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Walter Adams
Michigan State University

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Import Restraints and Industrial Performance: The Dilemma of Protectionism

WALTER ADAMS

With the internationalization of markets and the progressive liberalization of world trade, the threat of foreign competition has revived the age-old cry for protectionism: to protect the nation's balance of payments, to protect domestic labor from import-induced unemployment, and to protect domestic industry from the unfair competition of low wage countries. These arguments are particularly appealing in times of recession, and political office seekers are not loath to embrace them, especially in election years.

For an industry constrained to live in a free trade environment where it is striving for survival, profitability, and growth, foreign competition is a serious challenge. It is a disruptive force which undermines the market control of oligopolized industries and the cartel-like price maintenance schemes prevalent in many competitive industries. It causes instability by undermining "mutual dependence recognized," by promoting defection among cartel partners, and by encouraging entry. Foreign competition is the nemesis of orderly marketing and hence becomes a prime target for neomercantilist governments and the interest groups which manipulate them.

It is the thesis of this article that the remedies for the import problem—quotas, orderly marketing agreements, trigger price systems, and the like—do not provide adequate mechanisms for insuring acceptable industry performance or protecting the public interest. Instead of compelling—or even promoting—the kind of structural and behavioral changes which are imperative if an industry is to overcome its competitive infirmities, these protectionist devices, more often than not, are likely to have precisely the opposite effect, *i.e.*, to

Walter Adams is a Distinguished University Professor, professor of economics, and past president of Michigan State University. He was a member of the Attorney General's National Committee to study the Antitrust laws (1953-55). The author is indebted to Professor Joel B. Dirlam of the University of Rhode Island for his extensive collaboration in the preparation of this article.

perpetuate the very infirmities that caused the industry's plight to begin with. In short, an ailing organism is not prepared for the rigors of survival in nature by being privileged to live in the shelter of a hothouse.

THE UNITED STATES STEEL INDUSTRY: A CASE STUDY

The domestic steel industry has demanded protection from the steadily burgeoning import competition since the long steel strike of 1959, claiming at various times and in diverse forums that it has been victimized by dumping, unfair competition, and export subsidies.¹ A review of the industry's economic performance since World War II, and an assessment of the protection it has been accorded—first under the Voluntary Restraint Agreement (hereinafter VRA) of 1969 and later under the Trigger Price Mechanism (hereinafter TPM) of 1978—should underscore the difficulties of fashioning public policies designed to improve industrial performance through import restraints.

Performance: Price Escalation and Loss of Competitiveness

The persistent price escalation of steel prices during the 1950s was the primary cause of the industry's lackluster performance during the 1960s—resulting in the erosion of domestic markets by substitute materials and imports, the loss of export markets not tied to Agency for International Development (AID) control, and the decline in return on investment.

The facts on steel pricing are beyond question. According to the Council of Economic Advisers:

Steel prices played an important role in the general price increases of the 1950s. Between 1947 and 1951, the average increase in the price of basic steel products was 9 percent per year, twice the average increase of all wholesale prices. The unique behavior of steel prices was most pronounced in the mid-1950s. While the wholesale price index was falling an average of 0.9 percent annually from 1951 to 1955, the price index for steel was rising an average of 4.8 percent per year. From 1955 to 1958, steel prices were increasing 7.1 percent annually, or almost three times as fast as wholesale prices generally. No other major sector shows a similar record.²

During the 1960s, steel prices entered a relatively quiescent stage. The major factor in dampening the industry's enthusiasm for

marching in lockstep toward constantly higher price levels was the burgeoning of import competition. Thus, between January, 1960 and December, 1968, a period of nine years, the composite steel price index increased only 4.1 points, or 0.45 points per year. Starting in January, 1969, however, after the State Department had successfully persuaded the Europeans and Japanese to accept voluntary quotas on their sales to the United States (*i.e.*, to enter into an informal international steel cartel), imports were cut back drastically and the domestic steel prices resumed their pre-1960 climb.

The Nixon administration's price controls, in effect from August, 1971, to April, 1974, temporarily attenuated the steady climb of steel prices. But in 1974, spurred by a worldwide steel shortage, they resumed their long-run trend upward, rising 30 percent, as compared to 17 percent for all industrial commodities. In spite of its contention that it was living under a regime of *de facto* price controls, the record indicates the contrary. The *Wall Street Journal* reported:

The base price of hot-rolled sheet steel has climbed about 63% to the present \$283.50 a ton from its \$173.50 a ton level when government wage and price controls ended in April, 1974. A few days after the controls ended, the price was boosted 10% to \$191 a ton, and it was raised 15% to \$220 a ton in July, 1974. The base quote climbed 6.3% to \$234 a ton on Oct. 1, 1975.

The hot-rolled sheet base price was raised twice in 1976. The quote went up 6.4% to \$249 a ton on June 14 and was increased another 6.5% to \$265 a ton on Dec. 1. The 7% boost that took effect June 19 of this year brought the base price to its present \$283.50 a ton.³

The industry, it seemed, had once again returned to its traditional behavior model. The leaders again set prices "at full costs—fixed costs plus marginal costs—plus target rate of return, subject to certain limits."⁴ The followers again did what was expected of them. Inevitably, prices were characterized by uniformity and upward rigidity.

