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China's Shifting Economic Realities
Panel III: Overcapacity and Global Markets

Generally, an economy that follows state planning has the ability to pour resources into industries on a scale that doesn't reflect underlying demand patterns or that overshoots actual demand trends. In the past several decades, a massive amount of industrial capacity has been added in China in a large number of manufacturing sectors to enhance the competitive position of the country and to provide employment to large numbers of people, many in state-owned enterprises. These actions have created massive disequilibrium in China and globally in various important manufacturing sectors. This imbalance was exacerbated by the 2007-2008 global financial crisis and recession and has again surfaced as a destabilizing force amidst slowing global demand. In fact, the US and many other countries are suffering the consequences of China's actions as seen in the closure of aluminum smelters and steel mills and the layoff of thousands of workers.

Indeed, the scope of the excess capacity in certain major industries is extraordinary by any measure and flows from state planning, funding and subsidization on a massive scale. The central government of China has recognized that the problem is a serious one and has been trying to deal with it, often with little actual effect as planned capacity closures are undermined by local governments focused on creating or maintaining employment and by central government efforts to add capacity in the western part of the country. So mandated closures have in many sectors been more than offset by other capacity additions in the country.¹ However, with the recent and increasingly slowing internal growth in China, the increasing capacity overhang in China is creating very real problems for Chinese companies and their international competitors. These capacity increases in a time of declining global demand are destabilizing global markets as exports have increased in some cases by 100% in short periods. The result is depressed global prices for products and waves of dislocations around the world as producers in other markets shift product to export² as they lose market share at home. Ultimately, China must play a leadership role in the global economy to help find a way to rebalance supply and demand in each of these sectors. While it is doing so, the sectors will be depressed around the world with companies, workers and their

¹ See, e.g., Biman Mukherji, *Rising Chinese Production Keeps Lid on Aluminum Prices*, Wall Street Journal, Nov. 10, 2015 (noting that, since 2010, Chinese producers have closed 3 million tons of annual aluminum production capacity but have added an additional 17 million tons of capacity), <http://www.wsj.com/articles/rising-chinese-production-keeps-lid-on-aluminum-prices-1447186082> (requires subscription). See also *Aluminum producers staggering as factories lack orders*, http://china.org.cn/business/2013-08/27/content_29835483.htm; *China's aluminum glut set to continue*, <http://asia.nikkei.com/Markets/Commodities/China-s-aluminum-glut-set-to-continue>.

² *Will China Finally Tackle Overcapacity?*, <http://blogs.piie.com/china/?p=3857>; OECD China Economic Survey (March 2015), <http://www.oecd.org/eco/surveys/China-2015-overview.pdf>.

local communities paying the price for the massive excess capacity created and maintained by the Chinese economic system.

Because there are no multilaterally agreed rules to address situations of massive global excess capacity in a rapid or comprehensive manner, Chinese action now to get rid of excess capacity is critical to preventing the serious global dislocations caused by overcapacity in many critical industrial sectors. Otherwise market economy producers will respond to the market signals flowing from the excess capacity that prices are unsustainable by closing plants, writing off assets and laying off workers even if the plants being closed are in fact internationally competitive.³

For example, in the aluminum sector, western aluminum producers have been closing aluminum smelters in many parts of the world because of the depressed prices caused in large part by China's massive excess capacity and inventories of product overhanging the market. In the US, six aluminum smelters have closed or been announced as closing in the last six months, leaving the US with a capacity back at 1950s levels. Yet China has no natural competitive advantage in the production of aluminum and environmentally its production is not desirable being largely coal-powered for energy. Nonetheless, China has expanded its aluminum capacity from 1.75 million

³ The US Trade Representative's Office, in its December 2015 Report on China, summarized the problem of excess capacity:

Excess Capacity

Chinese government actions and financial support in manufacturing industries like steel and aluminum have contributed to massive excess capacity in China, with the resulting over-production distorting global markets and hurting U.S. producers and workers in both the United States and third country markets such as Canada and Mexico. While China recognizes the severe excess capacity problem in the steel and aluminum industries, among others, and has taken steps to try to address this problem, there have been mixed results.

