



**American  
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# **Government Intervention and Overcapacity: Causes and Consequences for the Global Steel Industry**

July 2013

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# **GOVERNMENT INTERVENTION AND OVERCAPACITY: CAUSES AND CONSEQUENCES FOR THE GLOBAL STEEL INDUSTRY<sup>1</sup>**

## **I. INTRODUCTION**

The global steel industry is currently experiencing unprecedented levels of overcapacity, which are severely distorting the global market and threatening the continued viability of many steel producers worldwide. While the crisis has become more pronounced in recent years, this is not a new problem for the industry. Overcapacity and its underlying causes – primarily government intervention and other market-distorting practices – have long plagued the global steel industry. For many decades, governments have attempted to create and maintain substantial steel capacity in their home countries, often far in excess of demand. Governments have owned, subsidized, and otherwise intervened in steel industries to ensure growing domestic manufacturing industries, often for reasons unrelated to commercial considerations. The result of this government intervention has been persistent global steel overcapacity, and the significant adverse effects that stem from this long-term supply-demand imbalance.

The U.S. steel industry suffered from the effects of this structural imbalance during the 1997-2001 steel import crisis, when enormous steel overcapacity around the world contributed to a flood of low-priced imports into the United States. Despite the clear lessons from that period, many in the global steel industry largely failed to address the underlying problems, resulting in the current massive levels of excess capacity in the industry – estimated at more than 500 million metric tons worldwide and growing. This huge capacity growth has not been driven by market forces, as it far exceeds levels of demand growth, and has not been supported by profitability, as the least profitable producers in the world are leading the growth in steelmaking capacity. Rather, the overcapacity largely results from increasing levels of government ownership and intervention in the global steel industry. To effectively address global steel overcapacity, the non-market-based factors that serve to increase and/or maintain inefficient capacity – primarily, government involvement in the steel industry – should be reduced or eliminated. Unless action is taken to address these issues on a global basis, unfair trade practices and the resulting trade friction will likely increase. The challenge facing governments worldwide is whether they can proactively address these issues in order to avoid the adverse effects associated with overcapacity.

## **II. A HISTORICAL PERSPECTIVE ON OVERCAPACITY: LESSONS LEARNED FROM THE 1997-2001 U.S. STEEL IMPORT CRISIS**

For decades, global steel producers have suffered from high levels of overcapacity in the industry, largely as a result of government subsidization and other market-distorting practices. While the adverse effects of overcapacity may be less visible in boom times, problems associated with this market imbalance become especially pronounced when the business cycle dips downward and global steel demand fails to keep pace with capacity increases. Indeed, persistent

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<sup>1</sup> This paper was prepared by Alan H. Price, Christopher B. Weld, and Laura El-Sabaawi of Wiley Rein LLP on behalf of the American Iron and Steel Institute (“AISI”) and the Steel Manufacturers Association (“SMA”). The views expressed in this paper are those of the authors alone.

global steel overcapacity has generally resulted in cyclically falling prices and industry losses in steel markets worldwide during most economic slowdowns.<sup>2</sup> In the U.S. market, this global imbalance has led to a recurring cycle of low-priced import surges and deteriorating U.S. market and industry conditions, followed by a period of increasing trade friction.

For example, between the 1950s and 1970s, steel producers in many OECD countries built capacity far in excess of demand, primarily as a result of government subsidies and other support. In Europe, especially, the 1970s were characterized by increasing levels of government subsidies, significant state ownership, and massive capacity builds.<sup>3</sup> Government support was used to bring new capacity online at a rapid rate and to maintain existing capacity regardless of demand and profitability.<sup>4</sup> This government-sponsored excess capacity resulted in price and profit deterioration in European steel markets.<sup>5</sup> It also resulted in a significant increase in exports to the United States, leading to heightened trade friction and a rise in trade remedy litigation.<sup>6</sup> This period was followed by a process of restructuring and privatization in Europe during the 1980s and 1990s that led to a more efficient and competitive industry.<sup>7</sup>

The 1997-2001 U.S. steel import crisis is another such example and demonstrates how excess capacity on the other side of the globe – fueled by government intervention and other market-distorting practices – can have devastating effects on the U.S. market.

#### **A. The 1997-2001 Steel Import Crisis**

In the late 1990s and early 2000s, the U.S. steel industry was engulfed in a crisis precipitated by a flood of low-priced imports, followed by company bankruptcies and massive layoffs. During a six-month period in 1998, the U.S. market experienced a record level of unfairly-traded imports, primarily from Russia, Japan, Korea and Brazil. U.S. imports of hot-rolled steel, the focal point of the crisis, increased by more than 70 percent during this period, while the average price of these imports fell almost 20 percent.<sup>8</sup> Import penetration reached 33.4 percent in November 1998, the highest monthly level in more than 20 years, while U.S. capacity utilization rates fell from 90 percent to 75 percent.<sup>9</sup> U.S. prices dropped to levels below which U.S. companies could price profitably.<sup>10</sup> As a result, domestic steel producers suffered significant financial losses, with six companies (accounting for almost half of total domestic

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<sup>2</sup> Gary Clyde Hufbauer, *Steel: Big Problems, Better Solutions*, Peterson Institute for International Economics, Policy Brief 01-9 (July 2001).

<sup>3</sup> OECD Directorate for Science, Technology and Industry, Steel Committee, *State Ownership in the Steel Industry: Issues for Consideration*, DSTI/SU/SC(2012)6 (“OECD State Ownership Report”) at 3.

<sup>4</sup> OECD Steel Committee, *Presentation for the Council Working Party on Shipbuilding* (July 9, 2009) at 3.

<sup>5</sup> *Id.* at 4; U.S. Department of Commerce, International Trade Administration, *Report to the President, Global Steel Trade: Structural Problems and Future Solutions* (July 2000) (“Commerce Global Steel Trade Report”) at 5.

<sup>6</sup> *Presentation for the Council Working Party on Shipbuilding*, OECD Steel Committee (July 9, 2009) at 4; Commerce Global Steel Trade Report at 5.

<sup>7</sup> *Id.* at 5.

<sup>8</sup> Commerce Global Steel Trade Report at 1.

<sup>9</sup> *Id.* at 22.