Performance: Technological Backwardness

The United States steel industry's performance on the technology front—like its rigid, inflationary price policy—served to reduce its international cost competitiveness and to make it vulnerable to import competition. The facts of the case document this finding.

The major steel inventions in recent years, including the basic oxygen furnace, continuous casting, and vacuum degassing, came from abroad. They were not made by the American steel giants.

In innovation, as in invention, the American steel giants seem to

lag, not lead their smaller domestic rivals and their foreign competitors. The oxygen furnace, for example, the only major technological breakthrough in basic steel making since the turn of the century, was invented and innovated by the miniscule Austrian steel industry in 1950. It was first installed in the United States in 1954 by a small company (McLouth) and not adopted by the steel giants until more than a decade later: United States Steel in December, 1963, Bethlehem in 1964, and Republic in 1965. As of September, 1963, the largest steel companies, operating more than 50 percent of basic steel capacity, had not installed a single basic oxygen furnace, whereas smaller companies, operating only 7 percent of the nation's steel capacity, accounted for almost half of the basic oxygen installations in the United States.⁵

Despite the fact that the new oxygen process entailed substantial operating cost as well as capital cost savings, the United States steel industry during the 1950s "bought 40 million tons of the wrong kind of capacity—the open-hearth furnace."⁶ As *Fortune* observed, much of this capacity "was obsolete when it was built," and the industry, by installing it, "prepared itself for dying."⁷ Or, as *Forbes* put it more mildly, "In the Fifties, the steel industry poured hundreds of millions of dollars into equipment that was already obsolete technologically—open-hearth furnaces."⁸ The technological blunder may have cost close to \$1 billion in "white elephant" facilities.

The belated adoption of continuous casting by the steel giants is a further illustration of their technological lethargy. Again, it was a small company (Roanoke Electric), with an annual capacity of 100,000 tons, that pioneered in introducing this European invention in the United States in 1962. Other small steel companies followed, so that by 1968, firms with roughly 3 percent of the nation's steel capacity accounted for 90 percent of continuous casting production in the United States.⁹

Even defenders of the American steel giants concede that it was the cold winds of competition rather than the sheltered atmosphere of protectionism that ultimately forced the domestic majors to belatedly follow the path of technological progress. Thus, Alan McAdams admits that by "1962 it appeared that the costs to United States producers for *not* innovating were significantly raised by actual and threatened competition from both domestic and foreign oxygen steel-makers."¹⁰ Competition, not protection, broke down the industry's habitual lethargy and resistance to change.

Even today, the United States steel industry seriously lags behind Japan in the adoption and use of the latest steel technology. Thus, according to the International Iron and Steel Institute, 81 percent of Japan's crude steel in 1976 was produced in efficient basic oxygen furnaces, compared with only 63 percent of United States output. By

contrast, higher-cost open-hearth furnaces accounted for 18 percent of United States crude steel production, but for only 0.5 percent in Japan. Moreover, 35 percent of Japanese steel was produced by the labor-saving continuous casting method, more than triple the 11 percent in the United States.¹¹ Also, as the *Wall Street Journal* reports, the Japanese appear to benefit from economies of scale by using giant blast furnaces to an extent unparalleled in the American steel industry.¹²

Performance: Profits

It is a truism that steel industry profits are intimately linked, not only with price increases that outpace cost increases, but with its ability to maintain high rates of capacity utilization. The steel study by the Council on Wage and Price Stability underscores this point. It finds that profit rates from the end of World War II through 1957 were good because of rapidly increasing prices and a high rate of capacity utilization. Between 1958 and 1972, the Council says, profits were poor because foreign competition prevented the industry from raising prices substantially and because the industry's market strategy—its refusal to cut prices to meet import competition—resulted in suboptimal levels of production. Only with the restriction of imports after 1969, the termination of government price controls in 1973, and an abnormally strong worldwide demand for steel in 1974 was the industry able to operate at near full capacity and, hence, earn higher profits.¹³

Under the circumstances, one obvious (and, to the industry, painless) way of increasing profits and cash flow is to restrain the most potent competitive force in domestic steel markets, *i.e.*, import competition, and thus prevent price erosion and maintain capacity utilization without a constant need to upgrade performance.

Import Restraints: Voluntary and Mandatory Quotas

The lesson was not lost on United States steel producers. Faced with what they viewed as a mounting flood of imports, and after filing unsuccessful countervailing duty and antidumping complaints, they shifted their protectionist efforts to the legislative and public relations front. This strategy eventually paid off with the signing of the Voluntary Restraint Agreement (hereinafter VRA) that went into effect on January 1, 1969.

Under the Agreement, annual steel imports from Japan and the European Community were limited to 5.8 million tons each, compared to their then current levels of 7.5 million and 7.3 million tons, respectively. The Agreement also provided for an annual growth of 5

percent in the allowable quotas. It was described approvingly by the Chairman of the powerful Ways and Means Committee of the United States House of Representatives as a "welcome and realistic step."

