From the desk of . . .

Aug. 31

PAUL W. McCRACKEN, *Chairman*
Council of Economic Advisers

HS

11:30 meeting tomorrow with Firestone officials in PM's office

Robert Beasley, Exec. VP and Chief Financial Officer
John Floberg, V.P. and Legal Counsel

Mike Moskow and Saul Nelson will attend

216-379-7000

The Firestone Tire & Rubber Company

HARVEY S. FIRESTONE · FOUNDER

AKRON, OHIO 44317

August 19
1970

Called Secretary B Thomas
on Aug 25 to assure
her that CEA
Chairman always
pleased to
meet with
industry
representatives

Dr. Paul W. McCracken
Council of Economic Advisors
Washington, D.C.

Dear Dr. McCracken:

We were, of course, dismayed to read recently in the press that the rubber industry should be treated by you as the prototype target of an "inflation alert". We are much more accustomed to being lauded, as we were in the President's 1966 annual economic report to the Congress, as an industry which has distinguished itself over the years by holding down price levels in the face of inflationary trends; and we still think of ourselves that way.

The rubber industry was recently identified in the <u>Fortune Directory</u> for May 1970 as being in a position which this Company, at least, would like to avoid in the future; <u>Fortune</u> classified the rubber industry as the worst or next to the worst of twenty-two industries from the various points of view which are of interest to its owners, hardly evidence of riding the crest of any inflation wave. As you undoubtedly noted, the rubber industry ranked twentieth of twenty-two industry groups in terms of increases in sales, twenty-second out of twenty-two with regard to increases in profits, twenty-first out of twenty-two with respect to return on sales, twenty-first out of twenty-two in return on invested capital and twenty-second out of twenty-two in return on total capital.

I am sure that you are also aware of the fact that the Federal Trade Commission analyses of various industries have shown the rubber industry to have an unenviable profit record. I refer you to the "Report of the FTC on Rate of Return in Selected Manufacturing Industries 1959-1968", which showed that the rubber industry had declined in that period from fourteenth to nineteenth of thirty-five industries in terms of return on stockholders' investment. The SEC's "Quarterly Financial Reports for Manufacturing Corporations" show for the first quarter of 1970 that the rubber industry stands twenty-second of twenty-eight industry groups in profit on stockholders' equity.

This Company's experience, I regret to say, has also reflected the declining trends of the industry over the past few years. Our return on net assets, on invested capital, and on stockholders' equity has been on a downward trend for several years, and we have every intention of doing our best to reverse that trend. I have no doubt that the fact that the index of wholesale prices has increased about 17% from the 1957-1959 level while the index of tire prices has increased only about 2% from that level is part of both the rubber industry's and this Company's problem. The fierce competition in the industry has simply prevented profit levels which would be reasonable.

Getting away from generalities, I should like to point to some of the specific facts regarding our recent price increase. The Wall Street Journal of August 11 quoted your Agency as soliciting information of this kind, and so I feel free to ask you to examine it.

We all remember the happy days when productivity in our Company was increasing at an annual rate of about 5%. That era, however, is now nothing more than a nostalgic memory, for during the life of our collective bargaining agreement which expired this spring, we estimate our productivity actually to have declined--during the first two years of that contract's life at the rate of at least 2 to 3%. Even with very large scale addition of new modern facilities, our labor cost per pound of product has increased substantially. These negative developments have been the result of several factors, but new types of tires have been the principal cause. Belted tires, and to a lesser extent because of much lower volume radial tires, introduced manufacturing complexities which reduced the capacity of our passenger tire facilities by 15% to 30% depending on the method of calculation. Enormous capital investment in the last two years has helped to recoup most of that loss, and we hope that during this year and at least by next year we shall be back to at least a break-even basis on productivity.

If anyone in the industry is expecting a substantial productivity increase in the next year, however, then he knows things this Company does not know. For the three years covered by our new collective bargaining agreement, our experience will probably not be much different from the last three years, but whether it is or not, our present pricing levels have to reflect our current total economic situation and our current plant productivity.

I am sure that you recognize as we do that the whole concept of increase in <u>labor productivity</u> as distinguished from <u>plant productivity</u> is basically a fiction. There can be, as there was in the early 1960's, an increase in <u>plant productivity</u>, but that is almost invariably the result of an increase in the productivity of machinery and equipment rather than of employees. One man with a mechanical sweeper may do the work of 10 men with brooms, but that does not mean that he is more productive than they; it only means that a mechanical sweeper is 10 times as efficient as a broom.

I should point out to you that an average hourly cash earning without overtime in this Company's plants before the recent $125,000,000 settlement of our labor negotiations was $4.05 per hour. As had been widely publicized, the cash wage increase for the first year of our new Agreement became effective on June 15, 1970, and amounted to 32.6¢ per hour or 8%. The non-cash portions of wage cost, as is typical in major labor settlements, are not spread uniformly over the three year period of the Contract as the cash wage increases usually have a rough tendency to be, but are in classical fashion heavily loaded into the first year of the Contract period. The benefit of an extra holiday, for example, begins at once and amounts to 1.5¢ per hour, and the same observation can be made of supplemental unemployment benefits for 1¢ per hour. Likewise pension and insurance benefits effective immediately amount to 25.8¢ per hour. Other less significant non-cash wage costs, at least a part of which become immediate burdens to the Company, amount to about 8.5¢ (including roll up or creep of 7.2¢) per hour, so that about half of the total non-wage costs of the three year increase are in the first year of the Contract. The total first year wage cost package, cash and non-cash, in the case of this Company, therefore, comes to 69.4¢ per hour or a 12.7% increase. I think that figure has to be close to the experience of others in the industry, because the increases announced in the press were pretty uniform from company to company, and I believe they all started from about the same point.

