly comparable first half shipment level was 1968, when the return already was down to 6.1ϕ . So at $5\frac{1}{2}\phi$ in the first half of 1974, the Industry has yet to fully recover even to the mediocre margin of 1968.

EARNINGS—STEEL VS. PRINCIPAL MANUFACTURING INDUSTRIES

Margin is one measure. I think it is even more instructive to consider the recent rates of return on stockholders' equity, which are shown in Chart 6.

CHART 6

PROFIT AS PERCENT OF NET WORTH
 PRINCIPAL MANUFACTURING INDUSTRIES vs. IRON AND STEEL
 1957 to 1973



Source: First National City Bank (New York)
 * 40 industries in 1972 and 1973; 41 in prior years

The position of Iron and Steel among the manufacturing industries tabulated by the First National City Bank (N.Y.) in the three years of 1970-1972, was dead last in profitability. The improvement in 1973, with volume up about 25% over the average of the preceding three years, brought Steel up to 36th place of the 40 industries. 1974 should show a more substantial gain.

Admittedly, such ranking of profitability by industries is only one indication of the relative attractiveness of Steel for the limited overall availability of capital funds. But it does provide substantial evidence, in my opinion, that the improved financial results for the steel companies which are now beginning to emerge are absolutely essential to the economic health of the domestic industry. They are clearly a "must" for bringing about dependable increases in the supply needed to meet the nation's steel requirements, which are expected to continue growing at the rate of 2½ to 3% per year.

FUTURE STEEL REQUIREMENTS

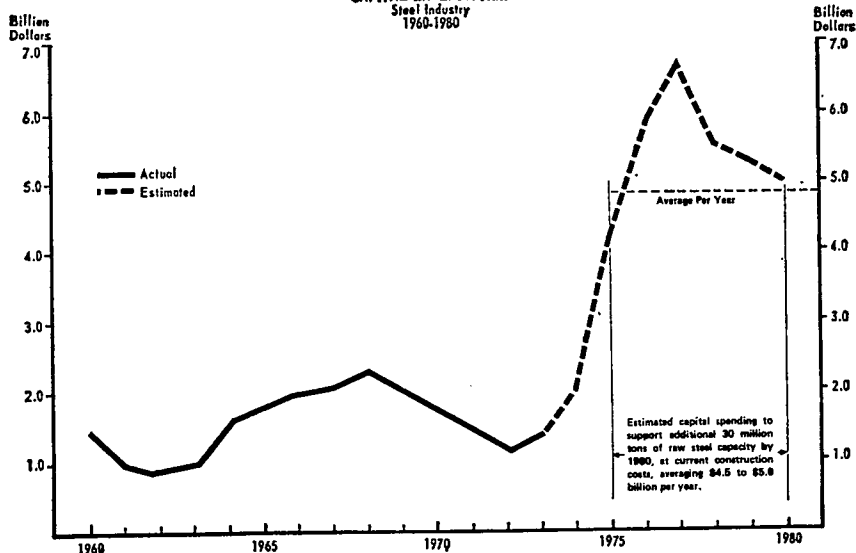
The steel needs of the rest of the world are growing at an even faster rate than the U.S.A.—approaching 5% per year, according to the widely accepted estimates. All other regions of the world have more pressing, if not overwhelming, needs to generate the immense amount of capital required to expand their steel producing capabilities apace with the rapid growth of their industrial economies. Consequently, it would be totally unrealistic to anticipate that any significant sustainable surplus steel producing capability will be available from the rest of the world to make up for any continuing steel deficit in this country.

Costs of construction and costs of production have been escalating rapidly around the world just as they have in the United States. Based on present world trade prices for capital goods, it is our belief that there is a clear advantage in constructing integrated capacity in the U.S.A. Similarly, it is our belief that steel produced in the United States will cost less than steel for the United States produced in virtually all other countries in the world. Consequently, as I see it, the low cost steel for this country in the future, as well as now, is steel produced right here in this country in American-built plants, operated by American production workers with American technology that is second to none in the world. Furthermore, as we have seen recently, this is the only dependable source of supply for American industry in today's real world of nations whose actions are governed by their own political and economic needs—and their political needs come first.

In my view, it is not a question of whether, but when this country can phase out its reliance on other countries for a significant portion of the growing steel requirements that are essential to keep this country's industrial economy running in high gear.

By 1980, assuming imports continue at the 1973 level of 13% of total domestic steel supply—although admittedly there is no assurance such level would continue to be available during future peak periods of demand—meeting the domestic steel needs would require additions to domestic raw steel capacity of at least 30 million tons over and above the substantial continuing replacements necessary to maintain the maximum present capability. We estimate that 1975-1980 expenditures, at current construction costs for continuing replacements and for government mandated non-productive facilities such as for pollution control—plus 30 million tons of expansion—would nearly triple the level of capital expenditure for the industry over recent years. As indicated in Chart 7, this would increase the level of capital expenditures to an average annual rate of 4½ to 5 billion dollars per year.

CHART 7
CAPITAL EXPENDITURES
Steel Industry
1960-1980



Some additional investment beyond this will be necessary in expanding dependable supplies of raw materials. Further escalation from continuing inflation would, of course, compound the expenditure requirements. Even so, I believe there is no alternative to substantially stepping up this country's industrial capacity for increasing productivity and supply—which is essential to any real progress in stemming inflation.

Major increases in capital expenditures for many companies would undoubtedly go beyond the abilities to finance expansion from their internally generated funds. Consequently, it is essential that the rate of steel company profits on their expanding investments be maintained at levels competitive with alternative investment opportunities available in the capital markets. In this respect, the attitude and actions of the government are crucial. Any revival of its past propensities to squeeze Steel Industry profits below levels which will attract investment will quickly choke off the nation's needed growth in domestic steel capacity and supply.

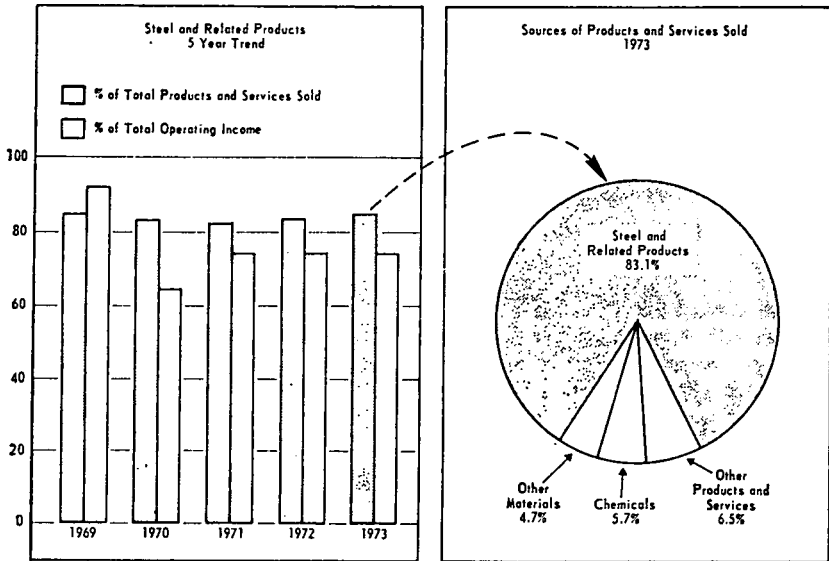
U.S. STEEL'S OPERATIONS

To bring the general situation of the steel industry into closer focus, perhaps a more specific review of some of these matters as they relate to U.S. Steel will be helpful.

U.S. Steel's principal business is the production and sale of virtually the entire range of steel mill products and various steel products manufactured from them. We are an integrated producer starting with the mining of coal, ore and stone. Some of these basic materials are also sold. Over the past five years, steel products in all forms provided about 80–85% of our revenues and provided from 64 to 92% of operating income, as shown in Chart 8.

CHART 8

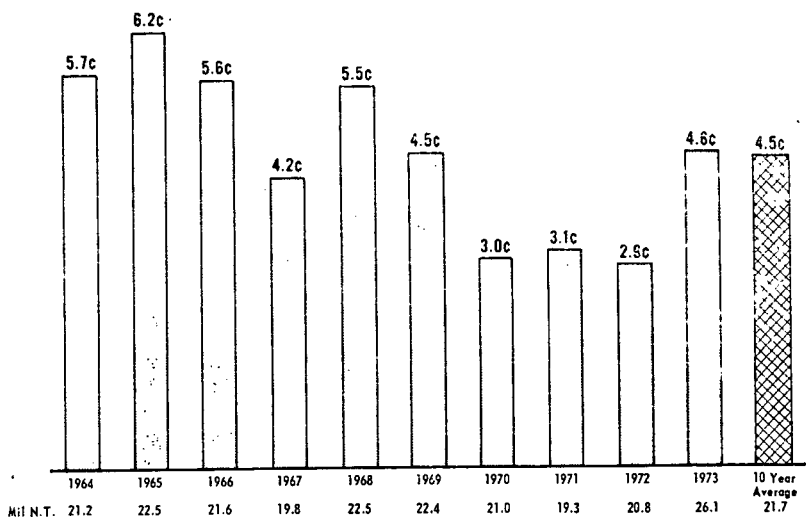
U. S. Steel Corporation
SIGNIFICANCE OF STEEL AND RELATED PRODUCTS TO TOTAL RESULTS



Chemicals, agricultural and industrial, provide about 6% of our revenues; sales of various other materials about 5%; and all other activities, including public transportation services and real estate, about 6%. For 1973, steel contributed about 83% of our revenues and only 74% of operating income. The rates of return we have earned have been unsatisfactory for a number of years. They have been inadequate to support or attract investment for expansion of steel capacity. This earnings history of the past ten years is shown on Chart 9.

CHART 9

U. S. Steel Corporation
TREND OF PROFIT PER SALES DOLLAR
1964 - 1973



During the ten years, profits ranged from 2.9¢ to 6.2¢ of the sales dollar, and averaged 4.5¢. The highest earnings rate in the period was not in 1973 when shipments were at all-time record levels of 26.1 million tons, but rather in 1965 when shipments of 22.5 million tons yielded the 6.2% rate. In 1973, earnings were only 4.6¢, a rate closely comparable to that earned in 1969 when shipments were some 3.7 million tons less. Such a low rate of earnings is entirely inadequate to justify or encourage investment in the much needed expansion of steel facilities. In fact, in recent years the capital investments made by U.S. Steel have been heavily directed to projects which had more attractive prospects than steel.

U.S. Steel wants to stay in the steel business and to grow in the steel business. We are convinced that the future growth in demand for steel will require major expansion, but such expansion will only be undertaken if the level of earnings attained and the prospects for continued earnings at that level will provide reasonable returns to stockholders, funds for reinvestment in the business, and are competitive with those earned by other manufacturers so that investors will be willing to invest in steel.

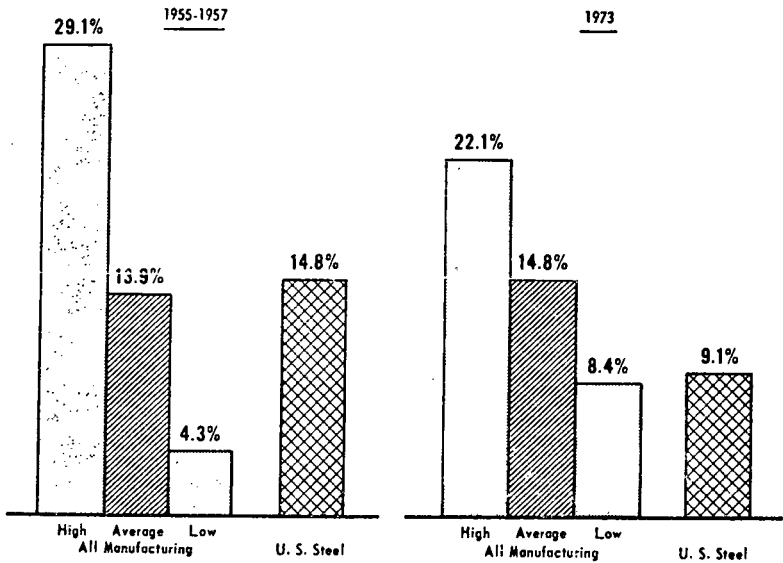
U.S. STEEL'S FINANCIAL NEEDS

Let me give you my views on what return is needed. In 1955-1957, the last period of virtual peak operations, U.S. Steel shipped an average of 24.3 million tons of steel products per year. Earnings averaged 8.9¢ on the sales dollar and 14.8% on stockholders' equity. The 14.8% return on equity was comparable, not

to the highs, but to the average return for all manufacturing industries as published by First National City Bank, as shown on Chart 10.

CHART 10

RETURN ON NET WORTH
U. S. Steel vs. All Manufacturing
1955-1957 and 1973

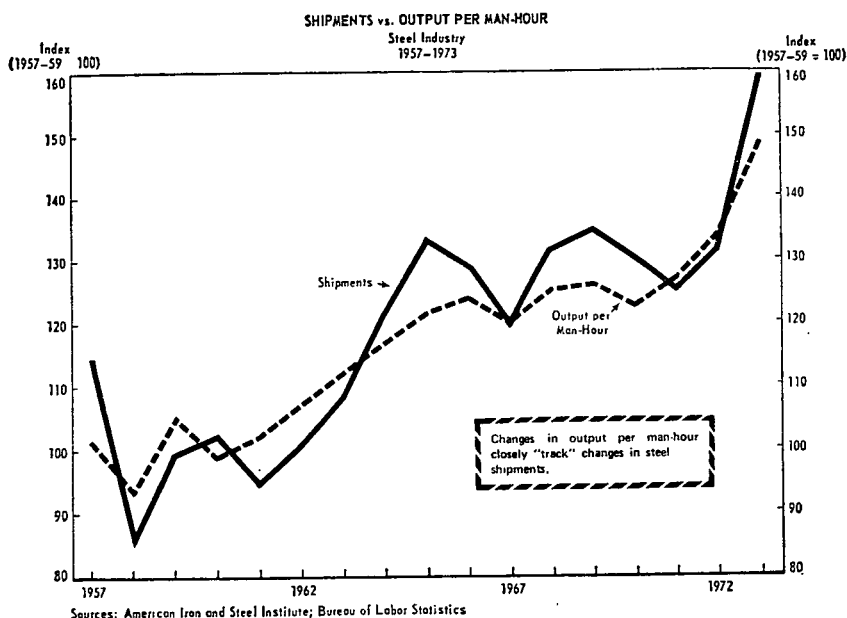


Source: All Manufacturing - First National City Bank

In 1973, with record peak operations, the return on equity for U.S. Steel was 9.1% compared with an average return for all manufacturing industries of 14.8%. For 1974, steel operations continue at peak levels. Under such conditions, earnings should also yield peak returns. In years of soft demand, they will be less. To accomplish the needed expansion, we will have to earn through the good and bad years a return at least equal to that of the average for other manufacturing industries. Our objective is to be competitive in earnings. Otherwise we cannot compete for the new capital needed. With competitive earnings, we would expect to finance our capital needs through reinvested earnings and the ability to attract new investment. We expect to see continued gains in productivity, but we also expect that cost increases in excess of sustainable rates of gain in productivity will have to be covered by price increases when market conditions permit.

There was improvement in output per man hour despite the fact that all the growth in domestic volume from 1965-1970 was siphoned away by imports. It is well recognized that improvements in output per man hour go hand in hand with increases in volume, and this is apparent in Chart 11.

CHART 11



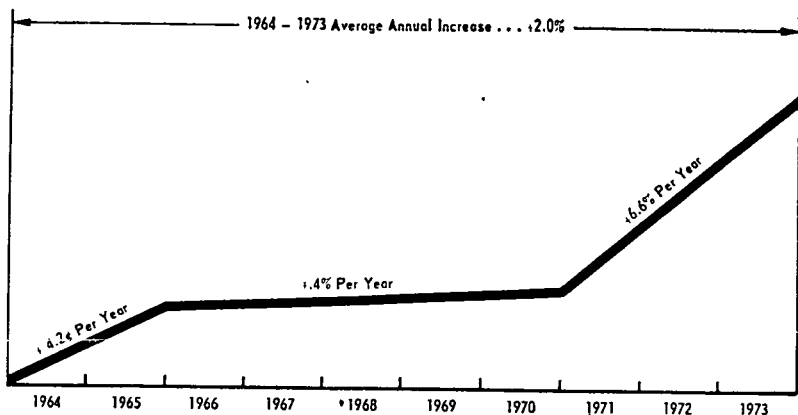
Another source of improvement comes from capital investment, and this source did provide gains. For the full period, our output per man hour rose an annual rate of improvement of about 2%, which is in line with the long term, sustainable trend of productivity in the Steel Industry.

The movement of productivity during this period is informative in understanding what has happened recently. It also demonstrates that the only valid rate of productivity gain is one which covers a long term period. Most economists and other students of this subject subscribe to this view. The Cost of Living Council, in fact, specified for each industry the long term rates of productivity gain to be used in determining allowable cost increases for price increase approvals.

The growth in productivity in the 10-year period covered extremes, as shown in Chart 12.

CHART 12

Steel Industry
TREND OF OUTPUT PER MAN-HOUR
1966 - 1973



From 1965 through 1970 there was virtually no improvement in volume, and consequently output per man hour increased at a rate of only 0.4 percent per year. After 1970, with rapidly increasing volume, output per man-hour has increased at an average rate of better than 6% per year, and in 1973—infused by shipments out of inventory—was more than 10%. But now that we have reached full output, this short term rate of gain cannot be maintained, for there is little additional production capability available and minimal inventories available to boost shipments.

But the overall 10-year gain in output per man hour was more than wiped out by continuing cost increases. The prices of the materials and services we buy to produce steel rose 49%. The hourly employment cost for 1973 averaged \$7.86—some 63% higher than for 1963. Steel prices had to increase to cover the gap. They moved up some 39%, but this was not enough to prevent a serious profit squeeze.

U.S. STEEL AND GOVERNMENT CONTROLS

I believe it most important that we understand the events of the last three years of this period, for those events are in large part the reason for this hearing and the characterization of the price increases that have been made as "enormous" and of a magnitude double that of any previous year. These price increases were absolutely necessary for the following reasons:

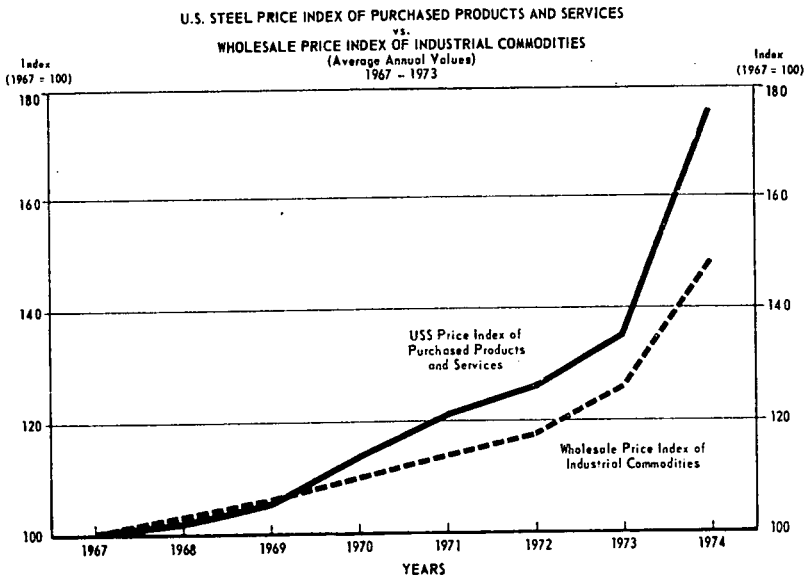
1. Cost increases during this period were also of a magnitude never experienced before.

2. Government interference in the marketplace, particularly during the peak demand period from January 1973 forward, forced artificial deferral of necessary cost-covering price increases into the last few months.

The result was low earnings from steel operations during the period of controls, further squeezed by the deteriorating cost-price relationship—a fact obscured by the benefits from increased volume and short term unsustainable gains in productivity. From July 1971 through August 1974, hourly employment costs were up 51%. The average rate in August was \$9.70 per hour. The prices of purchased products and services had risen 57%, with two-thirds of that increase occurring in 1974.

The prices of purchased products and services used in steel operations have increased much more than the BLS Wholesale Price Index of All Industrial Commodities, as shown in Chart 13.

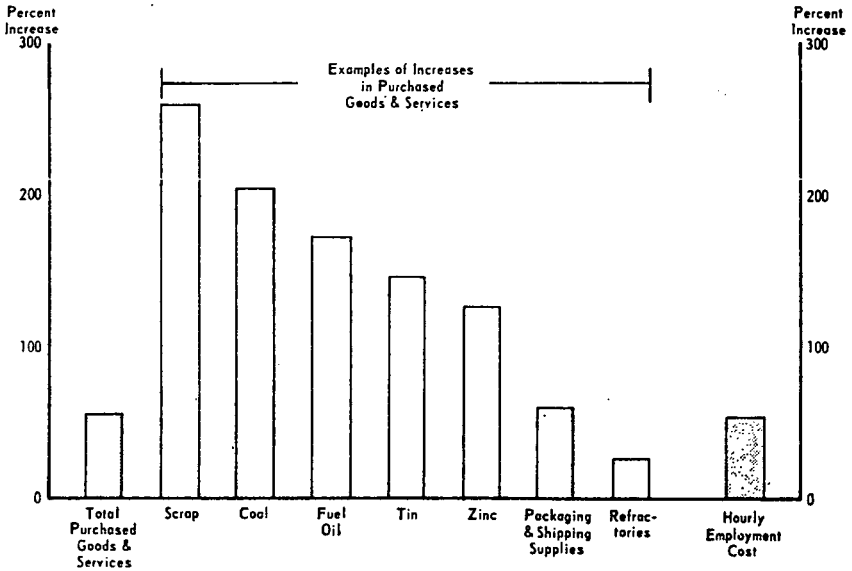
CHART 13



The U.S. Steel price index of purchased products and services used in steel operations rose at about the same rate as the Wholesale Price Index of Industrial Commodities from 1967 to 1969. Thereafter, the U.S. Steel price index of items used in steel operations increased at a much faster rate, reflecting the relatively high proportions in the steel materials mix of items which have far outpaced the average price increases of Industrial Commodities. Price increases for some of the major items over the last three years are: coal increased 205%; zinc, 126%; tin, 142%; fuel oil, 172%; scrap, 247%; packaging and shipping supplies, 59%; and refractories, 27%, which was below average, as shown in Chart 14.

CHART 14

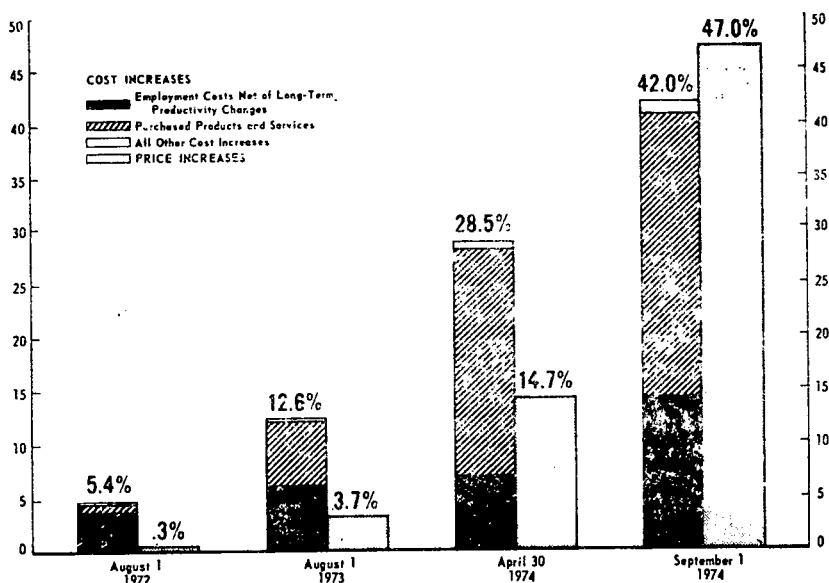
U. S. Steel Corporation
COST INCREASES SINCE BEGINNING OF CONTROLS
Through August 1974



Expressing these as unit cost increases in accordance with the Cost of Living Council formula, we find that after deducting long term productivity gains, by April 30, 1974 when controls ended, unit costs had increased 28% and price increases amounted to 15%, as shown in Chart 15.

CHART 15

U.S. Steel Corporation
 COMPARISON OF COST AND PRICE INCREASES
 From Beginning of Price Controls Through September 1, 1974
 STEEL MILL PRODUCTS



Under the Cost of Living Council rules, these price increases only partially recovered costs and provided for no profit margin. It was not until July of 1974 that the percentage increase in prices came up to the percentage increase in costs since the start of controls, and even then we had not obtained any margin for the substantial added costs. So, during that nearly 3-year period of controls, millions of dollars of costs remain unrecovered. Profits did improve in the first half of 1974 because of increasing volume and the attendant short term productivity gains.

Through August 1974, prices of steel products since the start of controls, as measured by the government index, had risen 47%—the rise has been 40% since August of 1973. Clearly these price increases were justified to cover cost increases, to recover the lost margin, and to help make the steel operations financially able to support expansion. They were made under market conditions of sustained demand in excess of available supply. American-made steel is still a bargain. Foreign producers shipping into the U.S. market since early 1973 have been and are still obtaining premium prices of \$50 to \$150 per ton above domestic prices.

U.S. STEEL—1974

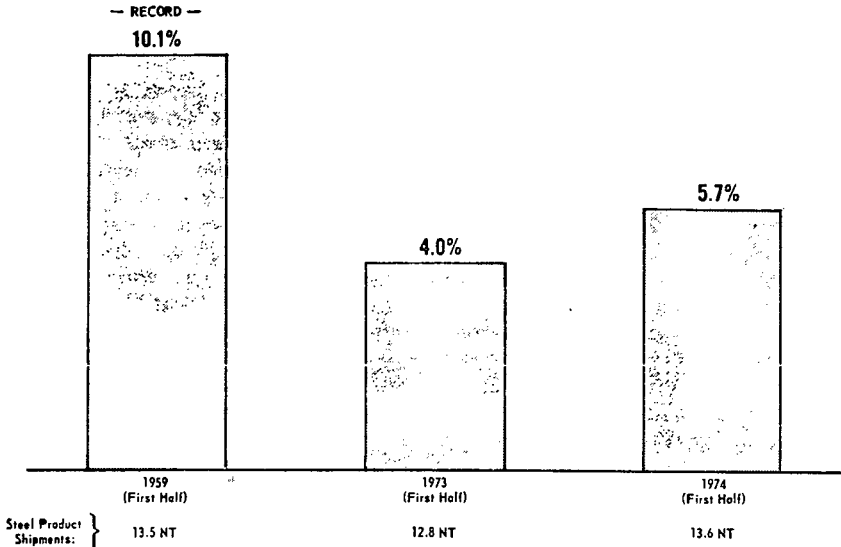
The general short supply of steel in this country that has enabled foreign producers to sell at such premiums has also resulted in the so-called "multi-tier" prices of domestic producers. That is, with the continuing excess steel demand over supply in this country, steel prices of the various producers aren't forced down to the lowest prices in the market. We believe that U.S. Steel's prices are generally the lowest prices for steel products available in the domestic market today.

We have heard statements about our 1974 results which need clarification. Here are the facts. Profit for the first half of 1974 was \$249.8 million on sales of \$4.4 billion, compared with first half 1973 income of \$134.0 million on sales of \$3.3 billion. The improvement in earnings reflected gains in steel operations as well as continued improvement in most non-steel operations. Steel products shipments, aided by inventory reductions, were at a record level of 13.6 million

tons, somewhat above both the previous high in 1956 and the first half of 1973, as shown in Chart 16.

CHART 16

U. S. Steel Corporation
PERCENT RETURN ON SALES
Record Half vs. First Half 1973 and 1974



Despite record shipments of steel products in the first half, earnings were not at record levels for the 6-month period. Earnings for the first half of 1974 were 5.7% on sales. This compares to a rate of 10.1% for the previous record six months of 1959.

Furthermore, in judging today's profit dollars, keep in mind that the purchasing power of today's profit dollar is substantially less than that of a few years ago. In addition, profits reflect depreciation costs allowed to recapture only the dollars originally spent, and that amount of dollars will not cover the cost of replacing those facilities. In effect, phantom profit dollars are being taxed as if they were real profits and the result is paying out in taxes what is in reality capital that is needed for growth.

U.S. STEEL AND THE FUTURE

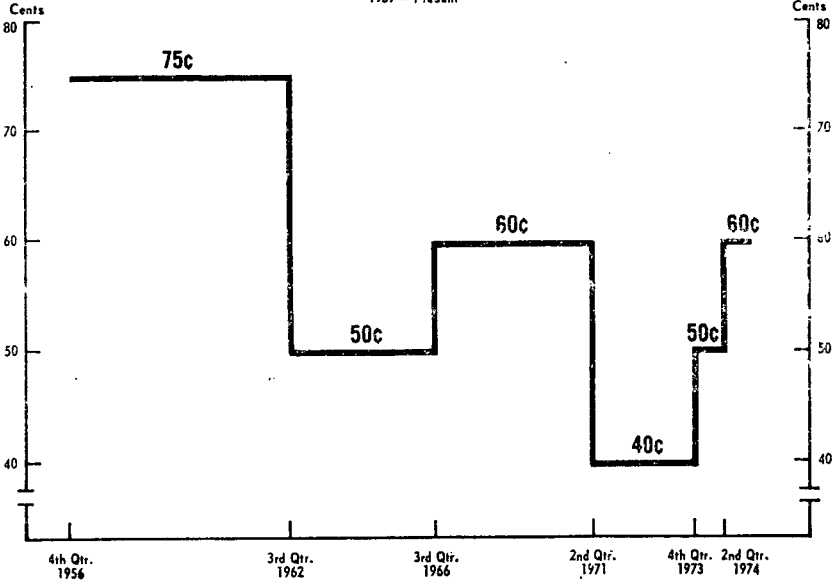
The improvement over last year's results is encouraging because it indicates that a level of profitability is emerging which can stimulate steelmaking expansion within the domestic steel industry. Such additional steel capacity is important to the economy as a whole.

U.S. Steel, by its investment decisions, has demonstrated its belief in steel as a business and in the steel business as a vital part of our economy. In spite of the inadequate level of profitability during the last ten years, we did make substantial capital investment. At the end of 1963, the investment in U.S. Steel (equity and debt) was \$4.3 billion. Since then, \$4.8 billion has been spent for new plant and equipment. Such spending gave us a complement of technologically modern steelmaking facilities with greater flexibility to meet shifting steel markets, better raw materials, an expanded chemicals operation, and facilities to provide cleaner air and water. It did not provide us, however, with any noticeable increase in our capability to make steel.

Even this level of spending, however, was in excess of our capabilities for generating cash. Dividends to our hundreds of thousands of stockholders were reduced in 1962 from the 75¢ quarterly rate to 50¢, and were dropped to 40¢ in 1971, as shown in Chart 17.

CHART 17

U. S. Steel Corporation
 QUARTERLY COMMON STOCK DIVIDENDS PER SHARE
 1957 - Present



The dividend has been increased this year to 60¢, so the stockholders have yet to catch up to earlier rates of payout. Since the cash available from operations and for reinvestment did not cover spending, our debt load was increased and has attained a high ratio of debt to total capitalization at the end of last year of 27.1%.

Looking ahead, our requirements for capital will be enormous for the steel expansion projected. We have already stepped up our capital program. Authorizations for new facilities averaged about \$333 million per year during the controls program. We are currently reviewing projects for authorization this year, which will step up this level to some \$800-900 million annually. Even this level of spending will accomplish only modest increases in capacity, so as we contemplate even further integrated expansion plans, we hope to be able to support further sizable increases in our capital spending.

Included in our current plans for capital spending are some roundout type projects which will increase steel availability by eliminating bottlenecks. U.S. Steel has announced that it would provide 5 million tons of additional raw steel annually by the end of 1976. Nearly 2 million tons of that increase should be available by the end of 1974. Though the capital cost of these and other roundout programs are much less than the cost of constructing new integrated capacity, there is a limit to capacity roundouts. Further major expansion will probably require the building of a fully integrated plant, the capital requirements for which are staggering. Our latest estimates indicate that the minimum starting size of such a plant should provide for at least 4 million tons of raw steel to produce 3 million tons of finished product.

At current investment cost of about \$800 per annual ton of product capacity, this investment alone would require \$2.5 billion of capital. We will, at the same time, have to continue replacement of existing capacity as it wears out and to spend vast sums required by government agencies such as EPA and OSHA. These amounts, too, are staggering. The job can be done, but only if steel operations generate adequate earnings for reinvestment and the attraction of new investment, and only if government requirements for mandated expenditures are realistic as to timing and real proven need.

U.S. Steel has spent billions in recent years to replace and modernize its plant and equipment with the expectation of earning for its shareholders a reasonable return on that investment. The economic climate that is essential for U.S. Steel

to justify financially the billions of dollars yet to be spent can only exist if that climate exists for all industry. The solution to part of our nation's current problem of double digit inflation is dependent on additional availability of goods and services to relieve shortages and to bring supply and demand in balance.