Within three years, the domestic industry found the VRA unsatisfactory; quotas had not been established, either for specific products or for individual exporting countries (other than Japan). Moreover, both the Japanese and Europeans claimed that fabricated structural steel and cold finished bars were not included in the VRA quotas, since the quotas were expressed in tonnage terms. Therefore, they rapidly expanded their shipments of stainless steel and other high-value products to the United States market—despite their promise to "try to maintain approximately the same product mix and pattern of distribution" as before the accord was signed. The effect of this upgrading in imports, combined with the inevitable increase in the price of imported steel, was that the total value of steel imports was as high in 1970 as in 1968 notwithstanding a 25 percent decline in the volume of imports during the same period.¹⁴

As a result, the three-year extension of the Agreement—announced by the White House on May 6, 1972—contained specific tonnage limitations on three categories of specialty steels (stainless, tool, and other alloys) and set the quotas at less than their 1971 import level. In addition, fabricated structural steel and cold-finished bars were specifically included in the Agreement. Also, the participants agreed to maintain their product mix and their customary geographic distribution pattern. Finally, a 2.5 percent (instead of the former 5 percent) annual increase in the allowable imports was to be applied to the global tonnage allocated to Japan and the EEC.

To enforce the extended VRA, the United States installed a monitoring system to be administered by Treasury and the Customs Service. The exporting countries not only had to agree among themselves to observe the VRA, but also had to set up machinery for the producers within each country to arrive at mutually satisfactory export quotas to the United States market. In other words, Japanese and European steel producers, under United States pressure, were obliged to set up cartels in order to arrange for their share of the United States market, and thus to engage in activity that is suspect, if not illegal, under the Treaty of Paris. More importantly, however, the connivance between the domestic industry, the State Department, and foreign steel producers to limit imports triggered an antitrust suit by Consumers Union which charged that the VRA constituted a *prima facie* conspiracy under the Sherman Act. While the Court eventually ruled only on the State Department's authority to insulate the agreement from the antitrust laws, it left little doubt that the foreign signatories to the pact could be held accountable for participation in any trade restraints. In any event, the decision was

clear enough to persuade all concerned that the VRA should not be renewed when it expired in May, 1975.¹⁵

After the passage of the Trade Act of 1974, the industry's pressure for action by the government—reinforced this time by the political influence of organized labor—was crowned with success in the stainless and specialty steel sector. The International Trade Commission ruled that the domestic firms were indeed injured by rising imports, and recommended to the President the imposition of quotas on four categories of specialty steel products.¹⁶

Stating that quotas are an inflexible and relatively undesirable remedy for the supposed injury, the President gave Japan, the EEC, and Sweden ninety days to enter into voluntary "orderly marketing agreements" with United States negotiators before approving the Commission's recommendation. Under the threat, the Japanese gave in, signing a VRA on the final day of the ultimatum. The other countries, however, spurned the proposed arrangement. Quotas were imposed, as threatened, with the Japanese benefiting and the EEC losing, as compared to the original Commission recommendations.¹⁷

At every stage of the proceeding, the political power of the steel industry was brought to bear on the decision makers. Senator Schweiker of Pennsylvania, admitting that he was unfamiliar with the relevant economic data, testified as an industry witness for the Specialty Steel Committee. Mr. I. W. Abel, president of the United Steel Workers, also testified as an industry witness. While the petition was still under consideration, Senator Ribicoff took the floor in Congress¹⁸ to excoriate the failure of the ITC, as evidenced in its negative decisions theretofore, to carry out the Congressional intent of the Trade Act of 1974. Moreover, after the ITC decision was announced, the president of Allegheny Ludlum Steel, the industry spokesman, "truculently" threatened to go to Congress to override the President if he did not approve the quotas recommended by the ITC,¹⁹ only to have his threat echoed by Senator Ribicoff as he presided over the Senate Finance Committee's oversight hearings on United States foreign trade policy. The chain of events was an object lesson in political economy.

What, then, were the economic consequences of the steel industry's maneuverings on behalf of import quotas? First, the succession of antidumping complaints, countervailing duty charges, mandatory quota threats, the VRA, and the import injury case (followed by a separate proceeding for the so-called round stainless steel wire industry) must have had a chilling effect on the intensity of import competition. Import sales were probably reduced simply to avoid the appearance of an excessive inflow during the period when remedies were being considered.

Second, there is hard evidence that the VRA has increased steel

prices and raised costs to American industry and consumers. Thus, according to one study, between January, 1960, and December, 1968, a period of nine years, the composite steel price index rose 4.1 points—or 0.45 points per year, indicating the moderating effects which surging imports had on domestic prices. In the four years between January, 1969, and December, 1972, while the VRA was in effect, the steel price index rose 26.7 points—or 6.67 per year. Put differently, steel prices increased at an annual rate fourteen times greater after the import quotas went into effect than in the nine years prior thereto.²⁰ Other studies have estimated the annual cost burden to the United States at between \$386 million and \$1 billion.²¹

Third, the use of quotas, or the threat of quotas, to moderate the intensity of competition from foreign steel has profound implications for the battle against inflation. While it may be difficult to specify the precise quantitative importance of steel in the wholesale price index, there can be little doubt that price increases in steel are used to justify concomitant price increases in a host of other products, particularly in the durable consumer goods industries.