<sup>10</sup> *Id.* at 13.

capacity) being driven into bankruptcy and thousands of workers laid off.<sup>11</sup> The speed and severity of the crisis, and the immediate deterioration of the U.S. industry's trade and financial performance, occurred despite a strong U.S. market and robust demand for steel.<sup>12</sup>

## **B. Causes of the Crisis**

There were a number of short-term factors that triggered the surge of imports from Russia, Japan, Korea, Brazil, and elsewhere. These included the Asian financial crisis and a significant drop in demand in that region, depressed economic conditions in Russia, currency depreciation in many of the world's largest steel producing countries, and comparatively strong U.S. steel demand.<sup>13</sup> However, as discussed below, long-term structural imbalances in the global steel industry also played a significant role in the events that gave rise to the import crisis – namely, global steel overcapacity, stemming primarily from government subsidies and other market-distorting policies and practices.<sup>14</sup>

The period preceding the 1997-2001 import crisis was characterized by a growing capacity surplus worldwide, including in Russia, Japan, Korea, and Brazil.<sup>15</sup> According to the OECD, world steelmaking capacity grew substantially between 1985 and 1999, with overcapacity widening significantly during this period.<sup>16</sup> By 2000, there was an estimated 50 million metric tons of overcapacity in the EU, 100 million metric tons in Eastern Europe, 70 million metric tons in Asia, and 20 to 30 million metric tons in Russia and Ukraine.<sup>17</sup> Some analysts estimate that world steel overcapacity was 275 million metric tons, exceeding one-third of total production.<sup>18</sup>

In its 2000 Report to the President on global steel trade, the U.S. Department of Commerce (“the Department”) concluded that this growing global overcapacity was due in large part to government subsidies and intervention in steel industries around the world, particularly in those countries referenced above.<sup>19</sup> The report details how direct and indirect government subsidies helped create massive capacity worldwide, and how government intervention ensured that neither capacity nor production was reduced in response to deteriorating demand conditions. Further, government-encouraged (or at least tolerated) resistance to restructuring in these industries meant that nonviable companies frequently did not exit the market, uneconomic capacity was maintained, and, ultimately, that significantly more steel was exported than would have occurred under normal market conditions.<sup>20</sup>

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<sup>11</sup> *Id.*

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

<sup>13</sup> *Id.* at 2.

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

<sup>15</sup> *Id.* at 3.

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

<sup>17</sup> *Id.*

<sup>18</sup> Gary Clyde Hufbauer, *Steel: Big Problems, Better Solutions*, Peterson Institute for International Economics, Policy Brief 01-9 (July 2001).

<sup>19</sup> Commerce Global Steel Trade Report at 4.

<sup>20</sup> *Id.* at 6, 90.

The Department also cited other market-distorting practices in certain non-U.S. markets, such as lax enforcement of antitrust and competition rules, import barriers and other measures that created insulated home markets, unsound banking practices, and ineffective or non-existent bankruptcy procedures.<sup>21</sup> Many of these practices artificially increased the competitiveness of foreign steel industries, allowing them to sustain low-priced exports and “maint[ain] capacity beyond what the market would otherwise warrant over the long term.”<sup>22</sup>

In short, government support, coupled with other market-distorting policies and practices, resulted in significant global steel overcapacity in the period preceding the 1997-2001 import crisis. This persistent overcapacity contributed to, and indeed amplified, the huge import volumes and import price declines that characterized the import surge.<sup>23</sup> When demand collapsed in Asia and elsewhere in 1998, steel producers in these countries continued to produce and export, often beyond the point of financial viability.<sup>24</sup> Millions of tons of steel had to be diverted to overseas markets, including the United States, with devastating consequences for the U.S. market and U.S. steel producers.

### C. The Aftermath of the Crisis: Efforts to Stem Imports and Restructure the U.S. Industry

In response to the import surge, the U.S. industry sought relief pursuant to the trade remedy laws. In September 1998, the industry and unions filed antidumping and countervailing duty cases against hot-rolled steel from Brazil, Japan, and Russia and subsequently filed cases against a wide range of steel imports, including cold-rolled steel, cut-to-length plate, heavy structurals, and seamless pipe.<sup>25</sup> In addition, in March 2002, President Bush granted the industry relief under Section 201 of the trade laws, with the President imposing tariffs and tariff-rate quotas on imports of a wide variety of steel products. Congress and the Administration also took action. The Commerce Department, for example, negotiated an agreement to address steel imports from Russia, and implemented a steel import monitoring program, improving the reporting of steel import data to aid in early detection of potential import surges. On an international level, the U.S. Trade Representative initiated consultations with Japan and Korea to address certain structural imbalances, and, as discussed further below, the OECD began global discussions toward reaching an agreement on removing subsidies and other government interference from the steel industry.<sup>26</sup>

In addition, the U.S. industry went through a significant period of restructuring in the wake of the import crisis. In the period immediately following the import surge, more than 40 steel companies filed for bankruptcy protection, with at least six going out of business altogether.<sup>27</sup> With conditions for consolidation greatly improved, Nucor, U.S. Steel, and the

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<sup>21</sup> *Id.* at 4.

<sup>22</sup> *Id.* at 66.

<sup>23</sup> *See id.* at 37.

<sup>24</sup> *See id.* at 97.

<sup>25</sup> *Id.* at 108.

<sup>26</sup> *Id.* at 107.

<sup>27</sup> Stephen Cooney, *The American Steel Industry: A Changing Profile*, Congressional Research Service, RL 31748 (Nov. 10, 2003) at Summary.

International Steel Group began purchasing some of the assets of failed companies,<sup>28</sup> beginning a period of industry restructuring. This process resulted in fewer U.S. steel producers and a reduction in capacity. Specifically, from 1999-2002, U.S. steel capacity was reduced by approximately 11 percent and employment fell by almost 20 percent, while productivity increased.<sup>29</sup> This period of consolidation helped maintain equilibrium between supply and demand in the U.S. market and resulted in a more efficient and competitive U.S. industry.

#### **D. Lessons Learned from the Crisis**

The 1997-2001 import crisis demonstrates how overcapacity – and the government intervention and other market-distorting practices that lead to overcapacity – threatens the stability of the global steel industry and can lead to significant adverse effects, including downward pressure on global prices and profitability, as well as import surges into open markets such as the United States. Such adverse effects can cause swift and devastating harm to the U.S. steel industry and other industries around the globe. The primary lesson drawn from this crisis, then, is that government interference in the steel industry, as well as other market-distorting practices, must be removed, and that these problems should be addressed on an international basis.