THE GOVERNMENT'S ROLE

U.S. Steel commends the Administration and Congress for recognizing that inflation is today's Number 1 domestic problem. Quite clearly, curtailing this intolerable rate of inflation and helping to insure that our nation enjoys sufficient goods and services in the future depends importantly on increasing the nation's rate of capital formation.

The share of the nation's Gross National Product going to capital formation last year was 15.7% ; this compares with 37% in Japan, 28% in France and 26% in West Germany. The consequences of our nation's inadequate capital investment have been clearly apparent in recent months: obsolete production facilities, too little economic growth, insufficient creation of new and better jobs and, perhaps most apparent, inadequate availability of goods and services and an intolerable rate of inflation.

Capital for additional investment is derived primarily from savings of individuals and from savings of corporations (profits reinvested in the business). Savings of individuals have been inadequate because the prospective returns on savings have been insufficient to cause people to save rather than to consume. In addition, tax laws have encouraged current consumption at the expense of saving and investment.

At the corporate level, profits as a percent of the Gross National Product have been on a downward trend for many years—moving from slightly above 8% in the post-war 1940's to around 6% from the early 1950's through mid-1960's, then downward to a low of 4% by 1970, and have recovered to only about 6% in 1974. Low levels of profit have provided insufficient incentive and inadequate ability for industry generally to invest in new plant and equipment. The speed with which businesses are permitted to recover their capital investment through depreciation allowances also has an important bearing on the incentive and ability to invest; capital cost allowances as a percent of this country's Gross National Product have shown no increase since the mid-1950's and are relatively lower than in most other industrialized nations. They obviously have been inadequate and must be improved, both for stemming inflation and for creating the industrial jobs that will be needed over the next decade.

Recent levels of taxation in this country have siphoned off dollars that otherwise might have been available for private savings and investment. A recent study by the Tax Foundation indicated that taxes are higher per capita in this country than in every other major industrial country except Sweden. The share of the GNP represented by government expenditures has grown enormously through the years and has diverted funds otherwise available for capital investment.

The needs for capital throughout the economy for some years to come will be enormous. One recent study of business fixed investment estimated that the total needs over the next twelve years will be some \$3.3 trillion—triple the level of the last twelve years. Every industry has its own unique needs. For example, in transportation there are critical shortages today of certain types of freight cars, and there is need for better track work to permit more economical speeds. In the utilities industry, construction should be under way on more generating capacity needed in the next few years, but capital shortages are forcing postponements. Lack of available energy will also force curtailment of production in the winter.

It is obvious that there is no quick or easy answer to the related critical problems of curtailing inflation and stimulating capital formation. But this is not to say that these problems cannot be solved, if the Federal government will: (1) adopt tough anti-inflationary policies and prove to the American people that it has the "will" to continue those policies until they produce the desired results, (2) adopt policies aimed at stimulating savings and investment. Briefly, such policies should center on five approaches:

(A) Adopt a tight fiscal policy which holds Federal expenditures to a bare minimum. We must reduce the proportion of our total wealth going into the government sector and allow a greater flow of monies into the private sector for increased saving and investment. All new government spending proposals and all

existing government spending programs should be subjected to tests such as the following:

1. Is the activity absolutely essential?
2. Is it essential that the activity be undertaken by government, or could it be carried out through private initiative?
3. Is it essential that the activity be undertaken by the Federal government or should it be a state or local responsibility?
4. If undertaken, how can the activity be conducted at lowest cost?

(B) Continue gradual moderation of monetary policy, but still maintain it reasonably tight. Monetary policy, by itself, cannot be expected to curtail the multifaceted inflation being experienced, but nevertheless is useful as one of a number of anti-inflationary tools.

(C) Stimulate greater saving and investment. Virtually every industry in the nation is in need of additional capital; one recent estimate places the total need over the next dozen years at some three times the level of the last dozen years. Savings to provide for such capital can be encouraged by removing present disincentives from the tax laws and replacing them with meaningful incentives. Among other things, our tax laws should refrain from higher taxes on incomes derived from savings and on business income. More flexible capital recovery should be permitted at an accelerated rate, with such capital recovery beginning as soon as it is spent. Immediate write-off of pollution abatement facilities should be permitted. The investment tax credit should be increased. A foreign trade bill should be provided that will assure investors in long-lived assets equal treatment to that accorded investors in other countries by their governments.

(D) Establish national priorities for the flow of capital to anti-inflationary, productive investment versus investment in that portion of pollution abatement facilities which, while necessary, is only marginally productive and can be deferred.

(E) Continue the free market economy, with no reimposition of either direct or indirect wage and price controls. History has demonstrated the clear superiority of the market system as a means of conducting our nation's economic affairs. This is a lesson we should not have to continue to relearn every few years.

Senator PROXMIRE. Now, I think we can agree that we want a healthy, strong, profitable steel industry, and I emphasize profitable. Profit is not a bad word, it is a very good word, and obviously we cannot expand, cannot grow, cannot have what we need to increase wages and have a better standard of living unless we have good profits in this country. We recognize that. I do not want anything that I am going to say to indicate that I am opposed to a profitable industry. It should be profitable.

I would agree also it has not been as profitable as it should have been in some years in the past.

At the same time, we also want, as I am sure you want, to reduce this raging inflation. So my goal, as I indicated in my opening statement, is that we have no further big increases in steel prices for years to come, and we can do that without crippling the steel industry and without limiting your expansion. It seems to me that we will have accomplished something if we can get some understanding that you will do all you can to achieve that. If we get understanding on that this morning, I think we will have made real progress in this hearing.

PROJECTED SOURCES AND USES OF FUNDS

Now, let me be specific. As I understand it, the present net income of the steel industry is about \$1.2 billion. I am not talking annual rate, I am talking about what it was for the first 6 months of 1974. This compares with the total of \$1.4 billion for the entire year in 1973.

Net income in 1972 was only about \$900 million. Since the second quarter of 1974 steel prices have gone up about \$36 per ton or about 15 percent further.

I estimate that costs rose by about \$10 per ton or about 4.5 percent in the third quarter.

If the industry ships 25 million tons a quarter—actually a little more—the increase in net income after taxes is over \$300 million per quarter. Therefore, for the second half of the year the net income should increase to at least \$1.5 billion. That means for the whole year profit will be \$2.7 billion. Therefore, you can say that the steel industry will almost double its profits in 1 year, and remember that 1973 was a fairly good year.

Last year, the industry reduced its external debt by \$300 million and has been improving its debt-equity ratio for the past 2 years. I, therefore, will include some net new debt.

Let me add the new debt at a rate which will not increase the industry's debt-equity ratio. I find the annual sources of funds from new income, \$3 billion; depreciation, \$1.5 billion; net debt, \$700 million. This yields a total of \$5.2 billion.

Dividend payments last year were running at an annual rate of \$500 million. This year plant and equipment expenditures, including \$400 million for pollution control, will total \$1.8 billion.

The uses of funds, allowing for generous increases in the coming year, might come to \$1½ billion for replacement and modernization; pollution control, \$500 million; cash dividends, \$800 million. Expansion of 3.3 to 3.5 tons at \$475 a ton could be done by rounding. I think this is conservative. And based on part of what Mr. West provided, and others, that is \$1.6 to \$1.7 million.

That is a total of \$4.5 million for the uses of funds.

Therefore, there is some \$700 million remaining for nonsteel outlays, for working capital and to cover some cost inflation.

STEEL PRICE OUTLOOK

This is why I say on the basis of the price increases you already have, looking at these figures as carefully as we can, it appears that there does not seem to be any basis for any further big price increase in the future.

Mr. West, would you like to respond to that?

Mr. WEST. Well, Senator Proxmire, as I indicated in both my oral statement and my prepared statement, our prices were cost-related and the escalation of our selling values this year were directly proportionate to the increase in costs that we had sustained.

Senator PROXMIRE. Let me—

Mr. WEST. Just to continue, I also made some reference that we were taking a first step toward increasing our profitability.

If our costs continue to escalate, we may not achieve an increment in profitability. So I think this is a question that answers itself.

Senator PROXMIRE. Well, I have in my mind an analysis the staff has worked very, very hard on. They have gotten the best expertise they could and they confirmed many of the assertions that you gentlemen have made about the terrific increases in some of your costs. But they have broken down these increases so they get the entire picture of your cost, not the fact that scrap has gone through the roof and some other costs have gone up very sharply. But they have factored it in so that each of these costs is put in the perspective of how much that adds to your overall costs.

For example, the scrap increase is very heavy, it is far more than 100 percent over the last year, but only represents about 2½ percent of your total cost. When we do that, when we take all of the costs that you have—the increase in the price of steel scrap, coal, 66.8 percent, and so forth. When we take the materials and multiply them by the amount that is of your total cost and then take labor, which represents, as I understand it, about 35 percent of your total cost, and the labor increase while substantial, is far, far less than the price increase steel had overall, it results in an increase in your average costs, when you allow for productivity, of 21.9 percent, 22 percent in the past year. Yet the price increase, as I say, is about 44 percent.

So you have increased your prices twice as much as you have increased your costs. You gentlemen have all given me some very proper and accurate descriptions of individual cost increases, but none of you has put it together to indicate how much your costs have increased in relation to your price, and we have, it seems to me, an irrefutable logic in the fact that your profits have increased very greatly. As I say, I do not necessarily quarrel with the increase in profits, I think these have been very great, but it would seem to me that your price situation is now healthy enough from your standpoint that you do not need any further price increases.

Mr. Speer.

Mr. SPEER. Senator Proxmire, I think if you and I could stop the clock right now I would agree with you. In other words, if all other prices remain in place for an extended period of time, I think the assumption that you have made, then further major increases in the price of steel products would not be necessary. But here we sit—

Senator PROXMIRE. Let me, at this point, say that is a very helpful observation on your part, Mr. Speer. This is exactly what I am trying to get at. There is not any question that in the last year, and you have made a good, strong case for it—in the last year you have increased your prices more than your overall cost increases, and the evidence is clear in the fact that you have improved your profit position.

Now, if you are telling me that in the future you would expect price increases in the steel industry to reflect cost increases, and without any further need for catchup, I think we would have achieved a great deal.

Mr. SPEER. I think the catchup or that bubble that has gone through the economy since May 1, 1974, is working its way through the economy, and I would not expect a bubble such as the one that has been experienced over the past 4 months to happen again.

Senator PROXMIRE. Mr. Jaicks, did you want to comment?

Mr. JAICKS. I just had a couple of comments.

The numbers came out pretty fast from your staff's résumé, Senator Proxmire, but I do not track some of the numbers that did come out.

First, it seems to me fair to date back not to the first of the year but to date back to the start of controls when we were locked into the—

Senator PROXMIRE. I took a full calendar year, August 1973 to August 1974.

Mr. JAICKS. But I still think the datum ought to be July or August 1971 when we really lost so much ground.

If you will ask your staff, I do not have any pride of authorship in the bar chart No. 8,¹ have them take a look at that, you will find over that period up to the current date our price increases are not ahead of our cost increases at all. They are just about on parity, if you will note that.

There was some mention in your comments about your staff's résumé of a 5-percent increase in costs and I did not get the time period, but I have gotten really out of Inland's cost sheets what our cost increase has been from the end of controls, April 30, 1974, up to the current date, September 30, and we show a 19 percent cost increase in that interim period since control. This is cost sheet data. The only other number I recall is the number of \$475 per annual ton of shipped product for investment cost, and this project that I described in the brief of ours has an \$800 a ton cost, not \$475. It is not totally rounded out, it is not totally "greenfield," call it the "brown-field" thing. There is some utilization of some existing finishing capacity which when we get more steel we will be able to get more product out.

There is also a major big investment in blast furnace, one of the more expensive capital tools which we have in there, which may be more categorized as greenfield.

Senator PROXMIRE. As you know, I did concede you had some catchup coming, and I am not arguing with you about that. But, given our present situation, would you disagree with Mr. Speer that price increases should generally reflect cost increases?

Mr. JACKS. I certainly do. I wish I could be sanguine that we are not going to have more than minimal cost increases up ahead before we get control of this thing. Coal is one that was mentioned.

DEMAND PULL VERSUS ADMINISTERED INFLATION

Senator PROXMIRE. Now let me try to put this situation in perspective.

Mr. Speer, you argue that the steel industry is really small potatoes compared to the Federal Government in spending in your detailed analysis; that the impact of Federal spending on prices is far more significant than the impact of your industry on inflation. Impressive figures.

I would like to dispute you a little bit on that.

I would agree that Federal spending in the past has been highly inflationary. That is why I introduced and secured passage of the Proxmire amendment, which would reduce Federal spending by \$10 billion below the President's request and balance the budget. We got that passed in the Senate twice. It has not been passed in the House. I do not know whether the President will approve it or not. But I agree that Federal spending in the past has been inflationary and it has very unfortunate monetary consequences, because the Federal Government has to borrow so much when it itself increases its debt.

But I disagree vigorously that my amendment would do as much to restrain inflation as price stability in steel, chemicals and other concentrated industries, and here is why:

¹ See chart 8, p. 149.

We just do not have a demand-induced inflation, the kind of inflation in which a government-induced slowdown would reduce prices. If this were so, prices would not have been rising in the past year. Consider retail sales, which are the best indication of demand. From a physical standpoint, retail sales have been declining, they are lower now than they were last year.

Production, as you know, is down. Indeed, in your own industry, with your very, very big price increases, production and physical sales are not up, they are down in your industry. When I look at the Business Week statistics, every week steel production is down below the week of last year.

Now this does not indicate to me that a slowdown is called for overall, although perhaps it is in the steel related industries. Consider unemployment. It just increased last month by one of the biggest margins in a long, long time. We now have 5.8 percent of our work force out of work. Now, does this indicate that a further slowdown, more unemployment, is the answer to inflation?

Consider further that the work force worked an average of less than 37 hours a week this year, the shortest hour workweek we have had in the history of this country ever, including the depth of the depression. That indicates to me this is not a demand type of inflation.

The answer is obvious. With the end of price-wage controls, the Federal Government no longer determines price levels, so while Federal spending is wasteful and does indeed contribute to inflation, it does not do so through the pressure on demand. But in your industry it is obvious to anyone who does not believe in the Easter Bunny that competition does not fix prices. Administered price leadership, under the umbrella of such corporate giants as your company does.

Incidentally, one big reason the Government is spending more is because the Government has to pay more for all the steel that it buys, especially for defense. These price increases in steel and elsewhere contribute to the inflation in so many other commodities.

If you would like to respond to that, I would like to hear it.

Incidentally, I have just received word that the Antitrust Subcommittee staff estimates various steel companies have been convicted or pleaded nolo contendere to price-fixing charges 15 times in the last 15 years. So it is not a situation in which there generally is the kind of price competition we would expect.

Mr. SPEER. Well, generally, I think as far as prices are concerned in the steel industry, anyone who wants to compete for the business that is available will put his prices down to the lowest price producer. This is our way of business.

Senator PROXMIRE. Why is it, as we so often have in the past, that with a softening of the demand, and steel operating far below local capacity, prices have not fallen, they have gone up. They go sharply, but they never seem to go down?

Mr. SPEER. Well, I think what you are referring to, though, is the published price, not the competitive price in the marketplace with any given customer.

Senator PROXMIRE. Well, I questioned the Commissioner of Labor Statistics, Mr. Shiskin, who testified before us Friday on that, and he agrees that you are right about the competitive market not being reflected in the published price. They argue they work very, very hard to get the statistics to disclose the actual price. That is what they are

supposed to do, not to report a fiction but what the price actually is. But they rarely show prices ever going down in the industry, they show them stable or rising under all circumstances. That is hardly a competitive situation. You can see how farm prices fluctuate.

Mr. SPEER. Of course, that is a general statement and I take it as such.

For example, over the past 6 years, when imports were heavy in our market, for all practical purposes the foreign steel producers, for example, took over merchant wire products. Those of us who produce merchant wire products went down as far as we felt we could go, then just dropped out of the market. So, consequently, what happened? At the time, for example, when price controls went into effect, the foreigners moved out of the market, or sold their products at exceedingly high prices. Take bailing wire as an example. There was a great plea for certain companies in this country to go back and make bailing wire. Our prices were fixed at an unrealistic price with no relief in sight at all.

Now, sure, I think that we can take average prices and we can see certain things, but when we take a look at the individual product-line prices, they do change. Senator Proxmire.

Senator PROXMIRE. Well, foreign prices, overall foreign steel prices, have gone down as well as up. They have gone down very sharply. At times they seem to fluctuate.

Mr. SPEER. They go up a whole lot more than ours.

Senator PROXMIRE. The American steel seems to have a one-way ticket to heaven, they seem to go up all the time.

Mr. SPEER. Today with the foreign steel coming into the country at a rate of about, well, it is a net rate of about 8 million tons, the foreigners are taking a trade balance out of this economy over and above what that same steel would cost the domestic producers, of over \$3 billion, and this does not make sense.

Senator PROXMIRE. Mr. Jaicks.

Mr. JAICKS. There really are a number of cases that fly in the face of the fact that steel prices have not gone down. I can think off the top of my head a major slash in merchant bars, in 1972, \$25 a ton, initiated by one producer, which Mr. Speer suggested. If you want to sell in that game you have to be in it, and the industry as a whole did meet that price cut. There was a hot roll band slash of a similar type in the late sixties. Another element of the thing is change in product description which has had major and significant impacts on prices. The shift to the sale of sheets on a theoretical weight basis was an 8- or 10-percent reduction in the price of that product right off the bat, which a producer initiated and the rest of the industry had to follow.

There has been the introduction of class B and class C grades of cold rolled sheets which had a similar effect. And then, furthermore, to say that there has not been a difference in the published and transaction prices in the period 1970, 1971, and 1972, just is not looking at it realistically, because there have been significant amounts of discount.

It is true that the Bureau of Labor Statistics reports the published prices, not the transaction prices, but they were significantly different during that low period.

Senator PROXMIRE. Well, let me just read an excerpt here from Iron Age of July 15:

The most decisive price move in recent steel history has been initiated by Bethlehem Steel Corp. In the current strong market, Bethlehem says its increases "recognize higher price levels already established by other producers." A quick check of published base prices of other producers failed to show this kind of parity. Yet, there is no question a lot of steel has been sold at elevated prices.

This has made for a fragmented price situation. In some cases, it has resulted in price gouging. It's possible Bethlehem wanted prices high enough to head off an auction market. If the practice of daily bidding took hold, moreover, it would be disastrous in a market slump.

All steel men want a greater measure of price uniformity. All top executives have endorsed the idea of profitable pricing.

Mr. JAICKS. Senator, it is not well understood but it certainly should be well understood that in the production and marketing of a homogeneous product such as steel, that no one supplier is going to be able to get more for his product than another supplier is, because given the similarity in the product, the lowest price is going to prevail, and so ultimately you are going to get down to a level where everybody has to meet the other fellow's price.

Senator PROXMIRE. Consider wheat as an example. There you have real competition except where the Government steps in and stops it, of course. But there you have competition inasmuch as prices go way up and way down, way down, and you have an absolutely homogeneous product. There is no difference within one grade of wheat between thousands of farmers producing wheat that is identical. Nobody can tell the difference, yet the price fluctuates way down as well as way up.

Mr. JAICKS. I understand that.

Senator PROXMIRE. In 7 months this year the price of farm products went down.

Mr. JAICKS. I am not an expert in the field but I submit one major difference. One is the seasonality. Another is uncertainty about weather, drought and that sort of thing that exists in the market and causes some of that change that does not exist in my market.

Senator PROXMIRE. There were drops in many months where normally the price of wheat goes up. At any rate, I do think there is a considerable body of conviction, right or wrong, that there is a degree of rigidity in steel pricing and that the price rarely drops.

MEASUREMENT AND EXPANSION OF STEELMAKING CAPACITY

Let me move to something else. I would like to get into the need that you have for additional capital in order to expand capacity.

I understand, in the first place, that capacity is about 10 million tons greater than indicated by the industry. This would mean a peak utilization rate in the fourth quarter of 1973 of about 90 percent of physical capacity instead of 97½ percent. Based on intimated industry figures.

In the first place, why in the world do we not have the capacity figures disclosed publicly, why are they not made available, what is so secret about it? This is not a matter of national security. Would we not be in a far healthier, more wholesome situation, if we knew just what the facts are, and were able to determine whether the assertions of the steel companies are right or wrong. See, what makes me very suspicious is, although you gentlemen have had these fine profits and enormous increases in prices in the last year, in spite of that, and in

spite of the fact that there must have been some expansion in facilities, you are producing and selling less steel than a year ago. It is awfully hard to understand how that can be if you are going all out.

Mr. SPEER. Well, I think, Senator Proxmire, you almost have to clarify *what* capacity. In other words, are we talking about raw material availability and its relationship to production of finished product? Are we talking about raw steel production? Are we talking about shipped steel production? I think that it is well worth mentioning that the industry today is hampered, as far as capability is concerned, from a number of external things that are occurring.

For example EPA with their stringent regulations on coke plants. The industry's coke plants are cut back to about 85 percent of their capability. This is having a tremendous effect. The coal industry has not been able to mine enough coal to take care of their export commitments as well as the domestic needs to even keep our coke plants going without our going offshore for coal, which is a ridiculous thing, in my opinion. The great Mesabi Range that supplied iron ore to the American steel industry for many, many years is worked out. By the 1978-79 period the run-of-mine ore in the Mesabi Range will be completely depleted, which means that the industry must invest in mining the taconite ores and upgrading them to take the place of that capacity.

So that really, there is a whole combination of things.

What the three of us have said, I think, today, and certainly what I tried to say is that United States Steel is producing every ton of steel that we are capable of producing with the restrictions, both internal and external restrictions, that we are faced with.

Senator PROXMIRE. Well, I would like both Mr. West and Mr. Jaicks to comment on this.

I understand Mr. Jaicks is head of the American Iron and Steel Institute, which compiles statistical information; is that right? Is that one of the things under your jurisdiction?

Mr. JAICKS. Yes, sir.

Senator PROXMIRE. You are the president of the Institute?

Mr. JAICKS. I meant to give you the background. The industry had traditionally up until the late fifties, I think 1960 itself, compiled capacity utilization data from its member companies, which represent well on to 90 percent, I think, of the domestic—

Senator PROXMIRE. Why was that discontinued? Why do we not get that now?

Mr. JAICKS. I think it really ties in with what Mr. Speer just said. That it was recognized at that point that the complexities of trying to set a capacity level were such that it was really a submission of fallacious data, because you can set capacity based on what each individual company thinks its individual steelmaking units can make, that is what that one facility, plant or open hearth plant or electric furnace, the actual point of production unit might be.

Senator PROXMIRE. We have statistics on the capacity in other industries. They are complicated too. They also have the same kind of difficulties that steel has in not being able to produce because of environmental restriction reasons and for other reasons.

Mr. JAICKS. I cannot comment on other industries but I can submit the fact that in the best judgment of the leadership of the industry, the stating of the theoretical capacity of the sum total of all of the

steelmaking units, assuming it was a raw steel production capability, does not supply good enough, accurate enough information to really give a measure of that particular statistic.

Senator PROXMIRE. It would seem to me with all of the perceptiveness you have in your industry, and I think you have a lot of intelligence and ability in the management level in steel, you could make these estimates. You gentlemen are able to make projections as to how much you want to expand, how much you should expand in the future. You give us very explicit and exact indications what capacity has to be. If you know that, I cannot understand why you cannot compute your capacity and what level you are operating at. You have a chart here that you presented.

Mr. JAICKS. I was going to comment about it, too. That even really is misleading in a sense. I did supply, Senator Proxmire, 5-year capacity data for this one steelplant. A company such as ours has a simpler time doing this because we have one steelplant unit, as I said earlier. But the statistics I show you, they really are misleading in a sense. I believe that figure shows for our internally stated capacity, that Indiana Harbor plant, 8.2 million annual raw steel production rate. I think I also inferred, if I did not actually state, that we are running on an all-out basis and yet our estimated 1974 production will not be quite up to that 8.2 million. The reason is exactly the reasons that Mr. Speer stated with regard to the raw materials availability. We have had the same problem that most of the companies, basic producers in the industry have had this year. We have had a very, very difficult time getting the stocks of coke we need to make the requisite amount of blast furnace pig iron that becomes a charge to the steelmaking furnaces, whose ideal capability may go up to the 8.2 million.

The net result is lower blast furnace production, inability to substitute adequate quality scrap for the lower blast furnace output, which means those steel furnaces that are all involved in the 8.2 million idealistic capacity rate will not be able to produce up to what we say they will right there. And it is not a big shortfall, as I recall the numbers, it is within 100,000 tons of design capacity, and we are backing these problems away as hard as we can. But with inadequate raw materials of the type that were assumed to be able to be available under ideal conditions, we simply cannot run at our capacity.

Senator PROXMIRE. What I suggest you do, and it would be very, very helpful for policymaking in the Congress and, I am sure, for the President and for other people in business, your customers and so forth, if you could make estimates, indicate they are estimates, and indicate the difficulties and the fact that they have to be hedged and qualified. But if you give us what you could for the industry as a whole, it would be very helpful for us to understand this and it would be fair.

Mr. JAICKS. I have your message and we will certainly take it up in the policy group.

Senator PROXMIRE. Now, a part of the reason for this big price increase, and you agreed that even with your projections it seemed adequate provided your costs were covered in the future. Part of the reason for the big increase in prices is to take care of the future demands for steel, to increase your capacity so you could meet it.

Now, your two biggest markets are automobiles and construction, as I understand it.

In the automobile industry, certainly the outlook there seems to be cloudy for two reasons. No. 1 is that the number of automobiles sold reached a very high level last year. It indicates that it is going to be lower this year. And there are all kinds of energy reasons that are long run and others why the demand for automobiles might not rise at the rate it has in the past.

No. 2, even if the demand does grow at that rate, there is a clear indication that they would be smaller cars that use less steel. So that that area of steel demand, it seems to me, might be moderate, might be less.

The second, of course, is in the area of construction. We have had a boom, as you know, in investment in plant and equipment over the past few years. That is one of the best and strongest parts of the economy. In fact, it kept the rest of the economy from going into a real tailspin. We do not know how long that is likely to continue. And certainly in the residential area we have a depression, and high interest rates are likely to continue for some time.

When you put these elements together, it would seem to me that you may be overstating your estimate of capacity needs.

Mr. Speer came in with an estimate of 30 million tons by 1980, as I understand it. Mr. West had a more moderate estimate of 25 million tons. How can you be so confident that over the next 6 years, by 1980, you would need that much?

Mr. WEST. Senator, I would like to—

Senator PROXMIRE. Mr. West, you went on to say there would have to be another 25 million tons by 1985.

Mr. WEST. That is true. I would like to make one observation, that you know you have to look at the difference between long-term and short-term steel demand. Obviously, we are all concerned about an analysis of the market and where we are going short term. But in the best judgment of the international steel market and our own economic forecasts, even though we may have some peaks and valleys in shipping or consumption of our products, looking down the road the trend for the long term is clearly indicated. This is not only substantiated by the three of us here, but the balance of the American industry and the world steel industry.

Mr. SPEER. Of course, there is one other thing, Senator Proxmire, I think is worth mentioning. When you talk about the automobile industry—

Senator PROXMIRE. Go ahead, I missed that.

Mr. SPEER. There is one other point I think should be made when you are talking about the automotive industry.

A good share of the American automobile industry is multinational, they produce automobiles the world over.

Automobile companies can buy American steel and ship it to almost anyplace in the world cheaper than they can purchase that same steel in the country where they are operating their stamping plants offshore.

Actually, our experience in selling steel to the three major auto companies has not shown any 19 percent fall-off which would reflect their production. It was one point that I tried to make, and hopefully did, that as we see it, things have changed and they change quite dra-

matically. Today it would appear as though steel made in America will compete in the American market by a country mile, given fair trade treatment, against products that are imported into this country.

Senator PROXMIRE. I think that is right. There are all kinds of reasons why it should. Our steel operations are the most efficient anywhere. I understand, with the possible exception of Japan.

Mr. SPEER. Plus—

Senator PROXMIRE. Number of man-hours, which is the best indication there is overall—eliminate all of that monetary folderol and concentrate on the number of man-hours it takes to produce a ton of steel—I understand we are more efficient than the European producers and we are probably as efficient or more efficient than the Japanese, are we not?

Mr. SPEER. I would think that the Japanese would probably be as close to us as anyone. But there is a reasonable margin of difference between the European and the American steel industry. But we have an opportunity in this country to not only produce steel for our own needs but to produce steel for the world marketplace, and it would seem to me as though as long as we have this advantage in the United States we should be making the most of it.

Senator PROXMIRE. Well, now, I have here a document from J. R. McAlpine of Armco Steel, Inc., in which he says:

The shortages will disappear in most products, although plates may be an exception due largely to the massive efforts of most industrial countries to become more self-sufficiency in energy. During the first half of 1974 another 3.0 million tons of steel went into stocks, raising them above normal. The world steel boom will run out of gas much as it did in 1971.

When you look around the world at the economic conditions of a number of countries, you have to look at the desperate countries like Italy and some of the developing countries, but even the more settled countries are having their difficulties. You wonder if the demand is not softening. The drop in prices by the foreign steelmakers indicates that is the case. So I wonder if—

Mr. SPEER. We have very definite indications this is a fact.

Senator PROXMIRE. Well, then, Mr. West, you said, "Do not look at the short run, think of this in longer terms." But you did not document it. That is good rhetoric. We always like to be optimistic. I just gave a series of speeches on what is right with the Federal Government, so I feel that way, and there are some things that are right, that are right with our country.

But I think we ought to be as specific as we can if we are going to assume that the future is going to be stronger rather than saying we like it that way. Sometimes we have been disappointed in the past. What is your specific basis for that?

Mr. WEST. I think we made reference in my prepared statement and somewhat in the oral statement to the growth of GNP. I think in making a forecast for the demand of any product they look at the rate of increase of GNP, which happens to be 3½ percent in the United States per year.

Senator PROXMIRE. Just take the 3½ percent and assume we are going to do that in the future.

Mr. WEST. You have to make some observations from somewhere, and I think it is a rather conservative number. If you translate growth of GNP whether—

Senator PROXMIRE. I am not so sure. I hope that is right. I hope we are going to grow. There are a lot of reasons why we may not. Pollution is one problem, and that has all kinds of facets, that is going to tend to inhibit growth to some extent. The fact we now have a situation where every family has a television and radio and a very large proportion of our families have automobiles. We do not have a surfeit of the world's goods. We still have people who have modest and poor circumstances, but we have made such great progress. I wonder if that tremendous growth we have had in the past is going to continue.

Mr. JAICKS. Senator, the 25 million tons or so do not represent some major increase in per capita consumption of steel in the United States. The fact is that it is based something around 3 percent per capita consumption sort of along with population growth.

Senator PROXMIRE. Close to zero now.

Mr. JAICKS. One of the big elements of the change is that because of the shifting cost advantage we do not any longer see the foreign suppliers supplying the growth in the market. We are going to grow ours in order to come up with minimum growth. Experts that are looking at it worldwide, and these are some academicians and some people in Government looking at this thing, say that in the developing countries and some of the more advanced countries abroad, you are going to have much higher growth rates than that, sufficiently higher to not only take all of the steel that can be produced overseas but some of our own steel as well, as Mr. Speer suggested. So this really is not a real blue sky estimate in terms of what is going to be needed by the domestic industry to meet demand, it is a normal growth rate.

Senator PROXMIRE. There has been a high world growth rate but then again, we may be enjoying an advantageous position now we will not in the future because of the undervaluation of the dollar. There is wide speculation that an inflow of petro-dollars for investment plus the fact that other nations will be more dependent on imported energy than we will, may cause the dollar to appreciate again from its present level. As it appreciates that means that you are at a disadvantage, that your prices relatively become higher.

Have you taken that into consideration?

Mr. JAICKS. Well, it is hard to speculate on that. I quite agree that is a possibility. If we do have something other than the disadvantaged fixed rates we got rid of in 1971, it seems to me those things are self-correcting over time.

Mr. SPEER. I think there is one other thing, too, Senator Proxmire, and that is with world growth excluding the United States somewhere around 5½ percent for steel, at least from all of the information we can get, the foreign steel industry is having as much of a problem with capital formulation as the domestic steel industry—

Senator PROXMIRE. Well, that is a good point. That is a good point, to the extent that they cannot expand it and to the extent that steel demand, world steel demand holds up, that may be a significant development.

Mr. SPEER. Plus the fact that with the changes in the raw material situation around the world, these countries that have been major producers of steel and have been 100 percent dependent on others to supply the raw materials, find themselves in an exceedingly vulnerable position today, particularly with the raw material costs or prices going

up by leaps and bounds as we have experienced over the past year or 2 years.

Senator PROXMIRE. Well, now, let us assume that your great profits and big increases in prices can result in producing greater capacity, the difficulty is that the steel industry is taking in big profits right now and actual commitments to investment in new capacity relatively small. Bethlehem, for example, is proposing in general terms to spend \$2 billion by 1977 but has actually committed only \$100 million.

