

## NAFTA:

# A North American Perspective on Global Steel Industry Developments

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**GOVERNMENT SUPPORT FOR THE CHINESE AND INDIAN  
STEEL INDUSTRIES: THE PERILS OF OVEREXPANSION**

**PRESENTED BY ALAN H. PRICE  
PARTNER, WILEY REIN & FIELDING LLP  
AT OECD STEEL WORKSHOP IN NEW DELHI, INDIA**

**MAY 16, 2006**

## INTRODUCTION

Thank you for giving me this opportunity to discuss an issue of enormous importance – the role of government aid in the creation of excess capacity – with the leaders of the global steel industry. I am appearing today on behalf of the five major trade associations representing the North American steel industry. The North American industry has been concerned for some time about the overexpansion of global capacity, and especially with the role that state aid may be playing in the process. Today I will focus on the situation in two of the world's greatest steel producers, China and India.

Governments around the world have frequently provided special assistance to their steel industries. The result has all too often been the creation of capacity in excess of real long-term needs. Currently, both China and India are planning major expansions of their steel industries, expansions that will be made possible in large part through state support. We are concerned that the governments and steel industries of China and India may be repeating the mistakes of other countries, and building excess capacity in response to government policies rather than the requirements of the market. We examine the role of government in the Chinese and Indian steel industries in detail in a separate paper we have submitted to the conference; today I will be discussing some of our main points and conclusions.

Overcapacity and overproduction inevitably result in falling prices and disappearing profit margins. Unfortunately, these effects are not limited to the countries in which the overcapacity was built. Because steel is a globally traded commodity, excess pro-

duction in one country can result in mill closures and bankruptcies in another. For these reasons, overcapacity in China and India could have a direct impact on the North American steel industry.

In 2005 China was the world's largest steel producer, and India the seventh-largest. Between 2000 and 2005, Chinese production increased by 176 percent, and Indian production by 45 percent. Both countries have recently added very large amounts of production capacity, and have plans to add more. While steel consumption has increased substantially in both countries, growth in capacity has outstripped growth in consumption. In both countries, government direction, subsidization, and indirect support have played a central role in the expansion of capacity. This raises the concern that capacity in these two countries may be expanding to meet government goals, rather than the needs of the market, and what the impact of such a development might be on the rest of the world steel industry.

## **THE CHINESE STEEL INDUSTRY**

The dramatic expansion of the Chinese steel industry between 2000 and 2005 reflected a conscious decision by the Chinese government to funnel resources into the steel industry. The Chinese steel industry continues to be primarily state-owned, and state-owned steel producers often receive special benefits from the government. Some of the ways in which the Chinese government has provided resources to the Chinese steel industry include:

*Transfers of ownership interests on terms inconsistent with commercial considerations.* Because the Chinese government owns most steel companies, it can subsidize companies by transferring ownership of shares or facilities from one company to another at below-market or even at no cost. For example, in January 2005, the Government of Hubei Province transferred a 51 percent stake in Ercheng Iron & Steel, a local steel producer with a production capacity of 3 million tons per year, to another state-owned producer, Wuhan Iron and Steel, at no cost.<sup>1</sup> Ercheng had crude steel output of 3 million metric tons, and profit of 20 million RMB in 2004.<sup>2</sup>

*Conversion of debt to equity in steel companies.* State-owned banks lend money at below-market rates to steel producers; then, when the borrower is unable to pay back even these subsidized loans, the bank converts the debt into equity in the company. Since 2000, China's iron and steel companies have benefited from debt-to-equity swaps worth at least \$8.4 billion, as part of the government's plan to restructure and consolidate the steel industry.<sup>3</sup> Two of China's largest steel producers, Shanghai Baosteel and Anshan, both benefited from this process.<sup>4</sup>

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<sup>1</sup> Citigroup Global Markets, *China Steel Industry: Capacity Continues to Grow, So Does Surplus*, Feb. 21, 2006, at 28, 69.

<sup>2</sup> *Id.*

<sup>3</sup> See Letter to Gloria Blue from American Iron and Steel Institute re: China's Compliance with its WTO Commitments, at 5 (Sept. 6, 2005); China's Iron/Steel Industry to See M&A Activity, Asia Times Online, Aug. 24, 2005.

<sup>4</sup> Organization for Economic Cooperation and Development, *Reforming China's Enterprises 78* (2000).

*Preferential loans and directed credit.* The Chinese government owns all of the major banks in China - the Industrial and Commercial Bank of China, the Bank of China, the China Construction Bank, and the Agricultural Bank of China. Traditionally, these banks have made loans based on political directives from the central or provincial governments, not creditworthiness or other market-based factors. Chinese steel companies have benefited significantly from subsidized loans. For example, in 2005, China Development Bank, a state-owned bank, agreed to provide Anshan Steel Group (now Anben) with RMB 10 billion (US\$1.2 billion) in subsidized loans.<sup>5</sup> The same year, Handan Iron & Steel Group received interest-subsidized loans from the government worth RMB 2.4 billion (US\$300 million) to fund a 1.3 million-ton cold rolled steel sheet project.<sup>6</sup>

*Benefits for export performance.* The Chinese government has provided extensive benefits, primarily in the form of tax credits, to steel producers that export a substantial portion of their production. These benefits are not necessarily directed specifically to steel production, but are rather available to producers with foreign investment<sup>7</sup> or who are located in certain areas of the country.<sup>8</sup>

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<sup>5</sup> Xinhuanet (September 26, 2005), available at <http://finance.sina.com.cn/stock/t/20050926/0829328489.shtml>.

<sup>6</sup> See Stockstar.com (September 21, 2005), available at <http://resource.stockstar.com/info2005/darticle.asp?id=SS,20050921,30269085&column=>.

<sup>7</sup> See People's Republic of China, Subsidies: New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement, G/SCM/N/123/CHN ("China Subsidies Notification") at 2-4. As discussed below, however, the Chinese government limits foreign ownership in the steel industry to a minority share, and generally requires the transfer of technology as a condition of investment.

<sup>8</sup> See *id.* at 11-18.

The Chinese government also provides a rebate of value added taxes of 11 percent on steel exports.<sup>9</sup> These rebates are permissible constitute a method of encouraging steel exports, as the Chinese government itself has admitted.<sup>10</sup> Recent reports state that “China will probably scrap tax rebates on all steel products in the second half {of 2006} to discourage exports” of steel.<sup>11</sup>

*Currency manipulation.* The refusal of the Chinese government to allow the RMB to float freely has been a major source of friction between China and its trade partners. By some estimates, China's continued linkage of the RMB to the U.S. dollar provides Chinese steel exports with an effective subsidy of 27 to 40 percent, and imposes an effective tax on steel imports of a similar magnitude.

## **EXPANSION PLANS FOR THE CHINESE INDUSTRY**

The Chinese government's steel policy explicitly calls for continued support for the expansion and modernization of the steel industry. Projects either under construction or in the planning stage would add another 150 million tons of capacity. At the same time, the Chinese government has realized that the industry in China already has excess capacity, as it is planning to close 55 million tons of capacity in older, smaller

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<sup>9</sup> *Current Situation of the Chinese Steel Industry* at 8.

<sup>10</sup> *See Current Situation of the Chinese Steel Industry* at 8.

<sup>11</sup> *Shanghai Daily* (April 25, 2006).

mills. If it carries out all of these plans, Chinese capacity will still rise from its current level of 414 million tons per year to around 509 million tons over the next few years.

## **THE INDIAN STEEL INDUSTRY**

The Indian steel industry is primarily privately owned, although the largest producer, SAIL, is state owned. Significantly, SAIL by itself accounts for over 35 percent of Indian steel production. Since 1990, the Indian government has significantly reduced regulation of the steel industry, and no longer directly controls investment and prices. Government support was essential to the survival of SAIL during the last decade, though, as it provided a rescue package worth some \$2.2 billion. The Indian government continues to provide benefits to steel producers through a number of programs.

Indian steel producers receive a range of export incentives, including excessive remissions of taxes on imports of raw materials and machinery; licenses to import raw materials duty free when the materials are used for export production; and exemptions from income tax on export income. Both the United States and Canada have found many of these incentives to constitute countervailable subsidies. The Indian government is also targeting investment in the infrastructure needed for exports, such as port facilities.

India also provides steel producers export credit on favorable terms. The Reserve Bank of India has directed commercial banks to provide export credit both at pre-

and post-shipment stages.<sup>12</sup> Pre-shipment credit, or packaging credit, is granted to exporters for purchase of raw materials of the finished product upon the presentation of confirmed export orders or letters of credit.<sup>13</sup> With post-shipment credit, the credit is offered to exporters against either the shipping bill or drawback claims.<sup>14</sup> The Steel Development Fund provides preferential loans to industry members. .

The Indian federal government, and those of certain states, also control prices for iron ore indirectly. India has some of the largest iron ore reserves in the world. The Indian government has granted SAIL and Tata the exclusive right to use the production from selected mines. This gives them a huge cost advantage; as of December 2005, the cost of extraction of iron ore for SAIL and Tata Steel was between Rs 250 and 325 per metric ton, while the market price for iron ore was approximately Rs 2,000 per metric ton.<sup>15</sup> Even India's Ministry of Mines admits that captive mining by steel producers results in a huge subsidy to them.<sup>16</sup> The Indian national government also restricts exports of high-grade iron ore, while several state governments, including Orissa, prohibit steel producers from exporting iron ore from the state.<sup>17</sup> This effectively requires that

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Ministry Opposes Captive Iron Ore Mining by Steel Producers*, Business Line, December 26, 2005.

<sup>16</sup> *Id.*

<sup>17</sup> THE INDIAN STEEL INDUSTRY, *supra* note 54, at 35.

the ore be used in the state, which has the inevitable result of driving the cost of iron ore for domestic steel producers down.

