

Testimony of  
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Hearing on China's Trade and Industrial Policies  
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These comments are filed on behalf of The American Iron and Steel Institute (AISI) and its U.S. member companies who account for over 75 percent of the raw steel produced annually in the United States, pursuant to the June 9, 2010 advisory requesting written statements for consideration by the House Ways and Means Committee and for inclusion in the printed record of the hearing on China's Trade and Industrial Policies.

America's steel producers have serious concerns about the growing number of trade and industrial policies that the Chinese government is instituting to provide an unfair advantage to Chinese manufacturers and exporters. These policies are distorting trade flows and disadvantaging manufacturers outside of China, including in the United States. Such policies include providing massive government subsidies to build and preserve manufacturing capacity and its "national champions," limiting imports, restricting foreign investment, manipulating VAT rebates, restricting exports of vital raw materials -- and the largest subsidy of all, pursuing a currency policy that is keeping the RMB (China's currency) severely and artificially undervalued. The government of China's continued and growing intervention in its economy is a direct and ongoing threat to the U.S government's stated policy goals of global rebalancing, economic recovery, strengthening manufacturing, creating jobs and doubling exports within five years.

The government of China will soon announce its new Five-Year Plan of central government direction and control of the Chinese iron and steel sector. Under the auspices of the bilateral Joint Commission on Commerce and Trade (JCCT), the U.S.-China Steel Dialogue has served as a useful "window" on the government of China's general approach to industrial policy, economic development and so-called "strategic industries." What we can learn from steel is that -- even as the Chinese domestic steel demand growth rate is widely expected to slow -- government-supported steel capacity additions are continuing, with expectations that China's total steelmaking capacity will expand to roughly seven times that of the United States by 2012. Unless countered, the result of these policies will be more Chinese disruption of world markets, not just in steel, but also in steel-consuming industries, which constitute the bulk of our domestic manufacturing base.

## **I. China's Iron and Steel Industrial Development Plan and Other Government Actions Are Disrupting and Distorting the Global Steel Market**

- Chinese crude steel production increased 2½ times from 222 million metric tons (MT) in 2003 to 568 million MT in 2009.<sup>1</sup> China's 2009 production increased 14 percent compared to 2008. In contrast, worldwide steel production (excluding China) declined 21 percent.<sup>2</sup> In response to the world economic crisis and drastic reductions in steel demand, global steel production outside of China plummeted in the first six months of 2009 by 23%. However, in spite of the large financial losses that China's steel producers themselves were claiming, Chinese steel production increased 18 percent in the first six months of 2009 compared to 2008,<sup>3</sup> causing some analysts to say that "China continues to defy market fundamentals."<sup>4</sup> China's share of total world production increased to 49% during this period.
- In 2009, China exported 24 million MT of steel, remaining one of the world's largest steel exporters.<sup>5</sup> Governments in several steel producing countries conducted antidumping and countervailing duty investigations and found that Chinese exports of flat steel products, long steel products and steel pipe and tubular products were injuring domestic steel industries.

According to the World Steel Association, China's annual crude steel capacity had reached 743 million MT by the end of 2009, exceeding actual consumption by 178 million MT.<sup>6</sup> The result: "Major difficulties for China's steel industry include expansion of production capacity, shrinking demand, grim export [prospects], excess supply on the domestic market, slumping steel prices and relatively high price raw materials."<sup>7</sup> The China Iron and Steel Association has admitted that restoring Chinese steel production in January and early February 2009 despite the lack of any real recovery in demand "only resulted in record high market inventories, which triggered a further price collapse."<sup>8</sup>

- In 2009, China had realized investment of CNY 335 billion in the steel sector, up by 3 percent, and will add approximately 70 million MT of new capacity in 2010, raising total steelmaking capacity to 796 million MT -- and the estimated amount of overcapacity to at least 130 million MT.<sup>9</sup>

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<sup>1</sup> "Worldsteel Monthly Crude Steel Statistics"

