COMMITTEE TO UNLEASH PROSPERITY

July 2024

The Nippon Steel Acquisition of U.S. Steel Corporation Can Save America's Steel Industry

By Stephen Moore and Phil Kerpen

Stephen Moore

Chairman and Co-Founder of the Committee to Unleash Prosperity

Philip G. Kerpen

President of the Committee to Unleash Prosperity
Founder of American Commitment

Introduction

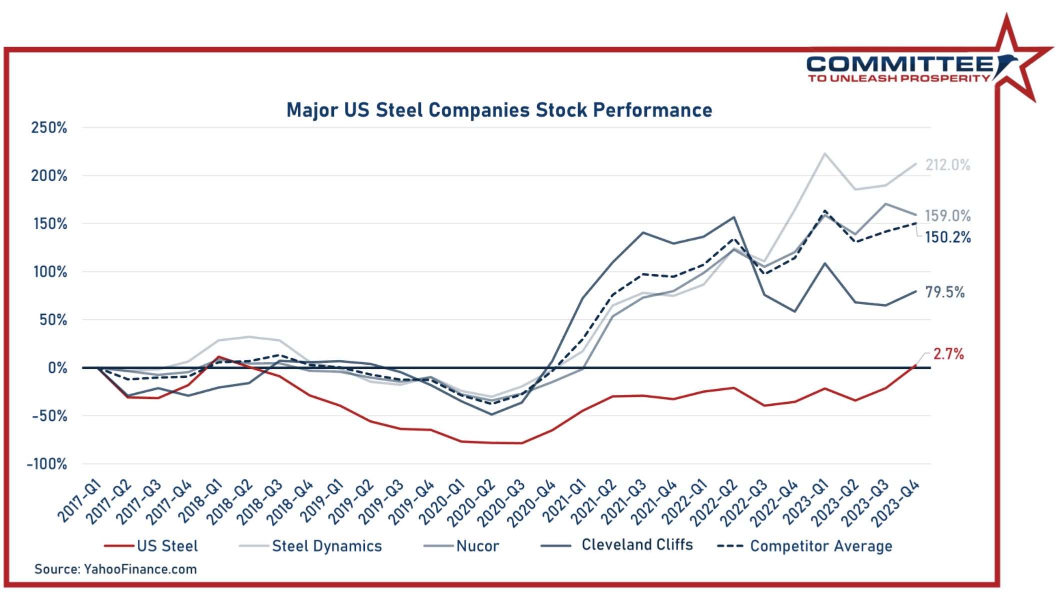
This study finds that Nippon Steel's offer to acquire U.S. Steel is an economic win for the U.S. manufacturing industry and the U.S. economy more broadly. American workers and shareholders benefit enormously from the $300 billion of new annual foreign investment in the United States. It is a global market sign of confidence in the American economy.

Yet this clear case of "friendshoring" between Japan and the U.S., has been met by leaders from both sides of the political aisle citing concerns over national defense, employment in the steel industry, and the future of American manufacturing.

The following analysis demonstrates that the acquisition of U.S. Steel by Nippon Steel Corporation is economically beneficial to American workers, Shareholders, and the future of steel production in the United States. The alternatives of tariffs, import quotas, subsidies and government support for the unions are far inferior from an economic and national security perspective. The Japanese investment in U.S. Steel could save the domestic steel industry.