Fourth, quotas are contagious, especially in times of weak demand, and are reminiscent of the “beggar-thy-neighbor” policies of the industrial nations during the Great Depression. Thus, while the United States imposed specialty steel quotas on the major exporting countries, the Europeans forced Japan to accept a “voluntary restraint” agreement on steel shipments into the EC. Japan “voluntarily” agreed to reduce steel exports to EC nations during 1976 by 23.8 percent from 1975 levels.²²

Import Restraints: The Trigger Price System

The most recent import relief accorded the United States steel industry was an outgrowth of the Solomon Report. A trigger price system,²³ administered by the Treasury Department, was a thinly veiled scheme to put a floor under the price of imported steel,²⁴ freeing the domestic industry to resume its price escalation tactics. The consequences were predictable.

First, the trigger price system, as its authors intended, resulted in an increase in steel prices. Inevitably, it also fueled the cost-push inflation which bedevils the United States economy.

Since the trigger prices were set at a level close to domestic list prices, they precipitated a two-pronged upward pressure on the price level: (a) importers could now raise prices that formerly reflected world market conditions to the higher level dictated by trigger prices; and (b) domestic producers could and did raise actual prices to at least the list price, thus wiping out the discounts from list prices which market conditions formerly compelled them to grant to their

customers. Furthermore, domestic producers, protected by the minimum prices established under the trigger price system, were now free to raise list prices so that they would be higher than import prices to at least the extent of the accustomed differential between domestic and foreign prices.

The quantitative impact was substantial. On December 7, 1977, one day after the concept of trigger pricing was announced by President Carter, a steel company executive stated that United States steel prices would be increased in the first quarter of 1978. Shortly thereafter, a 5.5 percent increase—reduced from an original 10.5 percent increase—in the domestic price of basic steel products was posted. This was followed by a further price rise of 1.1 percent in April, 1978.

On May 10, 1978, Treasury announced that it was raising trigger prices by 5.5 percent on sheet, plate, wire, and cold-finished bars; 13.9 percent on angles, 14 percent on reinforcing bars; and 14.5 percent on flat bars.²⁵ On August 2, Treasury raised the trigger prices by another 4.86 percent, effective October 1, 1978;²⁶ trigger price increases for calendar year 1978 totalled 10.6 percent.

While domestic steelmakers had raised their list prices by some 9.5 percent as of October 1, 1978, steel buyers report that the prices they actually had to pay increased by as much as 15 percent because, as the *Wall Street Journal* notes, “last fall’s widespread discounting has evaporated.”²⁷

Foreign producers are not displeased with these developments. Thus, M. Jacques Ferry, head of the Common Market’s steelmakers’ group, Eurofer, states: “We don’t have any problems [with the trigger price mechanism]. It has raised steel prices all around the world.”²⁸ Similarly, Nippon Steel Corporation’s president, Eishiro Saito, states that United States trigger prices—coupled with the EEC’s minimum prices under the Davignon Plan—“have gone a long way in improving the world steel market, as these pricing measures helped steelmakers everywhere to achieve better results (by) eliminating sales below costs previously practiced for some steel products.”²⁹

The inflationary impact on the United States economy is, of course, quite another matter. Considering only the original trigger prices announced by Treasury in January, 1978, the Federal Trade Commission, for instance, estimated the direct cost increase to steel consumers at \$1 billion.³⁰ An official of the Brookings Institute estimated that the direct price effect could be as much as \$1.25 billion.³¹ Kurt Orban, a steel importer and international expert on steel markets, found that the trigger price system had resulted in a veritable price explosion and estimated the increased steel costs to consumers at \$4 billion.³² Finally, if the domestic steel industry is to be believed in its claim that imports have caused transaction prices to be \$60 per

ton below list prices, then estimates of increased steel costs could range up to \$6 billion. (Note that all these estimates are based on the trigger prices of January, 1978, and do not, therefore, take account of their 10.63 percent increase since then.)

Second, the long-run implications of trigger pricing are even more foreboding. The publication and elaborate enforcement, under the guise of monitoring, of minimum steel prices, is one of the most efficient techniques for insuring concerted action among oligopolists conscious of their interdependence. Thus, John Shenefield, Assistant Attorney General in charge of the Antitrust Division, is currently calling attention to the role of press conferences on price changes, widely-publicized price announcements, and other techniques for keeping one's fellow oligopolists informed of prevailing prices and proposed changes, to insure parallel action.³³

The trigger pricing system carries this process one step further. It provides wholly reliable, government-certified, minimum price lists, subject to adjustment on a regular quarterly basis. Every domestic producer of wire rod, for example, will at all times know the minimum price at which this product can be imported and made available at every major port in the United States. Importers will be privy to the same information. To allow—or, in this case, virtually to compel—foreign steel producers to observe price floors on every major steel product carries *ad extremis* the very conduct which Mr. Shenefield finds in contravention of the antitrust laws. Through the intercession of government, interdependent oligopolists are therefore in a much better position to pursue a policy of price escalation than if they had to depend on private means to achieve that objective, and still remain within the strictures of the antitrust laws.