## **EXPANSION PLANS FOR THE INDIAN INDUSTRY**

The Indian government plans for Indian steel capacity to more than double by 2019, to reach 100 million tons per year. At least one participant in the industry predicts that the industry will in fact reach 200 million tons in capacity by 2020. The Indian government intends to assist the expansion process by providing the Indian industry with additional export incentives, and even buyback provisions.<sup>18</sup> Individual states, especially Orissa, have extremely ambitious plans to leverage government support into an enormously expanded industry.

While the government expects the Indian industry to increase capacity by 20 percent per year, domestic demand for steel in India is expected to grow by only 8-10 percent per year.<sup>19</sup> To use all of the planned capacity, Indian producers will have to increase their exports enormously. India already exports approximately 15 percent of its steel production; by 2010, this figure is expected to rise to 45 percent, or 35 million metric tons per year.<sup>20</sup>

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<sup>18</sup> National Steel Policy at 4.

<sup>19</sup> *The Indian Steel Industry* at 28.

<sup>20</sup> *Id.*

When the Chinese steel industry overbuilt, it was able to slough off with comparative ease a large portion of the cost to the state-owned banks and asset management companies. India has no such option. If the Indian steel producers encounter financial hardship as a result of excess capacity, the result is more likely to be bankruptcies and mill closures, as well as pressure for direct government bailouts (like that of SAIL) to avoid hardship on the workers, communities and local financial institutions.

## **THE CONSEQUENCES OF OVERCAPACITY**

The construction of excess capacity in China and India will cost both countries billions of dollars in scarce capital. It will also have a negative effect on producers in other countries. As the NAFTA steel industry explained in a paper submitted to the OECD in 2005, the construction of excess capacity “will impose costs on all world steel producers by driving up the prices of inputs such as scrap, iron ore, coke, and energy.”<sup>21</sup> Overexpansion of the Chinese steel industry has already had some of these effects, as high Chinese demand for scrap and coke drove world prices for these key inputs to record levels in 2004 and 2005.

Overcapacity will of course ultimately have an impact on steel prices as well. Steel is a cyclical industry, and producers depend on profits during the relatively short boom times to tide them over during the inevitable bust. The global steel industry has experienced such a boom over the last three years, although prices have already begun to decline from their highs in 2004. The construction of excess capacity in China and

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<sup>21</sup> Organization for Economic Cooperation and Development, *Capacity Expansion in the Global Steel Industry 2* (2005).

India will exacerbate the situation. This can lead to the well-known “death spiral,” in which producers race to cut prices while maintaining production.

The construction of excess capacity in China and India will cost both countries billions of dollars in scarce capital. Overexpansion of the Chinese steel industry has already had negative effects on producers in the rest of the world; overexpansion of the Indian industry will only exacerbate the situation. Steel producers in both the developed and developing countries, including Brazil, have expressed concern over the building of excess capacity in these countries. Elimination of state support for the steel industry by China, India, and all other developing and developed countries is likely to limit excess capacity, and is more likely to result in a stable and healthy global steel industry.

**THE NEED FOR AN ONGOING OECD FOCUS ON STEEL**

**PRESENTED BY TERRENCE D. STRAUB**

**SENIOR VICE PRESIDENT – PUBLIC POLICY & GOVERNMENTAL AFFAIRS  
AT OECD STEEL WORKSHOP IN NEW DELHI, INDIA**

**MAY 16, 2006**

It is a pleasure to be here and have the opportunity to address this distinguished gathering. I am going to be discussing a topic that is certainly of keen interest to the North American steel industry and, I think it is fair to say, of general and significant interest to those here today -- namely the policy implications flowing from concerns over state-supported capacity growth, particularly in terms of the ongoing work of the OECD Steel Committee and the High Level Group on Steel. The remarks I will give represent the views of the five major steel association of North America.

The discussion we have just heard relating to state-supported capacity growth in China and India is of course reflective of the wider concerns that have preoccupied industry participants and observers for years. Indeed, the persistence of subsidies in the global steel industry, and the seemingly ineradicable problem of excess capacity and market distortions flowing from government support, undoubtedly constitute the most significant area of policy concern confronting the industry now and for decades past.

It is sometimes observed that, "Everyone complains about the weather, but no one ever does anything about it." The more pessimistic among us might say the same is true of state supported capacity in the steel industry. The truth is, however, that the last few years have seen a level of serious engagement, and thoughtful dialogue, on the issue that goes well beyond the finger-pointing of the past, and offers some hope that global players may finally be coming to the realization that something needs to change.

The work of the High Level Group on Steel has of course centered on the issues of subsidies and overcapacity, while also prompting serious dialogue on other basic issues affecting steel producers and world markets. The failure to reach consensus on a steel subsidies agreement (SSA) was a disappointment, but the focus these discussions brought to the problem of trade-distorting aid -- a focus that has in many ways remained even as market conditions have rebounded -- was in itself a significant achievement and a foundation for future consideration of the issues involved.

If there is a single message we hope will come out of this discussion today it is this: that the failure to reach consensus in the SSA talks cannot and must not result in a loss of resolve to tackle the fundamental issues facing this industry globally, or a diminishment in the attention paid by policy makers to the industry's problems. We all know the problems have not gone away, and that we are nothing more than a downturn away from seeing their effects front and center once again.

The document circulated by Mr. Schlogl, Chairman of the High Level Group, regarding the future work of the OECD on steel reflects a thoughtful understanding of the need to keep an appropriate focus on the challenges confronting the industry, as well the need for a meaningful forum to address them. Indeed, if we are to avoid the pitfalls of the past, we need to enhance the level of dialogue and the sophistication of our approach. And that should be the touchstone of our thinking in terms of the OECD's work going forward.

In this regard, the question is not whether we need to continue a process where government officials and industry can engage in a meaningful and substantive way on the broader policy issues confronting the global steel sector. Rather, the question is what forum can best further this goal and invigorate it.

North American governments have taken the view, which the industry shares, that the OECD Steel Committee itself should serve as the primary locus for future work on the policy issues affecting steel, and that the work of the High Level Group should be largely reoriented into that of an expanded Steel Committee agenda in the near term. To the extent consensus comes within reach on one or more of the core policy issues considered by the Committee, the High Level Process could and likely should be reengaged to explore avenues to effectuate that consensus -- whether in terms of new subsidy disciplines or other policy action. But for now, we believe a single forum, with the resources and focus to succeed, should be our principal objective.

There are a number of factors that argue in support of the Steel Committee as the logical candidate to serve in that role.

- First, the Steel Committee offers a proven and ready site for such work. The Committee has long served as the only international forum for government-industry dialogue on steel policy issues, and has a structure in place suitable for future engagement.

- Second, the Committee has in the past served as a forum for discussion of the core policy issues identified in Mr. Schlogl's discussion paper -- namely steel-specific trade issues, structural adjustment, the situation in developing economies, and environmental challenges.
- Third, the need to maximize the impact of available resources argues to consolidate efforts in a single forum, at least initially -- avoiding redundancy of effort and allowing a streamlined, efficient and consistent focus.
- Fourth, the ongoing outreach efforts of the Steel Committee in terms of non-OECD members can and should be continued to encourage the broadest participation in future substantive dialogue.
- Finally, and most importantly, the Steel Committee has the expertise, resources and experience to facilitate meaningful work on the policy issues confronting the industry.

If the Steel Committee is to be tasked with an enhanced role to further and build upon the progress made by the High Level Group -- as we believe it should -- its agenda and budget must reflect the greater demands that will be placed upon it. We certainly agree with and support the elements of the proposed 2007/08 OECD work program, including studies and reports on world market and industry developments, capacity review, raw material issues, and steel trade -- as well as reports and workshops

relating to developments in non-Member economies. But we believe the agenda for the Committee should be substantially broadened beyond statistical reports and technical issues, to include serious engagement and discussion on the many challenging policy issues impacting the global steel industry.

These issues should no doubt include those highlighted by Mr. Schlogl and others, including most prominently consideration of trade and government support measures of steel industries around the world, the growth of excess capacity, and other trade distortions affecting steel producers globally. The agenda should include real engagement on potential policy tools needed to impact these problems. The same is true of other major policy areas confronting steel, including environmental issues of common concern, energy policy, raw materials issues, and the rapid growth of steel production in developing economies.

Any hope of conducting serious and productive work in these areas will obviously require a budget sufficient for the task -- and not merely resources geared to a technical and statistical role. The industry globally has a common interest in making clear the need for governments to insist on appropriate funding to further the core objectives originally laid out for the High Level Process, as now being integrated with the traditional work of the Steel Committee.

It is most critical right now to retain and build on the growing recognition of the need for market outcomes in the industry, and the imperative to eliminate state-support

and subsidies in the steel sector. As the Steel Committee receives renewed interest and energy, it is well to keep in mind that we simply do not have any time to lose in terms of dealing the fundamental problem of subsidized capacity growth.

The Steel Committee should explore innovative ways to keep attention on the problem and develop new tools to confront it. But we must also not lose sight of the need to maintain and enhance the effectiveness of the tools we already have -- and that too should be at the forefront of the Committee's concerns. In this regard, traditional fair trade remedies have in truth proven the only effective policy means to discipline trade-distorting practices, and to disincentivize the creation of unwarranted, excess capacity. So long as countries can essentially "export" their own problems in terms of excess capacity, there is little hope to garner the will on the part of steel-producing countries to meaningfully address the problem.

While the use of anti-dumping and anti-subsidy remedies -- along with direct WTO remedies -- has, to be sure, rankled those impacted by them, it is important to consider that they benefit all global producers to the extent that they force countries to confront the problems within their own industries. If these disciplines are weakened or eviscerated internationally, it will only mean that the marketplace will be ceded to those who can game the system the best and enlist their governments to help fight the battle in terms of subsidies and the inappropriate financial support of national industries. That will truly be a race to the bottom, a legitimate death spiral for the many, and a hollow victory for the few who remain.