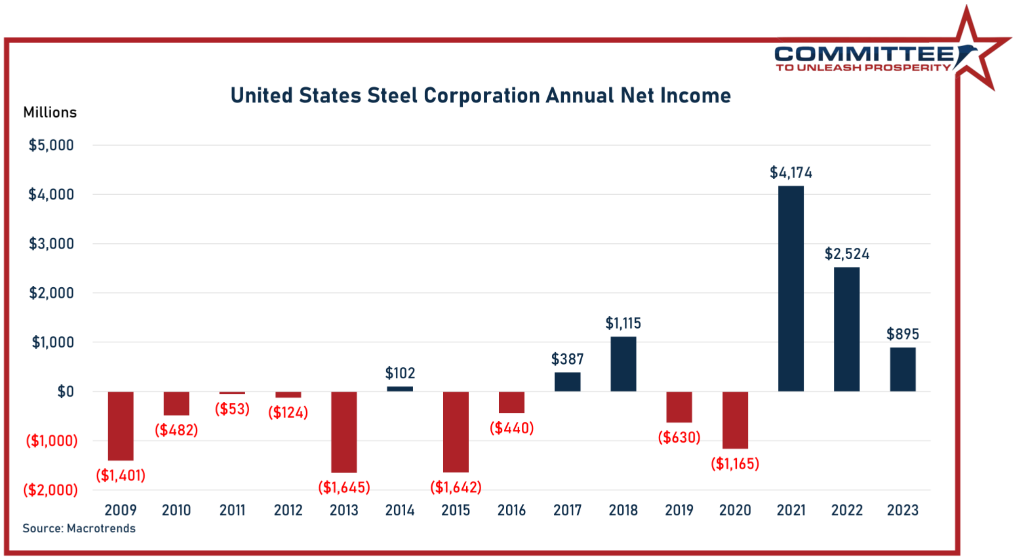
Background

Founded in 1901 by Andrew Carnegie, J.P. Morgan, and Charles Schwab, the United States Steel Corporation has stood for over a century as an icon of the U.S. manufacturing industry, producing the steel for notable American landmarks including San Francisco-Oakland Bay Bridge, the Willis Tower and Hancock Tower in Chicago, and the New Orleans Superdome. In the early 1900's, U.S. Steel reached its zenith, claiming the illustrious title of the first company in the world to achieve a market capitalization of over $1 billion and the producer of over two thirds of all steel in the United States at the time.[1]



1 https://www.engineering.com/story/the-long-strange-history-of-u-s-steel

Far from the global corporate power it once was, U.S. Steel isn't even in the top 1,500 most valuable companies in the world today.[2] And domestically, it is by far the weakest of the major steel producers. From the start of 2017 through the end of 2023, U.S. Steel saw less than a three percent increase in value while its competitors in the steel industry achieved an average of a 150% gain during the same time period.[3] In fact, at it's low in 2020, U.S. Steel was worth less than it was at its founding in 1901.[4]



U.S. Steel has shown a consistent trend of faltering profitability, achieving positive net income in only six of the last fifteen years of operation. U.S. Steel's position in the market made it a prime target for takeover, which happened last August when Cleveland-Cliffs made a low-ball acquisition bid, initiating a bidding process.

After rejecting an offer of $7.3 billion (with half in cash and half in stock) from industry rival Cleveland-Cliffs, U.S. Steel accepted a $14.1 billion all-cash offer from Japan's Nippon Steel. As a part of the deal, the Japanese steel producer also assumes approximately $800 million of U.S. Steel's debt obligations, bringing the total acquisition cost to $14.9 billion. This offer represented a 142% premium on the stock price of U.S. Steel on August 11, 2023, just prior to Cleveland-Cliffs initial offer.

Following the announcement of the deal, markets signaled stockholders' overwhelming approval of the deal, driving U.S. Steel's stock up by 26%. Even Cleveland-Cliffs saw its shares climb 10%, as investors reacted positively to the company's impending stock buybacks in lieu of the purchase of U.S. Steel.

2 https://companiesmarketcap.com/us-steel/marketcap/#:~:text=Year%2C%202024%2C%202023%2C%202022%2C%202021%2C%20Market%20cap%2C,$6.43%20B%2C%20Change%2C%20%2D16.4%%2C%2084.98%%2C%20%2D8.79-%%2C%2074.08%%2C

3 https://www.trade.gov/data-visualization/us-steel-executive-summary#:~:text=According%20to%20data%20from%20CRU,-metric%20tons%20in%20November%202023

4 https://www.engineering.com/story/the-long-strange-history-of-u-s-steel

Beyond the beneficial financial aspects of Nippon Steel's offer, the company has also made a number of commitments to U.S. Steel and its workers to sweeten the deal. The company has pledged to maintain the current agreement with United Steelworkers (USW) and invest an additional $1.4 billion in U.S. Steel - a 140% increase from the current agreement.[5] Nippon Steel has also announced its intention to move its U.S. headquarters from Houston to Pittsburgh, where U.S. Steel is based.[6] To assuage the fears of the more nostalgic naysayers, the Japanese steel producer has also committed to maintaining the iconic name of U.S. Steel. From every perspective, the Nippon Steel offer is a win for shareholders, workers, and the U.S. steel industry.