Third, most cartels break down because their members have a proclivity and incentive for cheating. A maverick cuts prices, expands his market share, and thus destroys the mutual trust on which the cartel, of necessity, is based. The trigger pricing system, especially when it is linked with a similar system enforced by the European Economic Community, achieves cartel goals without assigning market shares to its participants. By facilitating a framework of minimum import prices, it forecloses price competition as a means of winning new customers and hence insulates importer/customer relations from competition. Market shares will tend to change little, if at all. Most importantly, the bargaining and negotiating that in the past kept import prices flexible and forced the domestic firms to quote varying discounts below their list prices will have been effectively subverted. In brief, the trigger price mechanism, especially if it is to be supplemented by import quotas, is a long step toward the reconstitution of the old, interwar steel cartel.

Finally, we should note one further impact of the trigger price

mechanism, *viz.*, the impact on independent, nonintegrated wire drawers and fabricators. In the wire segment of the industry, for example, independent nonintegrated wire drawers are obliged to purchase wire rod (their raw material) at trigger price minima while facing competition in the sale of wire products at price levels prevailing in a free, unsupported market. Further, to the extent that foreign producers of wire products can purchase wire rod abroad at lower prices, they can produce and sell wire products in their home market and in the United States at a fair value that may be lower than profitable sales prices or cost of production of domestic wire producers. Thus, the independent, nonintegrated wire producers of the United States are inevitably caught in a squeeze imposed by the integrated mills at home and their rivals abroad.³⁴

Treasury does not dispute the existence of the squeeze on independent nonintegrated wire drawers and fabricators resulting from its imposition of the trigger price mechanism. Indeed, it insists that the Antidumping Act—as administered under this mechanism—does

not prevent a foreign producer of merchandise such as barbed wire from acquiring rod at low prices and fabricating that rod into wire that is sold at correspondingly low prices in both its home and export markets. In that situation, the producer is using savings in one factor of production no less proper than savings it may achieve in labor costs or energy expenses. The Antidumping Act is not aimed at preventing foreign producers from relying on savings in their production costs; it only seeks to prevent price discrimination in the sale of merchandise.³⁵

Treasury further maintains that:

[t]o the extent that the independent producers of wire products face competition from foreign and domestic rod suppliers who also use some of their rod to make wire products—and, thus, compete with their own customers—that problem is also beyond the reach of the Antidumping Act. No provision of that law prevents a supplier of a product, such as a rod, from setting high sales prices for that product, even though it also sells articles it makes therefrom, such as wire products, at relatively low prices to the disadvantage of its rod customers. To the extent such competition comes from domestic firms, the Antidumping Act cannot be applied at all; to the extent it comes from foreign companies, only to the extent that the wire product prices are below their own “fair value” can the Act apply. But in that setting, the foreign wire maker’s sales prices for rods are not relevant.³⁶

Treasury admits that its administration of the trigger price mechanism will squeeze the nonintegrated fabricators—both by the domestic integrated mills and foreign wire and wire products producers. At the same time, Treasury disclaims responsibility for this result. It takes the position that there is no relief for the nonintegrated fabricators under the Antidumping Act, when in fact it is Treasury's administration of that Act through the trigger price mechanism which has caused the very injury to which the fabricators are subjected. Not only does Treasury's posture represent an abdication of responsibility for promoting the public interest, but it ignores the vital competitive role played by nonintegrated fabricators in what would otherwise be a rigid, vertically integrated oligopoly market.³⁷

Import Restraints: Pending Proposals

Regulation breeds regulation; some protection leads to demands for more protection, and eventually ends up with demands for total protection. Steel imports are no exception to this rule.

Thus, Lewis Foy, chairman of the Bethlehem Steel Corp. and president of the American Iron and Steel Institute, is threatening to file a major antidumping complaint against European steelmakers, unless Treasury acts to curb imports (which in July, 1978, captured 19 percent of the United States market as compared to 18 percent in the same month a year earlier).³⁸ The industry, according to the *Wall Street Journal*, "just wants to keep the pressure on" in the hope of obtaining favorable revisions of the trigger price system from Treasury.³⁹ What the steel lobby wants is a new set of trigger prices based on European costs rather than on the lower Japanese costs.

Further, the United States industry, as might be expected from a study of cartel history, and judging by rumors current in industry circles, will almost inevitably have to demand an imposition of quantitative import restrictions to supplement the artificially high prices mandated by the trigger price mechanism. The reason is obvious. As the rising value of the yen pushes up the trigger prices based on Japanese costs, more and more steel exporters find sales in the American market increasingly remunerative which, in turn, induces them to raise their export volume to the United States market. Without more, high prices induce an increase in supply which must be restricted if the artificial price level is to be effectively maintained. Import quotas, therefore, become an indispensable supplement to trigger prices. And the higher the trigger prices, the greater the need for such quotas.