In its report to the President in the aftermath of the crisis, the Department of Commerce concluded as much. It found that the United States and its trading partners must address global market distortions, including “significant overcapacity in the global steel industry, government assistance to maintain older capacity, barriers to imports, anticompetitive practices [in certain non-U.S. markets] and, in some countries, the direct or indirect involvement of the government in the steel industry.”<sup>30</sup> To “avoid the cycle of import surges and trade actions that have characterized steel trade for the past thirty years,” the Department concluded that the United States and its trading partners must take “meaningful steps to deal with structural problems now.”<sup>31</sup> The recommended steps included the following:

- Address the apparent lack of competition among producers in certain non-U.S. steel-producing countries that inflates home market prices;<sup>32</sup> eliminate import barriers to steel and otherwise open foreign industries to market-based competition;<sup>33</sup> ensure market-based consolidation and reorganization to eliminate excess capacity; and establish well-functioning, market-based exit systems (i.e., bankruptcy procedures);<sup>34</sup>

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<sup>28</sup> For example, International Steel Group acquired the steelmaking assets of LTV Steel, Acme Metals, and Bethlehem Steel; U.S. Steel acquired the assets of National Steel; and Nucor acquired the assets of Trico Steel and Birmingham Steel. *Steel: Monitoring Developments in the Domestic Industry*, Inv. No. TA-204-9, USITC Pub. No. 3632 (Sept. 2003) at Overview III-4.

<sup>29</sup> *Id.* at Overview III-5, III-8-9.

<sup>30</sup> Commerce Global Steel Trade Report at 14.

<sup>31</sup> *Id.* at 10.

<sup>32</sup> *Id.* at 179.

<sup>33</sup> *Id.* at 180, 185.

<sup>34</sup> *Id.* at 133.

- Restrict government and multilateral development bank lending for expanded steel capacity as well as for other programs that contribute to the expansion of economically unjustifiable global steel capacity;<sup>35</sup> and
- Reinvigorate the international steel policy agenda, including working with the OECD Steel Committee to achieve real progress on underlying structural issues, including overcapacity.<sup>36</sup>

The Department also observed that the increasing globalization of the steel industry means that steel companies in open markets such as the United States may face injurious pressure caused by collapsing markets on the other side of the world – pressure which may quickly undercut healthy home market conditions.<sup>37</sup> Similarly, the U.S. market can be adversely affected by government subsidies and other market-distorting practices that occur elsewhere. As a result, if overcapacity and other market distortions are not addressed on a comprehensive, global basis, then “unfair trade practices and the bilateral trade frictions they elicit are likely to occur again.”<sup>38</sup>

On the international front, OECD countries determined that action was required to address these issues. As a result, in August 2001, the OECD initiated a series of high-level meetings to discuss the issue of excess capacity and market distortions within the global steel industry.<sup>39</sup> Delegates identified subsidies and related government supports as an area of significant concern. They directed that efforts be undertaken to formulate an international agreement to reduce or eliminate steel subsidies at all levels of government, establish a mechanism allowing for peer review of capacity developments, and create a plan to facilitate plant closures.<sup>40</sup>

As part of these efforts, in September 2001, the NAFTA steel industries submitted a statement of principles to address global overcapacity and market-distorting practices impacting the steel industry, which included the following:

- To reduce inefficient and excess steel capacity, governments should not provide any assistance for the building of additional steel capacity or the maintenance of existing capacity, including export credit.<sup>41</sup> In addition, all key governments should analyze what

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<sup>35</sup> *Id.* at 185.

<sup>36</sup> *Id.* at 10.

<sup>37</sup> *Id.* at 14.

<sup>38</sup> *Id.* at 9.

<sup>39</sup> *Steel: Evaluation of the Effectiveness of Import Relief*, Inv. No. TA-204-12, USITC Pub. No. 3797 (Sept. 2005) at Overview IV-1.

<sup>40</sup> *Steel: Monitoring Developments in the Domestic Industry*, USITC Pub. No. 3632 at Overview IV-3; *OECD High Level Meeting on Steel: Progress Made on Cutting Subsidies, Overcapacity*, PAC/COM/NEWS(2002)105 (Dec. 19, 2002).

<sup>41</sup> The Statement of Principles recognized that “governments may wish to explore an approach whereby incentives could be offered for the sole purpose of easing the burden of social and environmental costs related to the permanent closure of uneconomic or excess steel capacity.” OECD Directorate for Science, Technology and Industry, *Global Steel Industry Conditions and Efforts by Governments to Reduce Inefficient Excess Global Steel Capacity: Statement of NAFTA-Wide Principles*, SG/STEEL/RD(2001)5 (Sept. 17, 2001) (“Statement of NAFTA-Wide Principles”) at 3.

the steel capacity situation is in their country, including the extent to which market forces, and government actions to promote such forces, are reducing inefficient and excess steel capacity.<sup>42</sup>

- To address market-distorting practices, “the goal should be a comprehensive, transparent and effective international steel agreement” that has as its basis the elimination of direct and indirect steel subsidies. Indeed, “[a]ny effort to address market distorting practices should begin with a commitment from governments to get out of the steel business – there should be no new government or quasi-government investment in new or old mills.”<sup>43</sup>

In subsequent years, these efforts at the OECD to reduce overcapacity and eliminate market-distorting practices have been delayed or postponed at various times, with no lasting agreement achieved.<sup>44</sup> With the significant boom in global steel demand in the mid-2000s, and the removal of the U.S. Section 201 safeguards, there was reduced negotiating leverage and impetus to conclude an agreement addressing these structural imbalances. Nonetheless, the efforts of the U.S. and other OECD governments to remove subsidies and other government interference from the steel industry had achieved some success by the late 1990s, as the degree of government ownership and control over steel industries globally was declining.<sup>45</sup> As discussed below, however, this trend has sharply reversed over the last decade, with the rise of China as the largest steel-producing country, fueled in large part by government assistance.

### **III. THE CURRENT OVERCAPACITY CRISIS**

While the immediate economic circumstances differ somewhat from the 1997-2001 period, the global steel industry again finds itself in the midst of a crisis, as many regions of the world have failed to effectively address the long-term market distortions identified more than a decade ago, including “significant overcapacity in the global steel industry, government assistance to maintain older capacity, barriers to imports, anticompetitive practices [in certain non-U.S. markets] and, in some countries, the direct or indirect involvement of the government in the steel industry.”<sup>46</sup> Rather, government intervention has become more pervasive in certain countries, fostering the build-up of excessive and unwarranted capacity in the global steel industry.