Populist Political and Union Opposition

Despite its strong net benefits to U.S. Steel shareholders and workers alike, the Nippon Steel offer has been met with a bipartisan populist backlash from both sides of the political aisle.[7] Donald Trump blasted the deal after a meeting with the president of the Teamsters labor union in January, stating, "I would block it instantaneously, absolutely. We saved the steel industry. Now, U.S. Steel is being bought by Japan. So terrible." Trump has softened his opposition somewhat, but now Joe Biden has voiced opposition:

"It is important that we maintain strong American steel companies powered by American steel workers. I told our steel workers I have their backs, and I meant it," he said back in March. "U.S. Steel has been an iconic American steel company for more than a century, and it is vital for it to remain an American steel company that is domestically owned and operated." Markets immediately showed their disappointment in the president's opposition to the deal, plunging U.S. Steel stock down 15%.

The misguided sentiments of the two front runners in the 2024 presidential race have been loudly echoed by other political voices as well. Democratic Senator John Fetterman of Pennsylvania, vowed to use every resource available to him to "block this foreign sale." Republican Senator JD Vance of Ohio, also promised to thoroughly examine the deal for any potential risks the deal poses to "security, industry, and workers" of the United States. In mid-April, Vance over-delivered on his promise, sending a public letter to the SEC claiming that the U.S. Steel CEO and board violated Rule 14a-9 by failing to convey to its shareholders "... the significant political obstacles and regulatory risks the merger faces".[8] Oddly, Vance fails to mention in the letter that he is one of the primary instigators of the political opposition trying to kill the deal.

More recently, Senators Josh Hawley (R-Mo.), JD Vance (R-Ohio), and Marco Rubio (R-Fla.) sent a letter to President Biden venting their frustration with his statements on the deal, that as they claim, "amount to

5 https://www.argusmedia.com/en/news-and-insights/latest-market-news/2548224-japan-s-nippon-steel-committed-to-pursuit-of-us-steel

6 https://www.reuters.com/markets/deals/nippon-steel-pledges-move-us-hq-us-steels-pittsburgh-2024-03-19/

7 https://finance.yahoo.com/news/how-both-biden-and-trump-got-to-no-on-the-us-steel-nippon-merger-155231776.html

8 https://www.vance.senate.gov/press-releases/senator-vance-alleges-u-s-steel-board-misled-shareholders-ahead-of-nippon-buyout-vote/

wishes, not declarations, and belie your authority as President of the United States."[9] They demand that the president invoke emergency executive authority to unilaterally block the sale of U.S. Steel under the Defense Production Act or the International Emergency Economic Powers Act. These executive powers are reserved for only the most dire national emergencies. Claiming that the sale of U.S. Steel to a private company, headquartered in a close international ally constitutes a national emergency would be a gross misuse of executive powers, setting a dangerous precedent that could jeopardize all future foreign direct investment. Moreover, the existence of these authorities undermines the senators' national security argument and mitigates in favor of allowing shareholders to approve the transaction – because in the unlikely event that the U.S. entered into hostilities with Japan such authorities could be appropriately invoked.

United Steelworkers, the labor union representing U.S. Steel workers, has also voiced opposition to Nippon Steel, instead favoring the far less financially enticing offer from Cleveland-Cliffs due to its stronger union alliance. This opposition comes despite Nippon Steel's explicit commitment that, "All of U.S. Steel's commitments with its employees, including all collective bargaining agreements in place with its union, will be honored." Additionally, Nippon Steel's promise to infuse U.S. Steel with $1.4 billion in capital can only benefit union workers with better equipment, higher wages, and safer working conditions.

Perhaps the most nefarious opposition has come from industry competitor, Cleveland-Cliffs.1.[10] Following President Biden's statement opposing the deal, Cleveland-Cliffs' CEO, Lourenco Goncalves, touted his rent seeking relationship with the president, stating, "I'm not surprised. We have been in total contact with the administration so I know what's going on." He further elaborated that, "The contact is about making it abundantly clear between me and [United Steelworkers union president] Dave McCall that the only buyer the union accepts for the union-represented assets is Cleveland-Cliffs." Such blatant cronyism might have once been whispered in hushed tones behind closed doors, but to proudly state it to the media is all the evidence necessary for an objective observer to acknowledge the unsavory influence of special interests pressuring the levers of political power to decide the winners and losers of this deal.