From 2000 to 2014, China accounted for more than 75 percent of global steelmaking capacity growth. Currently, China's capacity alone exceeds the combined steelmaking capacity of the European Union (EU), Japan, the United States, and Russia. China has no comparative advantage with regard to the energy and raw material inputs that make up the majority of costs for steelmaking, yet China's capacity has continued to grow exponentially and is estimated to have exceeded 1.4 billion metric tons (MT) in 2014, despite weakening demand domestically and abroad. While China's steel production is slowing and China may produce approximately 2 to 3 percent less steel in 2015 than in 2014, steel demand in China is projected to decrease 5 percent this year. As a result, China's steel exports grew to be the largest in the world, at 93 million MT in 2014, a 50-percent increase over 2013 levels, despite sluggish steel demand abroad. In 2015, there is rising concern that China's steel exports are still growing and may have increased 25 percent in the first ten months of 2015, as compared to the same period in 2014.

Similarly, monthly production of aluminum in China doubled between January 2011 and July 2015 and continues to grow. Large new facilities are being built with government support, including through energy subsidies. China's aluminum excess capacity is contributing to a severe decline in global aluminum prices, harming U.S. plants and workers.

Excess capacity in China – whether in the steel industry or other industries like aluminum – hurts U.S. industries and workers not only because of direct exports from China to the United States, but because lower global prices and a glut of supply make it difficult for even the most competitive producers to remain viable. Domestic industries in many of China's trading partners have continued to respond to the effects of the trade-distortive effects of China's excess capacity by petitioning their governments to impose trade remedies such as antidumping and countervailing duties.

2015 USTR Report to Congress on China's WTO Compliance (December 2015) at 12-13, <https://ustr.gov/sites/default/files/2015-Report-to-Congress-China-WTO-Compliance.pdf>.

tons in 1996 to an estimated 36 million tons in 2015.⁴ And in 2014 alone, Chinese excess capacity was estimated at more than 10 million tons.⁵ China now accounts for more than half of the world's aluminum smelting capacity (52.3% vs. 7.9% in 1996).⁶ Meanwhile, US capacity has declined by 52 percent from 4.2 million tons in 1996 to 2 million tons in 2015 and will be much smaller in 2016 following the announced closures or planned closures of six smelters since September 2015 (one million tons).⁷ Thousands of aluminum workers in the US have lost or are losing their jobs. America now has less than 3 percent of the world's primary aluminum production capacity and will have less than 2 percent in 2016.⁸

The global steel sector is also in crisis.⁹ China's steel capacity has skyrocketed from 145 million tons in 2000 to more than 1 billion tons today (some estimates are as high as 1.4 billion tons) with excess capacity of as much as 40% – equal to the total capacity in the US, EU and Japan.¹⁰ The problem of excess capacity in the steel sector has been studied for a number of years within the OECD,¹¹ has been the subject of bilateral discussion between the US and China¹² as well as the EU and China. Over the past few years, the Chinese have announced a series of production cuts with little or no actual net reductions in steel capacity to date. The government of China has announced in recent weeks a program to close 100-150 million tons of capacity in the steel sector

⁴ U.S. Geological Survey, *Mineral Commodity Summaries, 1998 and 2016*, <http://minerals.er.usgs.gov/minerals/pubs/commodity/aluminum/050398.pdf>; <http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mcs-2016-alumi.pdf>. See also Attachment 2 (chart and table showing China's aluminum capacity).

⁵ U.S. Geological Survey, *Mineral Commodity Summaries, 2016*, <http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mcs-2016-alumi.pdf>.

⁶ U.S. Geological Survey, *Mineral Commodity Summaries, 1998 and 2016*, <http://minerals.er.usgs.gov/minerals/pubs/commodity/aluminum/050398.pdf>; <http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mcs-2016-alumi.pdf>.

⁷ *Id.*

⁸ U.S. Geological Survey, *Mineral Commodity Summaries, 2016*, <http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mcs-2016-alumi.pdf>.