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

<sup>43</sup> *Id.*

<sup>44</sup> *Steel: Evaluation of the Effectiveness of Import Relief*, USITC Pub. No. 3797 at Overview IV-1; *see also* OECD Annual Report 2007 (Apr. 30, 2007) at 28-29, stating that “[i]n 2006, the OECD High Level Group on Steel (HLG) agreed that significant differences remain among participants in certain key areas rendering it impossible for the moment to conclude a steel subsidy agreement. In view of this, the HLG decided to explore within the Steel Committee ways to develop common policy approaches on such outstanding policy issues and to resume negotiations within the HLG once agreement on these issues have been reached.”

<sup>45</sup> *See* OECD State Ownership Report at 2. According to the OECD, the process of privatization began in Europe in the mid-1980s and then accelerated in the 1990s as the newly independent states of the former Soviet Union began a restructuring and privatization process that ended in the early 2000s. *See id.*

<sup>46</sup> Commerce Global Steel Report at 14.



Strong global steel demand in the mid-2000s masked many of the adverse effects associated with excess capacity, and reduced the impetus to address its underlying causes. When the global recession struck in 2008-2009, and certain countries continued to expand capacity, an overcapacity crisis reemerged.<sup>47</sup> Since the recession, unfettered capacity growth, combined with decreasing demand (or declining demand growth rates), has put downward pressure on global prices and industry profitability and has pushed substantial levels of unfairly-priced imports into the U.S. market. According to official import statistics maintained by the Department, steel imports into the United States rose by 40 percent from 2010 to 2012.<sup>48</sup> This influx of low-priced imports has resulted in declining U.S. prices and profitability for many U.S. producers, as well as low capacity utilization rates for the industry<sup>49</sup> – U.S. producers’ capacity utilization has dropped to approximately 75 percent,<sup>50</sup> similar to levels during the 1997-2001 crisis. Declining utilization rates, in turn, generally result in declining profitability.<sup>51</sup>

Unless the long-term structural problems contributing to global overcapacity and the resulting import surge are effectively addressed, the U.S. and global steel industries could face a crisis even more severe than that experienced in 1997-2001.

#### **A. Continued Growth in Steel Capacity Since 2000**

Despite the clear lessons from the 1997-2001 steel crisis, the global steel industry has continued to add capacity at alarming rates, far in excess of global demand growth. “The period since 2000 has been characterized by unprecedented expansion of capacity.”<sup>52</sup> Indeed, since 2000, the global steel industry has added nearly 1 *billion* tons in crude steel capacity, for a current total of more than 2.05 metric billion tons of capacity worldwide. This capacity growth surpassed growth in steel demand during the same period by nearly 300 million metric tons,<sup>53</sup> resulting in the current excess capacity crisis facing the global steel industry.

These increases in global capacity have largely been led by the explosive growth of the Chinese steel industry over the past decade. China alone, which now accounts for approximately

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<sup>47</sup> See e.g., *OECD Excess Capacity Report* at 7 (showing growing levels of global overcapacity from 2007-2014).

<sup>48</sup> U.S. Department of Commerce, Import Administration, *Steel Import Monitoring and Analysis System*, <http://ia.ita.doc.gov/steel/license> (last updated Jan. 25, 2013).

<sup>49</sup> Capacity utilization is generally driven by two factors: domestic demand and import levels. Thus, the higher the import levels, the lower the capacity utilization rates of the domestic industry.

<sup>50</sup> U.S. Department of Commerce, International Trade Administration, *Steel Industry Executive Summary: May 2013* (May 6, 2013) at 9.

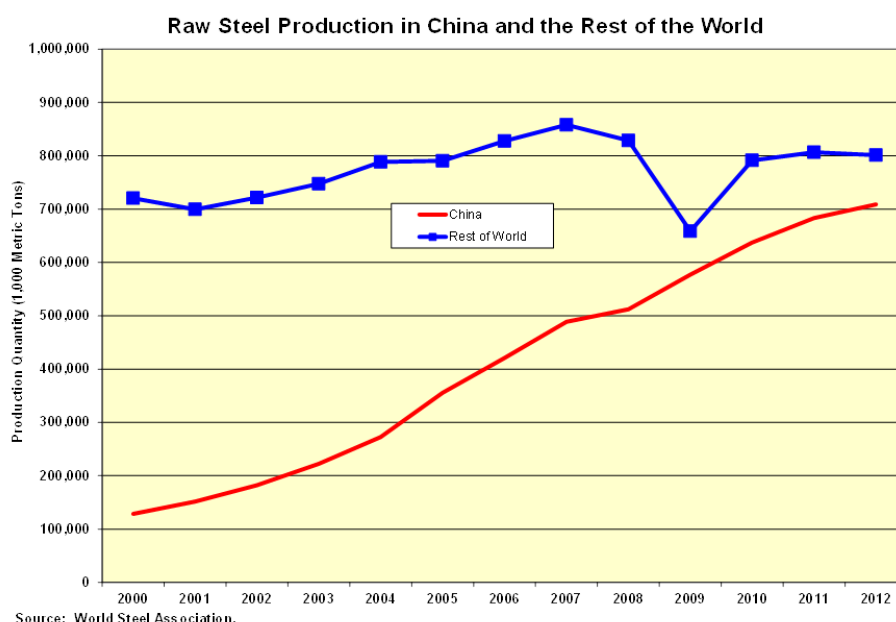
<sup>51</sup> The correlation coefficient between the U.S. steel industry’s capacity utilization rate and its operating profit margin for the 50 quarters between Q4 2000 (the first observation available) and Q1 2013 (the last observation available) is 0.643. Thus, approximately two-thirds of the variation in the U.S. steel industry’s profits are associated with changes in the industry’s capacity utilization rates. Simply put, the lower the industry’s capacity utilization rate, the lower the industry’s profitability.

<sup>52</sup> OECD Directorate for Science, Technology and Industry, Steel Committee, *Excess Capacity in the Steel Industry: An Examination of the Global and Regional Extent of the Challenge*, DSTI/SU/SC(2012)15 (Nov. 13, 2012) (“OECD Excess Capacity Report”) at 4.

<sup>53</sup> *Global Steel: Steeling for Oversupply*, Morgan Stanley Blue Paper (May 22, 2013) (“Morgan Stanley Global Steel Report”) at 13.