9 https://www.hawley.senate.gov/sites/default/files/2024-05/Hawley-Letter-to-Biden-re-Nippon-Steel-Takeover.pdf

10 https://www.wsj.com/articles/cleveland-cliffs-lourenco-goncalves-joe-biden-u-s-steel-nippon-steel-a2c4c7d1?mod=WTRN_pos2&cx_testId=3&cx_testVariant=cx_166&cx_artPos=1

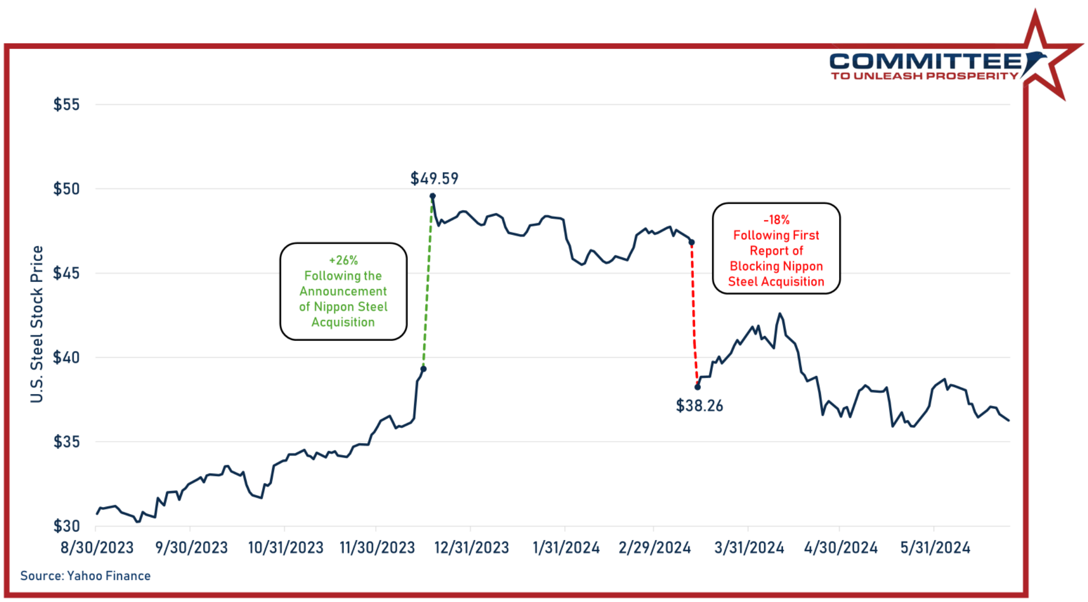
Benefits of the Nippon Steel Deal

In reality, almost all parties - except for Nippon/U.S. Steel's competitors - are losers if this deal is banned.

American Shareholders Benefit from the Merger

At a 40% premium to the value of U.S. Steel prior to Nippon Steel's offer (Dec. 15 2023), shareholders stand to lose at least $4 billion if the deal fails to go through. If U.S. Steel is muscled into accepting Cleveland-Cliffs paltry $7.3 billion offer, this loss rises to an astounding $6.8 billion. This doesn't even account for the loss of the additional $1.4 billion in capital that Nippon Steel plans to put to work to improve U.S. Steel's technology and production.[11] To help put the magnitude of this added investment in perspective, this is approximately the equivalent of transferring an additional $64,211 of Japanese capital to each of the 21,803 employees that currently work at U.S. Steel.

The chart below shows how the market valuation rose with the announcement of the deal and has fallen as Trump and Biden have promised to kill the deal.