⁹ See generally, *Surging Steel Imports Put Up To Half A Million U.S. Jobs At Risk*, Terence P. Stewart, Elizabeth J. Drake, Stephanie M. Bell, and Jessica Wang (Stewart and Stewart), and Robert E. Scott (The Economic Policy Institute), <http://www.epi.org/publication/surging-steel-imports/#iv.-the-future-of-the-domestic-steel-industry-depends-on-effective-trade-remedy-enforcement>.

¹⁰ See Attachment 2 (chart and table showing China's steel capacity). See also *Developments in Steelmaking Capacity of Non-OECD Economies*, http://www.oecd-ilibrary.org/industry-and-services/developments-in-steelmaking-capacity-of-non-oecd-countries_19991606; *China's excess crude steel still a problem*, <http://asia.nikkei.com/Politics-Economy/Economy/China-s-excess-crude-steel-still-a-problem>.

¹¹ See, e.g., OECD, *Steelmaking Capacity*, <http://www.oecd.org/sti/ind/steelcapacity.htm>.

¹² The United States and China engaged in discussions regarding excess capacity in the steel sector at the SE&D meeting in July 2014 and regarding the steel and aluminum sectors at the JCCT meeting in November 2015. See USTR December 2015 Report on China, at 104-105, <https://ustr.gov/sites/default/files/2015-Report-to-Congress-China-WTO-Compliance.pdf>.

over the next five years¹³ – a huge sum of capacity if actually achieved but as little as one fourth of what is needed in fact.

Companies harmed by globally depressed prices and rising import levels can seek relief through trade remedies.¹⁴ However, for products like aluminum or steel, problems often reflect loss of export markets (China or third country) as well as loss of one's home market. Trade remedies are generally available for import problems. WTO cases can be brought for loss of third country markets or loss of the market by the subsidizing country but require the willingness of the home government to bring such a case. However, existing WTO rules do not provide members with quick and effective means to address excess capacity.

The WTO has fairly limited tools to address these types of problems in large part because the problem is less common where economies work on market principles and hence large scale excess capacity is unusual (outside of a deep recession). While China has many practices which warrant WTO challenges and the massive level of government subsidies likely would permit a successful challenge for serious prejudice¹⁵ to the interests of many trading partners in these sectors, governments have a limited capacity to bring such challenges and, as shown by the serious delay in completing disputes in recent years, the WTO has an even lower capacity to handle a large number of disputes. WTO challenges at best are longer term in time frame – meaning a great deal of damage will be done to trading partners, to their companies, workers and communities before any resolution is possible.¹⁶

Even where the problem is primarily an import problem, the remedy is not necessarily simple or limited to the country which has created the problem. Excess capacity affects producers around the world, often creating a domino effect where loss of home market by producers in one market result in those producers increasing their exports to other countries trying to maintain their operations. Also, because trade remedies such as antidumping or countervailing duty measures are product- and country-specific, these “traditional trade remedies are micro-tools in nature and

¹³ *China to cut steel capacity by 100-150 mln tonnes in 5 years*, http://news.xinhuanet.com/english/2016-02/04/c_135075575.htm.

¹⁴ *Pain Spreads From China's Excess Production*, <http://blogs.wsj.com/chinarealtime/2014/07/16/pain-spreads-from-chinas-excess-production/> (noting that “China's vast excess capacity makes it the biggest target of [trade] sanctions”).

¹⁵ The WTO Agreement on Subsidies and Countervailing Measures (“SCM Agreement”), Article 5, provides: “No Member should cause, through the use of any subsidy ... adverse effects to the interests of other Members, i.e.: (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994; (c) serious prejudice to the interests of another Member.”

¹⁶ Terence P. Stewart, *Global Crisis in Steel and Aluminum Flowing from Chinese Excess Capacity; More to Come* (November 23, 2015), <http://www.stewartlaw.com/Article/ViewArticle/1050>.

can at best protect individual home markets, often requiring several rounds of cases on the same product in a given country where serious excess capacity remains in play and exports shift from one market to another as cases close off particular markets.”¹⁷ The result is that the number of cases that need to be brought and the potential multiple rounds of cases complicate efforts to address problems in the home market.