46 percent of world steel output,<sup>54</sup> added a massive 750 million metric tons of steelmaking capacity from 2000 to 2012 (making it responsible for more than two-thirds of the total global increase in capacity during that period).<sup>55</sup> In Turkey, where huge capacity growth also occurred extremely quickly, steelmaking capacity rose by nearly 150 percent from 2000 to 2012.<sup>56</sup> Capacity has also grown significantly since 2000 in India, Korea, the Middle East, Latin America (largely Brazil<sup>57</sup>), and the Commonwealth of Independent States (“CIS”) countries, with less substantial increases in Africa and the NAFTA and EU member countries.<sup>58</sup>

The growth in global steel capacity since 2000 is reflected in the increases in production, most notably in China, as shown in the chart below. Chinese capacity and production, unlike in the rest of the world, continued to grow steadily even during the 2008-2009 global economic recession.



The capacity increases described above, well in excess of market demand, have led to enormous levels of overcapacity in the global steel industry.<sup>59</sup> A recent OECD study concluded

<sup>54</sup> John W. Miller, *Global Steel Industry Faces Capacity Glut*, Wall Street Journal (Nov. 27, 2012); *China’s Steel Overcapacity Seen Continuing*, Fox Business (May 23, 2013).

<sup>55</sup> *Morgan Stanley Global Steel Report* at 13.

<sup>56</sup> Dr. Veysel Yayan, Secretary General, Turkish Iron and Steel Producers Association, *Turkish Steel Market and Regional Trade*, 11<sup>th</sup> International Steel Market and Trade Conference (Mar. 29, 2013) at 5.

<sup>57</sup> OECD, *Regional Capacity*, DSTI/SU/SC(2011)14 (Dec. 5-6, 2011) at 5 (“OECD Regional Capacity Report”).

<sup>58</sup> From 2000 to 2011, capacity increased by nearly 63 million metric tons in India, 35.1 metric million tons in Korea, 30 million metric tons in the Middle East, 21 million metric tons in Latin America, 19.4 metric million tons in the CIS countries, 9.6 metric million tons in Africa, 8.6 metric million tons in the EU countries, and 5.1 million metric tons in the NAFTA countries. OECD Regional Capacity Report at 2.

<sup>59</sup> “[T]he supply-demand imbalance has led to a level of overcapacity that will be extremely challenging to remedy.” *Morgan Stanley Global Steel Report* at 4.

that there were 542 million metric tons of excess capacity in the global steel industry in 2012<sup>60</sup> – a figure that has been adopted by the European Commission.<sup>61</sup> Ernst & Young estimates global overcapacity at 479 million metric tons<sup>62</sup> and, in May 2013, Morgan Stanley estimated that there are currently 334 million metric tons of excess capacity globally.<sup>63</sup>

China leads the world not just in capacity increases, but in *excess* capacity levels. Morgan Stanley estimates that excess capacity in China stands at 200 million metric tons,<sup>64</sup> while the China Iron and Steel Association (“CISA”) has estimated its surplus at close to 300 million metric tons.<sup>65</sup> Europe, too, has significant levels of overcapacity, estimated at 40 million tons by Morgan Stanley<sup>66</sup> and 80 million tons by the European Commission itself.<sup>67</sup> There is also significant overcapacity located in CIS/Russia, Latin America, and Japan, as seen in the table below.<sup>68</sup>

Country/Region	Overcapacity (million metric tons)
China	200
EU-27	40
CIS/Russia	37
Latin America	16
Japan	16
NAFTA	0

## **B. Given Current Trends, Overcapacity Will Only Worsen**

Despite the significant excess capacity currently overhanging the steel industry worldwide, many steelmakers plan additional capacity increases in the coming years. As a result, global steel capacity is projected to expand even further in the future, adding more than 100 million metric tons of capacity in the next two years<sup>69</sup> and continuing to outpace demand. The OECD has predicted that excess capacity will rise to approximately 559 million metric tons

<sup>60</sup> OECD Excess Capacity Report at 2.

<sup>61</sup> European Commission, *Memo: Ensuring a future for steel in Europe* (June 11, 2013).

<sup>62</sup> Ernst & Young, *Global Steel 2013: A New World, A New Strategy* (Jan. 1, 2013) (“*E&Y Global Steel 2013 Report*”) at 9.

<sup>63</sup> *Morgan Stanley Global Steel Report* at 4.

<sup>64</sup> *Morgan Stanley Global Steel Report* at 6.

<sup>65</sup> *China says top 10 steel mills to control 60 percent of capacity by 2015*, Reuters (Jan. 22, 2013).

<sup>66</sup> *Morgan Stanley Global Steel Report* at 6.

<sup>67</sup> European Commission, Communication from the Commission to the Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, *Action Plan for a competitive and sustainable steel industry in Europe*, COM(2103) 407 at 7.

<sup>68</sup> The excess capacity figures in the chart below are from *Morgan Stanley Global Steel Report* at 6.

<sup>69</sup> OECD Excess Capacity Report at 4.

this year.<sup>70</sup> By 2016, an estimated 100 new mills, with a total capacity of 350 million metric tons, are expected to come on stream globally.<sup>71</sup> As discussed below, these capacity increases are far in excess of anticipated increases in demand.

Once again, China leads in terms of planned future capacity increases. While demand is expected to continue to rise in China in the coming years (albeit at a slower pace), it will “be more than offset by capacity additions.”<sup>72</sup> And claims that the Chinese government is effectuating major consolidations and closures in the steel industry are unfounded.<sup>73</sup> Thus far in 2013, “announced steelmaking capacity increases [in China] are three times higher than closures.”<sup>74</sup> Specifically, Chinese capacity will rise to at least 950 million metric tons in 2013, as some 50 million metric tons of new capacity is being built.<sup>75</sup> Much of this capacity is being added by large, state-owned or state-supported steel producers in China.<sup>76</sup> As a result, Chinese steel producers expect net capacity in China to grow by 9 percent and 5 percent in 2013 and 2014, respectively.<sup>77</sup> While some capacity in China has been eliminated in the past three years as a result of limited consolidation efforts, “there are few plans to carry [capacity elimination] on into 2013 and 2014.”<sup>78</sup>

Other steel industries worldwide are also planning major capacity increases in the near future. For example, Russian producers plan to add more than 15 million metric tons of crude steel capacity by 2015 (net of decommissioned capacities), even though the Russian steel industry was only operating at a 73 percent capacity utilization rate in 2011.<sup>79</sup> Brazilian steelmakers are also planning significant capacity increases in the near future.<sup>80</sup>

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<sup>70</sup> *Id.* Ernst & Young predicts that excess capacity will reach approximately 479 million metric tons in 2013. *E&Y Global Steel 2013 Report* at 9.

<sup>71</sup> John W. Miller, *Global Steel Industry Faces Capacity Glut*, Wall Street Journal (Nov. 27, 2012).