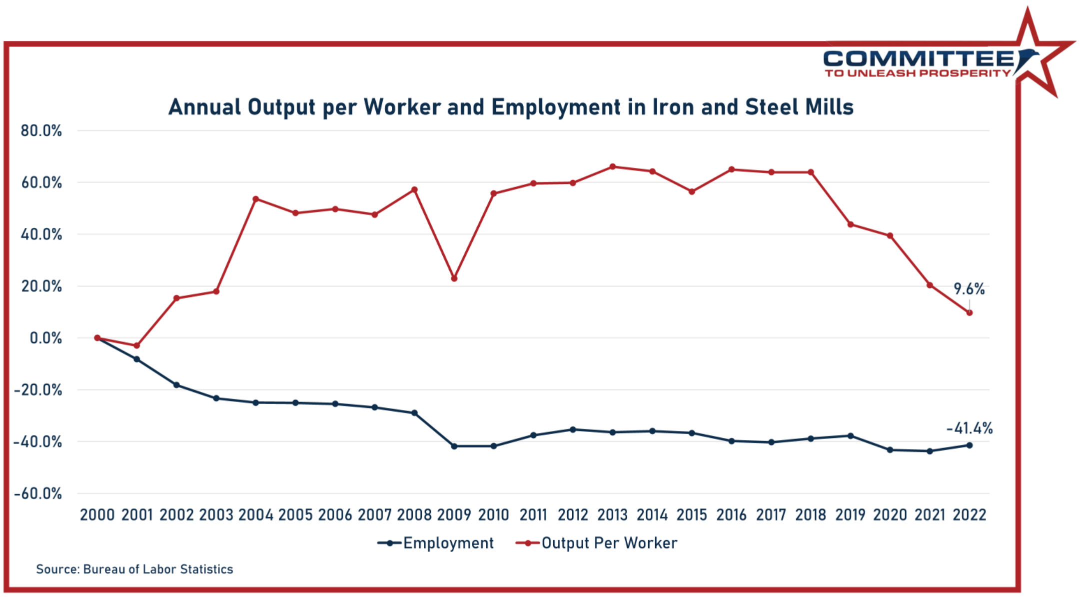


11 https://www.heritage.org/markets-and-finance/commentary/nippon-acquisition-us-steel

The Merger Can Save Our Domestic Steel Industry

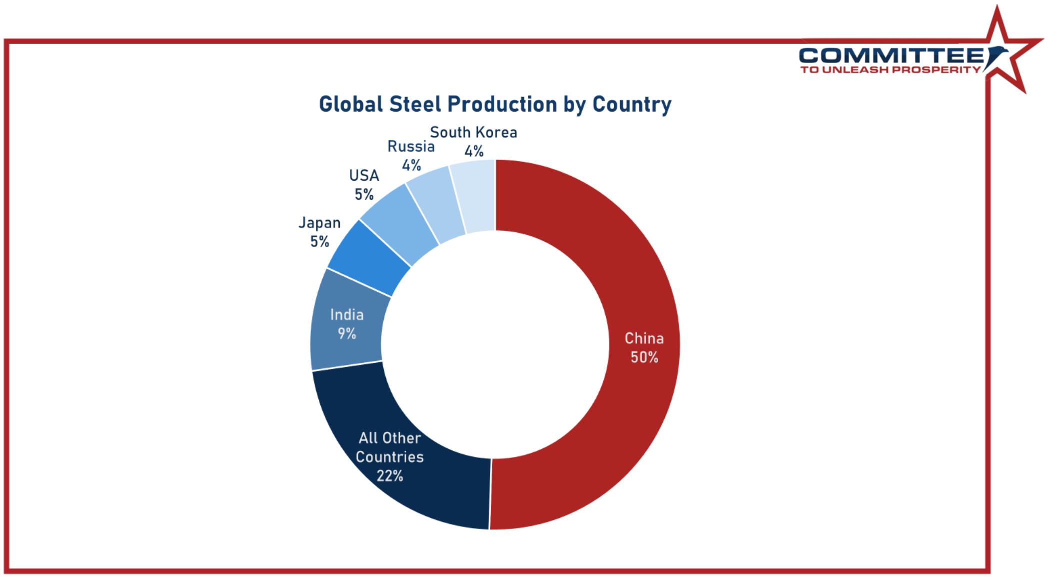
The U.S. steel industry has been struggling for many years and import quotas, tariffs, buy-America provisions have done little to revive the industry.

One long term benefit of the deal may be the technological advancement that the Japanese steel company promises to implement in U.S. Steel production. U.S. Steel's outdated equipment and production process will benefit from Nippon Steel's 2,000 steel technology patents and the companies highly successful digital transformation initiative, a production initiative developed by Nippon Steel to use simulation tools and mathematical optimization models to support comprehensive production management across their operations.