When will firm commitments start being made?

Mr. WEST. We are currently right now spending funds for this program that I covered in my prepared statement, Senator Proxmire. I think that we made reference to several steps, including a new BOF plant at Burns Harbor, increasing our steelmaking capacity at Burns Harbor by a million tons, 600,000 tons at Lackawanna.

The costs that were referred to of \$500 million covered those costs over and beyond the ongoing costs of maintaining the plant in a modern condition.

We have allocated, we are spending moneys right now for these new facilities. The blast furnace at Sparrows Point is underway. We have construction going on at Burns Harbor.

So that when we say this is what we are going to do, we are actually spending and committing funds right now for this expansion.

Senator PROXMIRE. Well, now, I have here an item from the Wall Street Journal of September 30, which said that Mr. Foy of your firm said a decision on further expansion probably will not be made until next year's first half. In December 1973, then-chairman Stewart Cort said Bethlehem was prepared to spend more than \$2 billion to add 6 million tons of capacity by 1985, if the Government will remove price controls from the steel industry. The rate of progress on the so-called Project 85 will depend on Bethlehem's ability to achieve a satisfactory return on sales—8 percent is a minimum goal—and the outlook for raising capital.

So it looks as if you have not made your decision.

Mr. WEST. Yes, we have made the decision on phase 1 of the 1985 project.

Senator PROXMIRE. \$500 million?

Mr. WEST. I think in answer to your question, we have taken the bull by the horns and assumed we can obtain elevated selling values to be able to continue with this expansion program.

You might make reference in our prepared statement that back in 1963, when we committed \$1 billion to build a steelplant at Burns Harbor, we did not have an order on the books, we did not have a guarantee from anyone that he would take the products of that plant or help us finance the costs.

PHASEOUT OF "VOLUNTARY RESTRAINT AGREEMENTS" ON IMPORTS AND NEW ANTI-DUMPING PROVISIONS

Senator PROXMIRE. I would like to ask you gentlemen to take a position that will affect national policy very directly. Am I correct in my understanding that the so-called voluntary agreement limiting steel exports to the United States from Europe and Japan will expire at the end of 1974 and is not being renewed?

If so, can you make an unambiguous statement, now that the overvalued dollar is a thing of the past, that the U.S. steel industry can stand on its own feet without protection from imports?

Mr. JAICKS. We have not sought as an industry, through our trade association, an extension of the VRA's.

Senator PROXMIRE. You have what?

Mr. JAICKS. We have not sought an extension of the VRA's leading up to this point where it lapses at the end of this year. We have, however, as you perhaps know, been presenting a case both to the Ways and Means Committee and the Senate Finance Committee for some better language, some built-in safeguards in the present trade bill under consideration by both Houses, some sprucing up of the dumping language, because we are still conscious of the fact that with the considerable amount of offshore tonnage which has moved away in the last year and a half, that with the considerable amount of that tonnage under either Government domination or with very strong Government ties, that there is the possibility of dumping, given a short-term downturn of world demand. And we certainly are not saying this is not going to continue to be a cyclical industry at the time, even though we do see over the long pull a better supply-demand relationship. A tighter one. We do see possibilities that flooding of imported steel could happen in this country over a short period of time. We recognize the difficulty unless we can hope to have better safeguards, that the ability to generate the investment moneys we need will be in doubt if we do run into periods of 6 months, a year, or a year and a half, where we have the problem back on our hands. But we are not pushing again for the VRA.

Senator PROXMIRE. Well, you know, I preface that by saying assuming that we do not have a dramatic change in the value of the dollar.

You have agreed that our efficiency compares favorably with the other countries.

Why should there be any protection? One of the very firm and strong points made in the series of summit meetings with the Government was criticism of inflationary policies in the form of quotas and restrictions on imports that keep prices high, and it was one that was particularly supported by business itself, by business people. And that seemed to me to strike a very sympathetic chord with almost everybody there. So, if they compete with you, why can you not take them on and if necessary reduce your prices temporarily?

Mr. SPEER. I would like to make a comment on that, if I might.

I think we all recognize that in the world steel industry, particularly the EEC countries, the Government is a partner in all of the steel companies. If not wholly owned by Government they are at least a partner. And I think they look at their steel industry a whole lot differently than we look at our steel industry in this country.

If there is an advantage, whatever it might be, to change the balance, the trade balance, these governments are satisfied to give export subsidy to their steel sector in order to get them to export steel, and their steel industry is used as a tool.

I think that all we have said, as far as the industry is concerned, is that today the American steel industry can and is able and willing to compete with the steel industry in the world, given fair trade,

administering a fair trade policy on a government-to-government basis.

Senator PROXMIRE. All right, I understand your position, Mr. Speer. But again, can you give us some documentation? Can you show that there has been some dumping on their part or selling below cost, some kind of analysis which could support this position?

Mr. SPEER. Well, I think it is a matter of record from time to time that there have been a number of European countries where the Government has given export incentives to the producer.

Senator PROXMIRE. For the record, would you provide, when you correct your remarks, any documentation that you can, as detailed and specific as possible, showing that they are dumping?

Mr. SPEER. I would be very happy to.

[The following information was subsequently supplied for the record:]

UNITED STATES STEEL CORP.,
Pittsburgh, Pa., October 24, 1974.

HON. WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR SIR: In my recent testimony before the Joint Economic Committee, you asked that we supply you with information concerning unfair foreign competition in steel as evidenced by subsidized and dumped imports. During my testimony, reference was made to the effect of government ownership or control of steel-making facilities in other nations of the world and its trade-distorting potential insofar as the American steel industry is concerned. Indeed, it is the efforts of foreign governments and their nationals to capitalize on the American steel market for their own economic or political purposes that has led domestic steel producers to seek to eliminate unfair import practices by resort to remedies mandated by Congress under these two statutes. I am pleased to have the opportunity to respond to your inquiry.

[EDITOR'S NOTE.—The exhibits and attachments referred to in this letter have been retained in the committee files.]

GOVERNMENT OWNERSHIP AND CONTROL OF FOREIGN STEEL INDUSTRIES

In a recent study by the American Iron and Steel Institute, it was shown that 44 percent of the rest of the world's steel production was under direct government ownership as of 1972. It is significant to note that in this study Japan is listed as having 0 percent of direct government ownership. However, the study also shows that the government of Japan controls the production, expansion, and export policies of its steel industry without the necessity of direct government ownership. Through the Ministry of Industry and Trade and the Bank of Japan, combined with the historic ethic in Japan of industry and government acting as one, the Japanese government has effective direct control over capital expansion, total steel production, and steel exports. A copy of this part of the AISI report is attached as Exhibit A. If government ownership or effective control of its steel industry were to be combined so as to comprehend such an obvious nation as Japan, then well over 60 percent of the rest of the world's steel production would be under government ownership or control.

A study done for the Senate Finance Committee in December of 1967 dealt with the direct government ownership, control, and assistance to its steel producers. In part the study concluded:

"There are at least 84 steel-producing companies of the free world in which the respective governments—national, state, municipal, and entities thereof, such as, banks, institutes, economic commissions, etc., have an equity interest or direct control. * * *

* * * * *

"Companies in which governments have a direct interest account for a significant share of world steel production. * * *" (Exhibit B.)

To a large degree this government ownership and control has resulted in foreign nations pursuing a policy of subsidizing steel exports. United States Steel

Corporation has attempted for a number of years to utilize our countervailing duty law to challenge the obviously unfair foreign competition of steel imports arriving in this country, where the producers have been the beneficiaries of significant subsidies. The first countervailing duty complaint involving steel products was filed by our corporation in July of 1966. This involved Italian transmission tower components; Treasury made an affirmative finding as to part of the complaint and imposed countervailing duties. However, to this date, Treasury has not acted on the remaining portion of the countervailing duty complaint.

Furthermore, U.S. Steel filed countervailing duty complaints against the six original members of the EEC detailing subsidies they provided their steel products, including the subsidy issue raised by their rebate of the value-added tax. U.S. Steel also filed a countervailing duty complaint against the United Kingdom setting forth the subsidies the British Steel Corporation received where that government-owned corporation exported significant quantities of extremely low-priced steel to this country while sustaining enormous losses during these years. These cases were filed in 1968, and no decision has yet been made. We would be happy to provide copies of all of these countervailing duty complaints, with the supporting legal memoranda, to the staff of this committee if so desired.

A countervailing duty complaint was filed against Mexico in the summer of 1972 dealing with substantial subsidies given to Mexican steel exporters of carbon steel plate. The major Mexican company exporting this subsidized product was 90 percent owned by the Mexican government. The laws and means of subsidization by the Mexican government were detailed in our complaint, but no action has yet been taken by our government.

For convenience, we have provided a compilation of the steel countervailing duty cases that have been filed which are still pending before Treasury. (Exhibit C.)

The Japanese had since the end of World War II provided substantial forms of subsidies for most of its exports, including steel as its most important export industry. After a decade of protests from the United States and other governments, Japan in the past three or four years changed its laws ostensibly to eliminate most of these subsidies. However, there are indications that the Japanese are considering the reinstatement of some form of subsidies as a reaction to the problems created by the enormous increase in the price of oil. Subsidized steel exports from Japan thus pose a very real threat for the immediate future.

In 1968 the United States was instrumental in getting GATT members to establish a Working Party to deal with the effect of the border taxes on exports, as well as the deterrent effect that the imposition of such duties had on other nations' efforts to export to the EEC countries. This Working Party as a part of its consultations dealt with the issue of subsidies in general; but after six years of effort, no agreement has been reached and no subsidies have been reduced or eliminated.

Despite this sorry history of other nations' failure to respond to negotiations to eliminate subsidies, the President's Trade Reform Act of 1973 provided for discretionary authority to suspend entirely the application of our countervailing duty statute for as much as four years while trade negotiations were under way. It seems naive to emasculate the statute in the fond hope of obtaining an acceptable international agreement. This government's efforts in GATT to eliminate subsidies was unsuccessful while the countervailing duty statute remained intact; it is strange logic that now dictates that these negotiations will be successful if we suspend enforcement of the statute. It cannot help but be observed that if the countervailing duty statute had been conscientiously enforced as Congress intended, international agreement probably would have been reached and the proliferation of subsidized exports competing unfairly in our market would have been minimized. It would be better to strengthen the statute and effectively enforce it rather than enter negotiations from a position of weakness.

We are providing the staff with a copy of an analysis made of the President's Trade Bill, which was sent to the House Ways and Means Committee. See Attachment 1.

The Trade Bill that was passed by the House Ways and Means Committee underwent rather substantial changes in the Senate Finance Committee, with most of the changes being highly desirable amendments. However, the Senate Finance Committee Bill contains a somewhat different form of discretionary authority to suspend the application of the countervailing duty statute for a period of five years. We cannot help but note again that this is a mistaken belief that trade negotiations will be enhanced by doing away with our statute. I am

providing more detailed comments on the Finance Committee's proposed moratorium on enforcement of the countervailing duty statute as Exhibit D. I believe Congress should not suspend the countervailing duty statute but should rather strengthen the existing statute. We have prepared an analysis and critique of the countervailing duty statute, its existing weaknesses, and the reasons why there need to be amendments to make it effective. We are submitting to the staff this analysis, together with proposed legislative changes, designed to make the countervailing duty statute an appropriate legal remedy. (Attachment 2.)

In the Introduction to the Study prepared by the Senate Finance Committee, it summed up the steel import problem about as well as it can be stated:

"There is also an urgent need for fairer rules in international steel trade. Today, our steel industry must compete in the face of foreign export subsidies favoring steel imports into this country and nontariff barriers frustrating U.S. steel exports. European and Japanese steel cartels also may be contributing to unfair trade practices abroad. If fair rules of international steel trade can be achieved, the industry should be able to expand both its domestic and foreign markets." (Exhibit B.)

DUMPING OF STEEL IN THIS COUNTRY

The decade beginning in 1960 marked the advent of the steel import problem. Beginning in 1962 and continuing to 1973, there were approximately 51 antidumping complaints filed with our government involving steel and steel-related products. These complaints covered products such as wire mesh, rods, steel pipe, reinforcing bars, sheet, plate, strip, cold rolled sheet and plate bars, structural shapes, wire strand, wire rope, pig iron, stainless steel plates, stainless steel sheets, high-speed tool steel, pipe and tubing, and upholstery spring wire. The dumping complaints dealt with such divergent countries as Belgium, France, Luxembourg, West Germany, the United Kingdom, Japan, Canada, Australia, Sweden, Italy, Poland, East Germany, Soviet Russia, Romania, Czechoslovakia, Finland, and Mexico. By and large, these efforts proved unsuccessful. There were some exceptions as evidenced by the pig iron and stainless steel plate cases. A recapitulation of all the Treasury and Tariff decisions involving these steel products from 1962 through 1973 is furnished as Exhibit E.

In 1954 the Tariff Commission received authority to make injury determinations in lieu of the Treasury authority in that area. The tariff Commission findings of no injury go through three quite distinct and remarkable phases. In the first phase, there was a very low percentage of findings of injury; during Phase 2 almost 90 percent of the cases referred to the Tariff Commission resulted in findings of injury; then in Phase 3 there was some trending back to the Phase 1 period, as the affirmative findings fell below 50 percent. This phenomena is graphically depicted in Exhibit F. These swings in enforcement are attributable to the antidumping statute's vague language and imprecise standards that permit widely divergent interpretation and result.

In an effort to remedy these statutory deficiencies and remove the antidumping statute from the realm of political involvement, we have prepared a detailed analysis and critique of the antidumping statute and have proposed specific amendatory language which we believe would go a long way toward insuring a fair but vigorous enforcement of this statute. We are submitting to the staff this critique with legislative proposals designed to remedy existing statutory deficiencies. (Attachment 3.) Any portions of our comments or legislative proposals to correct the deficiencies in either the antidumping or countervailing duty statutes may, of course, be included as a part of your record if you should deem any portions of those to be appropriate for such publication.

We believe that the devastating effects which dumped goods can have on an industry is most dramatically shown by the history of the domestic merchant pig iron industry. The antidumping complaints that were filed against Eastern Bloc Countries and subsequently against West Germany, Canada, and Finland and the elaboration of injury by the Tariff Commission could aptly be titled "The Decline and Almost Fall of the Domestic Pig Iron Industry". I had occasion to set forth these facts on pig iron earlier this year in response to an inquiry from Senator Hart. I am sending you a copy of that reply to Senator Hart. (Exhibit G.)

Returning to the importance of a proper Trade Bill being passed by Congress, I would urge that there be necessary amendments made to our fair trade statutes to minimize the injury inherent in dumped and subsidized imports.

We need to recognize that the strengthening of this nation's antidumping and countervailing duty statutes are not the pursuit of protectionist policies but merely a necessary means of assuring fair trade in the United States. We believe that there cannot be free trade in the world unless there be rules of law assuring that trade is fair as well as free. It is our deep concern that with the energy crunch other nations may engage in a campaign of expanding exports to obtain dollars through governmental subsidies and dumping. Certainly this nation's steel industry and indeed this country's economy cannot tolerate the harm caused by the unfair import trade of the sixties.

Very truly yours,

EDGAR B. SPEER.

Attachments.¹

Senator PROXMIRE. Now, it is true that there are some nationalized steel industries, Britain is an example, but they do not compete with us, by and large. Competition comes from Japan and West Germany. Japan is not nationalized at all, it is privately owned.

Mr. SPEER. I wish I had their setup.

Senator PROXMIRE. Germany has only 5 percent nationalization and Belgium has zero. Germany has only 5 percent of the steel industry Government-owned, I understand.

Mr. JAICKS. British steel does come into the market.

Senator PROXMIRE. It is not a principal competitor, it is not as strong a competitor as Japan.

Mr. JAICKS. Significant in some product lines. Japan over the peak period has been about half of the total imports coming in.

Mr. SPEER. I think we all recognize—

Senator PROXMIRE. Government-owned plants are less efficient, for all kinds of reasons.

Mr. SPEER. Yes; and we agree with that. But the fact still remains if Germany, in order to hold their employment, sees a need for exporting a million tons of steel products and they pay August-Thyssen a \$15 to \$30 export incentive, it could not mean that August-Thyssen is losing any money on it. It means the Government is subsidizing the steel going abroad in order to accomplish whatever its gains might be.

The same thing is true in France. The same thing is true in Italy.

RETURN ON SALES VERSUS RETURN ON EQUITY

Senator PROXMIRE. One point, Mr. Speer, it is one that concerns me just as a matter of economic presentations. You persistently cite levels of profits on sales to show that recent profits are modest. You know this is something that is very, very hard to buy because return on sales varies so much industry by industry.

If you compare your profits on sales with those of the supermarkets, they are very high. When grocery chains have one-half of 1 percent profit on sales they think they are doing very well. One percent is a tremendous profit on sales. And you would argue that 5 or 6 or 7 percent is not enough. So that I think you have to go to the return on equity to get any really comparable basis. Is that not true? You put a lot of emphasis on profits on sales and it would seem to me that is a far less valid basis for justifying profits.

Mr. SPEER. It probably is not as valid today as it was, let us say, 15 years ago, because it was generally recognized then that a dollar

¹ See editor's note, p. 188.

investment produced a dollar of sales. So when you were talking about return on the sales dollar you were talking really approximately the same thing as a dollar on equity.

Senator PROXMIRE. Well, I understand the Japanese, for example, have a 2 to 3 percent return on sales on their steel dollar.

Mr. SPEER. Sure, I agree with that. They also have 2½ percent money that they can borrow.

Senator PROXMIRE. Yes; but by and large there, of course, the capital cost over there is even higher, their inflation rate is higher.

Mr. JAICKS. I think within a given industry the swings in the return on sales indexes are not insignificant.

Mr. SPEER. I would like to point out, too, Senator Proxmire, in our prepared statement that was filed, we do address ourselves to the return on equity in United States Steel. We do relate it to return on equity for all American industry and we do make a notation that the steel industry as an industry has been, if not last, very close to the last in earnings on equity of all American industries.

R. & D. IN THE STEEL INDUSTRY

Senator PROXMIRE. Gentlemen, one of the elements that has troubled me the most about your industry—as I say. I have great respect for the people in it and, of course, you are vital for our economic health, and you do have considerable efficiency—still somehow you seem to spend less of your income in research and development, far less than other industries.

What is it, a fraction of 1 percent? It does not compare with other industries and it would seem to me this is an area where productivity improvements and efficiency in reducing costs and meeting the inflation problem yields high returns.

Why is it that your investment in research and development seems so limited, Mr. West?

Mr. WEST. Well, I think that the type of business that we have is considered more of a mature business than many other concerns that you might be making comparisons with. We happen to have, and we are damn proud of, a tremendous research facility that we have in Bethlehem, Pa.

Senator PROXMIRE. How much of your income goes into research and development?

Mr. WEST. Offhand, I do not know, sir; \$28 million versus sales of just over \$4 billion.

Senator PROXMIRE. Twenty-eight million versus sales of just over \$4 billion? That would be what, about three-quarters of 1 percent?

Mr. WEST. This is just for straight ongoing expenses. There is no capitalization of this thing.

Senator PROXMIRE. I understand overall, the industry as a whole, including Bethlehem, it is about three-tenths of 1 percent. I wonder. It is a mature industry, an industry that is settled. I wonder though if that does not suggest that your industry could not be improved by a greater investment in research and development. That is certainly true of most.

Mr. SPEER. Actually, we are talking definition, I think.

Senator PROXMIRE. What is not included in the research and development?

Mr. SPEER. The only thing that is included at least in United States Steel's research budget is truly research work that is done in a laboratory. Once a process is developed, and in many companies, particularly the chemical industry I understand, when they go from their bench model to a commercial facility, that first installation they will capitalize as part of their research budget.

In United States Steel we do not do that. We capitalize it as a commercial piece of equipment, and it does not get charged against the research budget. And I think this makes a tremendous difference. There is a difference between industries, for good and sufficient reasons, as to why they handle their research budgets differently.

Senator PROXMIRE. How do you explain the fact that the most important inventions to appear in steel production in the past 60 or 70 years were not invented in this country? Why were these processes such as the oxygen converter first introduced in the United States by small firms? Why was the continuous casting invented and first introduced by companies in Europe and installed first in small firms in the United States? Why is it the small firm or European firm seems to be the innovative element?

Mr. SPEER. I do not think necessarily size of country or size of company has any lease on the brain matter. Inventions are usually the result of necessity. I think that a number of the foreign steel companies have had certain necessities that were facing them that resulted in inventions. You named one, the basic oxygen process. In Europe, the greatest part of their capacity was in the Thomas process.

To replace the Thomas process was a major capital expenditure. And out of that necessity for a change came the Cuplum process. Maxhutte, is another little company in the eastern part of Germany with less than 1 million ton capacity, which developed a steelmaking process that they called the OMB. This was a process where, rather than introducing oxygen over the surface of the metal, they introduced oxygen through the metal. It was designed specifically for processing of high phosphorus ore. United States Steel some 3 years ago took that process, put it into their research facility and developed a process for processing iron of low phosphorus content. And I might say, Senator Proxmire, this is probably the most efficient steelmaking process right now.

But it seems to me that we can hardly be critical of ourselves for not inventing everything. I think the only criticism that we can have of ourselves is that we turn our back on inventions because they are not invented here—a sense of pride, false pride.

I think that the American steel industry has done very well in sending its people throughout the world to visit research laboratories.

Today in United States Steel, if they are researching in France something that we have an interest in, we will not duplicate their research. And it seems to me this just makes good sense.

Senator PROXMIRE. Well, I think that your industry, like any industry, could gain by putting more emphasis on research and development, more emphasis, therefore, on achieving a higher degree of productivity by intensive investment, than three-tenths of 1 percent of your sales. As I say, the record does indicate that—I am not asking for duplication, I am just asking for some original research to keep asking the question, how can we produce this for less, how can we get our costs down every way we possibly can?

Mr. SPEER. That is a never-ending question in this business.

HISTORICAL VERSUS REPLACEMENT-COST DEPRECIATION FORMULAS

Senator PROXMIRE. Businessmen are complaining often in this inflationary period that the tax laws do not let them recover the full replacement cost of plant and equipment. You too. But after all, when you buy new equipment, you get the advantage of all the increases in productivity that have taken place. When you replace an open hearth furnace with a basic oxygen furnace, you get a tremendous increase in efficiency. So you are buying more than just a replacement item. Then, too, you borrowed to buy the old plant. Recoupment of full replacement cost would more than pay off your old debts and yield a reduction in the debt proportion on the new purchase—a function not necessarily required by equity. And after all, you buy today's new equipment to sell its products at today's inflated prices and profit margins. The law already allows accelerated depreciation in advance of physical obsolescence.

So, while historical depreciation is too little, replacement cost recoupment about which we now hear so much would be excessive.

Do you disagree with that?

Mr. WEST. As we go back to the comments I made in the prepared statement and my oral statement on the funds that we are spending, I made the observation about the duplication of Burns Harbor, and when I said it would be twice as much, I think that could be a very moderate or modest comment.

When you spend the money, sir, there has not been that much improvement in technology. I made an observation about a platemill. We put a platemill at Burns Harbor, the most modern platemill in the world, and to duplicate that mill today would cost more than twice as much, and the mill is not very different from the one we put in in 1963 and 1965. But the costs have escalated and our problem with depreciation is we are doing this on a historical basis, and not getting in many areas the great improvement of production you alluded to.

Senator PROXMIRE. I agree that historical depreciation is not enough. I wonder if full replacement is not excessive and would enable you to show lower profits than actually you have.

SUMMARY AND CONCLUSIONS

Well, let me summarize what I believe are the facts, and conclusions which are a result of today's hearings.

First, the United States is suffering from a virulent inflation. Both present prices—the consumer price index—and future prices—the wholesale price index—are rising at an alarming rate.

Second, the bulk of this increase is found in a small number of highly concentrated industries; namely, oil, chemicals, nonferrous

metals, food prices after they leave the farm, and steel. This is not a demand inflation in which too much money is chasing too few goods. Unemployment is high and rising. Weekly hours of work are the lowest in our history. The real volume of retail sales is down.

Third, steel prices are responsible for about 14 percent or more of the total increase in the wholesale price index in the last year. Steel prices and steel profits have risen phenomenally with a 40-percent increase in prices between February and August and a doubling of profits in 1974.

The fundamental issue we face today is whether or not these fantastic increases in prices and profits are justified either by cost increases and/or the industry's needs for replacement, environmental costs, and expansion.

Steel wage increases do not justify the price increases. Steel wages are a relatively small part of total costs and our calculations are that the productivity increases in the industry are such that unit labor costs were essentially stable in the 2-year period beginning in 1972 until very recent months.

Other costs have risen—scrap, coal, coke, and materials, but our calculations indicate that prices in the industry in the past year have gone up at double the rate of cost increases.

What about replacement, modernization, and pollution outlays? The evidence we have is that the present price structure is sufficient to replace existing equipment to modernize the industry, to make the necessary antipollution investments, and to expand production by 20 to 25 million tons by 1980.

In addition, our calculations are that this same price structure could provide for a doubling of steel dividends.

While men may argue about whether or not the present increase in steel prices has been justified, one thing is certain. Short of extraordinary inflation, there is no justification whatsoever for future steel price increases in the foreseeable future.

Nothing we have heard here today indicates that further increases are justified on the basis of costs, needed investment, or equity to stockholders.

Those are the facts and our conclusions. If we are to deal with the kind of inflation this country is suffering from, we must deal with these facts and these issues.

Gentlemen, I want to thank you very much for your presentation. It was very good, and I think your responses to the questions were most helpful. You were responsive.

The committee stands adjourned.

[Whereupon, at 12:30 p.m., the committee adjourned, subject to the call of the Chair.]

APPENDIX

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., October 1, 1974.

Letter sent to 13 Steel Corporation Chairmen.

DEAR SIR: As you may know, the Joint Economic Committee is now conducting an emergency study of the current state of the American economy under Senate Congressional Resolution 93. Under this mandate the Committee feels it necessary to examine closely the present and prospective economic conditions in the American steel industry.

To fill an inexplicable gap in the existing statistical information, I am requesting that the major steel companies provide the Committee with the following data:

(1) The maximum physical capacity to produce raw steel of all of your company's production units that were in operation on June 30 for each of the past 5 years including 1974;

(2) The rates of utilization of this capacity on each of those dates; and

(3) A listing of the capacity of each and every in-place production unit excluded from the total submitted under item 1 and the reason for each and every exclusion.

To expedite this critical study, I am requesting that your response be received no later than October 15, 1974.

Sincerely,

WILLIAM PROXMIRE, *Vice Chairman,*
Joint Economic Committee.

UNITED STATES STEEL CORP.
Pittsburgh, Pa., October 24, 1974.

HON. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: I want to thank you for extending us additional time for submitting the information requested in your letter of October 1, 1974.

Exhibit I, attached lists for each of the past five years the facilities U.S. Steel has for the production of raw steel. The principal changes over this period were the replacement of open hearth furnaces with basic oxygen furnaces (BOP and Q-BOP) and some electric furnaces. The Q-BOP is a technological development by U.S. Steel for the large heat size production of steel by a bottom blown oxygen processing method. We believe this bottom blown oxygen process (as contrasted to top blown in the BOP process) offers advantages in capital construction cost, product yield and operating efficiency.

As the new facilities come on stream and attain full production, the open hearths are torn down. For example, our Gary Steel Works just a few short years ago had 5 open hearth shops totaling 53 furnaces. Today it has 2 basic oxygen shops with a total of 6 furnaces. One open hearth shop is still in partial operation until the newest Q-BOP reaches full production. This, in turn, is dependent upon attainment of designed output of our newest blast furnace when its current period of break-in is completed. At that time, open hearth production will end at Gary. Even if the expenditures needed to bring this open hearth shop in compliance with environmental requirements could be economically justified, there would be neither adequate raw materials with which to operate it nor the facilities to convert the raw steel to shippable product. This type replacement has occurred at all our plants where new steel production facilities have been installed.

For the past nineteen months, we have been operating all our available raw steel production facilities at the maximum levels attainable consistent with the environmental restrictions placed upon us and the quantities and qualities of raw materials and fuels available. Exhibit II shows the total raw steel produced monthly for each of the past five years. You will note that in only three months in this 19-month peak demand period were we able to produce more than 3 million tons. Our highest consecutive 3-month production (March-May 1973) averaged slightly over 100,000 tons per day which, if it could be sustained, would indicate an annual production of 36.5 million tons. For all practical purposes, this 36.5 million tons could be construed as our present maximum balanced capacity. But because of the limitations on the availability of quality coal and coke which limit iron production, the environmental restrictions which require reduced coking operations, and because of the necessity for repair outages, our production for 1973 was 34,698,000 tons and will be about the same for this year. This, we are convinced, is about the maximum sustainable production we can achieve under today's environment. The demand for steel throughout this last 19-month period has been and continues to be such that all steel that could be made could be sold. This condition of sustained peak demand has not prevailed for many years.

While we have replaced facilities during this 5-year period, our capability to produce raw steel has been basically unchanged. It is our best judgment that given optimum qualities and adequate quantities of materials and fuels and assuming environmental requirements can be met or modified, U.S. Steel's effective maximum productive capacity for raw steel is about 38 million tons or 104,000 tons per day, about 8-9% greater than was produced in 1973. With the completion of other facilities now under construction and attainment of full operations of those now in break-in, we would expect by the end of 1976 to be able to produce about 40 million tons annually.

The importance of the support capacity of coke and iron cannot be overemphasized. Coke production has been restricted because of environmental problems and because of a major rebuilding program that has been under way for some time. Under these conditions, the maximum production is currently about 16.5 to 17.0 million tons per year, although we would expect under optimum conditions and upon completion of the rebuilding program to produce about 18 million tons of quality coke from our by-product ovens. We have supplemented our own production in recent months with approximately 1.0 million tons of very high-priced purchased coke, mostly from Europe.

Our blast furnaces in 1973 produced 28.1 million tons of iron and are running at about this rate for 1974. Given the best available ore metallics and an adequate quantity of the proper quality coke, they could produce about 10% more.

In regard to Question 2 relative to rates of raw steel capacity utilization, the following estimates are given:

| | Maximum balanced capacity ¹ | Percent utilization |
|-----------|--|------------------------|
| For June— | | |
| 1974..... | 36,500,000 | 93.7 |
| 1973..... | 36,500,000 | 95.5 |
| 1972..... | 36,500,000 | 87.4 |
| 1971..... | 36,500,000 | 87.9 |
| 1970..... | 36,500,000 | 93.0 |

¹ Annual.

In regard to Question 3, all in-place operable raw steel production facilities have been included in the capability data given.

I want to assure you that we are striving constantly to increase production from, and the productive efficiency of, all of our facilities. We have projects under way to improve coal availability, coke quality and quantity, iron production and steel production. We started operation of another Q-BOP steel production shop in Alabama during the third quarter. To date, the start-up has been excellent. As full production is achieved, we will again phase out the present open hearth facil-

ities, which will go a long way toward solving an acute environmental problem in that area.

We appreciate the general concern relative to the nation's capability for the production of steel. I hope the data furnished will be helpful to you in the studies being made.

Very truly yours,

EDGAR B. SPEER.

Attachments.

EXHIBIT I

UNITED STATES STEEL CORP.—RAW STEEL FACILITIES, 1970-74

| | Number of furnaces | | | | |
|------------------|--------------------|------|------|------|------|
| | 1970 | 1971 | 1972 | 1973 | 1974 |
| Open hearth..... | 174 | 144 | 109 | 67 | 62 |
| Electric..... | 8 | 12 | 11 | 11 | 11 |
| BOP..... | 8 | 10 | 12 | 12 | 12 |
| Q-BOP..... | | | | 3 | 5 |
| Total..... | 190 | 166 | 132 | 93 | 90 |

Note.—The above represent all facilities in operation during the year, including new facilities starting up as well as the facilities which they are to replace.

| | | |
|-----------------------|---|---|
| 1974: Fairfield | 2 | furnace Q-BOP shop started operations during the third quarter. |
| 1973: Gary | 3 | furnace Q-BOP shop started operations. |
| 1972: | | |
| ET-Irvin | 2 | furnace BOP shop started operations. |
| Fairless | 2 | electric furnace shop and dual caster started operations. |
| 1971: | | |
| Lorain-Cuyahoga | 2 | furnace BOP shop started operations. |
| South | 2 | electric furnace shop started operations. |
| Texas | 2 | electric furnace shop and caster started operations. |
| Under construction: | | |
| South | 1 | electric furnace for completion in 1975. |
| Texas | 2 | electric furnaces and dual caster for completion in 1976. |

EXHIBIT II

UNITED STATES STEEL CORP.

| | 1970 | 1971 | 1972 | 1973 | 1974 |
|------------------------------|------------|------------|------------|------------|--------------|
| Raw steel production: | | | | | |
| January..... | 2,590,794 | 2,706,559 | 2,214,853 | 2,811,199 | 2,964,459 |
| February..... | 2,401,153 | 2,656,847 | 2,311,361 | 2,687,859 | 2,719,448 |
| March..... | 2,890,917 | 3,051,631 | 2,704,106 | 3,121,188 | 2,956,191 |
| April..... | 2,810,589 | 2,987,670 | 2,714,405 | 2,999,409 | 2,974,057 |
| May..... | 2,865,845 | 3,047,071 | 2,878,657 | 3,081,654 | 3,073,270 |
| June..... | 2,789,102 | 2,636,623 | 2,621,418 | 2,863,723 | 2,810,130 |
| July..... | 2,665,704 | 1,987,936 | 2,467,301 | 2,881,663 | 2,862,375 |
| August..... | 2,493,540 | 1,000,773 | 2,458,252 | 2,760,925 | 2,685,075 |
| September..... | 2,494,936 | 1,729,127 | 2,455,259 | 2,812,960 | 2,784,478 |
| October..... | 2,450,758 | 1,754,379 | 2,674,405 | 2,997,405 | |
| November..... | 2,410,525 | 1,747,519 | 2,565,415 | 2,965,515 | |
| December..... | 2,549,333 | 1,900,067 | 2,677,623 | 2,984,165 | |
| Total..... | 31,413,196 | 27,216,202 | 30,743,055 | 34,967,665 | 1 34,440,000 |
| Steel product shipments..... | 21,004,137 | 19,282,097 | 20,768,976 | 26,066,474 | 1 26,000,000 |

¹ Estimate.