<sup>72</sup> *Morgan Stanley Global Steel Report* at 5.

<sup>73</sup> China plans to phase out only about one percent of its current capacity in 2013, while the Chinese steel industry is expected to add about 50 million metric tons of new blast furnace capacity this year. *Id.* at 29. *See also* Jamil Anderlini, *Chinese industry: Ambitions in excess*, Financial Times (June 16, 2013) (“Previous efforts to consolidate the [Chinese] steel sector have been sidelined repeatedly”).

<sup>74</sup> *China Should Link New Steelmaking Capacity Additions with Plant Closures*, MEPS China Steel Review (May 7, 2013).

<sup>75</sup> *China’s Steel Overcapacity Seen Continuing*, Fox Business (May 23, 2013). *See also* CISA predicts 2012’s raw steel output at 720 million mt, Steel Business Briefing (Jan. 7, 2013) (“China’s investments in steelmaking during the first eleven months of 2012 were expected to lead to more than 50 million mt/y of new steel capacity”).

<sup>76</sup> *See, e.g., China’s Haixin I&S to commission first hot strip mill*, Steel Business Briefing (Jan. 17, 2013) (“major state-owned steel mills, such as Baosteel and Wuhan Iron & Steel, have also been pushing their major new integrated flat steel making capacities on southern China’s coast”); Colin Richardson, *Global steel industry to experience tough year in 2013: Jefferies*, Platts (Apr. 24, 2013) (“It quoted Baosteel to underline this point: ‘There is too much capacity in this industry. But in this competitive market, our competitors have been expanding capacity. For instance, Wuhan Iron & Steel’s expansion plan in Fangchenggang port. Under these circumstances, in order to maintain our leadership position, we have to expand’”).

<sup>77</sup> *Morgan Stanley Global Steel Report* at 5.

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

<sup>79</sup> *Overview of Russian Steel: Discussion Workshop*, Roland Berger Strategy Consultancy (Mar. 2012) at 13, 16.

<sup>80</sup> *See, e.g., European Factors to Watch-Shares seen higher, focus on U.S. jobs*, Reuters (June 7, 2013).

In India, which does not currently have high levels of excess capacity, the steel industry is expected to add significant amounts of capacity in coming years<sup>81</sup> – approximately 60 million metric tons from 2011 to 2017.<sup>82</sup> If these planned capacity expansions occur, India could become the second largest steel producing country in the world by 2015.<sup>83</sup> Despite growing demand in India, massive increases in Indian steel capacity will exacerbate the global oversupply situation, in part by lessening India’s availability as an export market, and especially if India’s GDP growth slows more than is expected.<sup>84</sup>

Thus, unless major changes are made to address the long-term distortions in the global steel industry, levels of excess capacity will only continue to rise rapidly, putting increasing downward pressure on steel prices and profitability around the world and causing further harm to the global industry.

#### **IV. MUCH OF GLOBAL STEEL CAPACITY GROWTH IS NOT MARKET-BASED**

The overcapacity crisis plaguing the global steel industry is largely a result of non-market-based forces. As the Department of Commerce found in 2000, while legitimate, market-based barriers to exit from the steel industry do exist, “government practices and policies that forestall adjustments mandated by the market” are a major cause of excess capacity in the steel industry.<sup>85</sup> This remains true today, as many governments continue to subsidize the start-up of additional, unnecessary capacity and prevent obsolete capacity from closure.

##### **A. Steel Capacity Growth Is Largely Not Driven by Demand**

“In a competitive industry, production and ultimately capacity should respond to market signals.”<sup>86</sup> However, growth in steel capacity clearly has not tracked demand in the market, particularly in recent years, resulting in the overcapacity crisis facing the industry today. Continued and accelerating capacity increases are at odds with trends in the market, as “[l]ower industrial production and reduced investment in large-scale infrastructure projects have resulted in a marked decrease in the growth of steel demand from both the developed and emerging markets.”<sup>87</sup>

In the previous decade, demand for steel globally grew by approximately five percent per year.<sup>88</sup> By contrast, apparent global steel usage in 2012 grew by only 1.2 percent – the slowest rate since 2009 when demand declined by 6.5 percent<sup>89</sup> – and a significant drop from 6.2 percent

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<sup>81</sup> OECD Regional Capacity Report at 4.

<sup>82</sup> *E&Y Global Steel 2013 Report* at 30.

<sup>83</sup> *Id.* at 31.

<sup>84</sup> India’s GDP growth has dropped from over nine percent in early 2010 to less than six percent for three successive quarters in 2012. *E&Y Global Steel 2013 Report* at 32.

<sup>85</sup> *See* Commerce Global Steel Report at 4.

<sup>86</sup> *Id.*

<sup>87</sup> *E&Y Global Steel 2013 Report* at 8.

<sup>88</sup> *Morgan Stanley Global Steel Report* at 1.

<sup>89</sup> *Worldsteel Short Range Outlook*, World Steel Association (Apr. 11, 2013).

growth in 2011.<sup>90</sup> Demand growth rates are expected to remain at lower levels in the near future.<sup>91</sup> For example, Morgan Stanley predicts that global demand for steel will grow by only about three percent annually for the next five years,<sup>92</sup> while Metal Bulletin Research estimates that global steel demand will grow by approximately 3.7 percent per year between 2011 and 2025, representing a slowdown from the previous decade.<sup>93</sup>

As shown in the table below, many of the producers in regions with growing steel capacity are already operating at low levels of capacity utilization, reflecting the oversupply and relatively weak demand in their home markets and underscoring the disconnect between continued capacity increases and demand. Moreover, as noted previously, given the positive correlation between capacity utilization and profitability, lower capacity utilization rates appear to be resulting in lower industry profitability.<sup>94</sup>

<b>Estimated capacity utilization rates by region<sup>95</sup></b>	
	<b>2013e</b>
<b>EU (27)</b>	69.3%
<b>Other Europe</b>	74.8%
<b>CIS</b>	73.8%
<b>NAFTA<sup>96</sup></b>	79.7%
<b>Central/South America</b>	72.9%
<b>China</b>	76.7%
<b>Japan</b>	84.9%
<b>India</b>	84.4%
<b>South Korea</b>	84.3%
<b>Other Asia/Pacific</b>	55%
<b>Global</b>	75.8%

In particular, and as reflected by the declining capacity utilization rates of Chinese steel producers, rates of demand growth in China have slowed considerably, while capacity continues to increase rapidly. Chinese steel demand grew by only approximately two percent in 2012 and

<sup>90</sup> *Worldsteel Short Range Outlook*, World Steel Association (Oct. 11, 2012).

