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States mount rearguard effort to protect remaining industrial base

by Andrew Rotstein

In late April, Massachusetts and Pennsylvania enacted legislation to block the hostile takeover of firms incorporated under their respective laws, joining 40 other states with similar provisions. Angered by the ravages of the merger-and-acquisition mania of the 1980s, Americans are demanding action to bar further cannibalization of the nation's dwindling industrial base. It is a populist upsurge few politicians dare oppose.

The Massachusetts law passed both legislative houses unanimously only weeks after BTR (British Tire and Rubber) made a hostile bid to acquire the Worcester-based Norton industrial group. BTR had previously bought out Worcester Controls and the Chicago-based Stewart Warner, moving some units to low-wage areas and selling off others for cash flow.

The Pennsylvania bill, the strongest anti-takeover measure of any state yet, was prompted by the proxy fight launched by Canada's Belzberg family to acquire Armstrong World Industries of Lancaster, the flooring materials manufacturer. The Belzbergs, who have also been major players in the savings and loans roulette game, did not endear themselves to Pennsylvanians by their reputation: Scovill, Inc. was dismembered after the family bought it in 1985, and H.H. Robertson has had a history of financial troubles since they acquired a 25% interest.

Corporate raiders have evolved some high-minded rhetoric to give their quest for short-term profits the aura of civic virtue. They claim that average shareholders are the victims of complacent executives, whose mismanagement deprives them of the potential worth of their invested savings. They point to the role of even unsuccessful takeover bids in boosting stock values, spurring efficiency on the part of incumbent management, and making American capitalism more "dynamic."

The chain-letter economy

Without a doubt, corporate managers may be easy and deserving targets for criticism in many cases. But the stock speculators themselves represent what is worst in the deregulated, paper-trading economy of the 1980s: profits without production, generated out of the fact that what is bought today may sometimes be sold for a gain tomorrow, whether any new wealth is created in the process or not—that is, at least until the day of reckoning arrives.

From 1980 to 1986, there were 26,671 mergers and acquisitions, with a combined value of over $1 trillion transacted in the United States. Much of the financing came from bank loans, thus squeezing out productive commercial lending, and from the junk bond market, which is now well advanced toward its inglorious fate. For this seven-year period, corporations spent some $688 billion on mergers and acquisitions, an amount 2.2 times greater than their expenditures for research and development, and 1.2 times their outlays for *all* capital investment—statistics embodied in the grim reality of this nation's stagnating productivity and technological mediocrity.

The consequences for the economy have been disastrous. Because of the tax deductibility of interest payments, corporations have become debt junkies. As the public coffers have in effect been depleted by debt financing, the corporate musical-chairs game has been indirectly subsidized by the taxpaying public.

The trend is stark: Corporate interest payments as a percentage of pre-tax profits have soared from 15% to almost 60% merely in the last decade. Bondholders have seen the value of their assets fall, as the steep rise in the new obligations of the increasingly leveraged firms heightens the risk of prior investments. And in the drive to meet mounting debt obligations and to stave off takeover bids, the sounder instincts of management—to plan for the long-term health of the company—tend to give way to the pressures to raise cash and to inflate stock value.

Paper begets paper

Of all the questionable practices associated with the feverish trade in corporate ownership, perhaps none is more illustrative, or more infamous, than "greenmail." This is the practice of putting a company "in play" by buying large blocks of shares, and then reaping huge profits by selling them back at a premium.

Consider the case of T. Boone Pickens, the "corporate gunslinger." A decade ago, as owner of Mesa Petroleum, Pickens made a run at buying Supron Energy. He failed, but

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made $22 million from running up the value of the stock he purchased. Next, he set his sights on Cities Services. Again, he lost the bid for ownership, this time to Occidental, but managed to make $44 million on an investment of $182 million. Then, it was another "unsuccessful" campaign for General American Oil. This time, Pickens netted $25.3 million by investing $32 million for a little over a month. A brief assault on Superior Oil gained a profit of $31.6 million.