<sup>2</sup> "Worldsteel Monthly Crude Steel Statistics"

<sup>3</sup> "Worldsteel Monthly Crude Steel Statistics"

<sup>4</sup> Michelle Applebaum, "Steel Market Intelligence" report, March 22, 2009 – "February Global Steel Production Rises; Chinese Production Back to Near Record Levels"

<sup>5</sup> "Worldsteel Annual Statistics"

<sup>6</sup> "Worldsteel Global Steel Capacity Development-Spring 2010"

<sup>7</sup> Wu Xichun, Honorary Chairman of China Iron and Steel Association, "Responding to Challenges and Overcoming the Difficulties Together", 7<sup>th</sup> International Steel Market and Trade Conference, Shanghai 19-20 March 2009

<sup>8</sup> Steel Business Briefing, March 20, 2009

<sup>9</sup> "The China Steel Industry-monthly update" and "World Steel Global Steel Capacity Development-Spring 2010"

## II. Recommendations Regarding Needed Reforms in Chinese Government Industrial Policies Affecting Steel and Related Manufacturing Sectors

The following recommendations would promote the development of a market-based Chinese steel industry and are fully consistent with the commitments China made on its accession to the WTO:

1. The Chinese government should discontinue providing subsidies to its steel producers. The current Steel Policy specifically provides for government support in the form of “taxation, interest subsidy and scientific research funds” for major iron and steel projects utilizing newly developed domestic equipment.<sup>10</sup> The Steel Policy also states that enterprises need only provide 40 percent or above of necessary investment capital for new projects of iron making, steel making and steel rolling, suggesting that the remainder of such capital will be supplied by government funds.<sup>11</sup>
2. The Chinese government should stop controlling and directing the operations of steel facilities, whether through the use of state-owned enterprises (“SOEs”) or other means. China’s Steel Policy provides detailed guidance for all Chinese steel producers -- including SOEs -- with respect to many key decisions. In particular, the Steel Policy:
  - Proposes the reorganization of China’s steel industry so that the 10 largest Chinese steel producers will account for more than 50 percent of all Chinese production by 2010, and more than 70 percent of all Chinese production by 2020;<sup>12</sup>
  - Calls for the establishment of “iron and steel factories of the recycling type,”<sup>13</sup> i.e., electric arc furnaces (EAFs), even though China wholly lacks a comprehensive system for recycling steel scrap, a system that is normally needed for expansion of the EAF sector;
  - Directs that “large scale steel enterprises shall be mainly arranged in coastal areas”;<sup>14</sup>
  - Provides detailed guidance regarding the size of new plants,<sup>15</sup> the minimum size

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<sup>10</sup> NDRC, “Steel Industry Development Policy” (July 20,2005) at Article 16 (English translation) Marcus Taube, “The State-Business Nexus in China’s Steel Industry- Chinese Market Distortions in Domestic and International Perspective”, January 2009 (Taube Report) p. 130-131

<sup>11</sup> Id at Article 23

<sup>12</sup> Id at Article 3, Taube Report p. 67

<sup>13</sup> Id at Article 5

<sup>14</sup> Id at Article 11, Taube Report p. 68

<sup>15</sup> Id at Article 12 (providing that new steel projects in coastal deepwater port areas shall have a capacity of more than 8 million MT), Taube Report p. 65

of blast furnaces to be installed in such plants,<sup>16</sup> and the amount of water and energy to be consumed in such plants;<sup>17</sup>

- Stipulates that, as a matter of principle, non-Chinese companies are prohibited from controlling Chinese steel producers,<sup>18</sup> a principle that is completely irreconcilable with the free movement of capital and equality of treatment that underlies the tenets of the WTO;
- Directs its steel industry to create massive state-owned and controlled national champions that are competitive on the international stage. China's current plan is to mandate that these massive state-run companies "go abroad" and compete directly with U.S. and other foreign companies in our home markets. In this regard, the Chinese government has stated that its steel industry should build production capacity in the United States in order to "study" U.S. technology and benefit from the U.S. stimulus program.