We are confident that a reinvigorated Steel Committee can serve as the right forum at the right time to make a difference. The steel crisis and the High Level Process helped to create an intellectual recognition of the fundamental problems facing the industry, and to begin the process of exploring how they can be meaningfully confronted and addressed at the policy level. To simply give up on that hope now would be a terrible mistake -- one that policy makers and industry participants would no doubt live to regret. Instead, we should build on the progress made, be realistic in our expectations, but strive to make the Steel Committee a forum that promises real results over time.

**GOVERNMENT SUPPORT FOR THE STEEL INDUSTRIES IN  
CHINA AND INDIA AND ITS IMPACT ON THE  
NORTH AMERICAN STEEL INDUSTRY**

**A PRESENTATION TO THE STEEL COMMITTEE OF THE ORGANIZATION FOR  
ECONOMIC COOPERATION AND DEVELOPMENT**

Presented by The American Iron & Steel Institute  
The Steel Manufacturers Association  
The Specialty Steel Industry of North America  
The Canadian Steel Producers Association  
La Cámara Nacional de la Industria del Hierro y del Acero

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## EXECUTIVE SUMMARY

In 2005, China was the world's largest steel producer, and India the seventh-largest. Between 2000 and 2005, Chinese production increased by 176 percent, and Indian production by 45 percent. Although demand has increased in both China and India, state-supported additions to capacity has resulted in excess capacity in both countries, and both have plans to add more. In both countries, government direction, subsidization, and indirect support have played a central role in the expansion of capacity.

The dramatic expansion of the Chinese steel industry between 2000 and 2005 reflected a conscious decision by the Chinese government to funnel resources into the steel industry. The Chinese steel industry continues to be primarily state-owned, and state-owned steel producers often receive special benefits from the government. The ways in which the Chinese government has provided resources to the Chinese steel industry include:

- Transfers of ownership interests on terms inconsistent with commercial considerations;
- Conversion of debt to equity in steel companies;
- Debt forgiveness and inaction regarding non-performing loans;
- Preferential loans and directed credit, including "policy loans" to favored state-owned enterprises on non-commercial terms; and
- Currency manipulation.

The Chinese government's steel policy explicitly calls for continued support for the expansion and modernization of the steel industry. Projects either under construction or in the planning stage would add another 150 million tons of capacity. At the same time, the Chinese government apparently realizes that the industry in China al-

ready has excess capacity, as it is planning to close 55 million tons of capacity in older, smaller mills.

The Indian government owns the largest steel producer in India, and provides benefits to all producers through a number of programs, including a broad variety of export incentives and controls over raw material prices. The Indian government plans for Indian steel capacity to more than double by 2019, and intends to assist the process by providing the Indian industry with still further export incentives, and even buyback provisions. Individual states, especially Orissa, have extremely ambitious plans to leverage government support into an enormously expanded industry.

The construction of excess capacity in China and India will cost both countries billions of dollars in scarce capital. Overexpansion of the Chinese steel industry has already had negative effects on producers in the rest of the world; overexpansion of the Indian industry will only exacerbate the situation. Steel producers in both the developed and developing countries, including Brazil, have expressed concern over the building of excess capacity in these countries. Elimination of state support for the steel industry by China, India, and all other developing and developed countries is likely to limit excess capacity, and is more likely to result in a stable and healthy global steel industry.

# GOVERNMENT SUPPORT FOR THE STEEL INDUSTRY IN CHINA AND INDIA

## INTRODUCTION

This paper has been prepared by the trade associations representing the vast majority of steel production in North America, including the American Iron and Steel Institute (AISI), the Steel Manufacturers Association (SMA), the Specialty Steel Industry of North America (SSINA), the Canadian Steel Producers Association (CSPA), and La Cámara Nacional de la Industria del Hierro y del Acero (Canacero). AISI and SMA include members located in Canada, Mexico, and the United States. These associations have cooperated on this paper because the issue of global overcapacity, and the support by governments for the creation of new capacity in excessive quantities, affects them directly.

### ***Overcapacity, Government Support, and the Business Cycle***

The North American steel industry has long been concerned with the role of state support in the creation of global overcapacity in steel production.<sup>22</sup> The global steel industry currently has approximately 125 million tons of excess capacity,<sup>23</sup> an amount greater than Japan's entire steel production in 2005. The steel industry is both capital intensive and cyclical in nature. During the boom portion of a cycle, overcapacity and its associated overproduction depress prices and prevent producers from gaining the full benefit of the cycle. When the cycle heads downward, the effects of overcapacity are even more severe, as producers attempt to maintain full production in the face of

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<sup>22</sup> See AISI et al., CAPACITY EXPANSION IN THE GLOBAL STEEL INDUSTRY, SG/STEEL31 (2005).

<sup>23</sup> World steel demand to reach 1.2 bn t in 2010, says ISSB, STEEL BUSINESS BRIEFING (May 8, 2006).

declining domestic demand by dropping prices and exporting their excess production, even though exports normally provide lower profits than domestic sales. This in turn can cause unpredictable surges in exports, collapses in prices, bankruptcies of steel firms, and the temporary or permanent closure of facilities.

The North American industry experienced this phenomenon at length during the period 1980 – 2003. Events in 2001 – 2002 reflect this experience. As a result of global overcapacity and a recession, steel production in Canada, Mexico, and the United States fell by more than 11 percent in a single year. Over the same period, prices for such basic products as hot-rolled sheet fell by more than 34 percent. Some 40 steel producers, including such well-established companies as LTV Steel and Geneva Steel, ceased production. Others, including Bethlehem Steel and National Steel, were forced into bankruptcy. While LTV and Bethlehem eventually became part of Mittal Steel USA, and National was purchased by US Steel, Geneva, Gulf States, and other producers stopped operations permanently. Indeed, production in the North American industry has still not recovered fully and remains below its 2000 levels.

The world steel industry is now enjoying a recovery. However, as Roland Baan, CEO of Mittal Steel, has explained that

In a process industry, serving a growing market, as is the case in steel, there will almost always be an over capacity. The reason is simple: capacity can only be added in discrete steps.

There might be periods of tightness, but on average the addition of capacity will always overshoot the immediate requirement of the market.

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<sup>24</sup> Statement by Mr. Roeland Baan at 3-4.

Unfortunately, state support tends to exaggerate the overexpansion of capacity and the resulting cycles of boom and bust. Government intervention by China and India in particular has caused and continues to spur the creation of capacity in both countries beyond what the market would appear to require. The overexpansion of the industry in these countries could ultimately prove to be unsustainable, with negative consequences for them as well as for producers and consumers in the rest of the world. For these reasons, it is essential that the Chinese and Indian steel industries, in cooperation with the OECD Steel Committee and their colleagues in other countries, examine exactly what these governments have done. This review must include actions by provincial or state and local governments as well as the national government. By undertaking this examination, the Chinese and Indian producers and their governments can decide how best to ensure that their expansion is sustainable and does not cause undue harm to producers and steel consumers in other countries.

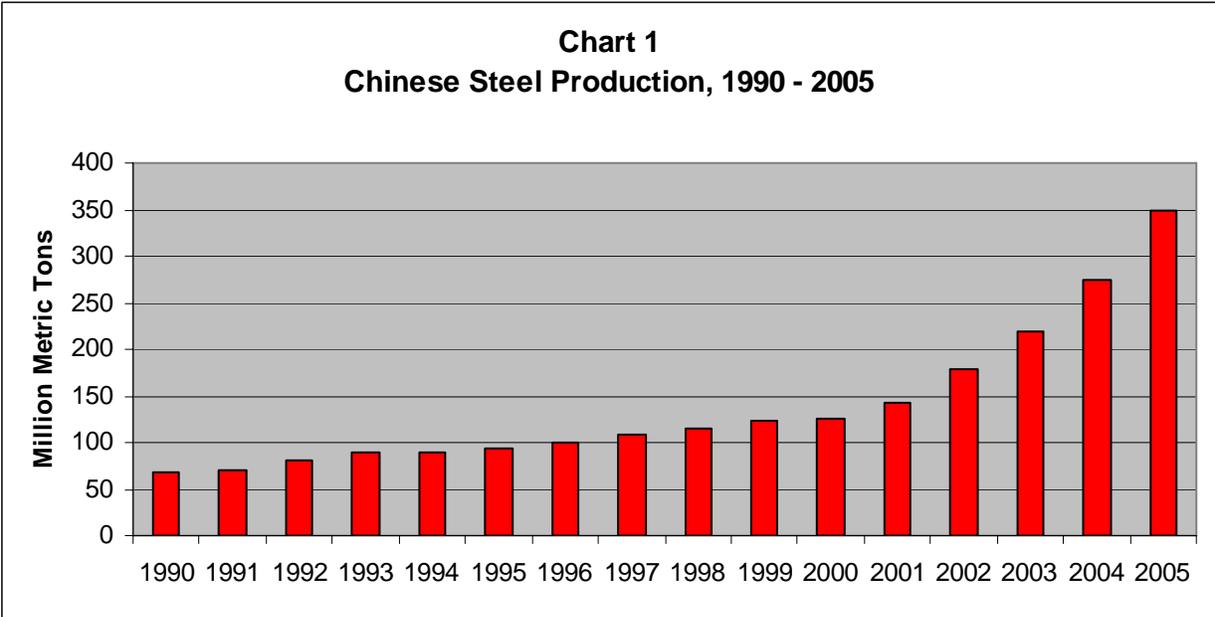
## **THE CHINESE STEEL INDUSTRY**

China is the world's largest steel producer. Given that it has the world's largest population, and is also the world's largest producer of coal and iron ore, it is not surprising that China would have a substantial steel industry. The meteoric growth of the Chinese steel industry over the past decade, however, to a size that even the Chinese government admits is excessive, reflects deliberate government policy intervention that is of great concern.