<sup>91</sup> *See, e.g., Worldsteel Short Range Outlook*, World Steel Association (Apr. 11, 2013).

<sup>92</sup> *Morgan Stanley Global Steel Report* at 1.

<sup>93</sup> OECD Directorate for Science, Technology and Industry, Steel Committee, *The Future of the Steel Industry: Selected Trends and Policy Issues*, DSTI/SU/SC(2012)(12) (Nov. 19, 2012) (“OECD Steel Industry Future Report”) at 2.

<sup>94</sup> *See e.g., Steel Score Card # 22*, World Steel Dynamics (June 5, 2013) at 46-47; *see also E&Y Global Steel 2013 Report* at 9.

<sup>95</sup> *Morgan Stanley Global Steel Report* at 14. Notably, some of these rates are boosted by significant net exports of steel and steel-containing products.

<sup>96</sup> In March 2013, the U.S. steel industry’s capacity utilization was estimated to be slightly lower than the NAFTA estimated rate, at 76.2 percent. U.S. Department of Commerce, International Trade Administration, *Steel Industry Executive Summary: May 2013* (May 6, 2013) at 9.

is expected to increase by only two to three percent in 2013 and 2014.<sup>97</sup> These modest demand increases stand in stark contrast to the major capacity increases occurring in China, which are projected to far outpace demand in coming years.

Similarly, in Russia, steel producers plan to increase their capacity by more than 16 percent by 2015.<sup>98</sup> However, Russian steel consumption is expected to rise by an average of only three percent annually over the next five years,<sup>99</sup> meaning that the already oversupplied Russian market will suffer from additional excess capacity.

Europe, still reeling from the effects of the financial crisis, experienced a severe reduction in demand last year, with apparent steel use in 2012 falling by 9.3 percent overall.<sup>100</sup> Steel demand in the EU is currently 27 percent below pre-crisis levels<sup>101</sup> and is expected to contract further by 0.5 percent this year.<sup>102</sup> European steel mills, however, have not been able to adjust their capacity in line with these market contractions, as discussed further below.

The North American steel market has generally fared better than the European market. For NAFTA as a whole, apparent steel use is projected to grow by approximately three percent in both 2013 and 2014.<sup>103</sup> At the same time, some NAFTA production capacity has recently been permanently removed from the market.<sup>104</sup> Thus, as European and other markets continue to feel the effects of the recession, and global capacity continues to climb far in excess of demand, the United States will remain an extremely attractive target for world steel exports, further threatening the U.S. steel industry.

## **B. Steel Capacity Growth Is Not Supported by Profitability**

The relatively low profits earned by many steel producers worldwide further demonstrate the disconnect between steel capacity growth and market forces.<sup>105</sup> The Chinese steel industry exemplifies this, as China's dramatic increase in steel capacity has occurred despite financial returns in the Chinese industry that are well below those achieved by other steel industries.<sup>106</sup> According to World Steel Dynamics, the Chinese steel industry's average earnings before interest, taxes, depreciation, and amortization was approximately one-half that of the rest of the

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<sup>97</sup> *Morgan Stanley Global Steel Report* at 28; *E&Y Global Steel 2013 Report* at 23; *Worldsteel Short Range Outlook*, World Steel Association (Apr. 11, 2013).

<sup>98</sup> *Overview of Russian Steel: Discussion Workshop*, Roland Berger Strategy Consultancy (Mar. 2012) at 16.

<sup>99</sup> Nadia Popova, *Moscow Steel Summit: Low demand, overcapacity, imports are major threats to Russian industry*, Steel First (June 6, 2013).

<sup>100</sup> *Worldsteel Short Range Outlook*, World Steel Association (Apr. 11, 2013).

<sup>101</sup> European Commission, Communication from the Commission to the Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, *Action Plan for a competitive and sustainable steel industry in Europe*, COM(2013) 407 at 3.

<sup>102</sup> *Worldsteel Short Range Outlook*, World Steel Association (Apr. 11, 2013).

<sup>103</sup> *Id.*

<sup>104</sup> See Bruce Vail, *An Ominous Quiet Descends On RG Steel's Troubled Mills*, inthesetimes.com (June 7, 2012).

<sup>105</sup> See *E&Y Global Steel 2013 Report* at 9 ("Margins will continue to be tight into 2013.").

<sup>106</sup> *Id.* at 24 ("With their profitability remaining the lowest globally, it is possible that Chinese companies will continue to operate even after posting losses, flooding the steel export markets with low-cost steel.").

world from 2005-2010.<sup>107</sup> In 2011, Chinese steel producers' operating margins were among the lowest of large steelmakers worldwide.<sup>108</sup> When discounting the significant subsidies granted to Chinese steel producers, the industry's profits are much lower, or even negative.<sup>109</sup>

Profits have not improved for Chinese steelmakers since 2011. In 2012, *The New York Times* reported that the Chinese steel sector "has seen margins plummet and has racked up a mountain of debt as it tries to serve the twin masters of the state and the market."<sup>110</sup> At the time, the industry was estimated to have \$400 billion in debt, caused primarily by losses incurred by China's largest state-owned enterprises ("SOEs").<sup>111</sup> Moreover, according to CISA, its member mills lost nearly 43 billion yuan (approximately \$6.9 billion) from their core steel businesses in 2012.<sup>112</sup> "The CISA complained in January [2013] that profits at its member mills – mostly large-scale and state-owned – slumped 98 percent [in 2012] on weak demand and chronic overcapacity, exacerbated by the small 'rampantly expanding' mills."<sup>113</sup> (In general, state-owned steel companies have lower operating margins than private companies.<sup>114</sup>) And more recently, 70 percent of Chinese steelmakers lost money in April and May 2013, according to the managing director of Shanghai-based steel trader Cumic Steel Ltd.<sup>115</sup>

In short, the overwhelming majority of global capacity increases since 2000 have occurred in what has become the least profitable steel industry in the world, highlighting the disconnect between profitability and increasing capacity. Despite such meager (or even

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<sup>107</sup> *Global Steel Finance #14*, World Steel Dynamics (July 2, 2010) at 22, 24. A recent World Steel Dynamics report shows that large and mid-size Chinese state-owned steel producers achieved essentially zero percent returns for most of 2011 and 2012. *Steel Score Card # 22*, World Steel Dynamics (June 5, 2013) at 46.

<sup>108</sup> OECD Steel Industry Future Report at 16.