On May 17, the Chinese government announced that the Anshan Iron and Steel Group ("Anshan"), its fourth-largest steel producer --owned and controlled by the central government's State-owned Assets Supervision Commission of the State Council ("SASAC"), will form a joint venture with the Steel Development Co. ("SDCO") of Amory, Mississippi to build up to five new steel plants in the United States, implementing part of the government of China's strategic plan to "go abroad" in its "competition" in the U.S. steel market. The investment of a Chinese SOE in the United States would undermine core U.S. economic values and market principles, further distort the U.S. steel market and raise significant national security concerns. As such, the Congress should ensure that the U.S. government thoroughly investigates this transaction to determine whether it is in the best interests of the United States.

3. The Chinese government should dismantle raw material export restrictions and should not introduce more distortions in the raw materials market. China continues to impose WTO-inconsistent restrictions on exports of key raw materials. "Despite its commitments, since its accession to the WTO, China has continued to impose restrictions on exports of raw materials, including export quotas, related export licensing and bidding requirements, minimum export prices and export duties, as China's economic planners have continued to guide the development of downstream industries. The export restrictions create disadvantages for foreign producers by artificially increasing China's export prices for their raw material inputs, which also drives up world prices. At the same time, the export restrictions appear to artificially lower China's domestic prices for the raw materials due to significant domestic oversupply, enabling China's downstream producers to produce lower priced products from the raw materials and thereby creating significant advantages for China's domestic downstream producers when competing against foreign

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<sup>16</sup> Id (providing that the blast furnaces for new steel projects in coastal deepwater port areas shall be over 3,000 cubic meters), Taube Report p. 65

<sup>17</sup> Id (setting strict targets for water and energy consumption),

<sup>18</sup> Id at Article 23, Taube Report p. 149-150

downstream producers both in the China market and in export markets.”<sup>19</sup> While China is restraining its raw material exports, the Chinese government is assisting China’s mining and steel companies in buying mines and other sources of raw materials in foreign countries.<sup>20</sup> To the extent that the Chinese government is subsidizing or otherwise supporting these purchases, such actions are inconsistent with market principles.

4. The Chinese government should stop manipulating its value-added tax (“VAT”) system and any other border measures that provide artificial competitiveness to China’s steel and manufacturing exports. “China’s economic planners also attempt to manage the export of many intermediate and downstream products, often by raising or lowering the VAT rebate available upon export and sometimes by imposing or retracting export duties. For example, China reduced or eliminated VAT export rebates in November 2006 and April 2007 and imposed export duties in May 2007, July 2007 and January 2008 on a wide range of semi-finished and finished steel products, as part of its efforts to discourage further unneeded creation of production capacity for these products in China. At the same time, these changes did not target all steel products, and the result was that Chinese steel producers shifted their production to high value steel products for which full or partial VAT export rebates were still available, particularly wire products and steel pipe and tube exports, causing a surge in exports of these products. In December 2008, China added even more uncertainty to the global steel market when it partially reversed course by eliminating export duties on some but not all semi-finished and finished steel products.”<sup>21</sup> More recently, China increased VAT export rebates on certain flat steels (carbon cold-rolled and coated sheets, electrical steels and stainless hot-rolled and cold-rolled sheets) and certain long products (carbon alloy bars, rod and wire and stainless bars and rod), coming at a time when global steel demand was still depressed and when capacity utilization in many industries outside of China was still severely underutilized.
5. China should establish more stringent environmental standards and enforce its environmental laws vigorously. The plan correctly calls for the steel industry to comply with local and state environmental laws, and for mills to include the equipment necessary to achieve compliance.<sup>22</sup> All of this will be pointless, however, unless the Chinese government actually monitors compliance with environmental laws, and punishes firms that violate those laws. A recent study shows that China’s environmental standards for steel production are not up to international norms and that, in any case, the Chinese government has failed to enforce even its existing environmental standards adequately.<sup>23</sup> Also, the Chinese government should