This infusion of foreign technology may be the key to revitalizing not only U.S. Steel as a company but the U.S. steel industry more broadly. After a rapid rise in productivity due to the introduction of electric arc furnaces to melt steel in the early 2000's, industry productivity has remained flat. That, as employment fell by 40% and labor costs fell from 20% of total operating costs, to an average of 11% in the 2010s. And since 2018, output per worker has plummeted from approximately a 60% increase in output per worker to a mere 9.6% increase relative to 2000. Although there is much debate on the cause of this productivity stagnation, research from the OECD demonstrates that this is in part due to government policies that keep older steel mills from closing (thereby keeping older technology in use), preventing reallocation of resources to the most productive firms and hindering the growth prospects of more innovative firms.[12] If the opponents of the acquisition of U.S. Steel succeed, government protectionism will have tightened its noose on an industry already gasping for the air of free market innovation.

12 Filipe Silva and Anthony de Carvalho, Research and Development, Innovation, and Productivity Growth in the Steel Sector, OECD, March 28, 2016, pp. 36-37. See also Filipe Silva, Evaluating the Financial Health of the Steel Industry, OECD, June 9, 2017, p. 9.



The Deal Will Make Our Steel Industry More Competitive Against Chinese Steel

The deal between Japan's premier steel producer and U.S. Steel also chips away at the China's international dominance in steel production. In 2023, China produced half of all steel globally while the U.S. and Japan each produced 5%.[13] Although it may only represent a combined 10% of global production between the two allied countries, any financial and technological exchange that rebalances the international scales of steel production is a step in the right direction and should be encouraged by politicians on both sides of the aisle.

There are particular mutual benefits to be enjoyed by both Japan and the US. Realizing that a declining population may translate to a stagnating demand for steel in Japan, Nippon Steel has shifted its focus to expanding in international markets with growing demand. In addition to their investment in U.S. Steel, they acquired an Indian steel producer in 2019 and a Thai steel company in 2022.

The United States doesn't produce enough steel to meet all its needs domestically. About 70% of steel materials in the U.S. comes from domestic sources, while the remaining 30% is imported.[14] The U.S. presents a lucrative market with increasing demand, driven by sustained population growth and the potential resurgence in manufacturing industries.[15] Nippon Steel's investment would mean increased domestic production of higher quality steel, benefiting all secondary industries that rely on access to large quantities of steel, such as the automotive and construction industry. Higher quality products at lower prices for secondary producers means better products for at lower prices for U.S. consumers.

13 https://www.trade.gov/data-visualization/us-steel-executive-summary#:~:text=According%20to%20data%20from%20CRU,-metric%20tons%20in%20November%202023

14 USGS, Mineral Commodity Summaries, "Iron and Steel Statistics and Information," January 2022.

15 https://home.treasury.gov/news/featured-stories/unpacking-the-boom-in-us-construction-of-manufacturing-facilities

The Nippon Steel Deal Is Not a Threat to National Defense

The Nippon Steel deal with U.S. Steel is currently under review by the Committee on Foreign Investment in the United States (CFIUS), the federal body that reviews foreign investment for national security reasons, but despite what rent seeking special interest groups may claim, the deal poses no credible threat to nation defense. Even the most ardent opponent would be forced to begrudgingly admit that all evidence shows Japan to be one of our closest and most trusted allies. Japan currently hosts more U.S. military personnel and U.S. bases than any other ally, with 53,973 troops and 120 bases.[16] This essentially means we have already entrusted a larger share of our national defense to Japan than we have to any other ally.

As CFIUS weighs the national defense implications (or lack thereof) of the deal in question, it is crucial to bear in mind the current volume of steel used for national defense purposes. Although the steel industry claims that 3% of domestically produced steel is used for national defense purposes, purchase records show that the pentagon has never bought more than 1% of the industry output. But even at the upper end of this range, this is an insignificant amount of steel because it is produced to such a high level of quality and specification. In fact, the steel sourced by the pentagon is primarily for armored plating that goes on Navy ships and armored ground vehicles used by the Army. All steel for these purposes is sourced from two plants in Pennsylvania, owned not by U.S. Steel, but Cleveland-Cliffs.[17]

The Benefits of Foreign Direct Investment

Opponents of the Nippon Steel deal have taken great pains to paint the acquisition of U.S. Steel as an act of foreign exploitation, with all benefits of the deal being extracted from U.S. blue collar workers and shipped to overseas competitors. In reality, foreign direct investment is a substantial financial bet on the future success of the recipient country. The naysayers fail to recognize that with the purchase of U.S. Steel, the Nippon Steel Corporation now has a vested interest in accelerating the growth of U.S. steel production.