### ***The Structure of the Chinese Steel Industry***

In 2000, China produced 126 million tons of steel, about 20 million tons more than the next largest producer, Japan. In 2005, China made 349.4 million tons of steel, an increase of 176 percent in only five years. This was more steel than the next three

largest producers combined.<sup>25</sup> Over this period, China moved from a net importer to a net exporter of steel. The following chart shows the growth in Chinese steel production between 1990 and 2005.<sup>26</sup>



This expansion of capacity reflected in large part a conscious decision to funnel resources into the steel industry. The Chinese steel industry continues to be primarily state-owned, with state-owned enterprises accounting for 57 percent of total production.<sup>27</sup> As the following chart shows, the Chinese government holds a majority interest

<sup>25</sup> INTERNATIONAL IRON AND STEEL INSTITUTE, World Crude Steel Production 2005, IISI 103 (2006).

<sup>26</sup> INTERNATIONAL IRON AND STEEL INSTITUTE, STEEL IN FIGURES, <http://www.worldsteel.org/?action=archivedsteellist2>.

<sup>27</sup> OECD Directorate for Science, Technology and Industry Steel Committee, CURRENT SITUATION OF THE CHINESE STEEL INDUSTRY DSTI/SU/SC(2006)9 (Apr. 4, 2006) (hereinafter CURRENT SITUATION OF THE CHINESE STEEL INDUSTRY).

in nine of the top ten Chinese steel producers.<sup>28</sup> The chart also shows the 2005 production of each of these producers.

TABLE 1  
GOVERNMENT OWNERSHIP OF CHINESE STEEL COMPANIES

Producer	Government Ownership (%)
Shanghai Baosteel	85.41%
Anben	64.70%
Wuhan	75.81%
Shougang	81.19%
Maanshan	62.50%
Tangshan	61.31%
Jiangsu Shagang	0.00%
Jinan	76.60%
Laiwu	78.01%
Panzhuhua	55.37%

The structure of the Chinese steel industry reflects the pervasive influence of the Chinese government. The Chinese industry is extremely fragmented, both in production and geographically. There are over 800 steel producers in China, with 264 producing crude steel.<sup>29</sup> Yet in 2005 only one Chinese producer, Shanghai Baosteel, produced more than 20 million tons.<sup>30</sup> The fifteen largest Chinese producers accounted for only a bit over 48 percent of total Chinese production in 2005.<sup>31</sup>

The Chinese industry is also fragmented geographically. While steel production is concentrated in the northeastern part of the country, no single province accounts for more than 18 percent of China's annual production. Several provinces have annual

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<sup>28</sup> See <http://www.corporateinformation.com>.

<sup>29</sup> *Id.* at 16.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

production of less than 5 million metric tons per year.<sup>32</sup> This fragmentation reflects the active intervention of the Chinese government at all levels – national, provincial, and local – in the steel industry. As Ian Christmas, Secretary-General of the International Iron and Steel Institute, has noted, “{e}ach region within China wishes to have its own steel industry.”<sup>33</sup>

### ***Government Direction of the Steel Industry***

The Chinese government continues to direct the growth and evolution of the Chinese steel industry through a number of policy instruments. In July 2005, the National Development and Reform Commission ("NDRC") issued China's new Steel and Iron Industry Development Policy ("Steel Policy"), which outlines the government's comprehensive policy for the steel industry. As a whole, the policy provides for the government's management of China's steel industry, including resource and equipment utilization, regional concentration of output, quality improvements, technological innovation, investment management, and consolidation. Article 20, for example, provides for the strategic reorganization of China's largest steel producers to create an industrial structure with two 30 million-ton steel groups and several 10 million-ton steel groups by 2010.<sup>34</sup>

The policy further prescribes the number and size of steel producers, where they will be located, the types of products that are allowed to be produced, and minute details relating to the technology that will be used (e.g., size and composition of blast fur-

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<sup>32</sup> *China's Steel Industry*, STEEL BUSINESS BRIEFING (2006).

<sup>33</sup> Ian Christmas, Secretary General, IISI, The Challenges Ahead for Steel, Address to the IMI Annual General Meeting (June 2, 2005), <http://www.worldsteel.org/?action=programs&id=37&about=1>.

<sup>34</sup> NATIONAL DEVELOPMENT AND REFORM COMMISSION, Steel And Iron Industry Development Policy 2005 at art. 20 ("China Steel Policy").

naces). The Steel Policy also mandates direct government subsidization of the steel industry. For example, Article 16 specifically provides for government support in the form of "tax refunds, discounted interest rates, funds for research and other policy support for major iron and steel projects utilizing newly developed domestic equipment."<sup>35</sup>

The central government's National Planning Commission also periodically issues a "Catalogue of Key Industries, Products and Technologies the Development of Which is Encouraged by the State." This planning document lists key industries and products which are favored by the central government and therefore eligible for preferential treatment. The Catalogue lists "Iron and Steel" as a preferred or favored industry along with dozens of specific steel products.<sup>36</sup> As a result, steel companies are eligible for various tax exemptions and reductions, including a 50 percent income tax reduction for companies that derive more than 70 percent of their revenues from manufacturing a product listed in the Catalogue. The Catalogue gives local authorities the discretion to pursue policies that promote the development of these industries.

### ***Plans for Expansion***

Despite the enormous recent increases in capacity, the Chinese government officially intends that the Chinese steel industry will reduce capacity slightly. China had

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<sup>35</sup> *Id.*, art. 17.

<sup>36</sup> See, e.g., GOVERNMENT OF CHINA, FOREIGN AFFAIRS OFFICE, FOREIGN AFFAIRS INFORMATION PORTAL, CURRENT CATALOGUE OF KEY INDUSTRIES, PRODUCTS AND TECHNOLOGIES THE DEVELOPMENT OF WHICH IS ENCOURAGED BY THE STATE (PROVISIONAL) (APPROVED BY THE STATE COUNCIL ON DEC. 31, 1997), available at <http://www.bjfao.gov.cn/english/law/003C/144.html>.

approximately 414 million tons of steel making capacity in 2005.<sup>37</sup> China intends that capacity will fall to 400 million tons in 2010.<sup>38</sup>

To accomplish the planned reduction, the Chinese government plans to remove about 55 million tons of obsolete steel making capacity from production.<sup>39</sup> However, at the end of 2005, 70 million tons of new capacity was already under construction, and another 80 million tons of capacity was planned.<sup>40</sup> This indicates that, even if China in fact closes the full 55 million tons of capacity targeted, capacity would actually increase to at least 429 million tons with the completion of projects currently underway, and potentially to 509 million tons if all planned projects are completed. The North American steel industry is encouraged by the fact that the Chinese government realizes that China currently has overcapacity in steel, but is concerned that projects underway will undercut the Chinese government's goal of reducing capacity to more sustainable levels.

#### ***Direct Government Support for the Steel Industry***

The various levels of the Chinese government (national, provincial, and local) have provided direct support and assistance to the Chinese steel industry through a number of mechanisms. These include both formal programs, such as tax rebates for exports, and specific decisions to benefit individual companies. The various forms of direct support have included:

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<sup>37</sup> *Id.* at 20.

<sup>38</sup> CURRENT SITUATION OF THE CHINESE STEEL INDUSTRY at 2.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

Transfers of ownership on terms inconsistent with commercial considerations.

Because the Chinese government owns most steel companies, it can subsidize companies by transferring ownership of shares or facilities from one company to another at below-market or even at no cost. For example, in January 2005, the Government of Hubei Province transferred a 51 percent stake in Ercheng Iron & Steel, a local steel producer with a production capacity of 3 million tons per year, to another state-owned producer, Wuhan Iron and Steel, at no cost.<sup>41</sup> Ercheng had crude steel output of 3 million metric tons, and profit of 20 million RMB in 2004.<sup>42</sup>

Debt-for-equity swaps. This has been a common way by which the Chinese government funds the steel industry. State-owned banks lend money at below-market rates to steel producers; then, when the borrower is unable to pay back even these subsidized loans, the bank converts the debt into equity in the company. Since 2000, the Chinese government has converted at least \$8.4 billion in direct government financing into equity in 37 different Chinese steel companies.<sup>43</sup> Xingang Steel, for example, was established in 2000 through a debt-to-equity swap in which several of China's state-owned asset management corporations purchased non-performing loans and then injected capital into the steel company.<sup>44</sup>

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<sup>41</sup> Citigroup Global Markets, *China Steel Industry: Capacity Continues to Grow, So Does Surplus*, Feb. 21, 2006, at 28, 69.

<sup>42</sup> *Id.*

<sup>43</sup> See Letter to Gloria Blue from American Iron and Steel Institute *re: China's Compliance with its WTO Commitments*, at 5 (Sept. 6, 2005); *Iron/Steel Industry to See M&A Activity*, ASIA TIMES ONLINE, Aug. 24, 2005.

<sup>44</sup> See *Debt-to-Equity Swap Brings Economic Results to Steel Firm*, PEOPLE'S DAILY ONLINE, June 7, 2001, [http://english.people.com.cn/200106/07/eng20010607\\_71985.html](http://english.people.com.cn/200106/07/eng20010607_71985.html).

Benefits for export performance. The Chinese government has provided extensive benefits, primarily in the form of tax credits, to steel producers that export a substantial portion of their production. These benefits are not necessarily directed specifically to steel production, but are rather available to producers with foreign investment<sup>45</sup> or who are located in certain areas of the country.<sup>46</sup>

The Chinese government also provides a rebate of value added taxes of 11 percent on steel exports.<sup>47</sup> These rebates constitute a method of encouraging steel exports, as the Chinese government itself has admitted.<sup>48</sup> The amount of these rebates can be substantial; in 2004, for example, Guangzhou Iron & Steel Co., Ltd. earned VAT rebates of RMB 9.6 million (US\$1.2 million) on exports of steel products.<sup>49</sup> Recent reports state that “China will probably scrap tax rebates on all steel products in the second half {of 2006} to discourage exports” of steel.<sup>50</sup> At present, however, the rebates continue in place for finished products.