Graduating to the big time, Mesa undertook to acquire Gulf. After a bidding war that lasted five months, Chevron wound up with the prize of ownership; but Pickens and his partners walked away $760 million richer. Then, he tried to buy out Phillips Petroleum, setting off a competition involving the likes of Carl Icahn, Irwin L. Jacobs, and the lately imprisoned Ivan Boesky. Phillips retained its independence—at a staggering cost—and, for four months of jockeying (it could hardly qualify as "work"), Pickens made $89 million, plus $25 million in expenses.

In all the above and similar episodes, numerous dealbrokers—securities lawyers, investment bankers, and financial advisers—also wound up with a windfall in "fees."

A 'free market' run amok

The raiders and their apologists argue that the movement of stock prices to "truer" (or, at any rate, higher) values has enriched those willing to risk their capital in promising enterprises, rewarded behavior tested and proven in the marketplace, and provided the resources for another cycle of investment and progress. Like their social Darwinist forebears, they claim that interference in this process, however well-intended, simply hampers growth and efficiency, and infringes on the rights of investors.

But in an economic climate where casino builders prosper while steel companies go bankrupt, the claims of the free-marketeers are just glib rationalization. The major scholarly studies of mergers and buyouts, including those by David Ravenscraft and F.M. Scherer of the Brookings Institution and the University of Maryland's Dennis C. Mueller, indicate that the mergers-mean-efficiency thesis is not borne out by experience. And these surveys merely study corporate performance, not even the larger economic impact referenced above.

Communities that have seen factories closed, jobs cut, suppliers and customers decimated, and firms slide into obsolescence in order to meet enormous debt burdens, have had enough of it. Companies and business federations like the Chamber of Commerce have joined with labor unions in pushing anti-takeover laws.

Admittedly, such efforts address only some of the most visible depredations of the speculative economy, and on a piecemeal basis at that; they only hint at the underlying problems of economic policy. But they are a healthy reaction to the ruinous course of the recent past, and a hopeful sign of a mass political awakening yet to come.

Nuclear deal gives Pakistan a breather

by Susan Maitra and Ramtanu Maitra

After years of frustration and waiting, Pakistan's nuclear power program received a boost when French President François Mitterrand announced in Islamabad in February, during the first-ever visit by a French head of state, that France would supply Pakistan a 900 megawatt (MW) pressurized light water reactor. Several months earlier, Chinese Premier Li Peng also promised to supply two fully safeguarded nuclear power plants of 300 MW each during a visit to Pakistan.

Li Peng's announcement was widely welcomed in Pakistan, but the French government's move is arguably the more dramatic and potentially far-reaching. Not only will France be helping this power-starved nation to realize an essential energy option crucial for the country's economic future, but in reversing its earlier capitulation to the superpowers' "non-proliferation" blackmail of Pakistan, France is helping break the embargo enforced against Pakistan, principally by the United States, at a time when there is a thrust within the country to establish policy independence from its erstwhile American ally.

One of the more important recent events in Pakistan is the rise of a significant group within the Pakistan military and bureaucracy who seek to cut its umbilical cord with the United States and reorient foreign policy around a regional consensus on Islam and an even-handed stance toward the superpowers. This grouping, of which Army Chief of Staff Aslam Beg is a prominent representative, would like to reduce Pakistan's vulnerability to both the carrots and sticks that have been Washington's routine fare for its "most allied ally."

This should not be surprising. Pakistan is important for the U.S. for electronic surveillance, a possible military base, and an opening to Iran; but after more than 40 years of "strategic" alliance, and a signficant amount of weapons transfers and economic aid, Pakistan has become the unwilling host to 3.5 million restless Afghan refugees, its bankrupt economy is in the clutches of the International Monetary Fund, and its people is still enmired in appalling poverty and illiteracy. On top of this, the United States has taken advantage of the intimacy to tinker with Pakistan's domestic politics with seeming impunity.

Nuclear "non-proliferation" has been one of the more important sticks the United States has consistently used