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<sup>19</sup> 2008 USTR Report to Congress on China’s WTO Compliance - “Export Restrictions on Raw Materials,” p. 36. Taube Report p. 145

<sup>20</sup> See, e.g., A. Price et al., Raw Deal: How Governmental Trade Barriers and Subsidies Are Distorting Global Trade in Raw materials 14-20 (2008), Taube Report p. 150-151

<sup>21</sup> Id “Vat Export Rebates and Export Duties on Intermediate and Downstream Products,” page 37

<sup>22</sup> Steel Industry Development Policy at Article 13

<sup>23</sup> Alliance for American Manufacturing study, “An Assessment of Environmental Regulation of the Steel Industry in China,” January 2009, Taube Report p. 153

accelerate the closure of the obsolete and cost-inefficient steel facilities.

6. China should stop manipulating its currency, which provides significant export subsidies. The RMB's modest revaluation in July 2005 and its appreciation since then are grossly inadequate. However, according to Deng Xianhong, China's Deputy Director of the State Administration of Foreign Exchange, China will "push forward with reform of the exchange rate regime in a self-initiated, gradual and controllable manner and keep the rate basically stable at a reasonable equilibrium level."<sup>24</sup> The problem for the rest of the world is that the RMB's fundamental misalignment acts as a major export subsidy for China's manufacturing base. It creates an artificial competitive advantage by making China's exports of steel and steel-containing manufactured goods cheaper than they would otherwise be, and further disadvantages imports in the Chinese market. There is a lot of blame to go around for the recent global financial crisis, but the government of China is also partly responsible, because its massive, ongoing interventions in exchange markets have caused the RMB to be significantly undervalued, and have contributed to global trade and financial structural imbalances. While government intervention in exchange markets is not part of the Steel Plan, currency has major impacts on Chinese steel and steel-related production and trade.

### III. Conclusions

The Chinese steel sector should be healthy and market-based – not government-owned, controlled and directed. A proper role for the Chinese government would be to:

- End state interventions and comply with WTO commitments;
- Stop fostering conditions (subsidies, trade barriers) that encourage unfair trade; and;
- Urgently address obsolete capacity and effectively adopt and enforce world-class environmental regulations.

However, if China continues to use trade and market-distorting industrial policies to support an export-driven economy, using subsidies and other unfair practices (many of which violate China's WTO commitments), the U.S. government should take decisive action to address these issues.

- The U.S. government should aggressively enforce U.S. countervailing duty (CVD) law against subsidized imports from China, which remains a non-market economy (NME), according to the statutory criteria approved by the Congress. It must also continue to defend vigorously in the WTO the U.S. right to utilize both our CVD law and our antidumping (AD) law (using NME methodology) against dumped and subsidized subject imports from China.

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<sup>24</sup> Xinhua article, February 18, 2009