Other direct subsidies. The various levels of the Chinese government provide direct subsidies, in the form of both grants and preferential tax treatment, to steel producers through a broad array of programs. These include reduced taxes for firms with

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<sup>45</sup> See PEOPLE’S REPUBLIC OF CHINA, SUBSIDIES: NEW AND FULL NOTIFICATION PURSUANT TO ARTICLE XVI:1 OF THE GATT 1994 AND ARTICLE 25 OF THE SCM AGREEMENT, G/SCM/N/123/CHN (“China Subsidies Notification”) at 2-4 (hereinafter CHINA SUBSIDIES NOTIFICATION). As discussed below, however, the Chinese government limits foreign ownership in the steel industry to a minority share, and generally requires the transfer of technology as a condition of investment.

<sup>46</sup> See *id.* at 11-18.

<sup>47</sup> CURRENT SITUATION OF THE CHINESE STEEL INDUSTRY at 8.

<sup>48</sup> See *id.* at 8.

<sup>49</sup> Guangzhou Iron & Steel Co., Ltd. 2004 Annual Report.

<sup>50</sup> SHANGHAI DAILY (April 25, 2006).

foreign investment and for firms located in specific regions, in special development zones, or in technology development zones; tax credits for research and development; tax deductions for purchases of domestically produced equipment and machinery; and grants for a number of different purposes.<sup>51</sup>

Preferential loans and directed credit. The Chinese government owns all of the major banks in China - the Industrial and Commercial Bank of China, the Bank of China, the China Construction Bank, and the Agricultural Bank of China. These four banks alone account for over 60 percent of all loans in China.<sup>52</sup> Traditionally, these banks have made loans based on political directives from the central or provincial governments, not creditworthiness or other market-based factors. These “policy loans” generally have gone to state-owned enterprises and to industries favored by the government, including steel.<sup>53</sup>

A WTO report issued in November 2005 highlighted the role of directed credit and preferential loans in the Chinese government’s overall economic policies, and its policy regarding the steel industry in particular.<sup>54</sup> The report identified state support to various industries through the banking system as taking primarily “the form of policy

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<sup>51</sup> See CHINA SUBSIDIES NOTIFICATION.

<sup>52</sup> LUO PING, CHALLENGES FOR CHINA’S BANKING SECTOR AND POLICY RESPONSES (Nov. 14-16, 2003).

<sup>53</sup> See KNOWLEDGE @ WHARTON, Reform of China’s Banks, Burdened by Bad Loans, Is Priority for Government (June 1, 2005) *available at* <http://knowledge.wharton.upenn.edu/index.cfm?fa=printArticle&ID=1202>. A recent IMF report concludes that “banks remain exposed to several sectors that are likely over invested, such as steel, cement, aluminum, and construction and, are therefore vulnerable to an economic slowdown and/or consolidation in these sectors.” RICHARD PODPIERA, PROGRESS IN CHINA’S BANKING SECTOR REFORM: HAS BANK BEHAVIOR CHANGED?, No. WP/06/71, at 11 (Mar. 1, 2006).

<sup>54</sup> WORLD TRADE ORGANIZATION, CHAIRPERSON’S REPORT TO THE COUNCIL FOR TRADE IN GOODS ON TRANSITIONAL REVIEW OF CHINA, No. G/SCM/118 (Nov. 9, 2005).

loans, the automatic roll-over of unpaid principle and interest, forgiven and non-performing loans and the selective use of below-market interest rates.”<sup>55</sup> The report concluded that China continues to provide “preferential bank financing to producers of agricultural and industrial goods, despite a clear commitment by China four years ago to eliminate all prohibited subsidies upon its accession to the WTO.”<sup>56</sup>

Chinese steel companies have benefited significantly from subsidized loans. For example, in 2005, China Development Bank, a state-owned bank, agreed to provide Anshan Steel Group (now Anben) with RMB 10 billion (US\$1.2 billion) in preferential policy (i.e., subsidized) loans.<sup>57</sup> The same year, Handan Iron & Steel Group received interest-subsidized loans from the government worth RMB 2.4 billion (US\$300 million) to fund a 1.3 million-ton cold rolled steel sheet project.<sup>58</sup> In 2005, Baosteel, China’s largest steel producer, funded one half of the RMB 10 billion cost of a new stainless steel production facility with subsidized loans from state-owned banks.<sup>59</sup>

Currency manipulation. By keeping the value of the Chinese RMB artificially low, the Chinese government effectively subsidizes Chinese steel exports, while making imports of steel more expensive. In the absence of a freely floating RMB, it is impossible to determine precisely how big this subsidy is. One recent study by the Australian government indicates that the Chinese government is holding the RMB at between 15 and

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<sup>55</sup> *Id.* at 12.

<sup>56</sup> *Id.* at 3.

<sup>57</sup> Xinhuanet (September 26, 2005), available at <http://finance.sina.com.cn/stock/t/20050926/0829328489.shtml>.

<sup>58</sup> See Stockstar.com (September 21, 2005), available at <http://resource.stockstar.com/info2005/darticle.asp?id=SS,20050921,30269085&column=>.

<sup>59</sup> CHINA CORPORATE CULTURE WEB, <http://www.ce-c.com/qyfc-60.htm>.

30 percent below its market value;<sup>60</sup> other estimates place the extent of undervaluation as high as 40 percent.

China has promised to allow the RMB to float across a wider range. Although China has announced plans to value the RMB against a basket of currencies, the RMB in fact still tracks the dollar quite closely. To keep the RMB's value vis-à-vis the U.S. dollar down, the Chinese government must make enormous purchases of U.S. dollars, usually in the form of U.S. government bonds. The Chinese government's purchases of U.S. dollars and other securities are currently averaging about \$200 billion per year. These purchases amount to fully 9 percent of China's GDP. Chinese government purchases of dollars and other securities represents a substantial 27 to 40 percent subsidy on China's exports.<sup>61</sup> This subsidy gives Chinese exports of steel a huge advantage in world markets. At the same time, an undervalued RMB makes imports, including steel imports, correspondingly more expensive.

### ***Indirect Assistance***

The Chinese government has also provided assistance to the Chinese steel industry using more indirect methods. While these methods may not constitute subsidies in the formal sense, they do reflect distortions in the operation of the market. Because these practices include manipulation of raw material supply and prices, they affect steel producers outside of China directly as well.

Control over raw material exports. The Chinese government has imposed export restrictions or high export taxes on key steelmaking raw materials such as coke and

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<sup>60</sup> See P. Garton and J. Chang, *The Chinese currency: how undervalued and how much does it matter?*, ECONOMIC ROUNDUP 2005 83, 107 (2005).

<sup>61</sup> THE DOHA ROUND: NO HELP FOR AMERICA'S TRADE DEFICIT? at 21.

steel scrap. These restrictions have had the effect of reducing domestic prices for these inputs to below world market levels. The best-known case involves coke, which is an essential input into making steel using the traditional blast furnace. In 2004, China imposed a quota on exports of coke of 14.3 million metric tons. China's coke production in 2004 was 208 million metric tons. The export restriction caused the price for coke exported from China to rise to artificially high levels.<sup>62</sup>

The export restrictions on coke provided a benefit to the Chinese steel industry in two distinct ways. First, by keeping the domestic supply of coke artificially high, the Chinese government kept its domestic price artificially low. At the same time, the export restrictions made Chinese coke more expensive for foreign steel producers, reducing their competitiveness vis-à-vis the Chinese industry. While China has eased its export restrictions on coke, the measures continued to have distortive effects. In late June 2005, for example, Chinese steel producers were paying only \$139/metric ton for coke, while foreign steel producers were paying \$220/metric ton for the same coke.<sup>63</sup>

This example shows how the Chinese government has intervened in markets in ways that directly benefit the Chinese steel industry. Moreover, the Chinese government has made it clear that it intends to continue to restrict exports of raw materials where this will benefit the steel industry.<sup>64</sup> China applies a 40 percent tax to exports of steel scrap, for example. Although China is a major net importer of scrap, this export

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<sup>62</sup> WORLD TRADE ORG., CHINA'S TRANSITIONAL REVIEW MECHANISM: COMMUNICATION OF THE UNITED STATES, No. G/MA/W/71, at 3 (Sept. 6, 2005).

<sup>63</sup> World Steel Dynamics, *Steel Thermometer #24 15* (June 30, 2005).

<sup>64</sup> China Steel Policy, art. 30.

tax prevents Chinese scrap from entering the world market, and inevitably drives down the price of scrap inside China, to the benefit of the Chinese steel producers.

Intervention in international markets for inputs. The Chinese government has also intervened in international markets to control the prices of raw materials imported by the Chinese steel industry. Although China is the world's largest producer of iron ore, by tonnage, Chinese iron ore reserves have a relatively low iron content. This has forced China to import large quantities of iron ore, primarily from Australia, Brazil, and India.<sup>65</sup>

Because the Chinese steel industry is heavily dependent on imported iron ore, a sharp increase in iron ore prices would have an immediate negative effect upon the industry. The Chinese government exhibited its willingness to intervene in international markets on behalf of its steel industry when precisely such a sharp increase appeared likely in the early part of 2006, as Chinese steel producers began negotiations with Australian and Brazilian iron ore suppliers. Initially, the Chinese government attempted to control the negotiations by limiting participation to a single Chinese steel producer, Shanghai Baosteel. The avowed purpose of this move was to impose discipline on the Chinese industry in the negotiations.<sup>66</sup>

Some sources subsequently reported that China would effectively cap imported iron ore prices by refusing to approve import permits for shipments above the cap price (\$54/ton for Australian ore, and \$70/ton for Brazilian ore).<sup>67</sup> The Chinese government

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<sup>65</sup> *China May Trim List of Domestic Iron Ore Importers*, DOW JONES, Mar. 15, 2006.

<sup>66</sup> *China Assoc: Only Baosteel to Hold Iron Ore Price Talks*, DOW JONES NEWSWIRE, Feb. 22, 2006.