It is very clear that there has been an explosion of steel trade remedy cases around the world – antidumping, countervailing duty and/or safeguard actions – in the last several years. In the US there have been a large number of trade remedy cases filed (various flat rolled products and various pipe and tube products, usually each set of cases going after 5-7 countries under the AD and/or CVD laws).¹⁸ And many other WTO members have similarly brought groups of cases in an effort to deal with depressed steel prices, closing mills and loss of jobs. For example, between January 1995 and June 2014, 1,022 antidumping initiations concerning steel and other products were brought against China of which 740 resulted in antidumping duties.¹⁹

Since the first countervailing duty cases were launched against China, to counter its large number of government subsidies, in 2004, more CVD cases have been brought against China than any other country (84 initiations; 53 measures).²⁰

In sectoral terms, more than 80% of the world’s antidumping and countervailing duty cases against China have been concentrated in six industries: base metal, chemical, machinery and equipment, textile, rubber and plastics and stone, cement, and glass.²¹

The base metal sector, including steel, copper, and aluminum, accounted for more than a quarter of the antidumping cases and over half of the countervailing duty cases.²² Thus, it is evident that the Chinese industries with excess capacity are the ones most often subject to trade remedy investigations. As must be clear, the time needed to pursue solutions, however short, ensures that some part of the “correction” in the market will occur in markets that have not contributed to the problem. That has already happened as the closure of various aluminum smelters²³ and steel mills

¹⁷ Terence P. Stewart, *Global Crisis in Steel and Aluminum Flowing from Chinese Excess Capacity; More to Come* (November 23, 2015), <http://www.stewartlaw.com/Article/ViewArticle/1050>.

¹⁸ See, e.g., AISI, *Comments Concerning China’s WTO Compliance* (September 23, 2015) at Appendix I (listing 19 antidumping orders and 14 countervailing duty orders imposed by the US on imports of steel products from China), <https://www.steel.org/~media/Files/AISI/Public%20Policy/Letters/AISI-Comments-Regarding-China-WTO-Compliance-092315.pdf>.

¹⁹ See *China’s Excess Capacity: Drivers and Implications*, Rui Fan, Trade Consultant, Stewart and Stewart (June 2015); <http://www.stewartlaw.com/Content/Documents/China's%20Excess%20Capacity%20-%20Drivers%20and%20Implications.pdf>.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ “Since September 2015, six primary aluminum smelters in the United States have shut down, or have announced plans to shut down, 1.08 million metric tons per year of capacity. (See Aluminum in July 2015, August 2015, September 2015, and October 2015.)” U.S. Geological Survey, *Mineral Industry Surveys*, November 2015 at 1, <http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mis-201511-alumi.pdf>. The months cited (July-Oct. 2015) are

in the US and elsewhere attests. The longer the time needed and the slower the implementation of correction in the causing market – here China – the more of the correction that will necessarily occur elsewhere. In the meantime, the sectors and their workers will be in crisis.

I have included a paper, “China’s Excess Capacity: Drivers and Implications” by Rui Fan, a trade consultant at Stewart and Stewart, as a supporting document to this testimony.²⁴ The paper is an updated version of a paper released last summer, which looks at causes, sectors affected and actions being taken by the Chinese government to address the problem of excess capacity in China. The enclosed paper also includes an addendum to address a number of the questions this panel was asked to consider. I am also attaching several charts which look at capacity (global and in China) and production for steel and aluminum reported in particular sources showing developments over the last 15-20 years.

In conclusion, I recognize that some progress is being made in addressing the Chinese overcapacity crisis. I recognize and commend the Obama Administration for being presently engaged in discussions with China on the steel and aluminum sectors. It is also evident that China recognizes the seriousness of the problem and has taken some steps to address the problem including its recent pronouncements in the steel sector. But the progress is much too slow -- meaning communities, workers and communities across the United States and much of the rest of the world are paying the price of the Chinese economic model and its massive subsidization of capacity additions across a wide array of manufacturing sectors. While some industries have pursued trade remedy relief to deal with the harm caused, the nature of trade remedies usually means significant harm has already occurred – plants have closed, workers have lost jobs, communities are seriously affected. Much more needs to be done now by China and, if necessary, by its trading partners.