Even quotas, however, are not the final step in this evolving scenario. Import quotas may be "necessary to prevent severe continuing damage to the American steel industry,"⁴⁰ but they are no more than

the first element of the industry's proposed, two-step "safeguard" system.⁴¹ The second element is a permanent, worldwide, mandatory, multilateral orderly marketing agreement for steel products.⁴² Stripped of euphemism, this means, as the *Wall Street Journal* noted, that the industry is really "angling for world-wide market rigging and price fixing along the lines of the international textile agreement."⁴³ It would mean comprehensive regulation of world steel markets by a cartel organized with the succor, and operated under the aegis of governmental authorities.

Summary

In light of the steel industry's performance since World War II, and the import relief it has been periodically accorded, the fundamental questions about the link between import restraints and improved performance remain. Are trigger prices, import quotas, or orderly marketing agreements likely to provide the necessary spur for technological progressiveness? Will they assure the badly needed modernization of the industry's anachronistic facilities? Will they provide the competitive discipline to curb the industry's proclivity for constant price escalation? Will they provide the government, in exchange for protection, the ability to exact "good performance" as a *quid pro quo* for the abandonment of competitive markets? In sum, as long as the industry can reasonably count on periodic government bailouts to avoid the consequences of its own conduct, does it have the incentive to perform at levels which, given the compulsions of competition, it would have to attain in order to survive? In light of the steel industry's record, these questions hardly survive the asking.

SOME PUBLIC POLICY CONCLUSIONS

Steel, of course, is not the only industry where deficient performance rather than imports is the basic explanation for "injury" or "probable injury," and where import restraints are not the appropriate remedy if improved economic performance is the goal.

In the automobile dumping case,⁴⁴ for example, the complaint filed by the United Automobile Workers charged that the increased market share of imported automobiles—up from 15.2 percent in 1970 to 15.9 percent in 1974 to 20.3 percent in the first half of 1975—was "at the expense of domestic sales"; that, discounting the effects of the United States recession, there was still a loss of domestic sales to imports; and that the pricing of imported cars *caused* the resulting injury to the American automobile industry and its workers. The union demanded the imposition of dumping penalties and simultaneously

asked Congress for quota protection against the import of compacts and subcompacts from Europe and Japan.

The complaint was dismissed "provisionally," after extended and bizarre maneuvering by various instrumentalities of the administrative bureaucracy.⁴⁵ It was eventually settled when foreign producers, at the insistence of United States government authorities, agreed to raise their prices in the United States market.

To a disinterested observer it is apparent that such injury as the industry suffered was not caused by imports, but rather deficient performance. First, a primary factor explaining the industry's travails—one that requires no elaboration—was the national recession which drastically reduced the demand for virtually all consumer durables, including automobiles.

Second, the success of the imports was partly attributable to the delayed response by United States car manufacturers to a shift in consumer demand toward smaller, more fuel-efficient models. As of January, 1975, according to the Council on Wage and Price Stability, no domestic cars obtained twenty miles per gallon or more in the EPA city driving test, whereas fifteen of nineteen foreign compacts and subcompacts obtained twenty miles per gallon or better. In the highway driving test, no United States compact or subcompact car had a mileage rating of over thirty miles per gallon whereas fourteen of nineteen foreign makes did.⁴⁶

Third, while foreign producers liquidated their large inventories of 1974 models at 1974 prices well into 1975, United States manufacturers posted price increases of roughly 12 percent on their 1975 models which went on sale in the autumn of 1974. This perverse pricing policy by United States producers in the face of a deepening recession, combined with the realistic market-oriented price policy of their foreign competitors, was an additional factor explaining the dramatic market penetration of the imports.

Fourth, the fact that imported compacts and subcompacts offered consumers a far wider range of price alternatives compared to their United States counterparts, may also have given imports a competitive edge over domestic models.

In any event, as the Council on Wage and Price Stability told the International Trade Commission (hereinafter the ITC), the most important factors explaining the increased market share of foreign automobiles "are the pricing policies of domestic producers and the inability of domestic manufacturers to respond rapidly to changing market conditions."⁴⁷ The Council warned the ITC that the imposition of special dumping penalties

would likely result in an immediate increase in the price of automobiles to the American consumer. Moreover, such penalties,

or even the threat of penalties, could substantially check what has been perhaps the single most effective spur to competition in this highly concentrated industry. This, in turn, could lead to less competitive prices and a reduced level of innovation.⁴⁸

One can only speculate on what might have been, if either dumping penalties or import quotas had been ordered. Would this have intensified the sensitivity of the domestic industry to the vagaries of consumer tastes? Would it have given the lusty automobile oligopoly (which cast itself in the role of an infant industry) the needed respite to adjust to foreign competition without long-term protection? Would it have accelerated the introduction of revolutionary engines or the development of radically new body designs? Would it have spurred investments in United States plants by foreign manufacturers, or discouraged the expansion by United States multinationals in their foreign affiliates? What would have been the effect on X-efficiency and on the industry's traditional pricing policy? Neither a *savantsans-culottes* nor an expert armed with computer models and multiple regressions would dare offer a definitive response.

Clearly, the problem of assessing quota-performance links is complex, if not insoluble. As United States experience with the so-called independent regulatory commissions demonstrates, an administrative agency, in the absence of competitive yardsticks, does not know what constitutes "good" performance; nor does it know how performance could be improved by changing an industry's structure. Most important, even if it did, the agency would lack the regulatory arsenal to exact "good" performance as a *quid pro quo* for protection from competition.