Notes: 1. Demand has been at peak levels for the last 9 months. 2. The peak activity during the 1st half of 1971 represents customer building of strike-hedge inventories in advance of the United Steelworkers' contract termination. 3. Shipments in 1973 and 1974 were increased by reductions in inventory. 4. 2 electrical power failures in Chicago district resulted in 400,000-ton loss of production in August and September.

BETHLEHEM STEEL CORPORATION,
Bethlehem, Pa., October 14, 1974.

HON. WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR SENATOR PROXMIRE: This letter is in response to your letter to Mr. Foy dated October 1, 1974 on the subject of steel industry capacity.

First of all, as you are well aware, any capacity figure is theoretical and subject to a large number of conditions. We ceased publishing such information, because we felt it was quite misleading. In February, 1974, the American Iron & Steel Institute published a Booklet entitled "Steel Industry Economics and Federal Income Tax Policy". On page 25 of this Booklet, the following statement was made with respect to published capacity: "In 1960, the American Iron & Steel Institute ceased to publish data on capacity for raw steel production in the United States because numerous factors made it difficult to measure capacity accurately by reference to physical facilities. Such factors as obsolete equipment which has been abandoned in place but not dismantled, but is theoretically available, distorted actual capacity measurement to a major degree. Production which is lost due to repair and regular rehabilitation activities, weather conditions, and the temporary unavailability of labor, power or materials also cause problems in arriving at a realistic measurement." Bethlehem agrees with this statement.

At Bethlehem, however, we still compile our own theoretical capacity information for internal use by people who are thoroughly familiar with the limitations of the data. We are making this internal information available to you and trust that it will be used only when accompanied by the qualifications which we are including herein.

Specifically, raw steel production capacity is calculated by Bethlehem as an "engineered" estimate. We develop the capability of individual producing units based on actual operating experience with what is considered to be a suitable mix of charge, fuel, etc. We then deduct from the total possible furnace operating hours the expected non-operating hours. The latter represent hours involved in various maintenance and repair activities, scheduled holiday or vacation shutdowns, and allowance for times in which duplicate facilities can not be operated simultaneously. From such a figure we generate what you can recognize is a highly theoretical production capability. It is this kind of number that we are listing in answers to your questions.

With these limitations in mind, the answers to your questions are as follows:

(1) Maximum physical capacity to produce raw steel at all of our production units that were in operation on June 30 for each of the past five years, including 1974:

| | <i>Theoretical raw steel capacity</i> | <i>Net tons</i> |
|------------|---------------------------------------|-----------------|
| 1970 ----- | | 25,600,000 |
| 1971 ----- | | 25,700,000 |
| 1972 ----- | | 25,100,000 |
| 1973 ----- | | 25,000,000 |
| 1974 ----- | | 25,150,000 |

(2) A rate of utilization for a single day or month is not a meaningful figure, and we are therefore showing below the average utilization for each of the years 1970-73 and for the January-June 1974 period:

| | <i>Operations (percent of theoretical raw steel capacity)</i> | |
|------------------------|---|------|
| 1970 ----- | | 80.4 |
| 1971 ----- | | 67.9 |
| 1972 ----- | | 73.0 |
| 1973 ----- | | 94.8 |
| 1974 (Jan.-June) ----- | | 92.4 |

(3) A listing of the capacity of each and every in-place production unit excluded from the total submitted under item 1 and the reason for each and every exclusion: The only operable in-place production unit excluded from our 1974 capacity figure listed under Question 1 is the Number 3 Open Hearth Shop at our Sparrows Point, Maryland plant. This Shop, totaling 2,629,000 tons of capacity in our 1971 figures, was removed from our effective capacity beginning 1972, because it could not be operated without extensive expenditures for pollution abatement. As a business judgment, it was not deemed a sound investment

to put such expensive facilities on an old production unit having high production costs. Today, assuming availability of scrap iron and steel and a waiving of environmental restrictions, we believe we could produce approximately 600,000 tons per year from Number 3 Open Hearth operating based on 100% scrap charge.

To illustrate the difficulties in using theoretical capacity, consider our actual experience in two periods. First, against Bethlehem's theoretical raw steel capacity for 1974 of 25,150,000 tons per year, our maximum actual production was in the second quarter of 1974. The output for that quarter times four equals 24.2 million tons of production. Further, as I mentioned in my testimony before the Joint Economic Committee on October 7, 1974, we have been going all out to produce everything we could since early 1973. Our actual production for the second half of 1973 and the first half of 1974 totaled 23.5 million tons and represented our effective capacity at that time due to limitations unrelated to the factors used in calculating the theoretical steelmaking capacity of our steel-making units. These limitations arose principally from shortage and below-normal quality of iron ore and coal. I can assure you that nothing would have made us happier than to have been able to produce at our theoretical capacity during this period.

We again urge, Senator, that information submitted be reviewed in the context of the limitations outlined above and in the realization that the lower utilization of capacity at the present time is primarily a result of our inability to obtain adequate materials with which to run our facilities at their maximum capability.

Sincerely yours,

F. W. WEST, Jr.

RAW STEELMAKING CAPACITY AND PRODUCTION RATES, REPUBLIC STEEL CORP.,
OCTOBER 23, 1974

EXPLANATORY NOTE

Raw steel capacity data are based on engineering estimates of steelmaking furnace capabilities, assuming a steady and ample flow of fuels and raw materials of a certain quality, proper balance between solid and molten charges and what might be termed a normal product mix of steel to be produced. Because certain steels can be produced in a steelmaking furnace at a somewhat faster rate than other steels, it is possible for production to exceed 100 per cent of capacity when the product mix emphasizes more rapidly refined steels and when all input factors are favorable. Generally, this is of limited duration.

Since production on a specific data can be adversely affected by special supply problems occurring at the time or by major shutdowns to permit repairs to furnaces and equipment, we are furnishing corresponding annual data that are far more accurate in portraying utilization of capacity over a meaningful period.

RAW STEEL CAPACITY AND PRODUCTION RATES

| | 1974 | 1973 | 1972 | 1971 | 1970 |
|--|------------|------------|------------|------------|------------|
| Annual capacity, net tons..... | 11,320,000 | 11,320,000 | 11,320,000 | 11,320,000 | 11,320,000 |
| Annual raw steel production, net tons..... | 8,217,000 | 11,288,000 | 10,400,000 | 8,729,000 | 9,638,000 |
| Production rate (percent)..... | 79.8 | 99.7 | 91.9 | 77.1 | 85.1 |
| Daily Capacity, net tons..... | 31,000 | 31,000 | 31,000 | 31,000 | 31,000 |
| Raw steel production, net tons, June 30..... | 28,064 | 33,931 | 31,113 | 29,132 | 24,779 |
| Production rate, June 30 (percent)..... | 90.5 | 109.5 | 100.4 | 94.0 | 79.9 |

¹ 9 months.

² The overall production rate in 1974 is below 1973 due primarily to a prevailing shortage of metallurgical quality coal. All production units are being utilized to the fullest extent that raw materials quality and availability and other inputs will permit. The production rate for June 30, 1974, is lower than the yearly rate thus far because of an extended repair to oxygen facilities which sharply reduced output at our Warren, Ohio, steel plant during the month of June. Throughout this year and during most of 1973, steel demand has been greater than 100 percent operations of our steelmaking facilities could supply.

Note: Physical capacity to produce raw steel has remained unchanged over the past 5 years.

At the present time, Republic is experiencing serious difficulty in the procurement of not only sufficient quantities of metallurgical grade coal but sufficient quality as well. To a somewhat lesser extent, this has also been true of scrap. Quantitative and qualitative problems with raw materials can adversely affect

our capacity to produce, as can unforeseen developments such as work stoppages—both internal and external—fuel cutbacks, major mill or furnace breakdowns, pollution alerts, etc.

The capacity figures recognize all operable melting facilities and do not include partially or largely dismantled furnaces. Two electric furnaces at Warren, Ohio have been largely dismantled and have not been considered in compiling the above data. Neither have two electric furnaces at Gadsden, Alabama, which have been partially dismantled and whose activation would require not only the replacement of missing furnace equipment and the installation of advanced pollution controls but also capital expenditures for added capacity in the Gadsden mill to roll and process the additional steel.

Republic's Cleveland open hearth shop is operated on a part-time basis when a basic oxygen steelmaking vessel is being relined. This is factored into the above data on capacity and production. Additional cokemaking, ironmaking and rolling or continuous casting facilities, along with added pollution controls, would be required to operate all open hearths and basic oxygen furnaces simultaneously at this plant.

NATIONAL STEEL CORP.,
October 11, 1974.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Vice Chairman, Joint Economic Committee,
Washington, D.C.

DEAR SENATOR: We are pleased to furnish the information requested in your letter of October 1, 1974, concerning our steel making capacity.

1. *Maximum physical capacity to produce raw steel—*

National Steel produces steel by two methods:

(a) In basic oxygen furnaces utilizing a mixed charge of (i) hot iron produced in blast furnaces and (ii) scrap. Capacity to produce steel by this method (accounting for over 90% of our production) is directly dependent on our capacity to produce blast furnace hot iron, since the amount of the scrap charge is limited to a percentage of the hot iron charged. Hot iron production, in turn, is determined by the length of time the furnaces must be taken out of production for relines. Maximum capacity, therefore, will vary from year to year dependent on the number of furnaces relined in any given year.

(b) In electric arc furnaces (which accounts for the balance of our production) which have a maximum rated capacity of 600,000 per year.

We have operated all our facilities at maximum capacity throughout the period July 1, 1973, to June 30, 1974, and continue to do so at the present time. The figures given below for this 12-month period, therefore, represent our maximum annual capacity, as of July 1, 1973–June 30, 1974, in an annual period when only one blast furnace is out for reline.

Since the normal number of relines is larger than (1) (as shown below) this figure somewhat overstates our annual sustainable capacity. We include comparable figures for all years requested.

PRODUCTION DATA

[All figures in net tons]

| | Blast furnace production | Blast furnace relines | Basic oxygen furnace production | Electric ^a arc furnace production | Total raw steel production |
|-----------------------------|--------------------------------|-----------------------------|---------------------------------------|--|----------------------------------|
| July 1969 to June 1970..... | 7,306,859 | 3 | 8,564,994 | 446,374 | 10,247,166 |
| July 1970 to June 1971..... | 6,862,272 | 5 | 8,674,569 | 470,501 | 9,445,442 |
| July 1971 to June 1972..... | 6,574,454 | 5 | 8,530,803 | 318,144 | 8,848,947 |
| July 1972 to June 1973..... | 7,619,240 | 4 | 9,967,421 | 628,134 | 10,595,555 |
| July 1973 to June 1974..... | 8,121,843 | 1 | 10,526,272 | 664,765 | 11,191,037 |

^a Includes open-hearth production which has been demolished.

2. *Rates of utilization of this capacity—*

Answer contained in material under (1), above.

3. *Exclusions of production units from (2) and (3) above—*

None.

We trust this information will meet your request. If you have further questions we will be glad to attempt to answer them.

Yours very truly,

GEORGE A. STINSON.

ADDITIONAL DATA FROM NATIONAL STEEL (MOUNT DIENER)

| Calendar year | Blast furnace output | Relines | BOF production | Elec arc production | Total raw steel output ¹ |
|---------------|----------------------|---------|----------------|---------------------|-------------------------------------|
| 1969..... | 7,335,243 | 3 | 9,897,531 | 427,068 | 10,324,599 |
| 1970..... | 7,123,450 | 6 | 9,410,153 | 459,288 | 9,869,441 |
| 1971..... | 6,533,438 | 5 | 8,404,658 | 276,456 | 8,681,114 |
| 1972..... | 7,094,935 | 3 | 9,264,798 | 579,076 | 9,843,674 |
| 1973..... | 8,170,818 | 1 | 10,676,291 | 644,658 | 11,320,948 |
| I./1974..... | 3,950,723 | 1 | 5,069,409 | 340,759 | 5,410,169 |
| II./1974..... | | 2 | | | |

¹ Including Granite City Steel in all data (acquired in 1971).

² End open hearth production. Max OH Capacity 7,900,000 tons per year. Had 3 batteries in operation. BOF replaced the open hearth. At Great Lakes, OH phased out in 1970. Wierdon in 1967, then demolished.

Note: Programs well advanced to produce more over last 2 years put full injection systems on to reduce coke and increase iron output. Putting sinter screening on all these facilities. Removes fines. Putting in oxygen in plants to boost iron. Steelmaking is adequate. Boosting iron output capacity about 1 million tons per year by 1976. Adding capacity for steel pellets.

INLAND STEEL CO.,
October 8, 1974.

HON. WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee, U.S. Congress, Washington, D.C.

DEAR SENATOR PROXMIRE: In order to keep the record straight, I wanted to write you to let you know that I had hand-delivered the information requested in your October 1 letter regarding the steel production capacity of our Company to Mr. William Cox on the staff of the Joint Economic Committee. This information was placed in Mr. Cox's hands at the time of the October 7 hearing of the Committee, and I hope that our submission is responsive to your request.

Sincerely,

FREDERICK G. JAICKS, Chairman.

PHYSICAL CAPACITY DATA—RAW STEEL
INLAND STEEL CO., INDIANA HARBOR WORKS

| Year | Capacity tons | Production tons | Utilization percent |
|-------------------------|---------------|------------------------|---------------------|
| 1970 ¹ | 7,700,000 | 7,051,000 | 91.6 |
| 1971 ¹ | 7,700,000 | 6,496,000 | 84.4 |
| 1972 ¹ | 8,200,000 | 7,771,000 | 94.8 |
| 1973 ¹ | 8,200,000 | 8,155,000 | 99.4 |
| 1974 ¹ | 8,200,000 | ² 8,100,000 | 98.7 |

¹ All producing units are included.

² Estimate.

ARMCO STEEL CORP.,
Middletown, Ohio, October 18, 1974.

HON. WILLIAM PROXMIRE,
U.S. Senate,
Dirksen Senate Office Building,
Washington, D.C.

DEAR SENATOR PROXMIRE: The following has been prepared in response to your October 1, 1974 request.

In explanation, raw steel is assumed to be the first solid state—either as ingots or continuously cast product.

We have assumed that you wished production data on a fiscal year basis. While there are several ways to express capacity, such as engineered, peak, average, and while mix plays a part in what can physically be produced, we have chosen to state our current maximum physical capacity to be what we

have been able to produce in those months in the last year and a half of the five-year period when maximum tonnage has been requested of the melt shops. We have excluded periods of less than full schedules—either due to low demand or to construction outages.

The maximum physical capacity to produce raw steel of all production units that were in operation in the year ending June 30 for each of the past five years including 1974 is as follows in terms of annual net tons:

| | |
|------------|-----------|
| 1970 ----- | 8,964,000 |
| 1971 ----- | 8,932,000 |
| 1972 ----- | 9,328,000 |
| 1973 ----- | 9,440,000 |
| 1974 ----- | 9,440,000 |

The rates of utilization of this capacity for the fiscal years ending June 30 in each of these years is as follows:

| | <i>Percent</i> |
|------------|----------------|
| 1970 ----- | 93.2 |
| 1971 ----- | 91.9 |
| 1972 ----- | 81.1 |
| 1973 ----- | 93.3 |
| 1974 ----- | 97.5 |

You must appreciate the fact that it is not always possible for us to operate at capacity levels. For example, shortages of commodities such as ferro chrome, ferro silicon, or primary nickel can impact our ability to make certain grades of steel. A prolonged coal strike later this year would severely impact our ability to produce at capacity levels at three of our locations. Restrictions in the usage of natural gas or fuel oil, restrictions in the availability of iron ore, periodic or unexpected outages for major maintenance, and construction outages can all affect our ability to melt steel.

Today, as we look down the road short range, we see a number of potential hazards to our ability to continue to do as well as we were able to do, meltwise, in fiscal 1974.

Sincerely,

C. WILLIAM VERITY, JR.

ARMCO

| <i>Maximum physical capacity, tons</i> | <i>Utilization, percent</i> |
|--|-----------------------------|
| 1970 ¹ —8,693,000 ----- | 90.3 |
| 1971 ¹ —9,115,000 ----- | 84.5 |
| 1972—9,440,000 ----- | 88.8 |
| 1973—9,440,000 ----- | 99.1 |
| 1974—9,440,000 ----- | 97.3 |

¹ Difference between data for calendar 1970 and fiscal 1970 implies shutdown of 274,000 tons of capacity between June 1969 and December 1970. Then opened some 422,000 tons in 1971; 183,000 tons in latter half of 1971.

YOUNGSTOWN SHEET & TUBE Co.,
P.O. Box 900,
Youngstown, Ohio, October 16, 1974.

Hon. WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee, New Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: Your letter of October 1, 1974 addressed to J. T. Lykes, Jr., Chairman of our parent company, Lykes-Youngstown Corporation, requests certain information to fill an "inexplicable gap" in existing statistical information regarding U.S. steel-making capacity.

From our vantage point as the eighth largest steel producer in the country, we find it difficult to understand why there should be any serious question as to what the real steelmaking capacity of the U.S. steel industry is. It seems clear to us that the effective steelmaking capacity of the country, give or take a few percentage points, has been pretty well pegged by the actual production figures over the last year and a half. For the last eighteen months or so, we—and we believe the entire industry—have been trying our utmost to make and ship every ton of steel we could possibly get out the door. In a capital intensive industry such as ours, all the incentive is to maximize production in periods of

high demand so long as direct production costs can be covered. If there is any real capacity for making steel which has not been utilized in the past year or so, I can't imagine where it might be—certainly not at our facilities.

I can sympathize with your feeling that there must be some better way of arriving at steel capacity other than looking at actual production figures, but I know of no way in which any meaningful figure could be arrived at short of a detailed plant-by-plant, facility-by-facility study. Even then, the capacity estimates would have to be related to attained production figures to have any validity, and would be no better than the experience and judgment of the person making the assessment. Capacity of a steel plant cannot be computed in the same way as an auto assembly plant.

Why is this so? Paradoxically, it's not because the steel industry is so sophisticated or complicated. Basically, in my opinion, it's because each plant in the industry has its own individual characteristics and personality, and its own peculiar restrictions, constraints, and problems, and its own steelmaking capacity. Most steel mills today have been around for a half century or more, and in that time they have expanded, replaced and revamped facilities a number of times, so that nearly every plant is a mixture of new and modern facilities, and older less efficient facilities. While individual units may be comparable, whole mills are not, and it is the mill complex as a whole which determines capacity.

In an integrated steel mill the basic steelmaking facilities consist of blast furnaces for making "hot metal," coke plants, and steelmaking furnaces, either open hearth furnaces or basic oxygen furnaces. So far as physical plant is concerned, the steelmaking capacity of a given plant is generally determined in the first instance by the most restrictive of these three major facilities. Capacity estimates are based on judgment, on experience with the particular steelmaking configuration involved and appraisal of the critical limitations on production. These estimates may change from time to time, and even day to day. In addition to possible improvements in productivity and yields, capacity estimates may be affected by quality of raw materials, blast furnace re-line cycles, estimates of maintenance down-time, scrap costs and availability, ratio of hot metal to scrap in steelmaking furnaces, product mix to the extent it affects ingot size and quality, and changes in the efficiency of various production units due to uncontrollable factors, to mention a few.

For individual companies, and perhaps the industry as a whole, there may be further limitations dictated by the ability to further process the product. In our case, and in many companies, restriction in the primary area (primary rolling mills and continuous casters) may put an effective lid on raw steel production. Although theoretically a company with excess steelmaking capacity could sell ingots to a company with excess primary rolling capacity, as a practical matter these opportunities are limited, and, in our judgment, would not significantly affect overall capacity.

In short, steelmaking capacity figures which have any validity are at best educated guesses by men familiar with the facilities and circumstances applicable to a particular plant or company at a given point in time. In my judgment, any attempt to construct an index of capacity for the industry which does not recognize the many variables affecting production capabilities between different plants and within a particular plant at different times, will almost certainly result in a misleading figure.

With respect to our own operations, we have steel plants in East Chicago, Indiana, and Youngstown, Ohio, areas. Our basic steelmaking configuration has not changed significantly since the completion of a basic oxygen furnace (BOF) shop at our Indiana Harbor works in June of 1970. This modern steelmaking facility permitted us to abandon operations at our ancient No. 1 open hearth shop, and to reduce the number of furnaces operated at our relatively new No. 2 open hearth shop. Our Youngstown district has two open hearth shops with a total of 21 operational furnaces, some of which are equipped with oxygen lances which significantly increase through-put in those furnaces.

Although we have eight operational open hearth furnaces at our Indiana plant and twenty-one in the Youngstown district, we consider three or four furnaces at Indiana and about 16 furnaces in Ohio (depending in some degree on the particular furnaces involved) to be our normal usage at full production. To a layman this might suggest that we had unused steelmaking capacity. The fact is, however, that we do not have sufficient "hot metal" from our blast furnaces to supply both the BOF shop and all our open hearth furnaces, so a capacity figure based on our steelmaking furnaces alone would be highly misleading. To compli-

cate things further, the hot metal capacity is limited by our coke production capability. The excess furnaces at our present hot metal capacity are redundant, and their capacity is not additive in determining steel capacity. They are kept operational in part to allow for flexibility in production and relining, and in part as "insurance" against a major outage of our BOF plant.

Even after more than four years' experience with our present facilities we are not prepared to settle on one figure as our "raw steel capacity." The best we can say at this time is that with transfer of coke between our operating plants, and purchase of outside coke (which is extremely scarce) we estimate that our company as a whole will produce slightly over 6,000,000 ingot tons in 1974, assuming no major production problems, and that we are aiming for an additional 400,000 tons next year. The higher target for 1975 was based on favorable assumptions as to the times critical production facilities would be on line during the year, and our ability to purchase outside coke, and may not represent a long-term capacity figure.

We view coke production and availability together with supporting supplies of metallurgical coal as the critical limitation on our raw steel production capacity with our present facilities. In this connection I would like to note that we have recently announced a \$200 million expansion program, principal items of which an 85-oven coke battery at our Indiana Harbor works and a two million ton a year metallurgical coal mine in Pennsylvania. These units will increase our effective capacity to produce hot metal and in turn increase our raw steel capacity. but it will be several years before the impact will be felt. The remaining item in our announced program is an oxygen furnace shop to replace one of our open hearth shops in the Youngstown district, but which will not in itself increase our raw steel production capacity.

With regard to the specific questions asked in your letter, we think we can best answer the intent of your questions in a somewhat different format than phrased, since the questions have implicit in them assumption which don't really fit our situation.

On the attached schedule we have listed our major steelmaking facilities—blast furnaces, coke batteries and steelmaking furnaces—which we consider to be in an operational status, even though they will seldom all be actually operational at any one given time because of scheduled relines and rebuilds, etc. Also shown is the actual operational status as of June 30 in each of the years 1970-74 inclusive, with comments as appropriate. We should note, however, that the facilities operating on a particular day are not likely to be indicative of the production level for the entire year. On June 30, 1971, for example, we were at an unusually high level of production because of the inventory build-up in anticipation of a possible steel strike that year. When the strike was averted, production fell to the lowest levels in several decades.

Percentage utilization is an elusive figure since it depends on capacity determinations which, as discussed above, are at best changing estimates. The best approach we can suggest for our company is that utilization for each year be calculated based upon our approximately 6 million ingot ton production estimated for 1974. These figures are also shown on the attached schedule.

Finally, we have noted on the attached sheets certain "in place" physical facilities which we consider non-operational, and which, in our judgment, would never be made operational for the reasons given.

In summary and conclusion, we would like to make the following points:

The "inexplicable gap" in steel industry capacity figures results, in our judgment, from the highly individualized factors affecting particular plants, so that constructing a theoretical formula for computing capacity would generate meaningless figures.

Despite the individual variances between plants and companies, the real effective steel capacity of the country as a whole has been pretty well proved by the actual production during the last year and a half.

Massive expenditures will be required just to keep capacity at present levels, and provide for required pollution control equipment. The investment required to expand capacity to meet conservative estimates of increases in demand is astronomical.

Statements or assertions that there is a vast amount of unused steelmaking capacity just waiting for the right price to be called into action would be not only misguided but a serious disservice to the American public. As our company, and particularly our Chairman, Frank A. Nemeo, has pointed out on numerous occasions, the "steel crunch" is here. We trust and hope our country will respond to the situation with intelligence and wisdom, and that those who should be most concerned do not get into a statistics war.

We have tried our best to give a responsive and meaningful reply to your letter within the brief time allotted, and hope we have done so. If you or your staff have any questions, we would be glad to sit down and discuss them with you.

Sincerely,

JENNINGS R. LAMBETH, *President.*

Attachment.

STEELMAKING FACILITIES AND UTILIZATION, 1970-74

| | Total | Operating on June 30 | | | | |
|---|-------|----------------------|------|------|------|------|
| | | 1970 | 1971 | 1972 | 1973 | 1974 |
| Operational steelmaking facilities: | | | | | | |
| Blast furnaces ¹ | 9 | 6 | 7 | 6 | 9 | 7 |
| Coke batteries (465 ovens) ² | 6 | 4 | 5 | 5½ | 6 | 6 |
| Basic oxygen furnace (2 vessels)..... | 1 | 1 | 1 | 1 | 1 | 1 |
| Open hearth furnaces (3 shops) ³ | 29 | 17 | 20 | 15 | 19 | 19 |

¹ Blast furnaces must be relined and rebuilt several times during their productive life, the frequency depending principally on usage. 1 blast furnace was down for rebuild on June 30, 1971, and another on June 30, 1974. Other furnaces were down in 1970 and 1972 because of business conditions, and in 1971 and 1974 because of coke shortage.

² On June 27, 1970, a major fire took 2 coke batteries out of production for about 2 weeks. All 6 batteries were operating before and after the fire. On June 30, 1971, 1 coke battery was down for rebuild, and on June 30, 1972 half of another battery was down for rebuild. It should be noted that at any particular time some of the ovens on a battery will usually be out of service for repairs, etc., so that the productive capacity of the battery will fluctuate.

³ Normally, at least 1 furnace in each open hearth shop will be undergoing relining at any particular time, making the net number of operational furnaces 26.

RAW STEEL PRODUCTION BY YEARS

| | Ingot tons | Percentage utilization based on 6,000,000 tons |
|----------------------|------------|--|
| 1970..... | 5,143,000 | 85.7 |
| 1971..... | 4,923,000 | 82.1 |
| 1972..... | 5,547,000 | 92.5 |
| 1973..... | 5,846,000 | 97.4 |
| 1974 (estimate)..... | 6,000,000 | 100.0 |

UNDISMANTLED NON-OPERATIONAL FACILITIES

As discussed in the accompanying letter, our No. 1 open hearth shop at our Indiana Harbor Works was abandoned in place when our BOF facility was completed in 1970. The shop has been allowed to deteriorate and lacks air pollution control facilities. We can think of no circumstances in which this shop would be resurrected.

At our Brier Hill Works in Youngstown there is a coke battery which has not been operated since prior to 1960. The battery has been cannibalized and has deteriorated, and would require a major investment to rehabilitate it. Because of its location and condition, we do not believe its rehabilitation would ever be justified.

A few of the furnaces in the existing open hearth shops have been removed from service and dismantled to make room for other activities. Restoration is theoretically possible, but not realistic in view of ability of the existing furnaces to handle present or anticipated raw steel production.

JONES & LAUGHLIN STEEL CORP.,
Pittsburgh, Pa., October 16, 1974.

HON. WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR PROXMIRE: In response to your letter of October 1, concerning raw steel production, we submit the following information:

| | Production—Month of June, net tons | |
|------|---------------------------------------|-----------|
| | Hot metal | Raw steel |
| 1970 | 377,000 | 538,400 |
| 1971 | 502,600 | 691,700 |
| 1972 | 389,400 | 616,100 |
| 1973 | 439,500 | 654,400 |
| 1974 | 454,800 | 680,500 |

Since raw steel capacity is affected by many variables such as the availability and mix of raw materials, furnace outages and relines, availability of hot metal to steelmaking, environmental requirements, etc., we regard precise figures with respect to raw steel capacity as less than meaningful. However, we can say that for all the years presented we have been producing raw steel to the maximum extent possible with the facilities and materials available, except for June, 1970 and June, 1972.

With respect to June, 1972, one (1) blast furnace was idle due to economic conditions which would have provided an estimated additional 30,000 to 35,000 tons of raw steel per month.

Our ability to produce raw steel in the years subsequent to 1971 has been reduced by the need to curtail utilization of certain Open Hearth furnaces due to environmental control problems. In late 1971, four of ten Open Hearth furnaces were taken out of service. Two of these furnaces have been dismantled. The remaining two furnaces are inoperable because the cost to rehabilitate them and provide necessary environmental control equipment would be prohibitive.

As stated above, we have been operating at practical capacity in 1974.

Sincerely,

T. C. GRAHAM.

[Telegram]

KAISER INDUSTRIES,
Oakland, Calif., October 14, 1974.

Senator WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR PROXMIRE: In response to your request of October 1 to Mr. Edgar Kaiser, Kaiser Steel's maximum steel ingot capacity and percent utilization for the years in question were as follows:

June 30, 1974, 3,200,000 tons, 96 percent.

June 30, 1973, 3,200,000 tons, 96 percent.

June 30, 1972, 3,200,000 tons, 78 percent.

June 30, 1971, 3,200,000 tons, 80 percent.

June 30, 1970, 3,200,000 tons, 92 percent.

(No production units have been excluded in the above table).

For all practical purposes we have been operating at 100 percent of our capability since March, 1973 but our total output has been reduced somewhat because of necessary blast furnace relinings which have occurred during the period.

It is significant to note that during the early part of this period foreign imports, selling at prices far below what we could compete with, captured 28 percent of the seven western states market in 1970, 31 percent in 1971 and 37 percent in 1972. After the dollar devaluation in early 1973 which occurred during a building world demand, import penetration in the west dropped to 28 percent in 1973 and was at 31 percent of the estimated market for the first six months of 1974. Imported steel prices during this period, however, were at high premiums above Kaiser steel's prices and still are.

Clearly, if western steel buyers are ever to be relieved from the dependence on imported steel which is available only at high premiums above domestic

steel during periods of shortage, domestic steel producers must be allowed to earn sufficient profit to attract capital for expansion with a reasonable economic payback and with reasonable assurance that at some future time foreign producers will not be in a position to undercut their markets and inundate them with cut-price steel with which domestic producers using American labor cannot compete.

We urge your support of the trade reform bill which is presently before the Senate, particularly in regard to section 202 on import relief and in support of an amendment which hopefully will be offered allowing the tariff commission to treat as a domestic industry within the meaning of the escape clause (section 201) the industry located in a major geographic area and serving a market in that area.

Such a provision, coupled with the ability to earn sufficient profits, might make it possible for a western producer to expand to serve the western market which today is woefully dependent on foreign steel.

We thank you for the question, your interest in the matter and for the opportunity to present these views.

Sincerely yours,

M. T. ANTHONY,
Vice President and General Manager.

WHEELING PITTSBURGH STEEL CORP.,
October 15, 1974.

HON. WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR SENATOR PROXMIRE: In answer to your letter of October 1, 1974, we are supplying the information you requested with regard to our maximum capacity to produce raw steel and the utilization of this capacity as of June 30, for the years 1970 through 1974.

The use of these statistics can be misleading since we do not believe that a simple steel capacity number for our company is really meaningful. This is the reason the steel industry stopped publishing these statistics some years ago. Capacity to produce raw steel is based upon the expected physical output of a furnace if all of the raw materials are supplied on time and there are no mechanical failures. Transportation problems, coke plant or other energy source problems, environmental interruptions, blast furnace problems and mechanical failures, as well as employee work stoppages are factors which contribute to operating below capacity levels at a time when we are striving for capacity output. Raw steel production is also quite different from finished steel shipments and most of the time there is no market for raw steel. The mixture of steel products to be produced has a bearing on the capacity numbers. The final tonnage of finished steel shipments from a given steel mill could vary greatly, depending upon the product shipped. In some cases, the prime product may be as low as 50% of the raw steel produced due to yield losses.