Some broader and perhaps more effective actions to address the ongoing crisis in key U.S. industries should also be considered. Among the ideas which should be on the table are:

- (1) The ITC *sua sponte* or Congress through amendment could recognize threat of material injury in any sector where there is global excess capacity of a significant magnitude and global prices have declined below full cost of production.
- (2) The US and major trading partners could encourage China to seek a waiver²⁵ at the WTO of obligations on export taxes not permitted by its Protocol of Accession and then apply

available at <http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mis-201507-alumi.pdf>;
<http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mis-201508-alumi.pdf>;
<http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mis-201509-alumi.pdf>;
<http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mis-201510-alumi.pdf>.

²⁴ Paper included in Panel III readings.

²⁵ Article IX:3 of the WTO Agreement provides that “the Ministerial Conference may decide to waive an obligation imposed on a Member by this Agreement or any of the Multilateral Trade Agreements, provided that any such decision shall be taken by three fourths of the Members.” Examples of waivers include the TRIPS waiver on access to essential medicines, waivers on trade preferences for developing countries, and the Kimberley waiver on conflict diamonds. A list of WTO waivers granted is available at https://www.wto.org/english/res_e/booksp_e/analytic_index_e/wto_agree_04_e.htm#tableD.

high export taxes on all products in sectors (not just upstream products but downstream products as well) where China has excess capacity until such time that global supply and demand are back in balance.

- (3) The US and major trading partners could seek a waiver²⁶ to permit imposition of quotas or above bound tariff rates on products where there is massive global excess capacity until such time as China's program of eliminating excess capacity has in fact been effective and balance between global supply and demand has been restored.
- (4) The US and major trading partners could seek consultations with China in the WTO on the serious prejudice and other violations of WTO obligations created by the massive subsidies and other practices that have created the excess capacities that have reduced access to the Chinese market, caused loss of market share in third countries, loss of market share at home or where China has increased its share of global trade above where it would have been.
- (5) For selected industries, the Administration could pursue action under Section 232 of the Trade Expansion Act of 1962 (national security).²⁷
- (6) The Administration (Department of Commerce) should issue guidance that in considering whether a country that is currently treated as a non-market economy should be treated as a market economy country under US antidumping law, one of the important "other factors" Commerce will consider is whether the policies of a country have created significant excess capacity that has not been eliminated at the time of the consideration of status of the country. 19 U.S.C. § 1677(18)(B)(vi).
- (7) Longer term, through FTAs or the WTO, the US and trading partners could seek agreed rules to prevent the build-up of significant excess capacity in industries and steps that can be taken to address such situations promptly if they do occur.

Finally and perhaps most immediately, the Obama Administration could self-initiate trade cases under Title VII of the Tariff Act of 1930 (antidumping and countervailing duty laws) on a broad basis and/or request the initiation of safeguard actions as the Bush Administration did in 2001 in steel. Companies and workers have been bringing many cases but, in some sectors, cases may be practically not possible because of retaliation concerns in China or the fragmented nature of the industry or the industry's financial condition.

What is clear is that the world faces serious economic challenges in many manufacturing sectors flowing from state activism by China that has created excess capacities in a host of industries. The size of the excess capacities in many industries has never been seen before and could not have happened under market economy conditions. US companies and workers as well as companies and workers in many other countries have already paid a price for this massive imbalance.

²⁶ *Id.*

²⁷ 19 U.S.C. § 1862. The purpose of a Section 232 investigation is to determine the effect of imports on the national security. Investigations may be initiated based on an application from an interested party, a request from the head of any department or agency, or may be self-initiated by the Secretary of Commerce. See <https://www.bis.doc.gov/index.php/other-areas/office-of-technology-evaluation-ote/section-232-investigations>.

Concerted efforts by China and its trading partners to address this disequilibrium within China are necessary now. Otherwise, balance will not be restored for many years, with massive job losses and destruction of much of the manufacturing infrastructure of the United States and elsewhere the result. Clearly, the stakes are high both for the future of manufacturing in America and for the global economy. We must put concerted pressure on China to act as it has realized it must but to do so on a timeframe and a scale that is meaningful to its trading partners and that results in a restoration of balance in global supply and demand.