It is a truism that once competition has been abandoned, or significantly crippled—and this is a necessary consequence of import quotas—some surrogate for the competitive process must be devised to assure acceptable performance and to induce progressive performance. Otherwise, the restrictions imposed would not only be injurious to consumers and detract from the general welfare, but would also fail to accomplish their only justifiable goal, *i.e.*, to give temporary protection to an infant industry.

It would seem, and here again the United States experience with regulation is enlightening, that there are only two systems of industrial organization, each with inherent shortcomings, which might be effective substitutes for competitive controls. One alternative is pervasive, dictatorial regulation, with an elaborate mechanism of rewards and penalties, reaching down to the management level, utilizing the most advanced techniques of management science, and capable of simulating the crucial elements of competitive structure and behavior. The cost of such regulation, not only directly, but in terms of

stifling entrepreneurial initiative, may suffice to condemn it. Another alternative is government ownership, again with the appropriate complement of efficiency-compelling and progress-inducing directives. In some circumstances, this solution appears to economize resources as compared to "effective" regulation. However, when the industry in question is not a natural monopoly, both regulation and nationalization (as Oscar Lange recognized long ago) almost inevitably tend to introduce bureaucratic rigidities and inefficiencies whose intensity will increase with the extent and detail of control.

One is driven to the conclusion, therefore, that import restrictions are to be embraced, if at all, only within a framework of comprehensive control, so that "good" performance is not jeopardized by the attenuation of competition and its disciplinary incentives.

NOTES

1. Prior to 1958, annual steel imports remained below the 2-million-ton level (except in 1951, a Korean War year, when 2.18 million tons were brought in). From 1959 on, imports steadily increased, reaching a total of 6.4 million tons in 1964, 10.8 million tons in 1966, and a high of slightly less than 18 million tons in 1968—the last year before "voluntary" quotas went into effect.
2. U.S. COUNCIL OF ECONOMIC ADVISERS, REPORT TO THE PRESIDENT ON STEEL PRICES 8–9 (1965).
3. *Antitrust Unit Studies Possible Steel Price Fixing*, Wall St. J., July 14, 1977, at 3, col. 1.
4. U.S. COUNCIL ON WAGE AND PRICE STABILITY, STAFF REPORT, A STUDY OF STEEL PRICES 1 (1975). In defense of the steel industry's pricing practices, it is sometimes argued that list prices may be characterized by upward rigidity, but that transaction prices fluctuate with the vagaries of market demand. Prior to the mid-1970s, there is little empirical evidence to support that claim. As George J. Stigler and J.K. Kindahl found in their comprehensive study, the quoted and transaction prices of steel products move together so closely that a description of one is a description of the other. . . . This finding, it must be confessed, comes as a surprise to us. The steel industry is now unconcentrated as compared with the first decade of the century, or indeed as compared with many other industries in our sample. Import competition was growing fairly steadily during the period. With the exception of three steel products, however, we were not able to learn of any important and continuous departures from quoted prices. The exceptions were reinforcing bars (where we saw, but could not obtain, records of extensive short-run price fluctuations), pipe, and stainless

- steel products. One encounters minor incidents of price cutting such as quantity discounts granted on small orders and the supply of qualities somewhat better than minimum specifications. Nevertheless, the general picture was one of close adherence to quoted prices even for very large buyers of steel. J. STIGLER & J. KINDAHL, *THE BEHAVIOR OF INDUSTRIAL PRICES* 72-74 (1970).
5. Adams and Dirlam, *Big Steel, Invention, & Innovation*, 80 Q. J. ECON. 167, 182-84 (1966).
 6. *Why Steelmakers Raise the Ante*, BUS. WEEK, Nov. 16, 1963, at 144, 144-46.
 7. McDonald, *Steel is Rebuilding for a New Era*, FORTUNE, October, 1966, at 130, 135.
 8. *Operation Catch-Up*, FORBES, Mar. 1, 1967, at 23.
 9. W. ADAMS, *THE STRUCTURE OF AMERICAN INDUSTRY* 119 (5th ed. 1977).
 10. McAdams, *Big Steel, Invention, and Innovation Reconsidered*, 81 Q. J. ECON. 457, 472 (1967).
 11. As reported in *Aging Mills*, Wall St. J., Aug. 3, 1978, at 1, col. 6.
 12. *Id.*
 13. COUNCIL ON WAGE AND PRICE STABILITY REPORT, *supra* note 4, at 17.
 14. L. WEISS, *CASE STUDIES IN AMERICAN INDUSTRY* 193 (2d ed. 1971).
 15. Consumers Union of U.S. Inc. v. Rogers, 352 F. Supp. 1319 (D.D.C. 1973), *aff'd sub nom.* Consumers Union of U.S. Inc. v. Kissinger, 506 F.2d 136 (D.C. Cir. 1974), *cert. denied*, 421 U.S. 1004 (1975).
 16. *Stainless Steel and Alloy Tool Steel*, TA201-5, USITC Publ. 756 (1976).
 17. See 41 Fed. Reg. 11,269, 24,101 (1976).
 18. 121 CONG. REC. 538, 862 (1975).
 19. At a press conference shortly after the ITC decision, a journalist asked Mr. Richard P. Simmons, president of Allegheny-Ludlum Steel, about prices: "If the President imposes quotas to protect his industry from foreign competition, would Mr. Simmons support wage and price controls to protect consumers from his industry?" Mr. Simmons replied that he opposes wage and price controls, and that he puts his faith in the free market. But, as the *Washington Post* said in an editorial comment. "A country under import quotas is not everybody's idea of a free market." (Mar. 8, 1976, § A, at 18.)
 20. *Cited in* COMPTROLLER GENERAL OF THE UNITED STATES, *ECONOMIC AND FOREIGN POLICY EFFECTS OF VOLUNTARY RESTRAINT AGREEMENTS ON TEXTILES AND STEEL*, REPORT B-179342 at 23 (1974). See also Richard Fanara, University of Rhode Island (unpublished study).
 21. Magee, *The Welfare Effects of Restrictions on U.S. Trade*, BROOKINGS PAPERS 645-701 (1972) (\$386 million); COMPTROLLER GENERAL, *supra* note 20, at 23 (up to \$1 billion).
 22. A steel industry spokesman pointed out that Japan's steel exports during 1975 were approximately 1,600,000 tons; the agreement limited Japanese