Our rated steel capacity which could be called "the maximum physical capacity to produce raw steel" on June 30 for each of the past five years, including 1974, was constant at 365,000 tons per month. The actual steel produced in the months ending June 30, referred to as the "utilization of this capacity on each of those dates," was 1970—347,000 tons, 1971—325,000 tons. In June of 1972, we suffered from a flood of the Ohio River and as a result we lost about 50,000 tons of steel from our plant due to the shutdown of our major facilities; final production was 290,000 tons. Both June of 1973 and 1974 were scheduled at capacity but this production was not attained due to either mechanical problems or a lack of raw materials; mainly, hot metal from our furnaces. Final production was 1973—365,000 tons, 1974—343,000 tons. During 1973 and 1974, we have been shipping steel beyond our capacity to finish it and have reduced our inventories to bare minimums to accommodate our customers' needs in a period of high demand. We are doing everything possible to maximize our production and shipments of steel to meet the high demand presently existing.

There were no production units excluded from the total submitted under our answer to item #1. I hope that this information will be helpful to you in your study.

Very truly yours,

J. S. HOWARD.

SHARON STEEL CORP.,
Sharon, Pa., October 14, 1974.

Senator WILLIAM PROXMIRE,
Vice Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR SENATOR PROXMIRE: You requested information for the Joint Economic Committee on October 1, 1974. Mr. Victor Posner, Chairman NVF Company, gave me your request with instructions to respond to you.

The data that you requested is as follows:

1. The maximum physical capacity to produce raw steel in all of our company's production units that were in operation on June 30 for each of the past five years including 1974 was as follows:

| | <i>Tons</i> |
|------------|-------------|
| 1970 ----- | 1, 680, 000 |
| 1971 ----- | 1, 680, 000 |
| 1972 ----- | 1, 320, 000 |
| 1973 ----- | 1, 320, 000 |
| 1974 ----- | 1, 320, 000 |

The reason for the reduction in capacity was due to a shutdown of open hearth furnaces due to pollution control requirements.

2. The rates of utilization of this capacity on each of those dates was as follows:

| | <i>Percent</i> |
|------------|----------------|
| 1970 ----- | 93. 6 |
| 1971 ----- | 81. 5 |
| 1972 ----- | 97, 1 |
| 1973 ----- | 96. 6 |
| 1974 ----- | 94. 9 |

3. We have no capacity which is in place and which has been excluded from the total submitted under Item 1. The open hearth capacity which existed in 1971 is now defunct and would have to be completely rebuilt to resume production.

Your very truly,

J. K. McCauley,
Vice President, Environmental Control.

INTERLAKE, INC.,
Chicago, Ill., October 14, 1974.

HON. WILLIAM PROXMIRE,
U.S. Senate, Washington, D.C.

SIR: Per your request of October 1, 1974 addressed to Mr. Reynold C. MacDonald, Interlake's Chairman and Chief Executive Officer, herewith is the information you requested:

Interlake's maximum physical capacity to produce raw steel is 1,377,000 net tons of ingots per year. The rates of utilization are as follows:

| | <i>Percent</i> |
|------------|----------------|
| 1970 ----- | 93. 9 |
| 1971 ----- | 101. 3 |
| 1972 ----- | 96. 2 |
| 1973 ----- | 84. 6 |
| 1974 ----- | 94. 0 |

For your information, the reduction of percent capacity utilized in 1973 and 1974 was caused almost wholly by the inability to get suitable scrap at almost any price. This was caused by the unconscionable export of steel scrap out of the country.

Very truly yours,

FRANK J. BURGERT, President.

McLOUTH STEEL CORP.,
 Detroit, Mich., October 14, 1974.

HON. WILLIAM PROXMIRE,
 Vice Chairman, Joint Economic Committee,
 Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: In response to your letter dated October 1, 1974 requesting statistical information regarding steel industry capacity, we are pleased to submit the following data:

1. Maximum theoretical physical capacity to produce raw steel on June 30 for each of the past five years:

| | <i>Net tons per month</i> |
|-----------|-------------------------------|
| 1974..... | 200,000 |
| 1973..... | 200,000 |
| 1972..... | 200,000 |
| 1971..... | 200,000 |
| 1970..... | 200,000 |

2. The rates of utilization of this capacity:

| | <i>Percent</i> |
|-----------|----------------|
| 1974..... | 88.8 |
| 1973..... | 87.8 |
| 1972..... | 83.5 |
| 1971..... | 84.2 |
| 1970..... | 65.3 |

(From a practical operating standpoint, we have been at capacity for the last two years.)

3. There were no production units excluded from Item 1, above.

Very truly yours,

G. E. GANN, *President.*

[Press release of the Joint Economic Committee, Congress of the United States,
 Nov. 29, 1974]

SENATOR PROXMIRE REVEALS STEEL CAPACITY DATA

Senator William Proxmire (D-Wis.), Vice-Chairman of the Joint Economic Committee, stated Friday that "steelmaking capacity in the United States is significantly greater than ever publicly acknowledged by the industry." The senator made this statement in releasing information on steelmaking capacity and its utilization compiled from questionnaires sent to all major steel companies on October 2.

"Our sample includes firms producing about 80 percent of all raw steel made in the United States. From this base, the Joint Economic Committee staff estimates the total raw steel capacity of the industry at nearly 163 million tons per year. This is almost ten million tons more than the capacity generally acknowledged by the industry. This figure represents the physical capacity of operable steelmaking facilities, assuming availability of all necessary inputs and minimal stoppages for maintenance. It does not include the capacity of open hearth furnaces listed as abandoned after replacement by new facilities.

"Second, the JEC staff also found that the utilization of steelmaking capacity dropped off by 1.7 percentage points in the first half of 1974. While this decline is not large and some of it can be related to deficiencies in raw materials, I find it peculiar that utilization has declined to 94 percent in a period of the most sharply rising steel prices in the nation's history.

"Third, the survey reveals that raw steel capacity in this country has not increased by one iota in the past five years. The industry has retired old facilities as soon as new ones came on line.

"I conclude from my examination of the data that the steel industry, with its record profits and sales, is in a very strong position to proceed with its

expansion plans without any additional price increases in the near future." Senator Proxmire continued. "Announced projects to expand capacity by 18 to 20 million annual tons should be sufficient to meet the demand for steel for the rest of this decade.

"This survey marks the first time in 15 years that the steel industry has made capacity and utilization data available to the public," Proxmire added. "I am happy to report that all companies cooperated in this inquiry. The Department of Commerce is trying to get similar information on a continuing basis. I hope the steel companies will see fit to help, and I intend to monitor their cooperation. Whatever the shortcomings of these data they are valuable for judging the health of the economy and necessary for important policy decisions."

A table summarizing the questionnaire data is attached to this release. The complete responses of each company will be published with the record of the October 7 hearing on administered pricing.

SIZE AND UTILIZATION OF STEELMAKING CAPACITY OF 13 U.S. STEEL COMPANIES, 1970-74

| Companies | Maximum capacity (million tons per year) | | | | | Utilization (percent) | | | | |
|--------------------------------|--|-------|-------|-------|-------|-----------------------|-------|------|-------|------|
| | 1974 | 1973 | 1972 | 1971 | 1970 | 1974 | 1973 | 1972 | 1971 | 1970 |
| United States Steel..... | 38.0 | 38.0 | 38.0 | 38.0 | 38.0 | 90.0 | 91.7 | 83.9 | 84.4 | 89.3 |
| Bethlehem Steel..... | 25.2 | 25.0 | 25.1 | 25.7 | 25.6 | 92.4 | 94.8 | 73.0 | 67.9 | 80.4 |
| National Steel..... | 11.3 | 11.3 | 11.3 | 11.3 | 11.3 | 95.6 | 100.0 | 87.0 | 76.7 | 87.2 |
| Republic Steel..... | 11.3 | 11.3 | 11.3 | 11.3 | 11.3 | 96.8 | 99.7 | 91.9 | 77.1 | 85.1 |
| Armco..... | 9.4 | 9.4 | 9.4 | 9.1 | 8.7 | 97.3 | 99.1 | 88.8 | 84.5 | 90.3 |
| Jones & Laughlin Steel..... | 8.3 | 8.0 | 7.8 | 9.0 | 9.0 | 98.0 | 97.7 | 94.8 | 92.2 | 71.8 |
| Inland Steel..... | 8.2 | 8.2 | 8.2 | 7.7 | 7.7 | 98.7 | 99.4 | 94.8 | 84.4 | 91.6 |
| Youngstown Steel..... | 6.1 | 6.1 | 6.0 | 6.0 | 6.0 | 98.4 | 95.8 | 92.5 | 82.1 | 85.7 |
| Wheeling Pittsburgh Steel..... | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 93.9 | 100.0 | 79.4 | 89.0 | 95.1 |
| Kaiser Industries..... | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 96.0 | 96.0 | 78.0 | 80.0 | 92.0 |
| McLouth Steel..... | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 88.8 | 87.8 | 83.5 | 84.2 | 65.3 |
| Interlake, Inc..... | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 | 94.0 | 84.6 | 96.2 | 101.3 | 93.9 |
| Sharonsteel..... | 1.3 | 1.3 | 1.3 | 1.7 | 1.7 | 94.9 | 96.6 | 97.1 | 81.5 | 93.6 |
| Total..... | 130.5 | 130.1 | 129.9 | 131.2 | 130.7 | 93.9 | 95.6 | 84.8 | 80.5 | 85.8 |
| Averages..... | | | | | | | | | | |

¹ Includes capacity of Granite City Steel, which was merged with National Steel in 1971.

Note: These companies made 80.2 percent of all raw steel produced in the United States in 1973. In view of that year's industrywide high rate of capacity use, it may be assumed that they had an equivalent share of the steelmaking capacity. On this assumption, total U.S. capacity for 1973 would equal the total capacity of the listed firms (130,100,000 tons) divided by 0.802, or 162,200,000 tons. Using the same proportions for 1974, this year's total U.S. capacity would be 130,500,000 tons ÷ 0.802 = 162,700,000 tons.

THE LIBRARY OF CONGRESS,
CONGRESSIONAL RESEARCH SERVICE,
Washington, D.C.

HON. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: In response to your request, I am pleased to transmit the report, "Recent Steel Prices and Pricing Practices in the United States: Background and Issues", prepared by Mr. Julius W. Allen, senior specialist in price economics, Economics Division, with the assistance of Mr. David Bruce Hack, analyst, Science Policy Research Division, and Miss Susan Dovell, research assistant, Economics Division.

The report is designed to provide a perspective on the factors bearing on the recent large price increases within the steel industry, the extent of these increases, and their impact on other sectors of the economy.

The basic methodology for Chapter 5, "Impact of Steel Price Increases on Other Sectors of the Economy" was developed by Mr. Hack, who also contributed substantially to the content and form of this chapter. Miss Dovell was responsible for most of the statistical tables of the report.

The assistance of the American Iron and Steel Institute and the U.S. Bureau of Labor Statistics in supplying data for the report is gratefully acknowledged.

Sincerely,

LESTER S. JAYSON, Director.

Attachment.

RECENT STEEL PRICES AND PRICING PRACTICES IN THE UNITED STATES: BACKGROUND
AND ISSUES

(By Julius W. Allen, Senior Specialist in Price Economics, Economics Division,
with the assistance of Susan Dovell and David Bruce Hack)

Contents

| | Page |
|---|-------------|
| I. Introduction..... | 213 |
| II. Structure of the steel industry..... | 213 |
| Characteristics of iron and steel..... | 213 |
| The United States and world production of steel..... | 214 |
| Range of steel mill products..... | 214 |
| Corporate structure of the steel industry..... | 217 |
| Integration in the steel industry..... | 218 |
| Changes in the iron and steel industry in the past decade..... | 219 |
| Technological changes..... | 219 |
| Output, exports, imports and employment..... | 220 |
| Financial data, 1963-73..... | 221 |
| III. Pricing practices in the steel industry..... | 225 |
| Economic characteristics of the steel industry..... | 225 |
| Price leadership..... | 226 |
| Pricing objectives of the United States Steel Corp..... | 228 |
| Basing point pricing..... | 229 |
| IV. Steel price changes..... | 230 |
| V. Impact of steel price increases on other sectors of the economy..... | 234 |
| VI. Conclusion..... | 238 |
| Appendix. "The Partial Effects of Cost, Demand, and Industry Concentra- tion in the Process of Inflation, on Interindustry Model," by David Bruce Hack..... | (1) |

I. INTRODUCTION

One of the striking but little publicized phenomena of the 1974 inflation in the United States is the spectacular increase in steel prices.

In the two months following the removal of price and wage controls on April 30, the United States Steel Corporation raised prices in six steps by an average of 23 percent. And it was not alone. In the six months from February to August 1974, the wholesale price of steel mill products, as measured by the Bureau of Labor Statistics, rose by 35.2 percent. During the same period, by comparison, wholesale prices generally rose by 12.0 percent and consumer prices by 6.1 percent.

Using the Iron Age Finished Steel Composite, we find that the steel composite price of \$190 per net ton in February had increased to \$247 a ton in August, or an increase of 30 percent. It is an interesting commentary of the times to compare the furor that occurred in April 1962 when the United States Steel Corporation announced a price increase of \$6 a ton, which public pressure and failure of key steel companies to follow its lead made it withdraw, and the situation in 1947 when an increase of \$57 a ton in a six month period is accepted with hardly a murmur. What protests there have been have been drowned out by the greater outcries against price increases in food and fuels. The pervasive impact which a steel price rise of this magnitude has throughout the national economy appears to be largely ignored.

This report is designed to present background information that will illuminate some of the elements involved in the recent increases and their impact on the rest of the economy. To this end, there are separate chapters on the structure of the steel industry, pricing practices within the industry, steel price trends, the impact of such trends in the economy, and finally a brief summary of issues raised by these price increases.

II. STRUCTURE OF THE STEEL INDUSTRY

Characteristics of Iron and Steel

The iron and steel industry of the United States has, throughout our history, been an indispensable element in the nation's strength and economic growth.

¹ The appendix material may be found in the committee files.

In their many forms and with various properties depending on carbon content and that of various alloys, iron and steel comprise by far the most widely used of all metals. No other metal has the combined characteristics of strength, ductility, malleability, and low cost that iron and steel do. It is, in fact, difficult to think of any consumer good which does not have iron or steel as a significant component, or in whose production iron and steel are not essential, or in the transportation of which, from producer to consumer, iron and steel are not indispensable. The security and economic well-being of the nation as well depend on steel.

The United States and World Production of Steel

Throughout the 20th century, until 1971, the United States has been the world's largest producer of raw steel. In that year and again in 1972, it was surpassed by the Soviet Union. But in 1973 its surge in production put it ahead of the Soviet Union. The rapid increase in production of raw steel abroad, notably in Japan, the third largest steel producer in the world, and in the Soviet Union has had the consequence of a rather continual drop in the proportion of world raw steel production attributable to the United States, from 46.6 percent in 1950 to a low of 18.8 percent in 1971. This increased to 19.7 percent in 1973.

Further details of the relative changes in shares of world raw steel production among the leading steel producing nations since 1950 are shown in Table 1.

Range of Steel Mill Products

While it is convenient to refer to aggregate quantities of steel production and steel shipments, and to speak of increases in the price of steel as if it were a single homogeneous commodity, it is important to recognize the broad range of steel mill products which represent that output of the industry. Table 2 shows a breakdown of the most important steel products, ranked by tonnage shipped in 1973.

Within these categories there is, of course wide diversity in specifications affecting among other factors weight, strength, durability, heat resistance and flexibility of the product.

TABLE 1.—WORLD PRODUCTION OF RAW STEEL: SELECTED YEARS, 1950-73
[In thousands of net tons]

| Year | World | United States | Percent of world | U.S.S.R. | Percent of world | Japan | Percent of world | West Germany | Percent of world | United Kingdom | Percent of world | France | Percent of world | Rest of world | Percent of world |
|-----------|---------|---------------|------------------|----------|------------------|---------|------------------|--------------|------------------|----------------|------------------|--------|------------------|---------------|------------------|
| 1973..... | 767,199 | 150,799 | 19.7 | 144,400 | 18.8 | 131,533 | 17.1 | 54,585 | 7.1 | 29,459 | 3.8 | 27,845 | 3.6 | 228,578 | 30.0 |
| 1972..... | 894,481 | 133,241 | 19.2 | 138,891 | 20.0 | 106,814 | 15.4 | 48,176 | 6.9 | 28,026 | 4.0 | 26,555 | 3.8 | 212,778 | 30.6 |
| 1971..... | 639,907 | 120,443 | 18.8 | 132,992 | 20.8 | 97,620 | 15.3 | 44,434 | 6.9 | 26,720 | 4.2 | 25,198 | 3.9 | 192,500 | 30.1 |
| 1970..... | 654,185 | 131,514 | 20.1 | 127,739 | 19.5 | 102,869 | 15.7 | 49,649 | 7.6 | 30,720 | 4.7 | 26,199 | 4.0 | 185,495 | 28.4 |
| 1965..... | 503,083 | 131,462 | 26.2 | 100,328 | 19.9 | 45,372 | 9.0 | 40,588 | 8.1 | 30,247 | 6.0 | 21,604 | 4.3 | 133,482 | 26.5 |
| 1960..... | 381,582 | 99,282 | 26.0 | 71,971 | 18.9 | 24,403 | 6.4 | 13,590 | 9.9 | 27,222 | 7.1 | 19,069 | 5.0 | 102,045 | 26.7 |
| 1955..... | 297,222 | 117,036 | 39.4 | 50,265 | 16.9 | 10,370 | 3.5 | 23,503 | 7.9 | 22,313 | 7.5 | 13,872 | 4.7 | 59,863 | 20.1 |
| 1950..... | 207,829 | 96,836 | 46.6 | 30,400 | 14.6 | 5,343 | 2.6 | 13,361 | 6.4 | 18,248 | 8.8 | 9,536 | 4.6 | 34,105 | 16.4 |

¹ Figure for West Germany for 1960 includes Saar.

Source: The American Iron and Steel Institute, annual statistical reports.

TABLE 2.—NET SHIPMENTS OF STEEL PRODUCTS IN 1973

| Steel products | Shipments (thousands of net tons) | Percent of total |
|---------------------------------------|---|---------------------|
| Total | 111,430 | 100 |
| Sheets, cold rolled | 20,377 | 18.3 |
| Sheets, hot rolled | 16,885 | 15.2 |
| Bars, hot rolled | 9,729 | 8.7 |
| Plates | 9,678 | 8.7 |
| Pipe and tubing | 9,133 | 8.2 |
| Sheets and strip, galvanized | 6,886 | 6.2 |
| Structural Shapes (heavy) | 6,556 | 5.9 |
| Tin plate—electrolytic and hot dipped | 5,288 | 4.7 |
| Reinforcing bar | 5,135 | 4.6 |
| Strip, hot and cold rolled | 3,412 | 3.1 |
| Blooms, slabs, billets, sheet bars | 3,095 | 2.8 |
| Drawn wires | 2,559 | 2.3 |
| Cold finished bars | 2,161 | 1.9 |
| Wire rods | 2,040 | 1.8 |
| All other | 8,496 | 7.6 |

Source: American Iron & Steel Institute, annual statistical report, 1973.

Correspondingly, in major product categories there are wide differences in price of steel products. For example, using only the average price quotations for the commonest of steel products in Pittsburgh for 1973, the following range of prices (in cents per pound) can be seen:

| | |
|------------------------|-------|
| Hot rolled sheets | 8.35 |
| Merchant bars | 8.38 |
| Hot rolled strip | 8.50 |
| Steel plates | 9.21 |
| Cold rolled sheets | 10.14 |
| Bright wire | 10.34 |
| Cold rolled strip | 11.08 |
| Cold finished bars | 11.99 |
| Stainless steel sheets | 51.33 |
| High speed tool steel | 236.0 |

The broad spectrum of markets to which steel mill products are sent is indicated by Table 3 which shows market classifications for steel shipments for 1963 and 1973.

From this table it can be seen that in both years the leading market was the automobile industry, followed by construction, machinery, and containers.¹ In fact, the similarity of proportions going to the different market categories in 1963 and again in 1973 is noteworthy.

TABLE 3.—SHIPMENTS OF STEEL PRODUCTS IN 1963 AND 1973, BY MARKET CLASSIFICATIONS

| Market classification | 1963 | | 1973 | |
|--|-------------------------|---------------------|-------------------------|---------------------|
| | Net tons (thousands) | Percent of total | Net tons (thousands) | Percent of total |
| Automotive | 16,889 | 22.4 | 23,217 | 20.8 |
| Construction | 14,390 | 19.0 | 17,864 | 16.0 |
| Containers | 6,464 | 8.6 | 7,811 | 7.0 |
| Railroads | 2,563 | 3.4 | 3,228 | 2.9 |
| Oil, gas, and mining | 2,101 | 2.8 | 3,265 | 3.0 |
| Machinery | 6,782 | 8.9 | 9,699 | 8.7 |
| Converting and processing | 2,612 | 3.5 | 4,714 | 4.2 |
| Agriculture | 1,225 | 1.6 | 1,772 | 1.6 |
| Shipbuilding | 1,712 | .9 | 1,019 | .9 |
| Warehouses (service centers), and distribution | 11,627 | 15.4 | 20,383 | 18.3 |
| Ordnance | 289 | .4 | 918 | .8 |
| All other | 8,070 | 10.7 | 14,402 | 13.0 |
| Total domestic | 73,724 | 97.6 | 108,292 | 97.2 |
| Exports | 1,831 | 2.4 | 3,138 | 2.8 |
| Total shipments | 75,555 | 100.0 | 111,430 | 100.0 |

Source: The American Iron & Steel Institute, annual statistical reports.

¹ The classification of service centers is excluded, since this is essentially a middleman category, from which shipments are made to most of the other categories, of which construction is probably the most significant.

Corporate Structure of the Steel Industry

The steel industry providing these thousands of products to such a wide range of markets includes a broad spectrum of companies, some gigantic in size. The largest integrated companies undertake activities ranging from the mining of iron ore, coal and limestone, through the transportation of ores by freighter and by rail, to the manufacture of pig iron and raw steel, to finally the fabrication of thousands of semi-finished and finished iron and steel products, and construction of bridges and other steel products. These integrated companies, in fact, account for the majority of the output of the steel industry. Thus as Tables 4 and 5 show, eleven companies, led by United States Steel Corporation, account for over 80 percent of steel production, steel shipments, employment, sales, income and assets within the industry.

TABLE 4.—SELECTED OPERATING DATA FOR STEEL INDUSTRY COMPANIES IN 1973

| Company | Raw steel production | | Steel shipments | | Average number of employees | |
|------------------------------|-----------------------|------------------|-----------------------|------------------|-----------------------------|------------------|
| | Thousands of net tons | Percent of total | Thousands of net tons | Percent of total | Number | Percent of total |
| Industry Total..... | 150,422 | 100.0 | 111,430 | 100.0 | 672,695 | 100.0 |
| United States Steel..... | 34,968 | 23.25 | 26,066 | 23.39 | 184,794 | 27.47 |
| Bethlehem..... | 23,702 | 15.76 | 16,627 | 14.92 | 118,000 | 17.54 |
| Armco..... | 5,464 | 6.23 | 6,872 | 6.17 | 52,187 | 7.76 |
| National..... | 11,321 | 7.53 | 9,142 | 8.20 | 37,330 | 5.55 |
| Republic..... | 11,288 | 7.50 | 8,501 | 7.63 | 43,803 | 6.51 |
| Inland..... | 8,155 | 5.42 | 5,891 | 5.29 | 34,604 | 5.14 |
| Jones & Laughlin..... | 7,986 | 5.31 | 6,013 | 5.40 | 133,800 | 5.02 |
| Youngstown Sheet & Tube..... | 5,846 | 3.89 | 4,478 | 4.02 | 230,000 | 4.46 |
| Allegheny-Ludlum..... | 1,013 | .67 | 557 | .50 | 18,817 | 2.80 |
| Wheeling-Pittsburgh..... | 4,407 | 2.93 | 3,476 | 3.12 | 18,821 | 2.80 |
| Kaiser Steel..... | 3,168 | 2.11 | 2,381 | 2.14 | 15,096 | 2.24 |
| All other..... | 29,104 | 19.35 | 21,426 | 19.23 | 85,443 | 12.70 |

¹ Figure from Moody's Industrial Manual, 1974.

² Figure for parent company, Lykes—Youngstown.

³ Yearend figure.

Sources: Raw steel production and steel shipment figures: Iron Age, Apr. 29, 1974. Employment figures: Fortune, May 1974 (for individual companies); American Iron & Steel Institute, annual statistical report 1973 (for industry total).

TABLE 5.—SELECTED FINANCIAL DATA FOR MAJOR STEEL INDUSTRY COMPANIES IN 1973

| Company | Sales | | Assets | | Net income | |
|--|-------------------------|------------------|-------------------------|------------------|-------------------------|------------------|
| | In thousands of dollars | Percent of total | In thousands of dollars | Percent of total | In thousands of dollars | Percent of total |
| Industry total..... | 28,321,285 | 100.00 | 26,274,000 | 100.00 | 1,302,700 | 100.00 |
| United States Steel..... | 6,951,905 | 24.55 | 6,918,535 | 26.33 | 325,758 | 25.00 |
| Bethlehem..... | 4,137,633 | 14.61 | 3,919,264 | 14.92 | 206,609 | 15.86 |
| Armco..... | 2,390,162 | 8.44 | 2,259,377 | 8.60 | 107,454 | 8.25 |
| National..... | 2,103,279 | 7.43 | 2,024,378 | 7.70 | 98,072 | 7.53 |
| Republic..... | 2,068,605 | 7.30 | 1,862,011 | 7.09 | 86,744 | 6.66 |
| Inland..... | 1,828,951 | 6.46 | 1,559,033 | 5.93 | 83,129 | 6.38 |
| Jones & Laughlin ¹ | 1,534,354 | 5.42 | 1,261,646 | 4.80 | 44,579 | 3.42 |
| Youngstown Sheet & Tube ² | 1,231,795 | 4.35 | 1,481,493 | 5.64 | 36,408 | 2.79 |
| Allegheny-Ludlum..... | 763,001 | 2.69 | 587,656 | 2.24 | 31,181 | 2.39 |
| Wheeling-Pittsburgh..... | 761,134 | 2.69 | 661,492 | 2.52 | 19,324 | 1.48 |
| Kaiser Steel..... | 608,830 | 2.15 | 758,255 | 2.89 | 52,694 | 4.04 |
| All other..... | 3,941,636 | 13.92 | 2,980,860 | 11.35 | 210,748 | 16.18 |

¹ Figures from Standard and Poor's Industry Surveys.

² Figures are for parent company, Lykes-Youngstown.

Sources: Fortune, May 1974 (for individual companies); American Iron and Steel Institute, annual statistical report 1973 (for Assets and Net Income, industry total); Iron Age, Apr. 29, 1974 (for sales, industry total).

United States Steel Corporation has been by far the largest company in the industry ever since it was formed in 1901 as a result of the merger of Carnegie Steel, Federal Steel, National Steel, American Steel and Wire, and several smaller companies. Although its share of total steel production has declined from its peak of nearly ⅓ of the nation's total, United States Steel in 1973 still

accounted for nearly a quarter of total production of raw steel, total steel shipments, and sales of the steel industry, and over a quarter of the industry's employment, assets and net income. Until 1970 United States Steel Corporation was in fact the largest single steel company in the world. In that year, however, it was surpassed in size by the Nippon Steel Company, formed as a result of the merger of Yawata and Fuji, the two largest steel companies in Japan.

Bethlehem ranks second among steel companies, with over 15 percent of raw steel production and of the industry's net income. No other company accounted for as much as 10 percent of the industry's output, employment, sales, income, or assets. Nevertheless, even the smaller steel companies rank large among U.S. industrial companies generally. This is reflected in the fact that of the 100 largest industrial companies in the United States in 1973, measured by sales, six were steel companies; of the 500 largest, 17 were steel companies; and of the 1,000 largest 26 were steel companies. To a considerable extent, the large size of steel companies is a reflection of the large capital costs required for successful operation of basic steel mills. It has been estimated, for example, that a new entrant into steel production would require somewhere near \$500 million in capital to have a chance of being a viable competitor in the business.¹

Nonetheless, it should be stressed that there are hundreds of companies that operate in the various segments of the iron and steel industry. This can be seen from Table 6 below. This table shows the nine subdivisions of the iron and steel industry (Standard Industrial Classification Code 4-digit industries) in the Census of Manufacturers, arranged in decreasing order of numbers of employees. As can be seen, over 60 percent of the employees and over 68 percent of the value of shipments come from companies and establishments classified as "blast furnaces and steel mills" as their principal function. Grey iron foundries rank second in employment and value of shipments. However, although they have slightly over a quarter of the employees and about a seventh of the value of shipments of blast furnaces and steel mills, they account numerically for nearly five times as many companies and three times as many establishments. Other industries, based upon primary product manufactured, with a hundred or more establishments are iron and steel forgings, steel pipe and tubes, steel wire and related products, and cold finishing of steel shapes. In addition, according to the Census of Mineral Industries, there were also about 100 companies primarily engaged in mining of iron ore.

TABLE 6.—SELECTED IRON AND STEEL INDUSTRY CENSUS DATA, 1967

| Standard industrial classification code | Industry group | Number of companies | Number of establishments | Number of employees (in thousands) | Value of shipments (in millions of dollars) |
|---|--------------------------------------|---------------------|--------------------------|------------------------------------|---|
| 3312..... | Blast furnaces and steel mills..... | 200 | 329 | 533.1 | 19,620.6 |
| 3321..... | Grey iron foundries..... | 969 | 1,061 | 138.0 | 2,637.8 |
| 3323..... | Steel foundries..... | 256 | 296 | 69.2 | 1,213.2 |
| 3391..... | Iron and steel forgings..... | 248 | 272 | 41.2 | 1,261.6 |
| 3317..... | Steel pipe and tubes..... | 123 | 151 | 27.0 | 1,148.6 |
| 3322..... | Malleable iron foundries..... | 72 | 81 | 25.4 | 438.3 |
| 3315..... | Steel wire and related products..... | 200 | 240 | 19.5 | 845.2 |
| 3316..... | Cold finishing of steel shapes..... | 77 | 107 | 19.5 | 1,038.7 |
| 3313..... | Electrometallurgical products..... | 21 | 34 | 10.4 | 467.9 |

Source: U.S. Bureau of the Census. 1967 Census of Manufacturers.

Integration in the Steel Industry

A corollary to the economic concentration within the largest iron and steel companies which are vertically integrated, is that many of the smaller companies engaged in only one or two branches of the entire industry find themselves in the position of being at the same time competitors of the integrated companies and sellers to or buyers from these same companies. Thus iron ore merchants compete with integrated companies as suppliers of ore, but also sell to them. Similarly, independent fabricators of particular steel items depend on integrated companies as a source of supply for semifinished steel and compete with them in the market for more finished products.

¹ Caves, Richard. *American Industry: Structure, Conduct, Performance*, (3rd edition, 1972), p. 27.

Mergers have played a part in the formation of steel companies throughout the 20th century. More recently several significant mergers have taken the form of conglomerate mergers in which large steel companies have been absorbed by companies otherwise outside the steel industry. These include (1) the acquisition of a majority of stock of Jones and Laughlin Steel Company in 1968 by Ling-Temco-Vought, Inc. (now LTV Corporation), originally a major electronics firm that has since expanded into many other fields; (2) merger of Youngstown Sheet and Tube Company in 1969 with Lykes Corporation, a major merchant shipping firm, to form Lykes-Youngstown Corporation; (3) stock control of CF & I Steel Corporation (formerly Colorado Fuel and Iron Corporation) being acquired in 1969 by Crane Company, a major producer of industrial construction products; and (4) a majority of common stock of Sharon Steel Corporation being acquired in 1969 by NVF Corporation.

In addition, Pittsburgh Steel Company and Wheeling Steel Corporation were merged in 1968 to form the Wheeling-Pittsburgh Steel Corporation and in 1971 National Steel Corporation acquired Granite City Steel Company.

Not only are the largest steel companies vertically integrated from mining to fabricating, but most of them are also conglomerates to some degree. Thus United States Steel, besides being the nation's largest steel producer, is also one of the largest cement producers, a major manufacturer of coal and chemicals and developer of real estate. With its American Bridge Division, it is one of the nation's largest builders of bridges, office buildings, and other steel structures. Bethlehem is engaged in shipbuilding and repair, and is also a producer of plastics. Armco Steel manufactures various kinds of machinery and recreational products, and is engaged in equipment leasing and property insurance. National Steel is engaged in aluminum production. Inland Steel fabricates mobile homes and develops and builds apartment houses. Youngstown Sheet and Tube manufactures fiberglass and leases dock facilities, Allegheny Ludlum manufactures a variety of consumer products.