- As was clear from the House Ways and Means Committee hearing on China's currency manipulation in April, there is overwhelming evidence that China is manipulating its currency. In January 2009, in written testimony provided to the Senate Finance Committee as part of his confirmation hearings, Treasury Secretary Timothy Geithner stated that "President Obama – backed by the conclusions of a broad range of economists – believes that China is manipulating its currency." Yet, in spite of this testimony, the Administration, as the one before it, has refused to cite China as a currency manipulator. We believe it is well past time for the Congress to pass legislation, as soon as possible, that would make currency manipulation of the type practiced by the government of China actionable under U.S. trade remedy law.
- The Commerce Department should also take the next step and find that China's severely undervalued currency does indeed constitute a countervailable export subsidy under U.S. CVD law. In addition, where the government of China is manipulating its VAT rebates to provide a specific benefit to exporters of certain types of merchandise, the Administration should treat them as prohibited export subsidies under WTO rules. In addition, the U.S. government should pursue additional WTO litigation against Chinese subsidies where appropriate.
- During the course of China's accession to the WTO, the government of China committed that it "would not influence, directly or indirectly, commercial decisions on the part of state-owned enterprises." However, China's steel-producing SOEs – which account for most of the production in the world's largest steel industry – are continuing to operate in accord with bureaucratic policies, not market principles. This, too, is a clear violation of China's WTO commitments, and constitutes a significant distorting force in steel markets around the world. USTR should take all possible steps – including WTO litigation as appropriate – to address this problem.
- As stated previously, China has taken numerous measures to inappropriately aid its producers in securing access to raw materials, and to manipulate raw material supply and prices in a manner that gives Chinese producers unfair advantages over their U.S. and other competitors. These measures include imposing barriers on the export of raw materials and using public resources to assist Chinese steel producers in acquiring raw materials overseas. These actions by China require that the Administration continue to pursue vigorously the WTO case that it has initiated, together with the European Union and Mexico, regarding China's export barriers on raw materials. In addition, the Administration should find that these export barriers constitute countervailable subsidies that confer a financial benefit to Chinese producers by allowing them to purchase inputs at less than adequate remuneration.
- At the same time, the Administration should find that, where the government of China is providing assistance to certain enterprises or industries to acquire raw materials overseas, any such benefit received by the enterprises or industries is also a countervailable subsidy.

As displayed throughout this testimony, China has not fully complied with its WTO obligations. Thus, the United States must effectively enforce all of its trade remedy tools.

- Under the terms of its WTO accession, China agreed that other WTO members could treat it as an NME for 15 years. Nevertheless, China has urged the United States during recent meetings of the U.S.-China Strategic and Economic Dialogue (S&ED) to treat it as a “market economy” for purposes of U.S. AD law. This would be wholly inappropriate and contrary to U.S. law and economic interests.
- Another issue presented by China’s NME status concerns the application of U.S. CVD law. In November 2007, Commerce decided for the first time to apply our CVD law to China. Unfortunately, it determined that the “uniform date” from which it will identify and measure Chinese subsidies is December 11, 2001, the date on which China became a WTO member. In other words, non-recurring subsidies provided prior to this date are treated as though they were not subject to our CVD law. AISI strongly disagrees with this decision. We believe that to decline to countervail subsidies bestowed prior to China’s WTO accession is inconsistent with Commerce’s usual practice, China’s WTO commitments and Congressional intent.
- As part of its WTO accession, China also agreed that, for 12 years, other members could impose product-specific safeguards against Chinese imports. This provision – implemented into U.S. law under Section 421 of the Trade Act of 1974, as amended – is critical to ensuring that U.S. industries and workers do not suffer market disruption as a result of surges in Chinese imports. Until last year, however, no relief had ever been granted under this statute – despite ITC findings in four separate cases that relief would be appropriate. Accordingly, AISI commends the Administration for providing relief in the Section 421 case on tires. This action sends an important signal that Section 421 is a viable remedy for U.S. companies and workers facing market disruption due to Chinese imports.

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In conclusion, China’s trade and market-distorting industrial policies, and its ongoing WTO non-compliance, continue to pose major problems for U.S. manufacturers. The facts shared today show that the United States’ approach to dealing with China’s mercantilist industrial policies has not been effective – whether in reducing the unsustainable \$250 billion annual U.S. bilateral trade deficit with China, bringing China into full compliance with its WTO obligations or preventing and countering China’s non-market behavior and trade-distorting measures. As a result, the government of China is continuing its drive to remain “the factory of the world,” and its industrial policies are continuing to injure the U.S. steel industry, the U.S. manufacturing base, the U.S. economy and the global environment.

The AISI, on behalf of its U.S. member companies, appreciates this opportunity to provide written comments to the House Ways and Means Committee on the Chinese

government's trade distorting practices that are disadvantaging U.S. businesses and on the impact that these policies are having on America's steel industry.