<sup>67</sup> *China Caps Iron-Ore Prices*, DAILY TELEGRAPH, Mar. 7, 2006.

also indicated that it was considering reducing the number of importers allowed to bring iron ore into China, so that it could exert greater control over iron ore imports.<sup>68</sup> The Chinese government made its goal absolutely clear in a statement by the Ministry of Commerce and the National Development and Reform Commission, as an official stated that “{t}he Chinese government will pay close attention to the negotiation process of iron ore price, and take necessary measures to avoid damaging interests of the nation and enterprises if price set is unreasonable and unacceptable to China.”<sup>69</sup>

China has recently assured the Brazilian government that it would not restrict iron ore imports,<sup>70</sup> and reports indicate that the Chinese government will acquiesce to price increases of 5-10 percent for iron ore.<sup>71</sup> Nonetheless, the Chinese government is planning to “strengthen its monitoring” of iron ore imports “in a move expected to increase pressure on miners as they seek to finalise yearly supply contracts with steelmakers.”<sup>72</sup>

Assistance in securing sources of supply. The explicit policy of the Chinese government is to assist the Chinese steel producers in securing sources of overseas supply through investments.<sup>73</sup> To ensure access to iron ore supplies, the Chinese government and Chinese companies have negotiated investments in a number of iron ore projects

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<sup>68</sup> *China May Trim List of Domestic Iron Ore Importers*, DOW JONES, Mar. 15, 2006.

<sup>69</sup> MINISTRY OF COMMERCE OF THE PEOPLE’S REPUBLIC OF CHINA, MOFCOM AND NDRC HIGHLY CONCERNED WITH THE LONG-TERM IRON ORE PRICE NEGOTIATION IN 2006, available at <http://english.mofcom.gov.cn/aarticle/newsrelease/significantnews/200603/20060301691985.html>.

<sup>70</sup> *China Tells Brazil It Will Not Restrict Iron Ore Imports*, STEEL BUSINESS BRIEFING, Mar. 21, 2006.

<sup>71</sup> M. Zonneveldt, *One Row Eases*, HERALD-SUN, Mar. 22, 2006, available [http://www.hwt.com.au/common/story\\_page/0,5478,18554730%255E664,00.html](http://www.hwt.com.au/common/story_page/0,5478,18554730%255E664,00.html).

<sup>72</sup> *China Introduces New Measures to Monitor Iron Ore Imports*, STEELDAY, Mar. 15, 2006.

<sup>73</sup> China Steel Policy, art. 30.

worldwide, with much of the investment subsidized by the government. For example, the Chinese government recently granted Jiangsu Sha Steel Group 1.3477 million RMB in subsidies for its iron mine project in Australia.<sup>74</sup>

## **THE INDIAN STEEL INDUSTRY**

In 2005, India was the world's seventh-largest steel maker. The Indian government has played a significant role in the expansion of the Indian industry, and continues to intervene in the steel market, especially in the market for steel inputs, in ways that cause distortions. Moreover, both the Indian federal government and individual state governments have endorsed plans that envision the Indian steel industry more than doubling its capacity over the next decade.

### ***Structure of the Indian Steel Industry***

With production of 38.1 million tons in 2005,<sup>75</sup> India's steel industry ranked as the seventh-largest in the world. While its growth has been less explosive than that of China's, the Indian steel industry nearly tripled in size between 1990 and 2005. As with China, its growth has been particularly rapid since 2000.

The Indian industry's current production capacity is approximately 43 million tons per year.<sup>76</sup> Capacity has increased by over 28 percent since 2000, and is projected to rise to 55.6 million tons per year by 2008.<sup>77</sup> As discussed below, some participants in the industry expect that Indian capacity will rise to 200 million tons by 2020.

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<sup>74</sup> *China Jiangsu Offering Over 6 M RMB of Subsidies to Overseas Investors*, FINANCIAL TIMES, Feb. 15, 2006.

<sup>75</sup> *World Crude Steel Production 2006*.

<sup>76</sup> OECD Directorate for Science, Technology and Industry Steel Committee, DSTI/SU/SC(2006)4, THE INDIAN STEEL INDUSTRY 28 (February 8, 2006) (hereinafter THE INDIAN STEEL INDUSTRY).

<sup>77</sup> See *id.* at 11.

The Indian steel industry is relatively export-oriented. India is a net exporter of steel products.<sup>78</sup> Between 2001 and 2005, exports of finished carbon steel ranged between 8.2 and 15.6 percent of total production.<sup>79</sup>

Unlike the Chinese industry, the Indian steel industry is relatively concentrated. The top six producers account for over 75 percent of production, with one producer, the Steel Authority of India Ltd. (SAIL), alone producing nearly 36 percent of all the steel manufactured in India.<sup>80</sup> Like the Chinese industry, a significant portion of the Indian industry continues to be state-owned. State-owned companies continue to produce a majority of crude steel, although the private sector predominates in the production of finished steel.<sup>81</sup> The largest Indian steel company, SAIL, is state-owned and is larger than the next four Indian producers combined.

### ***The Government's Role in the Steel Industry***

The Indian government has traditionally played a prominent role in the direction of the steel industry. The Indian government has since independence viewed steel as a backbone of the Indian economy. Until 1990, "the Indian steel industry operated under a regulated environment with insulated markets and large-scale capacities reserved for the public sector. Production and prices were determined and regulated by the Government ... ." <sup>82</sup> Since 1990, and especially since 1992, the Indian government has reduced regulation and allowed private investment in the industry. Nonetheless, the gov-

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<sup>78</sup> *Id. at 16.*

<sup>79</sup> *See id. at 16.*

<sup>80</sup> *See id. at 10.*

<sup>81</sup> *Id. at 16.*

<sup>82</sup> THE INDIAN STEEL INDUSTRY, at 7.

ernment remains heavily involved in the promotion of the industry. Indeed, an entire ministry, the aptly-named Ministry of Steel, is devoted to the industry. The Ministry of Steel's stated functions reveal the breadth of the government's involvement:

- Co-ordination and planning of the growth and development of Iron and Steel Industry in the country (including Re-rolling Mills, Alloy Steel and Ferro Alloy Industries, Refractories) both in the Public and Private Sectors;
- Formulation of policies in respect of production, pricing, distribution, import and export of iron and steel, ferro alloys and refractories; and
- Development of input industries relating to iron ore, manganese ore, chrome ore and refractories etc., required mainly by the steel industry.<sup>83</sup>

Of course, the government continues to be a direct participant in the industry through its ownership of SAIL, by far the largest Indian steel producer.

### ***Plans for Expansion***

The Indian government's plans for the steel industry, including its expansion, are set forth in the National Steel Policy 2005.<sup>84</sup> The centerpiece of the strategy is the construction of capacity to produce 110 million metric tons of steel per year by 2019.<sup>85</sup> This would represent an increase in Indian capacity of nearly 190 percent in fifteen years, and would make India one of the largest producers in the world. Even greater expansion is possible; J.P. Singh, former Secretary of the Steel Ministry, predicts that Indian capacity could grow as high as 200 million tons per year by 2020.<sup>86</sup>

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<sup>83</sup> MINISTRY OF STEEL OF THE GOVERNMENT OF INDIA, MAJOR ACTIVITIES OF THE MINISTRY, <http://steel.nic.in/activity.htm>.

<sup>84</sup> MINISTRY OF STEEL OF THE GOVERNMENT OF INDIA, NATIONAL STEEL POLICY-2005, <http://steel.nic.in/nspolicy2005.pdf> (hereinafter NATIONAL STEEL POLICY-2005).

<sup>85</sup> *Id.* at 1.

<sup>86</sup> *Steel Industry to Touch 200 mn Tonne Mark by 2020*, The Hindu News Update Service, March 3, 2006 <http://www.hinduonnet.com/thehindu/holnus/006200603031421.htm>.

The Indian government's plans for the steel industry will require an enormous increase in exports. By 2010, India is expected to export more than 45 percent of its total production, or 35 million metric tons per year, up from 4.5 million metric tons of exports in 2005.<sup>87</sup> The Indian government intends to take an active role in the promotion of exports:

It takes assiduous effort to create and hold on to export markets. While the business decision to export will depend on prevailing relative prices, the Government would encourage strategic alliances with buyback arrangements and dedicated export production through 100% export-oriented units. A growth rate of around 13 percent per annum is envisaged up to 2019-20.<sup>88</sup>

The Indian government intends to assist steel exports through a variety of measures, including excessive duty exemption or remission schemes and the provision of export credits. It also intends to encourage the export of products containing steel.<sup>89</sup>

### ***Direct Assistance***

India's steel industry has been the beneficiary of long-standing and substantial government support. The industry has developed in a highly protected and controlled environment characterized by high import tariffs, direct government assistance, government control over prices, and state allocation of resources.<sup>90</sup> Assistance has tradi-

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<sup>87</sup> See e.g., THE INDIAN STEEL INDUSTRY at 28.

<sup>88</sup> See NATIONAL STEEL POLICY-2005 at 3.

<sup>89</sup> *Id.* at 14.

<sup>90</sup> See IMPORT ADMINISTRATION, U.S. DEP'T OF COMMERCE, REPORT TO THE PRESIDENT, GLOBAL STEEL TRADE, STRUCTURAL PROBLEMS AND FUTURE SOLUTIONS 163 (2000) (hereinafter REPORT TO THE PRESIDENT).

tionally been in the form of tariffs on steel imports as high as 25-30 percent, export subsidies, debt forgiveness, and direct government funding of new capacity expansions.<sup>91</sup>

While import tariffs have been reduced in recent years, the government continues to assist the steel industry through preferential loans from the Steel Development Fund, government bailouts in the form of massive debt restructurings, and debt forgiveness. In 2000, for example, the government approved a \$2.2 billion package to assist SAIL's financial and business restructuring.<sup>92</sup> The package included a write-off of about \$1.14 billion in loans from the Steel Development Fund, new government loans in excess of \$85 million, and loan guarantees for private sector loans totaling about \$67 million.<sup>93</sup> In addition, the Indian government continues to provide substantial assistance in the form of export subsidies, control over vital raw materials, and tax incentives.