Changes in the Iron and Steel Industry in the Past Decade

The American iron and steel industry has undergone significant changes during the past decade that necessarily have a bearing on recent pricing policies within the industry. These are reflected in the next five tables.

Technological Changes

Table 7 shows the massive technological changes that have taken place in the 1960's and since in the production of raw steel.

As this table shows, at the beginning of the 1960's the open hearth method was the dominant method of raw steel production, accounting for 87 percent of the total. By 1973 the open hearth method had declined to 26 percent of total output. The basic oxygen process which was used in less than 4 percent of total output of raw steel in 1960, surpassed the open hearth method in 1970 and by 1973 accounted for 55 percent of total raw steel production, more than twice the amount accounted for by the open hearth method. The basic oxygen method has proven to be cheaper and faster than the older open hearth method.

TABLE 7.—RAW STEEL PRODUCTION IN THE UNITED STATES BY TYPE OF FURNACE, 1959-73

[In thousands of net tons]

| Year | Open hearth | Bessemer | Basic oxygen process | Electric | Total all grades |
|-----------|-------------|------------------|----------------------|----------|------------------|
| 1973..... | 39,780 | ----- | 83,260 | 27,759 | 150,799 |
| 1972..... | 34,936 | ----- | 74,584 | 23,721 | 133,241 |
| 1971..... | 35,559 | ----- | 63,943 | 20,941 | 120,443 |
| 1970..... | 48,022 | ----- | 63,330 | 20,162 | 131,514 |
| 1969..... | 60,894 | ----- | 60,236 | 20,132 | 141,262 |
| 1968..... | 65,836 | (¹) | 48,812 | 16,814 | 131,462 |
| 1967..... | 70,690 | (¹) | 41,434 | 15,089 | 127,213 |
| 1966..... | 85,025 | 278 | 33,928 | 14,870 | 134,101 |
| 1965..... | 94,193 | 586 | 22,879 | 13,804 | 131,462 |
| 1964..... | 98,098 | 858 | 15,442 | 12,678 | 127,076 |
| 1963..... | 88,834 | 963 | 8,544 | 10,920 | 109,261 |
| 1962..... | 82,957 | 805 | 5,553 | 9,013 | 98,328 |
| 1961..... | 84,502 | 881 | 3,967 | 8,664 | 98,014 |
| 1960..... | 86,368 | 1,189 | 3,346 | 8,379 | 99,282 |
| 1959..... | 81,669 | 1,380 | 1,864 | 8,533 | 93,346 |

¹ Included with open hearth.

Source: American Iron and Steel Institute, 1973 annual statistical report, p. 53.

While not as impressive as the spectacular growth of the basic oxygen process, the rise in importance of the electric furnace, accounting for 8 percent of total output in 1960 and 18 percent in 1973, is significant, particularly for the future because of the dependence of the electric furnace on scrap as a basic ingredient, its correlated savings in terms of raw material requirements, and its improved quality control.

It should be noted that the United States lagged appreciably behind most other steel producing nations in the adoption of the basic oxygen method and some observers believe that this lag contributed appreciably to the deterioration of United States mills to compete in the world steel market. Despite the rapid adoption of the basic oxygen method, as indicated above, this deterioration has continued because of the slowness of the American steel industry to adopt the continuous casting process, again lagging behind other nations in the world market. Other technological advances first made in Europe were in stainless steel production and improved utilization of byproduct coke ovens.

It has also been observed that, even within the United States, it has frequently been the smaller and medium-sized companies which have taken greater initiative in technological progress than the largest companies.

This slowness in adopting technological innovations may have several causes. One may be an insufficient emphasis and expenditure on research and development. Although interindustry comparisons on the ratio of research and development expenditures to total sales need to be interpreted with caution, it does appear striking, as shown in a 1973 McGraw-Hill survey of research and development in various industries (Table 8), that steel is near the bottom of the list of industries in terms of outlays for research and development. Another may be relatively poor profit margins of recent years, which may have led to decisions to curtail or postpone R & D expenditures. A third may be the concentrated structure of the industry itself, with the largest companies not feeling the need for innovation or technological competitive advantage as much as their smaller rivals.

Output, Exports, Imports and Employment

Table 9 shows statistics on domestic shipments, exports and imports of steel mill products, and of steel employment. Most apparent is the great jump in shipments in 1973 over any previous year, combined with an increase in exports and a drop in imports over the last two years. The improvement in the foreign trade balance in steel mill products, due in part to the two devaluations of the dollar and in part to a sizeable increase in world demand for steel products, was of course welcomed by the steel industry which had been suffering from growing imports throughout the 1960's.

Increasing efficiency of the steel industry was also reflected in the fact that the record 1973 output was achieved with fewer employees than had been hired by the industry in any year since 1939, except for the industry depressed years of 1971 and 1972.

TABLE 8.—RESEARCH AND DEVELOPMENT EXPENDITURES IN SELECTED INDUSTRIES, 1972-73

| Industry | Millions of dollars | | 1972-73 percent change | Research and development as percent of sales | | New products as percent of 1976 sale | Volume of new product sales in 1976 (billions of dollars) |
|---|---------------------|-------------------|------------------------------|---|--------|--|---|
| | 1973 planned | 1972 estimated | | 1972 | 1973 | | |
| Electrical machinery and com- munications..... | 5, 179 | 4, 840 | 7 | 8. 45 | 8. 15 | 20 | 16. 4 |
| Aerospace..... | 4, 778 | 5, 138 | -7 | 22. 17 | 18. 24 | 18 | 6. 13 |
| Autos and other transportations equipment..... | 2, 302 | 2, 093 | 10 | 2. 87 | 2. 81 | 13 | 11. 11 |
| Machinery..... | 2, 285 | 2, 059 | 11 | 3. 06 | 2. 99 | 26 | 26. 83 |
| Chemicals..... | 2, 066 | 1, 931 | 7 | 3. 36 | 3. 3 | 14 | 10. 79 |
| Scientific instruments..... | 996 | 931 | 7 | 7. 43 | 7. 1 | 22 | 4. 32 |
| Petroleum products..... | 556 | 530 | 5 | 1. 88 | 1. 86 | 5 | 1. 93 |
| Food and beverages..... | 245 | 233 | 5 | . 21 | . 2 | 9 | 14. 28 |
| Fabricated metals and ordnance..... | 237 | 228 | 4 | . 56 | . 53 | 15 | 8. 51 |
| Paper..... | 220 | 208 | 6 | . 73 | . 72 | 14 | 5. 33 |
| Stone, clay, and glass..... | 217 | 175 | 24 | . 72 | . 83 | 13 | 3. 91 |
| Rubber products..... | 216 | 193 | 12 | 1. 08 | 1. 11 | 17 | 4. 0 |
| Nonferrous metals..... | 159 | 147 | 8 | . 75 | . 72 | 8 | 2. 19 |
| Steel..... | 149 | 148 | 1 | . 34 | . 3 | 7 | 4. 12 |
| Textiles and apparel..... | 58 | 55 | 6 | . 1 | . 09 | 9 | 3. 83 |
| All manufacturing..... | 19, 844 | 19, 093 | 4 | 2. 55 | 2. 4 | 13 | 134. 75 |
| All industries..... | 21, 229 | 20, 192 | 5 | NA | NA | NA | NA |

Sources: McGraw-Hill Economics Department in Business Week, May 12, 1973.

TABLE 9.—STEEL MILL SHIPMENTS, EXPORTS, IMPORTS AND EMPLOYMENT IN THE UNITED STATES, 1963-73

| Year | Steel mill products (thousands of net tons) | | | | Imports as percent of apparent steel supply | Steel employment ¹ |
|-----------|---|--------------|--------------|--------------------------|--|---|
| | Total net shipments | Less exports | Plus imports | Apparent steel supply | | Average number of employees (thousands) |
| 1973..... | 111, 430 | 4, 052 | 15, 150 | 122, 528 | 12. 4 | 509 |
| 1972..... | 91, 805 | 2, 873 | 17, 681 | 106, 613 | 16. 6 | 478 |
| 1971..... | 87, 038 | 2, 827 | 18, 304 | 102, 515 | 17. 9 | 487 |
| 1970..... | 90, 798 | 7, 053 | 13, 364 | 97, 109 | 13. 8 | 531 |
| 1969..... | 93, 877 | 5, 229 | 14, 034 | 102, 682 | 13. 7 | 544 |
| 1968..... | 91, 856 | 2, 170 | 17, 960 | 107, 646 | 16. 7 | 552 |
| 1967..... | 83, 897 | 1, 685 | 11, 455 | 93, 667 | 12. 2 | 555 |
| 1966..... | 89, 995 | 1, 724 | 10, 753 | 99, 024 | 10. 9 | 576 |
| 1965..... | 92, 666 | 2, 496 | 10, 383 | 100, 553 | 10. 3 | 584 |
| 1964..... | 84, 945 | 3, 442 | 6, 440 | 87, 943 | 7. 3 | 555 |
| 1963..... | 75, 555 | 2, 224 | 5, 446 | 78, 777 | 6. 9 | 520 |

¹ Covering only those employees engaged in the production and sale of iron and steel products and excludes mining and quarrying operations, transportation, warehousing, fabrication and other nonsteel producing activities.

Sources: American Iron and Steel Institute, 1973 annual statistical report.

Financial Data, 1963-1973

Table 10 shows the relatively low profit levels of the primary iron and steel industry during most of the past decade, compared to the average for manufacturing generally, and the abrupt upturn since 1972, particularly in 1974.

TABLE 10.—INCOME AS PERCENT OF SALES AND STOCKHOLDERS' EQUITY, STEEL INDUSTRY AND ALL MANUFACTURING CORPORATIONS, 1963-74

| Year | Net profits after taxes as percent of— | | | |
|-------------------|--|------------------------|--------------------------------|------------------------|
| | Sales | | Stockholders' equity | |
| | All manufacturing corporations | Primary iron and steel | All manufacturing corporations | Primary iron and steel |
| 1963 | 4.7 | 4.8 | 10.3 | 7.0 |
| 1964 | 5.2 | 5.6 | 11.6 | 8.8 |
| 1965 | 5.6 | 5.7 | 13.0 | 9.8 |
| 1966 | 5.6 | 5.8 | 13.4 | 10.2 |
| 1967 | 5.0 | 4.8 | 11.7 | 7.7 |
| 1968 | 5.1 | 4.6 | 12.1 | 7.6 |
| 1969 | 4.8 | 4.4 | 11.5 | 7.6 |
| 1970 | 4.0 | 2.5 | 9.3 | 4.3 |
| 1971 | 4.1 | 2.6 | 9.7 | 4.5 |
| 1972 | 4.3 | 3.1 | 10.6 | 6.0 |
| 1973 | 4.7 | 4.1 | 12.8 | 9.5 |
| 1st quarter, 1974 | 5.6 | 4.7 | 14.3 | 11.25 |
| 2d quarter, 1974 | 6.0 | 6.7 | 16.7 | 18.50 |

Note: Annual ratios are averages of 4 end-of-quarter figures for each year.

Sources: Federal Trade Commission and Securities and Exchange Commission, "Quarterly Financial Report for all Manufacturing Corporations."

In the second quarter of 1974, profits after taxes of the primary iron and steel industry as a percentage of sales were for the first time since 1966 higher than those for manufacturing generally, and the only time in the past decade that they were higher as a percentage of stockholders' equity.

Profits in 1970 and 1971 show up particularly poorly for the steel industry, both as percent of sales and percent of stockholders' equity.

Beginning in 1972 there has been a decided improvement in profits of the industry, with the 1973 rate of return on stockholders' equity being the highest for any calendar year since 1966, but certainly far lower than the rate of 1974 will be on the basis of the first six months' returns.

The improved profit outlook for the major steel producers is also reflected in Table 11, which compares profits after taxes of nine of the leading steel companies for the first six months of 1973 and first six months of 1974. This very substantial improvement in the profits of these companies even before all of the announced price increases in the industry become fully effective should go a long way towards providing the means for increasing capacity that industry spokesmen themselves recognize as essential.

Various reasons may be indicated as likely causes for the unsatisfactory showing in rates of return in most recent years, particularly 1970 and 1971. Technological lags, whether compared to other industries or to the steel industry abroad, may be both cause and effect of lower profits. A sluggish industry is unlikely to attract as much investment capital as more innovative or aggressive industries; in turn, inadequate capital discourages innovation, research, and technological initiative.

TABLE 11.—PROFITS AFTER TAXES OF MAJOR STEEL CORPORATIONS, 1ST HALF OF 1973 AND 1ST HALF OF 1974

[Dollar amounts in thousands]

| Company | 1st half of 1973 | 1st half of 1974 | Percentage change |
|---------------------|------------------|------------------|-------------------|
| United States Steel | \$134,000 | \$249,800 | 86.4 |
| Bethlehem | 98,421 | 112,718 | 14.5 |
| Armco | 54,647 | 85,774 | 57.0 |
| Inland | 45,545 | 67,158 | 47.4 |
| National | 47,314 | 67,108 | 41.8 |
| Republic | 45,263 | 58,379 | 29.0 |
| Jones & Laughlin | 25,426 | 52,068 | 104.8 |
| Allegheny Ludlum | 17,511 | 27,337 | 56.1 |
| Wheeling-Pittsburgh | 6,998 | 26,209 | 274.5 |

Source: Moody's Industrial News Reports.

Foreign imports have affected prices and profits adversely. This competition was particularly acute before the two devaluations of the dollar which, together with increases in worldwide demand, have made U.S. steel producers more competitive in world markets and have limited to some extent the attractiveness of the U.S. market for foreign steel industries.

Steel companies have found it necessary to use capital funds for reduction of various forms of air and water pollution, which might otherwise have been available for increasing productive capacity or reducing unit costs.

The industry has found itself restricted and, not infrequently confused, by the on-again off-again price and wage policies of the Federal government. This is reflected in the abrupt and sizeable price increases after three years of stable prices or only modest increases.

Just as reasons for the poor profits of the 1960's and especially 1970 and 1971 have been spelled out above, the improving profits are readily explainable. Some reasons have already been mentioned. The increasing world demand and two dollar devaluations have stimulated exports and dampened the level of imports. Shortages of many steel products persist and demand remains high despite evidence of recession. The need to increase capacity becomes increasingly urgent. Above all, the end of price controls has been seized upon by most steel companies as a particularly opportune occasion to raise prices. As Iron Age noted in its "Steel Summary" section (p. 93) in its July 8, 1974 issue:

In any case, the aim seems clearly to be to lift steel profits to a level that will permit steel expansion. There is a feeling in steel circles that this is a now-or-never situation.

If steel profits can't be put on a satisfactory basis in today's shortage market, it is argued, they never will be. Some steel officials believe that prices for some products, especially cold-rolled sheets, should be increased even more.

The move is also critical in the sense that time is running out for steel expansion. The longer steel companies delay, the more difficult it will be to catch up with supply deficits.

All of which leaves an urgent need for steel mills to come up with a price formula which is acceptable from the standpoint of markets, profitability and competitive support.

The sources and uses of funds within the industry are shown in Table 12. This table shows, for example, the disturbingly low level of capital expenditures in the most recent two years, which were the two lowest of the past ten. Here again, 1974 will probably show a considerable turn around. Many steel companies have announced plans for substantial capital outlays to modernize facilities and increase capacity, although the rate does not thus far appear to be sufficient to meet projected needs for steel in the 1980's. Frederick Jaicks, president of Inland Steel Company, and recently elected head of the American Iron and Steel Institute, has stated: "Current evidence indicates there will be a sustained demand for roughly 25 million additional tons of capacity in the U.S. by 1980."¹ Thus far steel companies have not committed themselves to capacity expansion of this magnitude, largely because of uncertainty as to the outlook for inflation, demand, and capital costs.

¹ This is similar to the estimate of the economist, William T. Hogan in his 1972 book, "The 1970's: Critical Years for Steel," in which he estimates that to meet anticipated demand in 1980 and assuming that imports are maintained in approximately the current relationship to domestic supply, current (1971) raw steel capacity of about 165 million net tons will have to be increased to 190-195 million net tons.

TABLE 12.—SOURCES AND USES OF FUNDS IN THE U.S. STEEL INDUSTRY,¹ 1964-73

[In millions of dollars]

| Year | Source | | | | | Disposition | | | | | | |
|-------------------------|------------|------------------------------|-------------------|--|---------------------------------|------------------------|-------------------------|------------------------|----------------------|--|--|----------------------------|
| | Net income | Less cash dividends declared | Income reinvested | Depreciation, depletion and amortization | Increase (decrease) in reserves | Total internal sources | External debt and stock | Total sources of funds | Capital expenditures | Increase (decrease) in working capital | Miscellaneous investment and all other | Total disposition of funds |
| 1973..... | 1,302.7 | 443.5 | 859.2 | 1,246.8 | 166.5 | 2,272.5 | (300.9) | 1,971.6 | 1,381.3 | 524.1 | 66.2 | 1,971.6 |
| 1972..... | 774.8 | 402.3 | 372.5 | 1,170.7 | 44.8 | 1,588.0 | 105.8 | 1,693.8 | 1,174.3 | 375.9 | 161.6 | 1,693.8 |
| 1971..... | 562.8 | 390.3 | 172.5 | 1,076.9 | 46.2 | 1,295.6 | 152.8 | 1,448.4 | 1,425.0 | (55.5) | 78.9 | 1,448.4 |
| 1970..... | 531.6 | 487.5 | 44.1 | 1,044.2 | 83.7 | 1,172.0 | 612.2 | 1,784.2 | 1,736.2 | 346.1 | (298.1) | 1,784.2 |
| 1969..... | 879.4 | 488.6 | 390.8 | 1,042.4 | 131.0 | 1,564.2 | (165.5) | 1,398.7 | 2,046.6 | (337.7) | (310.2) | 1,398.7 |
| 1968 ² | 992.2 | 451.7 | 540.5 | 965.8 | 350.1 | 1,856.4 | 304.6 | 2,161.0 | 2,307.3 | (364.3) | 218.0 | 2,161.0 |
| 1967..... | 829.8 | 480.7 | 349.1 | 1,202.4 | 241.7 | 1,793.2 | 197.3 | 1,990.5 | 2,145.7 | (144.2) | (11.0) | 1,990.5 |
| 1966..... | 1,075.3 | 483.0 | 592.3 | 1,171.8 | 27.0 | 1,791.1 | 83.1 | 1,874.2 | 1,952.7 | (148.0) | 69.5 | 1,874.2 |
| 1965..... | 1,069.3 | 466.7 | 602.6 | 1,102.1 | 15.6 | 1,720.3 | 275.8 | 1,996.1 | 1,822.5 | 169.0 | 4.6 | 1,996.1 |
| 1964..... | 992.3 | 462.1 | 530.2 | 1,061.9 | (16.4) | 1,575.7 | 40.3 | 1,616.0 | 1,599.5 | (236.1) | 252.6 | 1,616.0 |

¹ Represents consolidated reports of steel industry companies who in 1973 produced 91.9 percent of the reported raw steel production.

² Many of the companies in the industry revised their method of depreciation accounting from an accelerated to a straightline basis during the year 1968 and a few companies revised their method of reporting the investment credit from amortizing it over the lives of the facilities to a flow-through basis which takes the entire credit into the year realized.

Source: American Iron and Steel Institute, annual statistical report.

Table 12 also reflects the very heavy dependence of the industry on internal sources of funds; of the internal sources depreciation, depletion and amortization were far larger than reinvested income, even in the high income year of 1973.

III. PRICING PRACTICES IN THE STEEL INDUSTRY

This chapter attempts to set forth major characteristics of pricing practices within the steel industry of the United States. At the outset it needs to be recognized that the subject is necessarily complex, if only because of the thousands of different products made within the steel industry, usually to exact specifications of customers, of whom there are more than 100,000. It is also important to note that there are many variations from posted prices and price lists as they are announced by steel companies. These modifications include such changes as quantity and other discounts to particular customers, freight absorption, and modification in quality standards and specifications.

Nonetheless a survey of literature on the subject suggests that certain general conclusions are warranted. First, the steel industry has been characterized by large optimum size of steel plants, which severely limits ease of entry into basic steel production, large fixed capital and overhead costs, and widely fluctuating cyclical demand for steel products. These factors have led to steps within the steel industry to limit price competition, originating well before the formation of the United States Steel Corporation in 1901. Second, since its formation in 1901 as a result of merger of several existing companies, United States Steel Corporation has been by far the largest company in the industry and has exercised price leadership within the industry throughout most of its history. At times such leadership has been open and accepted, at other times less clear, and occasionally it has been challenged. But its impact on industry pricing decisions has always reflected the dominance of its position in the market. Third, United States Steel Company has traditionally had as a goal stable prices sufficient to realize a satisfactory average return on the capital invested in the company instead of one of consistently maximizing profits, especially in the short run. Fourth, to achieve its pricing objectives, the United States Steel Corporation had been in the forefront of the industry in adopting basing point practices, until they were declared unlawful for the Supreme Court in the 1948 Cement Institute case.

Economic Characteristics of the Steel Industry

George Stocking in his 1954 study, "Basing Point Pricing and Regional Development, a Case Study of the Iron and Steel Industry," pointed to the following economic characteristics of the steel industry: large optimum size of steel plants, high proportion of fixed costs, the efficiency of continuous operation and conversely the great cost of shutdowns, and finally the wide and severe cyclical fluctuations in demand. These characteristics have led to strong pressures away from purely competitive prices to concerted action to regulate prices. As Stocking concludes, "The economic characteristics of the iron and steel industry make price competition in times of slack demand and surplus capacity 'ruinous' in the sense that it reduces prices below total unit cost of production. They also make price cutting almost inevitable in the absence of concerted action to avoid it. The urge to stabilize prices is therefore very great. Price leadership and basing point pricing are techniques for doing this." (p. 51).

A parallel conclusion had been reached by Carroll R. Daugherty, Melvin G. de Chazeau, and Samuel S. Stratton early two decades earlier in their classic two-volume study "The Economics of the Iron and Steel Industry," published in 1937: "The economic conditions under which steel is produced and sold dictate administered prices, and oligopoly maximizes the probability that these administered prices will be identical. The smaller the number of 'competing' firms, the less likely will be a break in the price established and the more orderly price changes will seem." (p. 600).

Similarly, "The conviction that the benefits of free price competition are economically unattainable in the steel industry has developed from both a theoretical and a practical study of the case. . . . With few qualifications, the evidence indicated general price control; whether this control was through agreement or through price leadership is inconsequential. The practice is compatible, even in the absence of collusion, with the economic conditions that characterize the production and distribution of tonnage steel. If the analysis in this study is sound, the problem is not how to force competition on steel mills—an undesirable condition and an impossible task in the long run—but rather how to curb those

monopoly elements necessary for efficiency and how to afford the maximum protection from the potential evils associated with monopoly." (p. 1118).

Price Leadership

There is general agreement that throughout most of the 20th century, a pattern of monopolistic pricing and price leadership by the largest steel producer, the United States Steel Corporation, has prevailed. This has not been absolute, since there have been occasions when other companies have initiated price changes, or have made some concession from posted prices, but the exceptions have been infrequent. In particular, changes in basic pricing practices, such as basing point policies, have consistently been introduced by United States Steel and followed by other steel producers.

This trend is set forth particularly cogently by A.D.H. Kaplan, Joel Dirlam, and Robert Lazillotti in their study, "Pricing in Big Business," published in 1958 from which the following extended quotation is taken:

"The markets for steel have been characterized by the convention of price leadership, implemented at least until 1948 through a formal basing point system. Factors considered essential to realization of certain major objectives of the steel industry are, first, stabilization of prices; secondly, protection of steel mill investments in the older, less favorably located centers of production vis-a-vis the more favorable locations of newer producers, and third, enlargement of the competitive market area of each steel plant. The focal point around which these objectives revolve is the United States Steel Corporation, which is generally recognized as the industry's price leader. The principal explanation of this situation lies in the history and market philosophy of steel producers' and ownership by U.S. Steel of over one third of the basic steel capacity, within reach of all the important markets. As a concomitant of the strategic position it has occupied for many years, the company carries a mantle of responsibility that none of the other producers in the industry attempts to shoulder.

"As a price leader, however, U.S. Steel regards itself as being hemmed in by limitations on its price policy imposed by followers who may not conform and by competitive products within or outside the steel industry that are beyond its control. The company has traditionally refused to nibble at its announced base prices by undercover price cutting but prefers to wait for its competitors to make the first move. It then decides when and how far to bring published prices into conformity with actual bids. Although these considerations may help explain the laggard tendencies of the corporation, they have not prevented it from setting the pricing pace for the steel industry.

"That this leadership has carried over to the period since the Second World War was shown by the lead of U.S. Steel in abandoning basing point pricing; its lead in raising steel prices after the unsuccessful attempt of the chief producers to hold the line against the postwar shortage; the announcement (October 1953) of its intention to meet delivered prices of competitors (and its effectiveness in firming prices); and priority in subsequent price moves to take account of increased costs. Although in the postwar market, some of the smaller competitors of the company broke away from uniformity on finished steel products (plates and sheets) to exploit their customers' shortages, these deviations can justifiably be termed abnormal. The premiums disappeared several years ago." (pp. 166-167).

Although the economic price leadership capacity of the United States Steel Corporation has remained potent throughout the postwar period, it has not been absolute and, at least on the surface, appears to be shared to some extent with other companies. The most conspicuous case in which the United States Steel Corporation made a significant price increase which other companies, albeit under great pressure from the government, failed to follow, resulting in a rescission of the increase by U.S. Steel, was that of April 1962. There have been numerous cases in which price increases were first announced by companies other than U.S. Steel, but at least on products where U.S. Steel was a significant factor in the market, such increases have had one of two consequences; either they were followed, usually within a period of a week or two, by a comparable price increase by U.S. Steel, or if U.S. Steel failed to go along, a withdrawal of the price increase.

The way in which pricing actions of the various major steel companies tend to converge in recent months during which there has been rapid escalation of prices is well illustrated in the following statement in *Iron Age* for July 15, 1974 (pp. 81, 83):

"Bethlehem Steel Corp. led the great leap forward in steel price increases in June in response to more moderate increases posted by United States Steel Corp. earlier in the month. As July started, Bethlehem backed off slightly and temporarily on plate and structurals prices. Others had failed to match its quotes.

"As the first week in July progressed, it was evident that fine-tuning of the price machine was still in progress. For example, Inland, Republic, National, Kaiser and Armco announced increases. But, as in the Bethlehem—USS increases, the companies were not in total agreement just how much prices should go up for each product.

"The result is that multi-tiered pricing is still in existence. However, it appears that the companies are moving closer together in their assessment of the market and market prices. While selected products remain \$10 to \$20 a ton apart for base prices, more and more have become the same."

As of the end of September, 1974, Bethlehem was still charging more than U.S. Steel on two key products, \$20 a ton more on structural shapes and \$10 a ton more on carbon plates. Sales officials of Bethlehem indicated that Bethlehem is prepared to stay with its pricing move because it "must price in relation to costs." Based on past experience, this statement may be interpreted with some skepticism, unless United States Steel narrows the gap, or unless the difference in base prices is significantly narrowed by extras and changes in extras, quality concessions, and freight equalization policies, making net prices close to the same.

The differences are more likely to persist in periods of exceptionally strong demand. Conversely when demand is weak there may be a temptation to undercut prices of U.S. Steel, but this is a practice which could rarely be engaged in successfully in any product in which U.S. Steel is a significant supply factor in the market. As *Iron Age* for July 1974 states (p. 93): "All steel men want a greater measure of price uniformity. All top executives have endorsed the idea of profitable pricing."

The recent (1971) five-volume "Economic History of the Iron and Steel Industry in the United States" by William T. Hogan, has little reference to price leadership, although considerable discussion about transportation pricing practices that led to price uniformity. Hogan does, however, quote a 1924 Federal Trade Commission report (8 F.T.C. Decisions 39) on the manner in which the price of steel sheets was established as follows:

"Uniform Pittsburgh Plus prices on sheets have been effectually maintained by the sheet steel producers to hold a number of small mills to price agreements or understandings during periods of business depression. But the sheet producers of the United States are members of an organization known as the National Association of Sheet and Tin Plate Manufacturers. Nearly every independent producer is a member. The respondent, American Sheet and Tin Plate Company, is not a member, but actively cooperates with the association in its price-fixing activities, which constitute an important part of the association's work. The prices of the said last named respondent company are furnished to the association and by the association wired to all of its members generally before they are announced to the public. The members generally adopt the new prices as their own."

He then adds: "A key word in the last sentence is 'generally'. Certainly a serious attempt was made to achieve price stability but, time after time, in periods of low demand or peak demand, individual companies ignored the leadership of United States Steel and cut prices or raised them, depending on the circumstances." (p. 1096).

Finally, particularly incisive is the following comment by John Blair, in his comprehensive volume, "Economic Concentration, Structure, Behavior and Public Policy," (1972):

"Any steel company contemplating not matching an increase by U.S. Steel would be not only inviting a probable rescission by the leader of its increase but risking the possibility of a price war. It would be aware that the rescission and possible war would in all probability be limited to the one or few products of which it is a significant producer. And it would also realize that such selective and limited retaliation, while probably disastrous to it, would pose no great financial hardship to U.S. Steel. It is because of their awareness of U.S. Steel's power of reprisal that other steel companies privately refer, without affection, to U.S. Steel as 'Big Brother.'" (p. 508).

Pricing Objectives of the United States Steel Corporation

Although exceptions to its general pricing policies may be found from time to time, and although among corporate spokesmen there may be differing emphases as to the way in which pricing decisions are made, there is considerable agreement among students of steel prices that a primary objective of United States Steel pricing is stability of prices. As A. D. H. Kaplan and his associates concluded about United States Steel Corporation in their 1958 study on pricing in big business:

"It seems . . . reasonable to assume . . . that the company is extremely conscious of its role as price leader; that it does not want to disturb the structure, and vastly prefers, unless impelled by sharp increases in direct costs or dangerous sniping by rivals, to avoid either price increases or decreases. The persistence of prices between shifts in costs testifies to the affection of the company for stability, which is sacrificed only when the decision is unavoidable" (p. 175).

To achieve price stability, United States Steel has engaged in a pricing policy which spokesmen for the company have sometimes called a public utility approach and others have called a policy of cost-plus or stable margin pricing. The public utility approach indicates a desire to realize a reasonable or satisfactory average return on the capital invested. It aims at a fair return during assumed normal rates of operation. Utilizing this policy of a "reasonable" rather than a maximum profit has meant that its prices have often not increased as rapidly as those of other steel producers in times of shortage and it has lagged the market in the downswing. In both situations U.S. Steel has consciously lost revenue because of its price policy. Nonetheless its position of price leadership has been strong enough that competing companies have complained that in periods of rising costs failure of U.S. Steel to raise prices promptly has made it impossible for them to set prices that would provide adequately for depreciation and new capacity.

United States Steel aims at maintaining stable price margins despite variations in sales volume by establishing standard costs for each of its product lines, setting the price based on such standard costs and then refusing to shade its prices from those it had publicly announced. Standard cost is defined as "pre-determined cost for each unit of finished product, intended to represent the value of direct material, direct labor, and manufacturing burden normally required under efficient conditions at normal capacity to process a unit of product." It is based on operations at 80 percent of capacity as normal. Standard costs are revised annually to account for such factors as increased labor costs, higher capital costs, rising markets, new machines, new processes, and similar factors affecting actual costs.

Standard costs are determined for each mill, but these individual standards are used primarily for gauging efficiency and for stimulating incentive at the local level. For pricing purposes, the standard cost used is an average, weighted by the volumes at respective mills.

Although standard cost pricing has been an objective for United States Steel, as well as for other steel companies, in order to minimize the need for short-run changes in prices due to temporary changes in volume, there is considerable evidence that the corporation often adapts its prices to changes in demand, particularly as demand shifts from one product line to another.

United States Steel has traditionally refused to shade its announced base prices by undercover price cutting but prefers to wait for its competitors to make the first move. It then decides when and how far to bring published prices into conformity with actual bids. Although these considerations may help explain the laggard tendencies of the corporation, they have not prevented it from setting the pricing pace of the steel industry.

It should not be implied that United States Steel (or other steel companies) does not take into account varying demand characteristics for the products it sells. It has been observed that U.S. Steel enjoys the largest profit margins in products where it faces less intense competition, where demand is relatively inelastic, and where substitute materials are unavailable. Steel rails and steel cable are examples of such products. On the other hand, where there is intense competition from other commodities which are more or less substitutable for steel, for which demand is elastic, or where purchasers buy in sufficient quantity to have considerable bargaining leverage, price margins are narrower. Examples of products with narrower margins include stainless steel, galvanized sheets and tin plate.