Because a wage adjustment is such a major fraction of the total cost of products, it becomes the crusher which precipitates price adjustments. Invariably it is the catalyst for other upward cost adjustments, such as, most noticeably, the inevitable large-scale adjustment of compensation of employees not covered by any collective bargaining agreement but who cannot be discriminated against on that account. These employees also have non-cash benefits to be considered, and the accumulation of those is significant.

Wage costs are far, however, from being the only cost increases which must somehow be recovered by the Company. A major class of additional expense in recent years has been the additional cost of construction for any capital repairs, expansions, improvements or new facilities. The enormous increases in the wage rates of the construction trades are passed on by builders to their customers such as ourselves, and we bear the burden not only in the form of increased current construction costs but also in increased interest expense and eventually increased depreciation charges.

Many other items add up. Workmen's Compensation expense has grown substantially, principally as a result of increases in the cost of medical treatment and hospital charges--about 33% in the past year. The same two factors have caused health, accident and hospitalization insurance benefits paid on behalf of employees to grow by approximately 15% in the past year; it has been climbing at at least that rate for the past couple of years, and is estimated to increase by more than 20% in the next year.

Then there are costs originating outside the Company. Transportation costs have increased for us by 11% in the past year (and another 2% before the year end is clearly visible), warehousing costs by 18%, interest costs by 50%, State and local taxes by 17% (about 38.5% since our 1967 labor settlement), fire and similar insurance by 6%, etc.

Most of these cost increases, whether directly related to our own labor settlement or not, are gradual and therefore continuously and helplessly absorbed, but nevertheless they are real added expense. They individually amount to millions of dollars, and collectively they are many millions. The time eventually comes when they have to be recovered--and no one can speak of increased productivity in most of those categories--

and while these items do not in themselves, because their individual impacts are not overwhelming and because of their diffusion in time, both within the Company and vis-a-vis our competitive position, generate immediate reaction in the form of price increases, their cumulative effect has to be considered as part of the total consideration when price increases become compulsory as a result of such a major instantaneous cost shock as a wage adjustment.

There is one other significant category of expense which is spread across many parts of the Company's operations. I refer to the obligation to conform with certain Federal Tire Standards promulgated by the Highway Safety Bureau of the Department of Transportation. The first of these Standards became effective January 1, 1968, but the full burden of the expense of complying with them is still on an increasing curve. New and additional Standards are even now in the process of adoption as a result of recent legislation. A round figure for the added cost of the testing, paper work, factory interruption and other general overhead required by the regulations will total close to $1.00 per tire. Some of this expense is, of course, redundant of items mentioned elsewhere in this letter, but mostly it is additional expense which would not be incurred except for government requirements.

Our calculations showed that if we wished just to keep our profit margins on sales of our products at the same level after our settlement as they had been before (and that wasn't good), we would have had to adjust our prices upward, after allowing for the reduced cost of natural rubber, by 5.7%.

We would, of course, have announced a larger figure than that if we had been able to do our calculating quickly enough to be the first company to announce a price increase. The fact, however, was that another company made the first announcement after the conclusion of the negotiations, and it was quite obvious to us that, in an industry as competitive as this one, we would get nowhere by announcing a greater price increase than had already been announced and published. Perhaps we can be fortunate enough to be first next time so that our price adjustment will reflect more adequately than did the recent one the level of return we shall have to get on our merchandise if we are to stay in business.

You will have a hard time finding anyone who deplores more than I do the trend of the price curve over the past two to five years. I have the greatest concern for the continued ability of our country's economy to withstand the body blows which it absorbs every time a major industry increases its prices, be it a consumer or a basic industry. I candidly recognize the fact that our recent price increase is inflationary, and I deplore that fact, but it only partially reflects an inflationary wage settlement by our industry and the equally or even more inflationary wage settlements of suppliers whose wage rates are absorbed in the costs of the products and services which we buy from them. Two of the major companies in our own industry took extended company-wide strikes in order to keep their labor settlements as low as they were--consistent with recent ones in other manufacturing industries--and I have no reason for thinking that our Company could have settled for any lower figure than the one which purportedly settled the strike. (We still have one plant on strike and various degrees of slowdown, absenteeism, etc. in others; I understand that some factories of our competitors have not yet terminated their strikes.) That the national economy will be unfavorably affected by our price increase would have to be both admitted and deplored, but it would be unreasonable on the part of our management to follow any other course than the one we recently took. You may be sure we understand the big picture and are very much discouraged that nobody seems to be able to do anything about the skyrocketing labor costs which make inevitable its trend. Until somebody figures out a way to cut off the flow of water, however, we are just swimmers tossing in the stream, and we have to do the best we can to protect ourselves from drowning.

One final thought deserves at least a passing mention. The management of this Company as in any other cannot ignore the welfare of the stockholders and investors who have delegated to them the responsibility for conducting the business profitably. This Company has been paying dividends which have ranged for the last several years between 3% and 4% of the prevailing value of its stock, and it isn't easy to explain that rate of return to stockholders who know that the Company itself is paying interest of about 10% on the money it borrows and who know that they can command that kind of yield for lending their money any time they choose. Even comparing the yield we pay with the 7% or so which riskless U.S. government paper pays makes us wonder how we can compete for funds with which to manage and expand this business when our investment return is as low as it is. The rate of compensation to our employees and the rate of payment on other expense accounts grows by several percent a year more than does the rate of return to the owners of the business, and I find that position very uncomfortable.

This whole subject is so important to us, and good relationships with the Administration are so important to us that we would like to come down and discuss this subject personally with you. If you agree, I shall give one of my officers the responsibility of establishing contact with you and of making an appointment at your convenience.

Respectfully,

R. D. Thomas
President