Export Incentives. The vast majority of India's new production capacity over the next decade will be for export. India has announced capacity expansions of 62 million metric tons from 2006-2010, a growth rate of 20 percent per year.<sup>94</sup> At the same time, domestic demand for steel is expected to grow at less than half that rate, by 8-10 percent per year, resulting in substantial oversupply of steel.<sup>95</sup> The only outlet for Indian steel producers will be a major increase in exports. Indeed, India currently exports ap-

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<sup>91</sup> *Id.*

<sup>92</sup> REPORT TO THE PRESIDENT at 167.

<sup>93</sup> *Id.*

<sup>94</sup> See e.g., THE INDIAN STEEL INDUSTRY at 28.

<sup>95</sup> *Id.*

proximately 15 percent of its steel production; by 2010, India is expected to export more than 45 percent of its production, or 35 million metric tons per year.<sup>96</sup>

To facilitate the needed exportation of such a large percentage of its steel production, the Government of India maintains a variety of schemes and incentives, including the following:

- **The Export Promotion of Capital Goods (EPCG)** scheme, which provides for an exemption or reduction of customs duties and an exemption from excise taxes on imports of capital goods. Under this program, steel producers and others may import capital equipment at zero or reduced duty rates by meeting certain export requirements.<sup>97</sup>
- **Income Tax Exemption Scheme**, whereby profits from export sales are exempt from income tax under India's tax code.<sup>98</sup>
- **The Critical Infrastructure Balance Scheme (CIBS)**, which provides investment in areas of critical deficiency in the interest of export promotion. Under this program, which is specifically provided for in India's 10<sup>th</sup> Five Year Plan, investment may relate to infrastructure in export intensive areas such as export processing zones, seaports and airports, and transportation.<sup>99</sup>

India also maintains a variety of duty exemption and remission schemes that allow for the excessive exemption or remission of import duties levied on inputs that are consumed in the production of exported products such as steel. These include the following:

- **The Duty Entitlement Passbook (DEPB) Scheme**, where certain producers and exporters are permitted to claim credits on imported inputs and use the credits to pay customs duties on subsequent imports – thereby avoiding the

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<sup>96</sup> *Id.*

<sup>97</sup> VEENA JHA ET AL., DEALING WITH TRADE DISTORTIONS IN STEEL INDUSTRY 66 (United Nations and Macmillan India Ltd. 2006) (hereinafter DEALING WITH TRADE DISTORTIONS IN STEEL INDUSTRY ).

<sup>98</sup> *Id.* at 67.

<sup>99</sup> PLANNING COMMISSION, GOVERNMENT OF INDIA, 10<sup>TH</sup> FIVE YEAR PLAN (2002-2007), CHAPTER 7.1.9 at 669 [HTTP://PLANNINGCOMMISSION.NIC.IN/PLANS/PLANREL/FIVEYR/10TH/DEFAULT.HTM](http://planningcommission.nic.in/plans/planrel/fiveyr/10th/default.htm) (HEREINAFTER INDIA'S 10TH FIVE YEAR PLAN (2002-2007)).

payment of customs duties on the import of inputs.<sup>100</sup> While the DEPB was temporarily suspended in March 2004 for several months, it has since been reinstated.

- **The Duty Free Replenishment Certificate** which is issued to exporters for the duty free import of inputs used in the manufacture of goods.<sup>101</sup>
- **The Advance License Scheme**, which allows for the duty free import of raw materials used to produce goods for export.<sup>102</sup>

The administration of the DEFB, and other similar schemes including the Duty Free Replenishment Certificate, have been determined to confer export subsidies to the extent that they result in a remission or drawback of import duties in excess of those levied on inputs consumed in the production of the exported product.<sup>103</sup> Indeed, the European Commission, Canada, and the United States have found the DEFB, the Advance License, and the EPCG schemes to be countervailable export subsidies.<sup>104</sup>

India also provides steel producers export credit on favorable terms. The Reserve Bank of India has directed commercial banks to provide export credit both at pre- and post-shipment stages.<sup>105</sup> Pre-shipment credit, or packaging credit, is granted to exporters for purchase of raw materials of the finished product upon the presentation of

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<sup>100</sup> See DIRECTORATE OF EXPORT PROMOTION AND MARKETING, STATE OF ORISSA, INDIA, DUTY EXEMPTION/REMISSION SCHEME, chapter 4, section 4.3. available at [www.epmorissa.org/chapter4.htm](http://www.epmorissa.org/chapter4.htm); see also DEALING WITH TRADE DISTORTIONS IN STEEL INDUSTRY at 67.

<sup>101</sup> DUTY EXEMPTION/REMISSION SCHEME at chapter 4, section 4.2.

<sup>102</sup> See e.g., THE INDIAN STEEL INDUSTRY at 16.

<sup>103</sup> DEALING WITH TRADE DISTORTIONS IN STEEL INDUSTRY at 67.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

confirmed export orders or letters of credit.<sup>106</sup> With post-shipment credit, the credit is offered to exporters against either the shipping bill or drawback claims.<sup>107</sup>

In addition, the government maintains a number of programs to promote industrial parks and Special Economic Zones (SEZs) for the purpose of increasing exports. The 10<sup>th</sup> Five Year Plan, for example, describes the Export Promotion Industrial Park (EPIP) as a “centrally sponsored scheme for providing assistance to State Governments for setting up and maintaining industrial parks with appropriate infrastructure for housing industrial units with export commitments.”<sup>108</sup> The government approved an initial expenditure of Rs. 250 core to establish 25 EPIPs in 25 states.<sup>109</sup> The government also continues to promote the creation of SEZs. According to the 10<sup>th</sup> Five Year Plan, the purpose of these zones is “enabling hassle-free manufacturing and trading activities for the purpose of exports.”<sup>110</sup> Indeed, the Special Economic Zones Act was enacted in June 2005 to “provide for the establishment, development, and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto.”<sup>111</sup> These SEZs provide exporters a broad array of benefits, including:

- Exemption from customs duty on imports of capital goods, raw materials, consumables, etc.;

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<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> INDIA'S 10TH FIVE YEAR PLAN (2002-2007) Chapter 7.1.32 at 668.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*, Ch. 7.1.34 at 669.

<sup>111</sup> The Special Economic Zones Act, 2005, No. 28, Acts of Parliament, 2005 (India).

- Exemption from the Central Excise Duty on procurement of capital goods, raw materials, consumables, etc. from the domestic market;
- Reimbursement of the Central Sales Tax paid on domestic purchases;
- A 100 percent income tax exemption for five years and 50 percent tax exemption for two years thereafter; and
- Deduction of profits and gains from exports.<sup>112</sup>

The Government of India has also approved a new plan “to involve State Governments in the export effort.”<sup>113</sup> Under the “Assistance to States for Infrastructure Development for Export and Allied Activities,” funds will be granted to States for development of export-related infrastructure such as roads, ports, and the creation of industrial parks and improvement of facilities in existing industrial parks. Rs 1,725 crore is budgeted for this project from 2002-2007.<sup>114</sup>

Many of the state governments are already actively involved in encouraging steel exports. The State of Orissa, for example, promotes the various duty exemption and remission schemes mentioned above, as well as the CIBS and EPIP.<sup>115</sup> Moreover, the objectives of the Draft Export Policy of Orissa are to:

“facilitate sustained growth in exports ... to take necessary and effective steps in co-ordination with all Government Departments to create a favorable environment for export growth ... [and] to bring about technology and skill up-gradation in the traditional export sectors so as to enhance their

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<sup>112</sup> See SPECIAL ECONOMIC ZONES IN INDIA, MINISTRY OF COMMERCE AND INDUSTRY, FACILITIES AND INCENTIVES, available at [http://www.sezindia.nic.in/facilities\\_enterprise.asp](http://www.sezindia.nic.in/facilities_enterprise.asp).

<sup>113</sup> INDIA'S 10TH FIVE YEAR PLAN (2002-2007) Chapter 7.1.35 at 669.

<sup>114</sup> *Id.* at 730.

<sup>115</sup> See EXEMPTION/REMISSION SCHEME at chapter 4, section 4.2.; see also, DIRECTORATE OF EXPORT PROMOTION AND MARKETING, STATE OF ORISSA, INDIA DRAFT EXPORT POLICY OF ORISSA, available at [www.epmorissa.org/Draftexportpolicy.htm](http://www.epmorissa.org/Draftexportpolicy.htm).

competitiveness and to encourage diversification and quality improvement.”<sup>116</sup>

The “minerals and metallurgical” sector is one of eleven core sectors singled out by the policy, which offers market development assistance, export credits, and other benefits to export-oriented industries.<sup>117</sup>

### ***Control Over Raw Materials***

India has abundant supplies of key raw materials used in steel production. It has one of the largest iron ore reserves in the world, with 8.6 billion metric tons of proven iron ore reserves and an additional 9.1 billion metric tons of probable and possible reserves.<sup>118</sup> The government plays an active role in controlling access to and distribution of this iron ore and other key raw materials; in addition to controlling access to the mines, the government also controls contract prices for the raw materials.<sup>119</sup> Moreover, despite the abundance of iron ore reserves, the government has placed substantial restrictions on exports of iron ore. The combination of government grants of captive mines to Indian steel producers and government restrictions on the export of vital raw materials effectively subsidizes domestic steel producers and creates significant market-distorting effects.

The government has granted captive coal and iron ore mines to several steel producers. India’s two largest steel producers, SAIL and Tata Steel, have been granted

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<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> THE INDIAN STEEL INDUSTRY at 26.