Basing Point Pricing

Although basing point pricing as such has been unlawful since 1948, during more than half a century it was a prominent feature of steel price policy and a major tool by which United States Steel was able to exert price leadership throughout the industry. A convenient definition of basing point pricing is the following:

The major characteristic of basing point pricing is that all sellers wherever located customarily quote delivered prices made up of a base price plus a railway freight charge which may or may not be identical with actual railway freight. The base price is the price quoted at some recognized basing point. A basing point ordinarily, although not always, is a place where some firm makes the product. When all rivals use a single basing point for quoting delivered prices, the pricing method has been conveniently designated as a single basing point system; where they use two or more basing points, the method has become known as a multiple basing point system. Whether operating under a single or a multiple basing point system, all rivals customarily quote identical delivered prices to any buyer regardless of where the buyer or the seller is located.¹

Thus, for example, if the price of a ton of steel plate was \$50 in Pittsburgh, when Pittsburgh was the basing point for steel, and freight to Chicago was \$10, then the buyer in Chicago would pay \$60, whether the steel plate was actually made in Pittsburgh, Chicago, Cleveland, or Birmingham.

George Stocking adds that basing point prices ordinarily will have five characteristics: "every seller's price at any destination regardless of where the product originates or who sells it will be identical; prices will be relatively stable; some delivered prices will contain phantom freight; others will reflect freight absorption; and where prices either contain phantom freight or reflect freight absorption, they will yield varying mill nets."²

The basing point system was developed within the steel industry as early as the 1880's. Probably the first group of firms to use it were the members of the Steel Beam Association, which was formed in 1880. The system was only slowly extended to other steel products by various pools and trade associations, until it was more or less generally adopted by the entire industry under the leadership of the United States Steel Corporation.

By 1903, two years after the formation of the United States Steel Corporation, basing point policy was formalized into the so-called "Pittsburgh Plus" pricing system by which each delivered price was computed as the sum of (1) the base price of a particular steel product, (2) the extras for particular specifications, and (3) the railroad freight from Pittsburgh to the destination.

Until 1920 the Pittsburgh Plus pricing system was followed with great consistency by all tonnage steel producers. The only exceptions were brief attempts by underutilized Chicago steel mills to establish Chicago as a separate basing point.

After 1920 multiple basing points were established, superseding the Pittsburgh Plus system, as a result first of the breaking away again of Chicago mills from Pittsburgh Plus, by protests of western steel consumers, finally, by a Federal Trade Commission cease and desist order in 1924 which required the United States Steel Corporation to cease and desist "from quoting for sale or selling . . . their said rolled-steel products upon any other basing point than that where the products are manufactured or from which they are shipped."

But this FTC order was only a step towards condemnation of all basing price practices, whether from single or multiple basing points. In contrast to the 1924 FTC order against basing points which was directed solely against the United States Steel Corporation, in 1947 the FTC issued a complaint against the American Iron and Steel Institute and 101 firms in the steel industry claiming that the use of basing-point practices by these companies constituted unfair methods of competition in violation of the Federal Trade Commission Act. However, by reason of the Cement Institute decision, upheld by the Supreme Court in 1948, the industry discontinued using the basing-point system and started selling steel on an f.o.b. mill basis, explaining this action by pointing to the fact that the system had been declared unlawful.

¹ Stocking, George W. Basing point pricing and regional development, a case study of the iron and steel industry, 1954, p. 4.

² *Ibid.*, p. 5.

The impact of basing point practices which were a part of the pattern of U.S. Steel price leadership for nearly half a century may be summarized as follows:

"Basing point pricing and the other paraphernalia of which it was a part have contributed directly to relatively rigid and relatively high prices for steel. They have contributed indirectly to high and rigid prices by increasing costs. Cross-hauling, increased selling expenses, and inefficiency growing out of a preoccupation with stabilizing prices have tended to make steel prices relatively high, particularly in times of surplus capacity. And until World War II that has been most of the time."³

IV. STEEL PRICE CHANGES

The large steel price increases that have occurred in 1974 have already been referred to in the introduction of this report. In order to have a grasp of their magnitude, comparisons with steel prices in earlier periods and with other price increases are presented.

Although, as noted in chapter 2, there is no such thing as a price per pound, or per ton, of "steel", widely accepted averages have been developed both within government and within the private sector. Two of the most widely used measures of steel prices are the steel mill products component of the wholesale price index of the U.S. Bureau of Labor Statistics and the composite base price for finished steel, developed and maintained by the trade journal, *Iron Age*.⁴

These measures are the basis of the statistics developed in the tables and chart of this chapter.

Table 13 shows the longer term (1951-1974) trend of wholesale prices of steel mill products, compared to wholesale prices generally and wholesale prices for industrial commodities. Over the entire period, as this table shows, steel mill prices have risen by nearly 150 percent, substantially more than the 70 percent increase for wholesale prices generally and 72 percent for industrial commodities. In general the greatest increases, before 1974, occurred between 1950 and 1957, a reflection of the inflation of the Korean War and its aftermath, and between 1969 and 1971.

On the other hand, the increase in the average price of steel mill products between 1972 and 1973 was far below the average increase in wholesale prices generally during that year and also below the average increase in industrial prices.

As can be seen with greater clarity from Tables 14 and 15, the wholesale prices of steel mill products were more stable than most wholesale prices during most of the price and wage control era, from August 1971 through December 1973. During this 28 month period steel mill prices increased by about 5.6 percent. Since then, first under decontrol actions of the Cost of Living Council, and then following the end of controls on April 30, 1974, the steel industry has more than made up for lost time, marking a 39.9 percent increase in the eight month period, December 1973 to August 1974.

³ Stocking, op. cit., p. 143.

⁴ The wholesale price index of the U.S. Bureau of Labor Statistics is designed to measure price changes for goods sold in primary markets in the United States. In measuring the wholesale price index for all commodities and for various components, the BLS currently assigns weights to each commodity based on total net selling value of commodities produced, processed, or imported into the United States and flowing into primary markets in 1963. Thus steel mill products have a weight of 3.154 out of a total of 100 for all commodities. This is broken down into semifinished steel products (with a weight of 0.189) and finished steel products (with a weight of 2.965). Of the 53 classes of finished steel products the most important are cold rolled carbon sheets (0.449), hot rolled carbon bars (0.214), carbon plates, A-36 (0.178), galvanized carbon sheets (0.154), drawn carbon wire (0.125), and coil hot rolled carbon sheets (0.111).

The *Iron Age* composite is based on the average of annual average steel shipments during the two periods, 1937-40 and 1940-48. The weights attached to the ten components of the composite price are as follows:

| | | | |
|-------------------------|------|------------------------|------|
| Hot rolled sheets----- | 18.3 | Structural shapes----- | 10.2 |
| Hot rolled bars----- | 14.2 | Wire----- | 5.7 |
| Pipe----- | 13.9 | Rails----- | 4.9 |
| Plates----- | 13.5 | Hot rolled strip----- | 4.7 |
| Cold rolled sheets----- | 11.2 | Cold rolled strip----- | 3.4 |

TABLE 13.—WHOLESALE PRICE INDEX FOR ALL COMMODITIES, INDUSTRIAL COMMODITIES, AND STEEL MILL PRODUCTS, 1951-74

[1967=100]

| Year | All commodities | | Industrial commodities | | Steel mill products | |
|-------------------------|-----------------|--------------------------------------|------------------------|--------------------------------------|---------------------|--------------------------------------|
| | Index | Percentage change from previous year | Index | Percentage change from previous year | Index | Percentage change from previous year |
| 1951..... | 19.1 | +11.1 | 86.1 | +10.4 | 64.0 | +7.7 |
| 1952..... | 88.6 | -2.7 | 84.1 | -2.2 | 65.4 | +1.6 |
| 1953..... | 87.4 | -1.4 | 84.8 | + .8 | 70.5 | +7.8 |
| 1954..... | 87.6 | + .2 | 85.0 | + .2 | 73.8 | +4.7 |
| 1955..... | 87.8 | + .2 | 86.9 | +2.2 | 77.2 | +4.6 |
| 1956..... | 90.7 | +3.3 | 90.8 | +4.5 | 83.8 | +8.5 |
| 1957..... | 93.3 | +2.9 | 93.3 | +2.8 | 91.8 | +9.5 |
| 1958..... | 94.6 | +1.4 | 93.6 | + .3 | 95.0 | +3.5 |
| 1959..... | 94.8 | + .2 | 95.3 | +1.8 | 96.5 | +1.6 |
| 1960..... | 94.9 | + .1 | 95.3 | 0 | 96.4 | - .1 |
| 1961..... | 94.5 | - .4 | 94.8 | - .5 | 96.0 | - .4 |
| 1962..... | 94.8 | + .3 | 94.8 | 0 | 95.8 | - .2 |
| 1963..... | 94.5 | - .3 | 94.7 | - .1 | 96.3 | + .5 |
| 1964..... | 94.7 | + .2 | 95.2 | + .5 | 97.1 | + .8 |
| 1965..... | 96.6 | +2.0 | 96.4 | +1.3 | 97.5 | + .4 |
| 1966..... | 99.8 | +3.3 | 98.5 | +2.2 | 98.9 | +1.4 |
| 1967..... | 100.0 | + .2 | 100.0 | +1.5 | 100.0 | +1.1 |
| 1968..... | 102.5 | +2.5 | 102.5 | +2.5 | 102.5 | +2.5 |
| 1969..... | 106.5 | +3.9 | 106.0 | +3.4 | 107.4 | +4.8 |
| 1970..... | 110.4 | +3.7 | 110.0 | +3.8 | 114.3 | +6.4 |
| 1971..... | 113.9 | +3.2 | 114.0 | +3.6 | 123.0 | +7.6 |
| 1972..... | 119.1 | +4.6 | 117.9 | +3.4 | 130.4 | +6.0 |
| 1973..... | 134.7 | +13.1 | 125.9 | +6.8 | 134.1 | +2.8 |
| 1974 ¹ | 155.0 | +15.1 | 148.3 | +17.8 | 159.5 | +18.9 |

¹ 8-month average.

Source: U.S. Bureau of Labor Statistics.

TABLE 14.—WHOLESALE PRICE INDEX FOR STEEL MILL PRODUCTS; ANNUAL AND SEMIANNUAL INCREASES, 1971-74

| Date | I. Annual comparison | |
|-------------------|---|--|
| | Wholesale price index for steel mill products | Percentage increase over index of previous August |
| August 1971..... | 128.1 | ----- |
| August 1972..... | 130.2 | 1.6 |
| August 1973..... | 134.3 | 3.1 |
| August 1974..... | 187.9 | 39.9 |
| Date | II. Semiannual comparison | |
| | Wholesale price index for steel mill products | Percentage increase over index of previous month shown |
| January 1971..... | 116.8 | ----- |
| July 1971..... | 123.4 | 5.7 |
| January 1972..... | 129.6 | 5.0 |
| July 1972..... | 130.3 | .5 |
| January 1973..... | 132.6 | 1.8 |
| July 1973..... | 134.3 | 1.3 |
| January 1974..... | 138.1 | 2.8 |
| July 1974..... | 181.4 | 31.4 |

Source: U.S. Bureau of Labor Statistics.

TABLE 15.—BUREAU OF LABOR STATISTICS WHOLESALE PRICE INDEXES FOR STEEL MILL PRODUCTS AND IRON AGE STEEL COMPOSITE PRICES, 1971-74

| Wholesale price indexes (1967=100) | | Steel composite prices | |
|------------------------------------|-------|-------------------------------------|-----------------|
| Month | Index | Period | Cents per pound |
| 1971: | | | |
| January..... | 116.8 | | |
| February..... | 117.0 | Jan. 4, 1971 to Mar. 1, 1971..... | 7.838 |
| March..... | 118.0 | Mar. 1, 1971 to Mar. 15, 1971..... | 7.970 |
| April..... | 118.5 | | |
| May..... | 120.7 | Mar. 15, 1971 to June 16, 1971..... | 8.055 |
| June..... | 121.1 | June 16, 1971 to July 1, 1971..... | 8.413 |
| July..... | 123.4 | July 1, 1971 to Aug. 16, 1971..... | 8.480 |
| August..... | 128.1 | | |
| September..... | 128.2 | | |
| October..... | 128.1 | Aug. 16, 1971 to Jan. 6, 1972..... | 8.977 |
| November..... | 128.2 | | |
| December..... | 128.2 | | |
| 1972: | | | |
| January..... | 129.6 | Jan. 6, 1972 to Jan. 27, 1972..... | 9.164 |
| February..... | 131.0 | Jan. 27, 1972 to Feb. 1, 1972..... | 8.901 |
| March..... | 130.9 | | |
| April..... | 130.9 | | |
| May..... | 130.7 | | |
| June..... | 130.4 | | |
| July..... | 130.3 | | |
| August..... | 130.2 | Feb. 1, 1972 to Jan. 3, 1973..... | 8.998 |
| September..... | 130.2 | | |
| October..... | 130.2 | | |
| November..... | 130.2 | | |
| December..... | 130.2 | | |
| 1973: | | | |
| January..... | 132.6 | | |
| February..... | 132.7 | | |
| March..... | 133.2 | | |
| April..... | 133.7 | | |
| May..... | 134.1 | Jan. 3, 1973 to Oct. 1, 1973..... | 9.363 |
| June..... | 134.3 | | |
| July..... | 134.3 | | |
| August..... | 134.3 | | |
| September..... | 134.3 | | |
| October..... | 135.3 | | |
| November..... | 135.3 | | |
| December..... | 135.3 | Oct. 1, 1973 to Jan. 14, 1974..... | 9.432 |
| 1974: | | | |
| January..... | 138.1 | | |
| February..... | 139.0 | Jan. 14, 1974 to Mar. 25, 1974..... | 9.480 |
| March..... | 146.6 | | |
| April..... | 150.5 | Mar. 25, 1974 to May 27, 1974..... | 10.033 |
| May..... | 162.4 | | |
| June..... | 169.8 | May 27, 1974 to June 24, 1974..... | 11.046 |
| | | June 24, 1974 to July 8, 1974..... | 11.170 |
| July..... | 181.4 | July 8, 1974 to July 15, 1974..... | 11.883 |
| | | July 15, 1974 to July 22, 1974..... | 12.030 |
| | | July 22, 1974 to July 29, 1974..... | 12.044 |
| August..... | 187.9 | July 29, 1974 to Sept. 9, 1974..... | 12.346 |

CHART 1

STEEL COMPOSITE PRICES AND WHOLESALE PRICE INDEXES

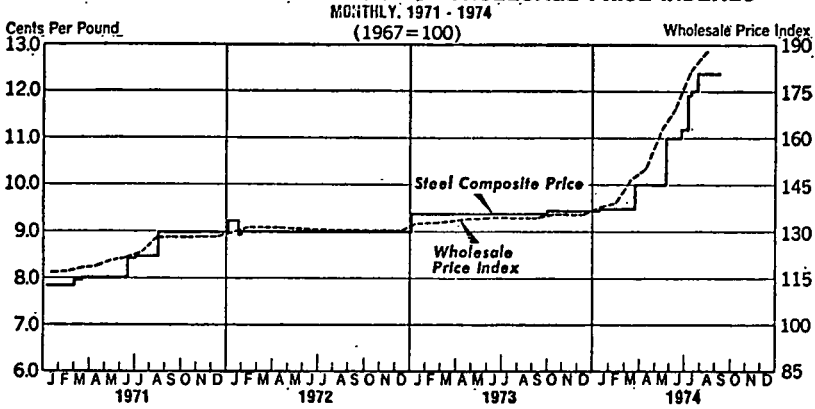


Table 15 and Chart 1 permit a comparison of the price changes for steel as reported by *Iron Age* with those issued by the Bureau of Labor Statistics. Although the components of the two price indicators are not identical, the two indicate very similar price movements. The *Iron Age* composite price is better at showing the length of time for which base prices of steel producers remain unchanged and the extent of the change when it is made. The BLS index takes more factors into account, such as import prices, and discounts from base prices. But the same pattern emerges, that of stability during the period from August 1971 through the end of 1973 and rapid acceleration of prices in 1974 with particularly frequent price boosts in June and July.

Table 16 provides another perspective on the increases in wholesale prices of steel mill products by comparing, for the last year and the latest six months, the relative increase of steel mill prices and of other component parts of the wholesale price index.

Comparing the index for steel mill products with the overall wholesale index for all commodities, it can be seen that from the base period, 1967, till February 1974, the rise in steel mill prices was less than for the all-commodities index, but in the following six months the increase reversed that relationship.

For the year ending August 1974 steel mill products rose by a greater percentage than any of the major commodity groups, except for fuel and chemicals. In the latest six months the increase in steel mill products was greater than any major commodity group except fuels.

TABLE 16.—PERCENTAGE INCREASES IN SELECTED COMPONENTS OF WHOLESALE PRICE INDEX, AUGUST 1973 TO AUGUST 1974

| Commodities | (1967=100) | | | Percentage increases | |
|---|-------------|---------------|-------------|----------------------------|------------------------------|
| | August 1973 | February 1974 | August 1974 | August 1973 to August 1974 | February 1974 to August 1974 |
| All commodities..... | 142.1 | 149.5 | 167.4 | 17.8 | 12.0 |
| All industrials..... | 126.7 | 138.2 | 161.6 | 27.5 | 16.9 |
| Intermediate materials..... | 129.3 | 140.6 | 169.6 | 31.2 | 20.6 |
| Producer finished goods..... | 123.9 | 129.3 | 145.2 | 17.2 | 12.3 |
| Consumer durable finished goods..... | 116.3 | 120.2 | 127.3 | 9.5 | 5.9 |
| Consumer nondurable finished goods, excluding food..... | 120.9 | 134.0 | 153.0 | 26.6 | 14.2 |
| Metals and metal products..... | 133.7 | 148.0 | 185.6 | 38.8 | 25.4 |
| Iron and steel..... | 136.0 | 148.9 | 195.7 | 43.9 | 31.4 |
| Steel mill products..... | 134.3 | 139.0 | 187.9 | 39.9 | 35.2 |
| Foods and feeds, processed..... | 166.2 | 164.7 | 179.7 | 8.1 | 9.1 |
| Chemicals and allied products..... | 111.0 | 120.2 | 158.5 | 42.8 | 31.9 |
| Fuels and related products, and power..... | 135.2 | 177.4 | 226.0 | 67.2 | 27.4 |
| Coal..... | 214.4 | 252.9 | 357.7 | 66.8 | 41.4 |
| Electric power..... | 129.1 | 142.2 | 170.6 | 32.1 | 20.0 |
| Petroleum products, refined..... | 130.3 | 187.8 | 243.9 | 87.2 | 30.0 |

Source: U.S. Bureau of Labor Statistics.

In fact, for the year ending August 1974 the index for steel mill products rose more than twice as much as the wholesale price index generally, and for the latest six months, it rose nearly 3 times as much.

It seems fair to conclude that of all the price increases in the past year, and particularly in the latest six months, none outside of fuels is likely to have a greater impact on the economy and on inflationary pressures in many segments of the economy, particularly in the capital goods and durable consumer goods sectors, than the increases in steel mill prices. It is to that impact that the next chapter is directed.

V. IMPACT OF STEEL PRICE INCREASES ON OTHER SECTORS OF THE ECONOMY⁵

The fundamental place of iron and steel within the economy makes it important to consider the impact which changes in the price of steel are likely to have on the various sectors of the economy. There can be little doubt that the sizeable increases in steel prices in 1974, as described in the previous chapter, have a significant impact on the costs in many industries and inescapably have a pervasive effect throughout the national economy.

Estimation of this impact is vastly facilitated by means of the input-output system for the American economy, as developed originally by Wassily Leontief⁶ and now carried forward in the Interindustry Economics Division of the United States Department of Commerce.⁷ Basically input-output analysis provides a means of measuring the inputs of goods and services required to achieve a given volume of production of each major item (goods or service) in the United States during a given time period, normally a year. It consequently permits an analysis of what impact an increase in the output rate of one product or service will have on the output rate of the various goods and services required as inputs to that production process.⁸

With the aid of such analysis, it also is possible to approximate the impact of a change in price of one input factor on the prices of products which require

⁵ The contribution of Mr. David Bruce Hack, Analyst, Science Policy Research Division, Congressional Research Service, Library of Congress, in the preparation of this chapter is gratefully acknowledged. Mr. Hack developed the methodology on which the chapter is based and made major technical and editorial contributions.

⁶ See especially his "The Structure of the American Economy, 1919-1939". New York, Oxford University Press, 1951.

⁷ See especially "The Input-Output Structure of the U.S. Economy: 1967", Survey of Current Business, February 1974, pp. 24-56.

⁸ With respect to steel this was done by Otto Eckstein and Gary Fromm in *Steel and the Postwar Inflation*, Study Paper No. 2, published on November 6, 1959, by the Joint Economic Committee, United States Congress, in a committee print. (pp. 1-38)

that input. Thus it is possible to make estimates of how a given percentage change in the wholesale price of steel will affect the cost of production and therefore the price of the various groups of products in which the price of steel, directly or indirectly, is a factor. This is done in Table 17. This table provides an estimate of what impact the change in the wholesale price of steel mill products during two periods, August 1973–August 1974 and February 1974–August 1974, has on the price levels of the 82 industries into which the economy is divided in the Department of Commerce's input-output tables. These two price increases are respectively 39.9 percent (for the twelve month period ending August 1974), and 35.2 percent (for the six month period ending August 1974). The relative importance of a given increase in steel prices on the various industries is based on the input-output tables of the Department of Commerce, which include estimates of the inputs from the primary iron and steel manufacturing per dollar of output in each of the 82 industries making up the American economy.

TABLE 17.—ESTIMATED PERCENTAGE CHANGE IN PRICE LEVELS FOR 82 INDUSTRIES RESULTING FROM 39.9 PERCENT AND 35.2 PERCENT INCREASES IN WHOLESALE PRICE OF STEEL MILL PRODUCTS¹

| Sector | Percentage change resulting from— | |
|---|-----------------------------------|-----------------------|
| | 39.9 percent increase | 35.2 percent increase |
| 37 Primary iron and steel manufacturing..... | 39.9 | 35.2 |
| 39 Metal containers..... | 15.26616 | 13.55611 |
| 40 Heating, plumbing and structural metal products..... | 10.95523 | 9.66477 |
| 41 Stampings, screw machine products and bolts..... | 10.47965 | 9.24521 |
| 45 Construction, mining, and oil field machinery..... | 8.05579 | 7.10686 |
| 42 Other fabricated metal products..... | 8.05047 | 7.10217 |
| 44 Farm machinery and equipment..... | 7.36040 | 6.49338 |
| 61 Other transportation equipment..... | 6.47396 | 5.71136 |
| 46 Materials handling machinery and equipment..... | 6.35858 | 5.60957 |
| 43 Engines and turbines..... | 6.10156 | 5.38283 |
| 49 General industry machinery and equipment..... | 5.86393 | 5.17319 |
| 59 Motor vehicles and equipment..... | 5.67132 | 5.00327 |
| 48 Special industry machinery and equipment..... | 4.92715 | 4.34676 |
| 52 Service industry machines..... | 4.69733 | 4.14401 |
| 54 Household appliances..... | 4.65512 | 4.10677 |
| 47 Metalworking machinery and equipment..... | 4.62416 | 4.07946 |
| 23 Other furniture and fixtures..... | 4.58133 | 4.04167 |
| 50 Machine shop products..... | 4.38934 | 3.87230 |
| 55 Electric lighting and wiring equipment..... | 3.51291 | 3.09911 |
| 53 Electric industrial equipment and apparatus..... | 3.16552 | 2.79237 |
| 13 Ordnance and accessories..... | 3.02264 | 2.66659 |
| 11 New construction..... | 2.43418 | 2.14745 |
| 62 Scientific and controlling instruments..... | 2.19592 | 1.93725 |
| 58 Miscellaneous electrical machinery, equipment, and supplies..... | 2.16559 | 1.91050 |
| 60 Aircraft and parts..... | 2.15183 | 1.89836 |
| 64 Miscellaneous manufacturing..... | 1.74379 | 1.53838 |
| 6 Nonferrous metal ores mining..... | 1.69658 | 1.49673 |
| 12 Maintenance and repair construction..... | 1.63029 | 1.43825 |
| 38 Primary nonferrous metal manufacturing..... | 1.56400 | 1.37977 |
| 22 Household furniture..... | 1.56338 | 1.37922 |
| 30 Paints and allied products..... | 1.50272 | 1.32571 |
| 74 Automobile repair and services..... | 1.49865 | 1.32212 |
| 51 Office, computing and accounting machines..... | 1.47770 | 1.30364 |
| 57 Electronic components and accessories..... | 1.42580 | 1.25785 |
| 5 Iron and ferroalloy ores mining..... | 1.37952 | 1.21702 |
| 9 Stone and clay mining and quarrying..... | 1.34575 | 1.18723 |
| 7 Coal mining..... | 1.28228 | 1.13123 |
| 56 Radio, television, and communication equipment..... | 1.10406 | 0.97400 |
| 10 Chemical and fertilizer mineral mining..... | 1.04027 | 0.91773 |
| 36 Stone and clay products..... | .99618 | 0.87884 |
| 27 Chemicals and selected chemical products..... | .85485 | 0.75415 |
| 63 Optical, ophthalmic, and photographic equipment..... | .73916 | 0.65209 |
| 29 Drugs, cleaning, and toilet preparations..... | .72165 | 0.63664 |
| 14 Food and kindred products..... | .71415 | 0.63002 |
| 81 Office supplies..... | .70164 | 0.61899 |
| 25 Paperboard containers and boxes..... | .69664 | 0.61458 |
| 8 Crude petroleum and natural gas..... | .67819 | 0.59830 |
| 20 Lumber and wood products except containers..... | .65099 | 0.57430 |
| 32 Rubber and miscellaneous plastics products..... | .63004 | 0.55582 |
| 21 Wooden containers..... | .62472 | 0.55113 |
| 80 Business travel, entertainment, and gifts..... | .54061 | 0.47693 |
| 65 Transportation and warehousing..... | .52310 | 0.46148 |
| 28 Plastics and synthetic materials..... | .52060 | 0.45928 |
| 31 Petroleum refining and related industries..... | .51872 | 0.45762 |
| 3 Forestry and fishery products..... | .51622 | 0.45541 |
| 78 State and local government expenditures..... | .47339 | 0.41762 |
| 24 Paper and allied products, except containers..... | .40835 | 0.36025 |
| 34 Footwear and other leather products..... | .40647 | 0.35859 |

TABLE 17.—ESTIMATED PERCENTAGE CHANGE IN PRICE LEVELS FOR 82 INDUSTRIES RESULTING FROM 39.9 PERCENT AND 35.2 PERCENT INCREASES IN WHOLESALE PRICE OF STEEL MILL PRODUCTS—Continued

| Sector | Percentage change resulting from— | |
|--|-----------------------------------|-----------------------|
| | 39.9 percent increase | 35.2 percent increase |
| 73 Business services..... | .39584 | .34921 |
| 72 Hotels; personal and repair services except auto..... | .37052 | .32687 |
| 26 Printing and publishing..... | .36833 | .32494 |
| 19 Miscellaneous fabricated textile products..... | .36489 | .32191 |
| 2 Other agricultural products..... | .32174 | .28384 |
| 1 Livestock and livestock products..... | .32018 | .28246 |
| 68 Electric, gas, water, and sanitary services..... | .31767 | .28025 |
| 17 Miscellaneous textile goods and floor coverings..... | .30454 | .26867 |
| 35 Glass and glass products..... | .29891 | .26370 |
| 16 Broad and narrow fabrics, yarn, and thread mills..... | .27703 | .24439 |
| 71 Real estate and rental..... | .22543 | .19888 |
| 4 Agricultural, forestry, and fishery services..... | .21074 | .18591 |
| 18 Apparel..... | .20980 | .18509 |
| 69 Wholesale and retail trade..... | .18197 | .16054 |
| 33 Leather tanning and industrial leather products..... | .18166 | .16026 |
| 15 Tobacco manufacturers..... | .16884 | .14895 |
| 76 Medical, educational services, and nonprofit organizations..... | .15727 | .13874 |
| 77 Federal Government enterprises..... | .14226 | .12550 |
| 75 Amusements..... | .14195 | .12523 |
| 67 Radio and television broadcasting..... | .12413 | .10951 |
| 66 Communications; except radio and television broadcasting..... | .11131 | .09820 |
| 70 Finance and insurance..... | .11100 | .09792 |
| 79 Gross imports of goods and services..... | .00000 | .00000 |
| 82 Scrap, used and secondhand goods..... | .00000 | .00000 |

¹ The wholesale price index for steel mill products rose by 39.9 percent from August 1973 to August 1974 and by 35.2 percent from February 1974 to August 1974.

Sources: Computed from data in table 3, "Total Requirements . . . 1967," Survey of Current Business, February 1974, p. 50.

The Department of Commerce input-output data also underlie a model developed by the Office of Emergency Preparedness, Executive Office of the President, in 1970-1971.⁹ This model computes the percentage changes in the price indexes for major GNP components, as weighted averages of the price changes in the industrial sectors which produce the goods making up major GNP components.

Thus Table 17 indicates that the 39.9 percent increase in the price of steel mill products in the 12 months ending August 1974, on the basis of passthrough of the cost of steel, may be expected by itself to result in a 15.4 percent increase in the price of metal containers; an 11 percent price increase in heating, plumbing and structural metal products; a 5.7 percent increase in the price of new construction; a 1.3 percent increase in the price of coal; and a 0.3 percent increase in the price of livestock and livestock products. Prices in the six machinery categories were affected within a range of 4.6 to 8.1 percent.¹⁰

A supplementary table, Table 18, provides estimates of the impact of these same two increases (39.9 and 35.2 percent) in steel mill products on the entire economy as measured by the price indices for the gross national product and its components. Thus it is estimated that, using the gross national product deflator as the most appropriate price index for measuring price changes in the economy as a whole, a 39.9 percent increase in steel mill product prices for the year ending August 1974 is estimated to produce a 1.4 percent increase in the price level of total gross national product, an increase of .6 percent in the price level of personal consumption expenditures and a 5.7 percent increase in the price level of gross private fixed capital formation.¹¹

⁹ See: Hack, David Bruce. Cost push, demand pull—an input-output model of price behavior. The 1971 Business and Economic Statistics Section proceedings of the American Statistical Association. Washington, D.C., American Statistical Association. 1972. p. 361-365.

¹⁰ The 35.2 percent increase during the latest six months is reflected in the second percentage column of Table 17 and is 88.2 percent of the amount in the first percentage column. No attempt is made to project steel price increases for subsequent months or to estimate any annual rates for periods beyond August 1973-August 1974.

¹¹ The corresponding increases resulting from the six-month increase of 35.2 percent are 1.2 percent for the gross national product price level, a .55 percent increase in the price level of personal consumption expenditures, and a 5.0 percent increase in the price level of gross private fixed capital consumption.

TABLE 18.—ESTIMATED PERCENTAGE CHANGE IN SELECTED GROSS NATIONAL PRODUCT DEFLATORS ATTRIBUTABLE TO AN INCREASE IN THE WHOLESALE PRICE OF STEEL MILL PRODUCTS OF 39.9 PERCENT AND OF 35.2 PERCENT¹

| | Estimated percentage change in GNP deflator attributable to steel mill products wholesale price index increase of— | |
|--|--|--------------|
| | 39.9 percent | 35.2 percent |
| Total gross national product..... | 1.355 | 1.195 |
| Personal consumption expenditures..... | .629 | .553 |
| Gross private fixed capital formation..... | 5.689 | 5.019 |
| Federal Government purchases..... | 2.250 | 1.985 |
| State and local government purchases..... | 1.831 | 1.615 |

¹ Wholesale price index for steel mill products increased by 39.9 percent from August 1973 to August 1974 and by 35.2 percent from February 1974 to August 1974.

Source: Computed from data in table 1, "Interindustry Transactions, 1967," Survey of Current Business, February 1974 p. 43, and from the results tabulated in the preceding table, table 17.

It needs to be stressed that all of the estimates in the two tables just discussed are based solely on changes in the price of steel mill products between August 1973 and August 1974 and between February and August 1974. The lengths of the lags between the steel price increase, and the subsequent price increases in industries directly or indirectly dependent on steel are not known, though it is likely that most of the effect caused would be realized in less than a year after any discrete rise in the price of steel.

While these two tables have a usefulness in showing the pervasive nature of any increases in the price of steel, they have limitations which should be borne in mind. First, the relationships between steel production and other industries are based on demands, prices, and product mixtures for 1967. Updating the relationships would bring about some changes in the utilization of steel directly and indirectly, in certain lines of production. In limited fields, alternative materials have made inroads in the steel market, such as aluminum in beverage cans, and plastics in some consumer durables. But for most uses no economically acceptable alternative has appeared, especially for the kinds of steel with greatest tonnage output. Thus it is likely that in general the 1967 pattern of utilization of steel will be valid a decade later.

There remains the question as to how elastic the demand for the broad complex of steel products is at the present time. While it is possible that the sharp price increases in most steel products in 1974 will cause some curtailment in purchases, and some shift to alternative materials, the likelihood of major shifts is not great. Competitive metals and other materials have also risen substantially in price. Demand for steel, both domestic and foreign, is strong and barring a lengthy recession, is likely to remain so.