- producers to 1,220,000 tons between them. OVERSIGHT HEARINGS ON U.S. FOREIGN TRADE POLICY BEFORE THE SEN. COMM. ON FINANCE, 94th Cong., 2d Sess. 171 (1976) (prepared statement of R. Heath Larry, vice chmn., Trade Committee, American Iron and Steel Institute).
23. 42 Fed. Reg. 65,214 (1977); 43 Fed. Reg. 1,964 (1978).
 24. While Treasury claims that trigger prices are not minimum prices, it admits that "most foreign producers have raised their prices to the trigger price level to avoid an anti-dumping investigation which could result in antidumping duties equal to or greater than the difference between their export prices and the trigger prices." Treasury considers this a "voluntary decision" on the part of foreign producers and finds it "understandable" and "reasonable" (Treasury Findings, *infra* note 34, at 30). In other words, Treasury concedes that, irrespective of an exporter's legal rights to sell at lower prices, the trigger prices as a matter of practical reality are in fact minimum prices.
 25. 43 Fed. Reg. 20,020 (1978).
 26. 43 Fed. Reg. 33,993 (1978).
 27. *Tarnished Shield: Steel Companies are Irvked with Trigger-Price Plan*, Wall St. J., Sept. 26, 1978, at 1, col. 1.
 28. Quoted in *Treasury Official Says U.S. May Initiate an Inquiry Into Cut Rate Steel Imports*, Wall St. J., Oct. 3, 1978, at 2, col. 3.
 29. *Id.*
 30. U.S. FEDERAL TRADE COMMISSION, *THE UNITED STATES STEEL INDUSTRY AND ITS INTERNATIONAL RIVALS* 559-65 (1977).
 31. Wall St. J., *supra* note 27.
 32. American Metal Market, Mar. 29, 1978. (Mr. Orban is one of the largest steel importers in the United States and is president of the American Institute for Imported Steel in New York City.)
 33. Remarks before the Financial Analysts Federation, June 29, 1977 (mimeo); *Block the Press Conference*, FORBES, Feb. 20, 1978, at 31.
 34. Findings of the Department of Treasury with Regard to the Coverage of Wire Rod, Wire and Wire Products under the Trigger Price Mechanism, at 21 (April 13, 1978).
 35. *Id.* at 22.
 36. *Id.* at 23-24.
 37. See, e.g., Adams & Dirlam, *Steel Imports and Vertical Oligopoly Power*, 54 AMER. ECON. REV. 626 (1964).
 38. Wall St. J., *supra* note 27, at 19, col. 1.
 39. *Id.*
 40. Statement by Thomas C. Graham, quoted in *Steel Industry Trade Group Urges Quotas on U.S. Imports of Carbon Steel Products*, Wall St. J., Jul. 5, 1977, at 8, col. 2.
 41. Petition of the Tool and Stainless Steel Industry Committee for Import Relief, Investigation No. TA-201-5, at 36 (1975).
 42. *Id.* The remedy section of this petition sets forth a detailed draft of the proposed "Multilateral Specialty Steel Arrangement" (at 42-70) which is reminiscent of the constitution of the pre-World War II

- international steel cartel. (E. HEXNER, *THE INTERNATIONAL STEEL CARTEL* (1943)).
43. *Steel's Trauma*, Wall St. J., June 20, 1977, at 14, col. 1.
44. New, On-the-Highway, Four-Wheeled, Passenger Automobiles from Belgium, Canada, France, Italy, Sweden, the United Kingdom, and West Germany. AA1921-Inq.-2 USITC Publ. 739 (1975).
45. For a detailed discussion of the factors involved, see Comments of the Staff of the Council on Wage and Price Stability, submitted to the ITC during its investigation.
46. *Id.*
47. *Id.*
48. *Id.*