There is clear evidence illustrating this fact. Although U.S. affiliates of foreign multinational enterprises comprise less than 1% of U.S. companies, in 2021 these affiliates in America accounted for 13% of business spending on research and development, 17.3% of investment in plant and equipment, and 23.6% of total goods exports. In short, foreign direct investment fuels a disproportionate share of U.S. economic growth. And far from exporting American jobs, multinational affiliates employed more than 7.9 million U.S. workers, of which 35% were in manufacturing - far higher than manufacturing's 9.7% share of all U.S. private-sector jobs today. Total annual compensation at these companies averaged $86,859 per worker, a full 22% above the average for the rest of the private sector.

16 https://globalaffairs.org/bluemarble/us-sending-more-troops-middle-east-where-world-are-us-military-deployed

17 https://breakingdefense.com/2024/03/the-mythical-national-security-argument-for-protecting-the-steel-industry/

Japan has been a shining example of foreign direct investment in the United States. In 2022, Japan was the top source of foreign direct investment in the U.S., investing over $775 billion.[18] Opponents of the deal also forget the success of Japanese friendshoring in the auto industry. In 1979, Honda opened the country's first automobile production plant owned by a foreign company. Today, nearly 600,000 Americans work in foreign-owned transportation-equipment facilities. Across all U.S. industries, more than 963,000 Americans work for Japanese companies like Nippon Steel.

Private Investment is Superior to Investment in Government Spending

The unspoken irony of the clamoring horde of politicians decrying Nippon Steel's proposed investment in U.S. Steel, is that they themselves seem to have no qualms with foreign dollars funding their wasteful spending and utterly unproductive activities. Approximately one third of our $24.5 trillion publicly held debt (as of December 2022) is owned by foreign creditors. So while politicians claim that Nippon Steel's $14.9 billion investment poses a national defense risk, they have implicitly accepted approximately $8 trillion in foreign investment in their activities.[19] Only a politician with logs in both eyes could miss the hypocrisy. The reality is that global funds will flow to where they are believed to be most productive and profitable. The United States is an economic powerhouse and foreign dollars will flow into the U.S. as either profitable foreign direct investment in private enterprises, or as the purchase of U.S. government debt securities. One funds private innovation and economic growth while the other funds the wasteful spending of the federal government.

18 https://apps.bea.gov/iTable/?ReqID=2&step=1&_gl=1*1ujr7g5*_ga*MTAwOTQ0Mjc1Mi4xNzExNTU1NDYz*_ga_J4698JNNFT*MTcxMTU1NTQ2My4xLjEuMTcxMTU1NTY3MC40Ny4wLjA.#eyJhcHBpZCI6Miwic3RlcHMiOlsxLDIsMyw0LDUsNywxMF0sImRhdGEiOltbIlN0ZXAxUHJvbXB0MSIsIjIiXSxbIlN0ZXAxUHJvbXB0MiIsIjEiXSxbIlN0ZXAyUHJvbXB0MyIsIjEiXSxbIlN0ZXAzUHJvbXB0NCIsIjIyIl0sWyJTdGVwNFByb21wdDUiLCIyMiJdLFsiU3RlcDVQcm9tcHQ2IiwiMSJdLFsiU3RlcDdQcm9tcHQ4IixbIjY2Il1dLFsiU3RlcDhQcm9tcHQ5QSIsWyIyIl1dLFsiU3RlcDhQcm9tcHQxMEEiLFsiMSJdXV19

19 https://www.pgpf.org/blog/2023/05/the-federal-government-has-borrowed-trillions-but-who-owns-all-that-debt

Conclusion

The proposed acquisition of U.S. Steel by Japan's Nippon Steel Corporation represents a pivotal moment for the U.S. steel industry. Despite opposition from political figures and special interest groups, this analysis highlights the overwhelming benefits this deal offers to American stakeholders.

The deal offered by Nippon Steel, provides an unprecedented premium to U.S. Steel shareholders, bolstering the company's financial health and potential for growth. Moreover, the infusion of capital and technological advancements promised by Nippon Steel can rejuvenate U.S. Steel's operations, enhancing productivity and competitiveness.

There is a strong possibility that if the government blocks the Nippon acquisition, the alternative will be massive government subsidies to a new domestic purchaser and the steel workers union. This is a much worse outcome for taxpayers and the steel industry and may play into the hands of the Chinese - who want to dominate the global steel industry.

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