Finally, while the input-output analysis on which Tables 17 and 18 are based identifies the structural relationships between industries in terms of the steel input coefficients for various industries and thus provides a basis for estimates of the impact on other industries of changes in the prices of steel mill products, it cannot provide an assessment as to the total impact which such a steel price increase may actually have on pricing decisions in other industries. In some businesses it may be determined that not merely a passthrough of the steel price increase is warranted but that a percentage markup of the final product equal to or greater than the percentage increase in the price of steel is called for. Other businesses may use the announced steel price increases as reasons for raising prices when factors other than steel may form a larger proportion of production costs and therefore be more relevant to price increases in that industry.

Thus the significance of the increase in steel prices is at least threefold. First, the direct impact of the steel price increases in many basic industries, including motor vehicles, industrial and farm machinery, and metal containers, is very substantial. Second, these costs will in general be passed on, not infrequently on a percentage mark-up basis, to the ultimate consumer. Third, even in the many industries when the inputs of steel, direct and indirect, are relatively small, the well publicized steel price increases may be used as a reason for price and wage increases that are substantially greater than what would be warranted on the basis of steel inputs themselves.

Finally, cost-push calculations by themselves take no account of non-cost factors tending to increase the price of a given industry's product by enlargement of that industry's gross profits (or value added). Among such factors are demand-supply relationships as measured by (e.g.) capacity utilization ratios, and the presence of monopoly power as measured by indices of industry concentration. Such non-cost factors have been discussed by Eckstein and Fromm (Op. cit.), and Hack (Op. cit.). An econometric investigation into the magnitudes of such effects was begun by the Office of Emergency Preparedness. A paper by David Bruce Hack, "The partial effects of cost, demand, and industry concentration in the process of inflation—an interindustry model", based on this investigation, is attached as a companion report.

VI. CONCLUSION

It is beyond the scope of this report to pass judgment on the extent to which the price increases that have been instituted within the steel industry are justified, either from the point of view of the steel companies themselves or from the point of view of the consumer or the national economy as a whole. It has been the function of this report to set forth data and information which illuminate the factors which have led to these price increases.

This chapter attempts to indicate some of the relationship of the steel price increases to the outlook for the steel industry, based on statements of industry spokesmen, business analysts, and others. At the outset three general observations seem worth stating as parameters for the ensuing discussion. First, a healthy and productive steel industry is essential to the national economy, and clearly in recent years, especially 1970 and 1971, it was far from healthy and productive, due both to external and internal causes. Second, some increase in prices over the level of 1973 is warranted on the basis of increased costs. Third, the 1974 increases of steel prices, although called forth in large measure as a means of overcoming the rises in both past and anticipated production costs, are of such magnitude that they inescapably have an inflationary impact on steel users and thus on the entire economy.

It may be suggested that there are aspects of the outlook for the steel industry that are sufficiently favorable as to make a price increase of the magnitude that has occurred unnecessary or unwise; there are others that might be seen as providing rationale for such an increase.

The bright outlook for the steel industry has many facets that might suggest that the magnitude of price increases posted by the steel companies has been excessive. Demand, both domestic and worldwide, has continued strong, despite reduction of domestic shipments to automobile, appliance, and ordnance manufacturing. The United States still has a price advantage over its chief foreign competitors, thanks in large measure to the devaluation of the dollar and more favorable energy costs.

The labor agreement negotiated with the United Steel Workers Union in 1973 goes far towards assuring no strikes through 1980. Although the costs of the new agreement are substantial, the assurance of production uninterrupted by strikes or threats of strikes should go far to eliminate large cyclical swings in steel purchases. Strike hedging purchases involve heavy costs to the industry in terms of overtime and extra maintenance costs. And, after a signing of a new contract, there are usually abnormally low production rates as consumers work down inventories.

There have been substantial gains in productivity since 1967. While such gains may slacken this year as a result of the need for undertaking extensive long-deferred maintenance work, the long run trend looks upward with installation of new more efficient equipment and indications of continued cooperation between management and labor.

The greater reliance of the U.S. steel industry compared to its foreign competitors on coal as a fuel has been a decided advantage, as already noted, combined with generally adequate supplies of raw materials. As Frederick Jaicks, president of the American Iron and Steel Institute, recently stated in Chicago, "We have a degree of confidence in our raw material situation. The steel industry here possibly has the best posture among the world's steel industries in this sense."¹³ While in the short run there is obvious concern about possible shortages of coking coal as a result of a strike threatened by the United Mine Workers, the long-run prospect for adequate supplies is good, particularly since in many cases steel companies own and operate their own mines.

¹³ *Iron Age*, September 2, 1974, p. 37.

Frederick Jaicks has also pointed out that half of the expansion needed in the remainder of this decade can be obtained by investment in rolling mills and auxiliary equipment, rather than in extremely expensive blast furnaces.

The reasons for the substantial price increases within the steel industry within the last six months would appear to be based on the belief of leaders of the industry that raising prices to as high a level as prevailing supply and demand conditions would support is the best insurance against the uncertainties of inflation, the cost of capital, the inescapable pollution control costs to the industry, and the vagaries of future demand. The industry also apparently counted on little or no public resistance to these increases. As *Iron Age* pointed out in its July 8 issue (as already referred to on p. 24-25 of this report), "There is a feeling in steel circles that this is a now-or-never situation. If steel profits can't be put on a satisfactory basis in today's shortage market, it's argued, they never will be." In other words, it was a matter of getting while the getting was good.

The case for the large steel price hikes that have occurred is usually made in terms of such prices being essential to enable the industry to increase capacity needed to meet anticipated demands for steel. Of the alternative sources to the industry for such capital, retained earnings, equity financing, and debt financing, the first appears by far the most attractive to the steel industry at this time. Depressed stock prices make equity financing a questionable proposition. At current interest rates, the cost of borrowing in the capital markets is similarly unattractive. And obviously higher profits and retained earnings resulting from higher prices will automatically make steel company equities more attractive and improve access to capital bond markets.

The steel industry appears to have taken a calculated risk in its pricing decisions of this year that (1) domestic demand will continue at a high level, with little appreciable net competitive advantage being gained by substitutable non-ferrous materials; (2) that the price increases are not so great as to encourage damaging foreign competition, both in domestic and in their export markets, and (3) that the price increases will not have seriously adverse repercussions in public policy.

As a hedge against at least the first two of these three risks, steel executives would like to be assured of (1) protection against any sharp increase in steel imports from foreign government-owned or subsidized steel mills operating with discriminatory competitive advantage; (2) immediate full write-off of non-productive pollution control investment; and (3) greater tax incentives for investment, such as a permanent investment tax credit, more rapid depreciation, greater depletion allowance on domestic ore and coal, and repeal of the minimum tax as it applies to corporations.¹⁴

There remain several interrelated questions that need to be answered, both in the interest of the steel industry itself and for the American people. How large an increase in steel prices is really required to provide the means for expanding capacity to meet the needs of the economy in the coming decade? Is the full amount of the sharp rise in prices since May 1, 1974 necessary to achieve this objective? Is it possibly even counterproductive by leading to shrinkage of demand, greater use of substitutable materials, and increased competition from abroad? What assurance can the American people have that the profits engendered by the price increase will really be utilized for modernization and expansion of capacity, and not for other purposes? Answers to these questions should be sought both from the industry and from disinterested experts as well.

¹⁴ See for example: Jaicks, Frederick G. Steel tax policy must acknowledge need for capital. *Money Manager*, April 8, 1974, pp. 17-18.

Mitchell, Hutchins Inc.

Basic
Analysis

STEEL: HOW MANY YEARS OF GRASS DOES
THE MASTODON HAVE LEFT?

The purpose of this memo is to give our perspective on how the steel industry is evolving and what that means for profitability. To summarize our conclusions, we see good news in the 1970's outlook. We expect a period of fluctuating, but high, profitability for the American steel industry. Some more serious "bad news" questions arise in the 1980's. The outlook by the early- to mid-1980's, we think, would be clearly negative were it not for the probability of continued inflationary forces in the economy.

We expect the common stocks of the major steel companies to be extremely good performers during the next few years.

FAVORABLE OUTLOOK FOR
THE REMAINDER OF 1970's

The profitability of the American steel industry should remain high for the remainder of the 1970's:

- ¶ We predict that during periods of tight supplies for steel the steel industry's return on equity will at least approach 20%, with the possibility of "supra-normal" earnings at 25-30% on equity.
- ¶ During periods of moderate oversupply for steel, we still think that net income will average at least 10-15% on equity.

September 10, 1974

Peter F. Marcus
(212) 623-4996

THE INFORMATION CONTAINED HEREIN HAS BEEN OBTAINED FROM SOURCES WHICH WE BELIEVE TO BE RELIABLE, BUT ITS ACCURACY IS NOT GUARANTEED. OFFICERS, DIRECTORS AND EMPLOYEES OF MITCHELL, HUTCHINS INC. AND THE CORPORATION ITSELF MAY AT TIMES HAVE A POSITION IN ANY SECURITY DESCRIBED HEREIN.

Mitchell, Hutchins Inc.

In fact, based on price increases effected since the end of price controls, the steel industry already is at a high level of profitability according to historic measurements:

- ¶ We estimate that domestic steel profits will rise to about \$2.3 billion in 1974 (assuming no coal strike) versus \$1.3 billion in 1973, but that the current, annualized, earnings rate is closer to \$2.6 billion--an 17% return on present stockholders' equity of about \$15 billion.
- ¶ For 1975, we project that U.S. steel shipments will range from 97 to 110 million tons, depending on whether the economy is weak or strong, and that industry profits will range from \$1.7 billion to \$3.2 billion. The "most likely" scenario, we think, is a flat economy, with domestic steel shipments at about 102 million tons and industry profits at about \$2.1 billion.

We at Mitchell, Hutchins are evolving a new theory about the nature of the profit environment for the steel industry--a theory that advances beyond our "shortage thesis" which now seems somewhat obsolete since

- ¶ Profit levels already reflect much of the predicted "catch-up"
- ¶ The tight supply argument may not continue to apply during 1975 if the economy remains stagnant.

The new perspective we are embracing might be called the "sustainable profitability thesis" which, in turn, is broken down into two propositions:

1. There is a strong probability of adequate pricing for integrated steel companies
2. There is a high expectation of good returns on reinvested "discretionary" cash flow.

Regarding the first proposition, we think that the domestic steel industry should be able to adequately maintain pricing, even during periods of moderate oversupply. Accordingly, if higher costs can be "passed on" over the years, the industry should be able to turn in above-average earnings results during inflationary periods.

Regarding the second proposition, we think that most steel companies do not need all of their cash flow at today's level of profits to maintain the status quo. For example, we estimate that the steel industry needs about

Mitchell, Hutchins Inc.

\$2 billion of its present cash flow to maintain and modernize equipment and meet pollution control requirements. The "discretionary" cash flow the industry invests over and above this amount should produce good returns since:

1. Most major steel companies possess "potentially productive assets," such as land or raw material holdings, which can be converted into income-producing assets
2. The economics of "rounding out" a well-situated steel plant seem to be extremely favorable.

What is the "normal" level of earnings we should expect during the remainder of the 1970's, assuming that the marketplace enables domestic producers to set prices at whatever level they deem necessary? One approach to an answer is to assume new greenfield steel plants will be built and to look at the steel price necessary for any such "new" producer to earn a 10% return on total capital investment. (We should emphasize that we define a "new" producer as any company, steel producer or otherwise, that builds a greenfield steel plant.) Thus, as we can see from Table 1, this would require about a \$145 per ton rise in the price of steel from \$255 at present to about \$400. This, in turn, would boost domestic steel profits, all other things equal, by almost fourfold to about \$10 billion--about a 50% return on the domestic steel industry's present level of debt plus equity, and close to a 66% return on present stockholders' equity of about \$15 million.

A second, and more realistic, approach to forecasting "normal" earnings might be to calculate how much cash flow the steel industry needs to meet its requirements

1. To expand its shipping capacity by, let's say, 3% per annum
2. To pay dividends at a rate equal to 40% of earnings
3. To maintain its present strong debt to equity ratio. Long- and short-term debt presently runs about 28% of capitalization for the domestic industry.

Taking this approach, we also should factor in some other items:

1. Steel is closely watched by government policymakers, and it undoubtedly would become a "whipping boy" once again if observers thought that it was earning profits at an "excessive" or "exploitative" rate.

Mitchell, Hutchins Inc.

Table 1

Comparison at Mid-1974 of Profitability at an Existing,
Rounded-Out and Greenfield Steel Plant

| | Established Steel Plant | Rounding Out a Steel Plant | "Greenfield" Steel Plant |
|---|----------------------------|----------------------------------|-----------------------------|
| Shipment capacity | 4.0 mill. tons | 1.0 mill. tons | 5.0 mill. tons |
| Man-hours | -----per ton shipped----- | | |
| At plant | 8.0 | 3.0 | 4.4 |
| Overhead | <u>1.0</u> | <u>0.6</u> | <u>1.0</u> |
| Total | 9.0 | 3.6 | 5.4 |
| Steel price | \$255 | \$255 | \$255 |
| Other income | <u>5</u> | <u>-</u> | <u>-</u> |
| Total revenues | 260 | 255 | 255 |
| Labor cost | 81 | 32 | 49 |
| Material cost | 125 | 125 | 120 |
| State and local taxes | <u>3</u> | <u>4</u> | <u>6</u> |
| Total operating cost | 209 | 161 | 175 |
| Interest expense* | 3 | 15 | 62 |
| Depreciation expense* | <u>10</u> | <u>21</u> | <u>45</u> |
| Pretax costs | 222 | 197 | 282 |
| Pretax profit | 38 | 58 | (27) |
| Income taxes | <u>18</u> | <u>28</u> | <u>(14)</u> |
| After tax profit | 20 | 30 | (13) |
| Debt (long and short) | 50 | 140 | 560 |
| Stockholders' equity | <u>120</u> | <u>260</u> | <u>240</u> |
| Capitalization | 170 | 400 | 800 |
| Net plant | 120 | 360 | 760 |
| Working capital | <u>40</u> | <u>40</u> | <u>40</u> |
| Net plant plus working capital | 160 | 400 | 800 |
| Return on equity | 16.7% | 11.5% | -5.5% |
| Return on capitalization | 12.6% | 9.4% | 2.3% |
| Price needed for 10% return on capitalization | \$246 | \$260 | \$401 |

*Depreciation - 17 year life

Interest expense - new debt at 11%

Mitchell, Hutchins Inc.

2. The industry probably is "conditioned" to spend most of its cash flow on steel-related facilities when the profitability outlook is favorable. (Note: Might we call this the Pavlov syndrome?)
3. Unlike many industries, steel has the ability to "round out" its existing facilities at an investment cost equal to about one-half of the cost of building a new steel plant. We guess that the industry can add at least 20 million tons (about 18%) to its shipping capacity via this route by 1980.

We conclude (Table 2) that a "normal" level of industry earnings (in mid-1974 dollars) might be about \$3.0 billion per year assuming that only "round out" expansions of steelmaking capacity are made. This compares with our earnings estimate of \$2.3 billion for the domestic steel industry in 1974, but is only about 15% above our estimate of the industry's current annualized earnings power.

Of course, by the late 1970's, the steel industry will probably have used up its optimum "round out" opportunities. And, it also seems reasonable to submit that there is a strong need to complete a number of "greenfield" plants in the United States by the early- to mid-1980's if the domestic industry is to remain competitive in international markets. Thus, one can argue that another "catch-up" of steel profits might be required not too many years hence.

For the following reasons, we see the positions of the leading domestic steel companies as fundamentally strong--at least through the 1970's:

1. These companies now have low-costs by international standards, in good part because of their major advantages in the area of material costs.
2. The import threat is reduced, in part because of the higher cost levels prevailing in many foreign countries, and in part due to the existence of anti-dumping legislation.
3. Most major steel producers have made substantial changes in their organizations in recent years.
4. The government's attitude towards basic industry seems to have shifted from negative to neutral in recent years, and there are some good conceptual reasons to expect further positive changes.
5. It would appear that the U.S. dollar will not become as over-

Mitchell, Hutchins Inc.

Table 2

Projected Annual 1975-1979 Sources and Uses of Funds Requirements*
for Domestic Steel Industry if Only "Round Out" Capacity Expansions are Made

| <u>Source of Funds</u> | | <u>Use of Funds</u> | |
|------------------------|--------------------|--|--------------------|
| Net Income | \$3.0 billion | Capital Outlays: | |
| Depreciation | 1.4 billion | Replace and Modernize | \$1.5 billion |
| Net New Debt | <u>0.8 billion</u> | Pollution Outlays | 0.5 billion |
| Total | \$5.2 billion | Expansion (3.3 million tons at \$400 per ton) | 1.3 billion |
| | | Nonsteel Outlays | <u>0.5 billion</u> |
| | | Total Outlays | \$3.8 billion |
| | | Cash Dividends (40% payout) | 1.2 billion |
| | | Working Capital Require- ment | <u>0.2 billion</u> |
| | | Total | \$5.2 billion |

*In mid-1974 dollars.

Mitchell, Hutchins Inc.

valued in the years ahead as it was during the 1960's since we are in a period of flexible exchange rates.

6. No new producers are visible on the domestic horizon. A well-situated steel plant can earn, we estimate, about 18% on equity at today's price for steel, but a new producer would lose money. Expansions of capacity are only taking place at moderate rates, and would cease should there be a sharp dip in profits. The domestic industry is able to "round out" its existing facilities on an extremely favorable economic basis. As noted in Table 1 and Appendix A, we think that:
 - a. Existing plants can be "rounded out" at an investment cost of about \$400 per ton shipped, versus a cost of about \$800 per ton* to build a new steel plant, and the current carrying value (net plant plus working capital) of existing facilities of about \$150 per ton.
 - b. The additional man-hours incurred when "rounding out" a steel plant may be about 3.6 per ton shipped, versus maybe 5.4 m.h. for a greenfield steel plant today (maybe 4.9 m.h. by 1980), and versus about 9.0 m.h. for the average existing domestic steel plant.
 - c. At today's price for steel of about \$255 per ton, a steel plant can be "rounded out" at a ROI of about 9% versus the domestic industry's present ROI of about 12%. In comparison, we think that the ROI at a "greenfield" steel plant at today's steel price levels would only be about 2%.
 - d. The productivity gain for the American steel industry through 1980 may average about 2.6% per annum because of the low incremental man-hours incurred on the "round out" capacity expansions. Thus, if the man-hours per ton of carbon steel shipped in the American steel industry in 1980 are about 7.7 (at a shipment level of 130 million tons)

* We have recently raised our estimate of the cost of building a "greenfield" steel plant from \$600 to \$800 per ton shipped. This includes full integration in raw materials, startup costs, interest costs during construction, and working capital.

Mitchell, Hutchins Inc.

versus about 9.0 man-hours at present (at 110 million tons), the advantage gained in man-hours by building a "greenfield" steel plant will be less in 1980 than at present.

In summary, as our earnings forecasts would indicate, a combination of favorable circumstances have all come together at about the same time. Barring really adverse government policies or long-term stagnation of the Free World economy, we think the outlook may seem even more positive several years from now. Accordingly, it seems logical to expect the domestic steel industry's capital outlays to approach the rate of \$3.5 billion per annum within the next 18 months.

CROSSCURRENTS IN THE 1980's

A look at the 1980's demonstrates how a number of today's "positives" can turn into "negatives." For example, longer-term there is a real question as to how competitive the U.S. steel industry will remain if it does not build some large new plants.

Many large-sized plants will be operating in the 1980's around the world. Major steelmaking capacity additions are forecast to come on-stream in many countries starting about 1979 or 1980 since producers in most foreign nations are far less constrained by profit considerations. They operate under eco-political systems that see additional objectives for an efficient steel industry, most notably

- § Employment of hundreds of thousands
- § The generation of foreign exchange reserves
- § The granting of lower prices to major users.

This gives rise to a number of questions

- § To what degree will these new plants put pressures on the generally smaller U.S. facilities?
- § Does the domestic industry have the financial strength to be able to build greenfield plants, if it decides it wants to?
- § Will the high levels of profitability we forecast lead to the failure to abandon marginal facilities? Will much money be wasted on smaller units?

Mitchell, Hutchins Inc.

§ What are the risks from new technology in the 1980's in areas such as:

- Direct reduction
- Nuclear steelmaking
- Continuous processing techniques.

We see other powerful--and likely--negative forces as well:

§ The current favorable relative cost position enjoyed by the U.S. steel industry may not be sustainable.

- A number of less-efficient foreign producers seem to have the prospect of large productivity gains, and their wage levels are much lower (only about \$3.00 per hour in the U.K.).
- The U.S. dollar may very well firm from present levels.
- The huge U.S. advantage in raw material costs will narrow somewhat, in part because foreigners will invest in U.S. raw material properties.

§ U.S. government policies are a real intangible when making longer-term forecasts.

§ The patterns of worldwide economic growth could be much less favorable.

- Demographic factors
- The building of infrastructures may be less of a factor.

§ "Supra-normal" earnings levels later in the 1970's could lead to excessive optimism and capacity additions.

Thus far, our picture for the 1980's has been pretty grim. We do, however, see some countervailing forces. Two of these are:

1. The pervasive impact of inflation on steelmaking equipment construction costs

Mitchell, Hutchins Inc.

2. The fact that the domestic steel industry could be earning substantial profits from the "discretionary" cash flow invested in the 1970's.

In order to better visualize the impact of inflation, we have made some projections out to 1981. We undertook this exercise since we felt that we were underestimating the forces at work. For example, 1973 and 1974 are the only two years since 1951 when the consumer price index has risen more than 6.0% per annum. In Table 3, we have looked at the economics of new and existing steelmaking facilities in 1981, on the assumption that labor, material, and construction costs are 50% higher. (Note: This would be the case if inflation continues at a 6% rate.) Thus, hourly labor costs would rise to about \$13.50 per hour versus \$9.00 at present; material costs would escalate to about \$185 per ton shipped versus an estimated \$125 at present, and "greenfield" construction costs would be at least \$1,200 per ton versus possibly \$800 at present. Some of the highlights of Table 3 are as follows:

1. Pretax costs per ton shipped would be \$323 for a typical existing producer, and \$414 for the potential new producer.
2. Net plant plus working capital might be about \$330 per ton shipped for the existing producer.
3. A new plant's operating costs might be about \$43 per ton below those at the existing plant, but depreciation and interest expenses would be about \$134 per ton higher.
4. The steel price needed to earn 10% on investment would be \$376 for the existing producer and \$556 for the new producer, versus the present estimated price level of about \$255 per ton.

Thus, a clear-cut conclusion seems to be that, with each passing year of high inflation, the advantage of the established producer becomes wider, barring dramatic technological advances.

STEEL STOCKS ATTRACTIVE

We expect that steel common stocks will continue to outperform the stock market during the next few years. The earnings outlook is relatively good, yet steel stocks today are selling below their historic relative price/earnings ratio range. Historically, it seems that the relative P/E ratio of a common stock has been a function of investors views of its:

Mitchell, Hutchins Inc.

Table 3

Comparison of the Economics at an Existing and
Greenfield Steel Plant in 1981 assuming a 50%
Boost in Labor, Material, and Construction Costs.

| | <u>Established Steel Plant</u> | <u>"Greenfield" Steel Plant</u> |
|--|------------------------------------|-------------------------------------|
| Shipment capacity | 5.0 mill. tons | 6.0 mill. tons |
| Man-hours/ton shipped | | |
| At plant | 6.8 | 4.0 |
| Overhead | <u>0.9</u> | <u>0.9</u> |
| Total | 7.7 | 4.9 |
| Labor cost per hour | \$13.50 | \$13.50 |
| | -----per ton shipped----- | |
| Labor cost | \$104 | \$ 66 |
| Material costs | 188 | 180 |
| State & local taxes | <u>6</u> | <u>9</u> |
| Total operating cost | 298 | 255 |
| Interest expense* | 11 | 92 |
| Depreciation expense* | <u>14</u> | <u>67</u> |
| Pretax costs | 323 | 414 |
| Debt (long and short) | 110 | 840 |
| Equity | <u>220</u> | <u>360</u> |
| Capitalization | 330 | 1200 |
| Net plant | 240 | 1140 |
| Working capital | <u>60</u> | <u>60</u> |
| Net plant plus working capital | 300 | 1200 |
| Price needed for 10% return on capitalization | \$376 | \$556 |
| Present price of steel | 255 | 255 |

*Depreciation - 17 year life

Interest expense - new debt at 11%

Mitchell, Hutchins Inc.

- § Rate of earnings growth
- § Predictability of earnings results
- § Qualitative standing.

Thus, it is not very mysterious why steel stocks have rated so poorly. Today, however, we probably can add a fourth key factor to this equation, which is a company's inflation hedge characteristics. And, in view of the changed fundamentals for the steel industry, we are wondering whether steel stocks might sell at higher relative price/earnings ratios in the years ahead than the 50-80% range which generally prevailed between 1946 and 1972, and the 45% relative P.E.R. which is the case today (see Graph 1). While it is true that a steel company's cyclicality will always tend to obscure trends in the underlying earnings power, steel stocks look much better to us from the other perspectives. For example:

- § Inflation hedge characteristics: A well-situated steel company should be able to pass on its higher costs over a period of years. This is partly because of the company's strong raw material holdings. However, the key factor, we think, is that the rising cost to build new facilities should add to the ability of existing producers to adequately maintain pricing.
- § Qualitative standing: Well-situated steel companies are financially strong, relatively low-cost, invulnerable to the entrance of new competitors, less vulnerable to import threats, fully integrated, and they generate substantial cash flow. They use LIFO accounting and some producers are blessed with "potentially productive assets" such as raw material reserves. Thus, they now should rank "qualitatively" much better versus other companies than in the past.
- § Underlying growth of earnings power: We hypothesize that a strongly-situated steel company could have a growth rate of earning power of 8-13% per year, on average, as long as a reasonably good supply/demand relationship exists for steel. This argument is stated as follows:
 - a. Unit growth volume for steel should average at least 2-3% per annum.
 - b. Inflation may add 6-7% per year to revenues (and also to profits if margins remain constant).

Mitchell, Hutchins Inc.

- c. Reinvestment of cash flow, over and above that needed to maintain the status quo, could easily boost profits by 4% per annum, on average. More specifically, if the domestic steel industry can earn only 10% after taxes on "aggressive" capital spending of \$1.2 billion per annum, this would add about \$120 million (about 4%) to the industry's current, annualized, and estimated earnings rate of \$2.6 billion.

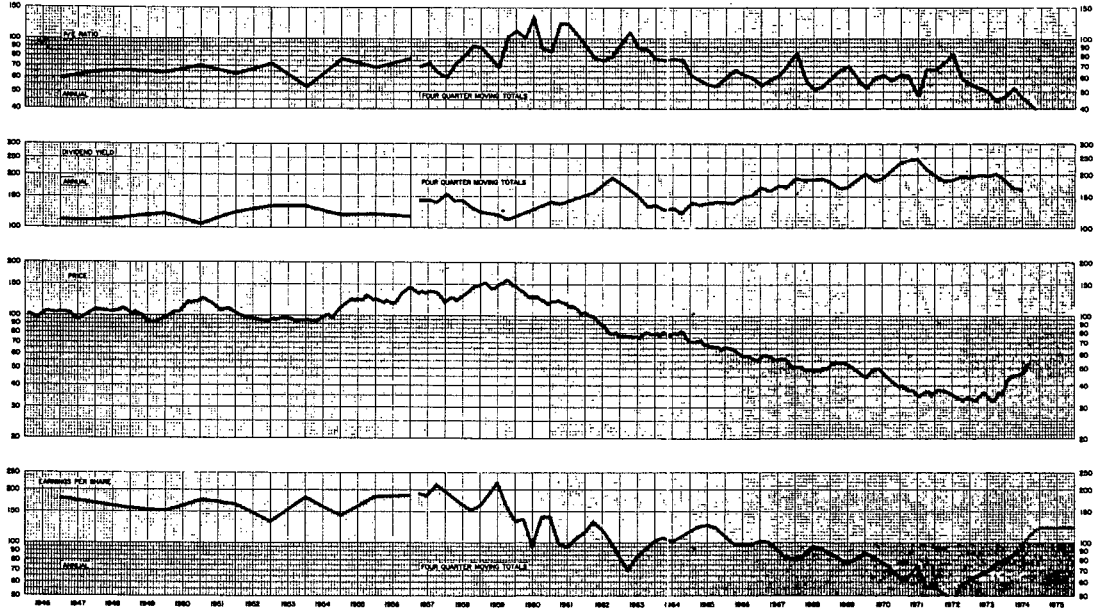
Thus, we think steel stocks today are offering a great deal to common stock investors. The companies possess some key characteristics which seem to be important over the longer-term; many of the stocks yield close to 10% based on estimated dividend payments during the next 12 months, and the earnings of the major companies in 1975 should be quite respectable relative to the overall business environment. Most steel stocks are selling below their historic relative P.E.R. range, yet the qualitative arguments to purchase the stocks seem to be better than at any time since the 1940's.

September 10, 1974

Peter F. Marcus
(212) 623-4996

THE INFORMATION CONTAINED HEREIN HAS BEEN OBTAINED FROM SOURCES WHICH WE BELIEVE TO BE RELIABLE, BUT ITS ACCURACY IS NOT GUARANTEED. OFFICERS, DIRECTORS AND EMPLOYEES OF MITCHELL, HUTCHINS INC. AND THE CORPORATION ITSELF MAY AT TIMES HAVE A POSITION IN ANY SECURITY DESCRIBED HEREIN.

Graph 1
RELATIVE PERFORMANCE OF THE S&P STEEL GROUP
1945 TO THE PRESENT



Mitchell, Hutchins Inc.

APPENDIX A

Calculation of the Productivity Levels at Existing and Greenfield American Steel Plants in 1980

| | | | | | | | |
|---|-----------|-----------------|------------|---|-----------|------------|------------|
| 1) Present m.h. /ton shipped in 1974 | | | | | | | |
| | | Direct | | | | 8.0 | |
| | | Indirect (GS&A) | | | | <u>1.0</u> | |
| | | Total | | | | 9.0 | |
| 2) Assumed direct man-hours in 1980, given no change in volume, if productivity rate is 1.0% per year | | | | | | | 7.5 |
| 3) Incremental direct man-hours incurred when shipping 20 million tons more from "rounded-out" facilities | | | | | | | 3.0 |
| 4) Calculated direct man-hours per ton shipped at 130 m. t. in 1980 | | | | | | | |
| | 110 | x | 7.5 | = | 825 | | |
| | <u>20</u> | x | <u>3.0</u> | = | <u>60</u> | | |
| | 130 | x | 6.8 | = | 885 | 6.8 | |
| 5) Assumed indirect man-hours in 1980 | | | | | | | 0.9 |
| 6) Derived total man-hours per ton shipped in 1980 | | | | | | | 7.7 |
| 7) Shipment gain 1980 vs. 1970 = 130/110 = Average over 6 years | | | | | | 18.2% | 2.8%/year |
| 8) Productivity gain 1980 vs. 1970 = 9.0/7.7 = Average over 6 years | | | | | | 16.9% | 2.6%/year* |
| 9) Estimated man-hours at a greenfield steel plant in 1980 | | | | | | | |
| | | Direct | | | | 4.0 | |
| | | Indirect | | | | <u>0.9</u> | |
| | | Total | | | | 4.9 | |
| 10) Derived savings in man-hours at a new steel plant vs. typical well-established plant in 1980 | | | | | | | |
| | | Man-hours | | | | 2.8 | |
| | | Percent | | | | 28% | |
| | | At \$9.00/hour | | | | \$25.20 | |

*Very close to the industry's historic average.

Graph A-1

Calculation of American Steel Industry
Productivity Level in 1980

| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------------|
| Direct man-hours at shipment level of 110 m. t. (assumes 1%/year productivity gain) | 8.00 | 7.92 | 7.84 | 7.76 | 7.68 | 7.60 | 7.53 |
| Additional direct man-hours needed for a 20 million ton shipment gain from "rounded out" facilities | | | | | | | 3.00 |
| Indirect man-hours at 110 million tons | 1.00 | 0.99 | 0.98 | 0.97 | 0.96 | 0.95 | 0.94 |
| Indirect man-hours needed for a 20 million ton shipment gain | | | | | | - | <u>0.60</u> |
| Total man-hours per ton shipped: At 110 million tons | 9.00 | | | | | | 7.70 ^d |
| At 130 million tons | | | | | | | |

^dCalculated as follows:

| | <u>Steel Shipments (million tons)</u> | | <u>M. H. per Ton Shipped</u> | | <u>Total Man-Hours (millions)</u> |
|------------------|---|---|----------------------------------|---|---|
| Direct workers | 110 | x | 7.53 | = | 828 |
| | <u>20</u> | x | <u>3.00</u> | = | <u>60</u> |
| (A) | 130 | | 6.82* | | 886 |
| Indirect workers | 110 | x | 0.94 | = | 103 |
| | <u>20</u> | x | <u>.60</u> | = | <u>12</u> |
| (B) | 130 | | <u>0.88</u> | | <u>115</u> |
| | <u> </u> | | <u> </u> | | <u> </u> |
| Totals (A) + (B) | | | 7.70 | | 1001 |

*Derived by dividing man-hours by tons.