<sup>119</sup> See OECD Directorate for Science, Technology and Industry Steel Committee, INDIA: STEEL-MAKING RAW MATERIALS, DSTI/SU/SC(2006)8, at 12 (March 23, 2006) (hereinafter , INDIA: STEEL-MAKING RAW MATERIALS).

captive iron ore mines, while other producers are waiting for government approval for mine leases.<sup>120</sup> SAIL, for example, operates ten iron ore mines in Jharkhand, Orissa, and Chhattisgarh, producing more than 20 million metric tons per year for captive consumption.<sup>121</sup> Its raw material strategy includes increasing annual iron ore capacity to 35 million metric tons per year by 2011-2012.<sup>122</sup>

Government grants of captive mines provide multiple benefits to Indian steel producers. The rights to captive mines ensure the availability of cheap iron ore and other raw materials. Steel producers with captive mines are insulated from rising global raw material prices and then benefit from the upward pressure on steel prices. Some producers, such as Jindal Steel and Power Ltd., export iron ore from their captive mines to China to take advantage of high spot prices for iron ore and then purchase the shortfall for their own use from the domestic market.<sup>123</sup> Captive mining also allows steel producers to capitalize on the difference between the cost of extraction and the market price for raw materials. For example, as of December 2005, the cost of extraction of iron ore for SAIL and Tata Steel was between Rs 250 and 325 per metric ton, while the market price for iron ore was approximately Rs 2,000 per metric ton.<sup>124</sup> Even India's

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<sup>120</sup> THE INDIAN STEEL INDUSTRY at 35.

<sup>121</sup> *India Flies High*, THE MINING JOURNAL, Apr. 7 2006.

<sup>122</sup> *Id.*

<sup>123</sup> INDIA: STEEL-MAKING RAW MATERIALS at 12.

<sup>124</sup> *Ministry Opposes Captive Iron Ore Mining by Steel Producers*, BUSINESS LINE, December 26, 2005.

Ministry of Mines admits that captive mining by steel producers results in a huge subsidy to them.<sup>125</sup>

The government also imposes substantial restrictions on the export of raw materials, including iron ore, and is considering further restrictions under pressure from domestic steel producers to build up reserves in anticipation of the massive capacity expansions over the next decade. State-run Minerals and Metals Trading Corp. (MMTC), the only permitted exporter of iron ore of grade 64 percent and above, has been asked to reduce export quantities.<sup>126</sup> The government has also imposed quantitative restrictions on the export of high-grade iron ore by state-owned National Mineral Development Corporation (NMDC). Earlier this year, for example, the Indian Government lowered the maximum allowable quantity of exports of iron ore from one of its major mines that is owned and operated by NMDC; the government capped the annual ceiling for exports from the Bailadila mines in the central Indian state of Chhattisgarh at 2.7 million tons per year of lumps (down from 3 million) and 1.81 million tons per year of fines (down from 3.8 million).<sup>127</sup> The government is considering further restrictions and is expected to reduce NMDC's overall iron ore exports to 1.7 million metric tons from the current 6.5 million metric tons.<sup>128</sup> Such export restrictions effectively function as subsidies and mean cheaper and more readily available iron ore for domestic steel producers.

In addition, several state governments, including Orissa, Jharkhand and Chhattisgarh, prohibit steel producers from exporting iron ore from the state – mandating, in

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<sup>125</sup> *Id.*

<sup>126</sup> *India Steel Industry Expects Iron Ore Export Limit*, REUTERS, March 15, 2006.

<sup>127</sup> *India Caps Iron Ore Mine's Exports*, STEEL DAY, Apr. 3, 2006.

<sup>128</sup> *Id.*

essence, that the iron ore be processed into steel in that state.<sup>129</sup> The state of Orissa, for example, grants mining leases only to steel producers and only after 25 percent of the proposed steel plant expenditure has been incurred.<sup>130</sup>

Ironically, the Chinese has complained about the restrictions placed on Indian raw materials. Liu Zhengang, chief representative of China Minmetals Corporations recently stated that “Chinese steel companies can make use of Indian iron-ore reserves and many companies are exploring investment possibilities in India. But the Indian Government should make changes in its mines and minerals policy to allow freer movement of raw materials.”<sup>131</sup>

## **THE IMPACT OF OVEREXPANSION**

### ***The Impact of Overexpansion on India and China***

Overcapacity in the steel industry represents a misallocation of resources. Because of the high cost of new steel projects, these misallocations can represent the misuse of billions of dollars in scarce funds. Limiting the expansion of steel making capacity to sustainable levels will free up capital for other, more productive uses.

The Chinese steel industry may have already expanded to an unsustainable size. The inevitable slowdown in China’s economic growth will reduce domestic demand for steel. This will lead to either reductions in production and employment inside China, or, what is more likely, attempts to maintain high levels of capacity utilization and employment by exporting excess production. Given the enormous size of China’s industry, the

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<sup>129</sup> THE INDIAN STEEL INDUSTRY at 35.

<sup>130</sup> THE INDIAN STEEL INDUSTRY at 35; , INDIA: STEEL-MAKING RAW MATERIALS at 14.

<sup>131</sup> *Chinese Steel Cos. Exploring Opportunities in India*, SIFY.COM, Apr. 18, 2006 <http://sify.com/finance/fullstory.php?id=14186435>.

diversion of even a relatively small share of production to exports could have sweeping consequences for world steel markets.

In light of these facts, it is very much in the interests of both the Chinese steel industry and the Chinese government to implement fully the government's plans to take obsolete and inefficient facilities out of production. This would reduce Chinese capacity by at least 55 million tons. The Chinese government should subject projects to rigorous review to ensure that public funds are not being used for projects that do not offer a reasonable expectation of a long-term market rate of return.

India still has time to adjust its industry's expansion plans to more realistic levels. Rather than anticipating expansion to fulfill an *a priori* expectation of steel consumption in a developed economy, India should allow the market to determine whether and to what extent the industry should expand. With its plentiful inputs and large domestic market, the Indian steel industry may well need to expand to meet domestic demand. Expansion should occur because it is needed to satisfy demand, though, and not simply to reach a certain size.

In both China and India, the ability of the national government to limit the creation of excessive production capacity may be hampered by the activities of sub-national levels of government. In India, the individual states have substantial economic and regulatory powers, and can often act independently of the central government. The largest projects under development in India are under the aegis of the State of Orissa. Similarly, in China provincial and local governments are often the formal owners of steel enterprises, and can provide benefits to steel production without informing the central gov-

ernment. For both countries, the rational development of steel capacity will require increased market-oriented disciplines that apply to both national and local governments.

### ***The Impact of Overexpansion on the World Steel Industry***

Overexpansion of the Chinese steel industry has already had negative effects on producers in the rest of the world. As a submission to the OECD's January 2005 conference on steel noted:

The state-supported capacity expansion will impose costs on all world steel producers by driving up the prices of inputs such as scrap, iron ore, coke, and energy. Increased production will also increase the burden on global transportation systems, making it more difficult and more expensive for producers to ship their products and raw materials, both domestically and internationally.<sup>132</sup>

In the period between 2002 and 2004, for example, China's demand for inputs to feed its growing capacity played a major role in increases in the cost of steel scrap of 300 percent, and of coke of over 450 percent.<sup>133</sup>

Overcapacity will of course ultimately have an impact on steel prices as well. Because the steel industry has high fixed costs, producers endeavor to use as much capacity as possible. When demand falls, they are more likely to maintain full production and drop prices than to restrict production. If, as frequently happens, the domestic market still cannot absorb all of their production, they will export the excess at whatever prices they can obtain. This can lead to the well-known "death spiral," in which producers race to cut prices while maintaining production. The end result has often been bankruptcies and facilities taken out of operation, with all the loss of jobs that implies.

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<sup>132</sup> ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, CAPACITY EXPANSION IN THE GLOBAL STEEL INDUSTRY 2 (2005).

<sup>133</sup> *Id.* at 10.

World steel prices are currently at high levels by historic standards. This in itself implies that prices are likely to decline at some point. Recent experience demonstrates that steel prices can change quite quickly. Prices for hot-rolled sheet in the United States, for example, rose from \$290/ton in September 2003 to \$756/ton in September 2004, before falling to \$500/ton in September 2005.<sup>134</sup>

Steel producers in the developed countries will not be the only ones adversely affected by excess additions to capacity in India and China. The President of the Brazilian Steel Institute, Luiz Andre Rico Vicente, recently described China's growing capacity as "a threat to Brazilian producers."<sup>135</sup> Mr. Vicente predicts that China will be able to export up to 35 million additional tons of steel by 2010. This could threaten Brazilian steel exports. The Brazilian steel industry is heavily dependent on exports, with 43 percent of its production in 2005 going to other markets.<sup>136</sup> The same would be true of other export-oriented steel producers, including Korea and Japan, which are already facing increased competition from Chinese exports in both their home and overseas markets.

## CONCLUSION

Between the 1950s and the 1970s, the developed economies built capacity far in excess of demand, largely as the result of government intervention and government subsidies. After their governments decided to allow the market to decide the industry's size, such countries as the United Kingdom and France took significant amounts of ca-

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<sup>134</sup> Hot-Rolled Sheet Average, PURCHASING MAGAZINE (2005).

<sup>135</sup> *China seen as threat to Brazilian steel exporters*, REUTERS (Apr. 25, 2006).

<sup>136</sup> *Id.*

capacity out of production. Contraction was not restricted to countries where the government actively intervened in the steel industry, however; largely in response to global overcapacity caused by subsidies, the U.S. steel industry was also forced to reduced capacity, even though the industry had operated with little government support or intervention.

It now appears that China may have repeated the mistake of building too much capacity too fast, and India may be on the verge of doing so. In both cases, the creation of excess capacity has been encouraged by government policies and actions. Construction of excess capacity in China and India will have adverse consequences for steel producers and steel consumers world-wide. It will also deprive these countries of valuable investment funds that they could apply to other, more productive uses. The Indian and Chinese governments and industries should work with their colleagues in the rest of the world to avoid these consequences, and to ensure that their steel industries develop in a manner that is economically sustainable and that brings the maximum benefit to their economies and those of their trading partners around the world.