<sup>109</sup> See U.S.-China Economic and Security Review Commission, *2012 Report to Congress*, 112th Cong., 2d Sess. (Nov. 2012) at 53 ("Considering all the subsidies and preferences enjoyed by the [Chinese] SOEs, they actually had a negative return on equity... A study by the Hong Kong Institute for Monetary Research estimated that SOE profits would disappear if they were required to repay loans at market rates."). See also, *Chinese Industry: Ambitions in Excess*, Financial Times (June 16, 2013) ("There is enormous overcapacity and no gauging of supply and demand and we found that subsidies account for about 30 percent of industrial output. Most of the companies we looked at would probably be bankrupt without subsidies.")

<sup>110</sup> *In China's Floundering Steel Sector, the Burden of Politics*, The New York Times (May 3, 2012).

<sup>111</sup> *Id.*

<sup>112</sup> *Local resistance to Beijing's steel consolidation*, CRU Steel News Daily (Feb. 27, 2013). Other reports note that Chinese mills lost 5.5 billion yuan (\$883 million) between January and September 2012. *China Steelmakers Poised for Rebound, Xinhua Says, Citing CISA*, Bloomberg (Nov. 25, 2012). See also Dexter Roberts, *For China, Too Much Steel Isn't Enough*, Bloomberg Businessweek (June 28, 2012) ("China's steel industry lost \$1 billion yuan in the first quarter" of 2012.); *China Should Link New Steelmaking Capacity Additions with Plant Closures*, MEPS China Steel Review (May 7, 2013) ("In 2012, the majority of Chinese steel companies operated at a loss.")

<sup>113</sup> David Stanway and Ruby Lian, *New rules may ease China pollution, won't solve steel overcapacity*, Reuters (Mar. 10, 2013). See also *Special Report: Shougang Jingtang's loss 'a timely warning'*, Steel Business Briefing (May 31, 2013) ("China's steel sector last year achieved an average profit margin of just 0.04%").

<sup>114</sup> OECD Steel Industry Future Report at 25.

<sup>115</sup> *China's Steel Overcapacity Seen Continuing*, Fox Business (May 23, 2013). See also *Surging Chinese Steel Exports Put Pressure on World Prices*, Wall Street Journal (May 16, 2013) ("Some 80 large and medium-size Chinese steelmakers were reporting breakeven-level profits in March [2013], 'with a danger of falling back into negative territory in April.'")



nonexistent) profits, Chinese steel producers continue to increase production and add capacity largely as a result of governmental control over and intervention in the industry, as discussed below.

### **C. Current Steel Overcapacity Is Largely the Result of Government Intervention**

Rather than market-based growth, capacity continues to grow largely as a result of government intervention in the steel industry. Many governments around the world have significantly subsidized the growth of their steel industries, including through low-interest loans, grants, and the provision of low-priced inputs. Such intervention has resulted in enormous capacity increases over short periods of time in many countries, causing oversupply globally and otherwise distorting the world market.

In addition to the use of government ownership and control to build capacity in their domestic steel industries, political intervention is a key barrier to permanent capacity closures in the industry, as governments often will prevent mill closure in order to maintain employment levels and for other non-commercial purposes.<sup>116</sup> In a purely market-based system, “the power of the market alleviates excess capacity, by forcing inefficient producers that incur profit losses to eventually exit the market.”<sup>117</sup> However, government intervention artificially prevents the market from self-correcting in this manner. Thus, in the steel industry, government impediments to capacity closure, combined with legitimate market-based barriers to exit, have led to the accumulation of persistent, and growing, excess capacity.

China provides the most striking example of government intervention in the steel industry, which has resulted in the enormous growth in steel capacity discussed above. The unprecedented growth in Chinese capacity is largely a result of massive government ownership and control over the steel industry, at the expense of market-oriented steel producers around the globe.<sup>118</sup> The Chinese government has ownership interests in 18 of the 20 largest steel producers in China.<sup>119</sup> The OECD has identified 29 large Chinese steel companies (*i.e.*, companies which produced 2 million metric tons of steel or more in 2011) as being majority owned by the state.<sup>120</sup> In addition to owning majority shares in most of its major steel producers, the Chinese government maintains a high degree of decision-making authority over the steel industry and continues to intervene extensively in the operations of individual steel companies.

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<sup>116</sup> See *Morgan Stanley Global Steel Report* at 15.

<sup>117</sup> OECD Excess Capacity Report at 2. See, e.g., Bruce Vail, *An Ominous Quiet Descends On RG Steel's Troubled Mills*, *inthesetimes.com* (June 7, 2012).

<sup>118</sup> See, e.g., *Perverse advantage: A new book lays out the scale of China's industrial subsidies*, *The Economist* (Apr. 27, 2013) (“On their conservative calculations, China spent over \$300 billion, in nominal terms, on the biggest SOEs between 1985 and 2005. This help often came in the form of cheap capital and underpriced inputs unavailable to international rivals ... Such distortions breed indiscipline and overcapacity... A similar problem looms in the steel industry, where the country's excess capacity of some 200m tonnes surpasses the entire capacity of Japan's steelmakers.”).

<sup>119</sup> OECD State Ownership Report at 6-7.

<sup>120</sup> OECD Steel Industry Future Report at 25.

The Chinese government's significant involvement in its steel industry has both contributed to the enormous increases in new capacity and prevented the closure of inefficient capacity. Through various laws, policies, and industrial plans, the Chinese government for decades has directly subsidized its steel industry through the provision of grants, preferential loans, debt-for-equity swaps, tax refunds, and other preferential policies, as well as various forms of indirect support, such as restrictions on foreign investment.<sup>121</sup> Using such policies, as well as its significant ownership over the industry, the Chinese government has created the world's largest steel industry.

The Chinese government also intervenes in its steel industry to prevent the closure of capacity. Many older, low-technology mills in China, which would likely close in a purely market-based environment, have been supported by local governments and continue to operate, intensifying global oversupply. While the limited attempts at consolidation in the steel industry have been largely ineffective, "[l]ocal governments, still desperately pursuing economic growth, are approving new steel projects."<sup>122</sup> These circumstances led Morgan Stanley to conclude that state-owned Chinese steel companies are "highly unlikely" to undergo any large-scale mill closures, and that it is "likely" that local governments would intervene to prevent any major closures even by privately owned steel companies in China.<sup>123</sup> As a result, the enormous overcapacity in China is "unlikely to exit anytime soon."<sup>124</sup>

Turkey is another prime example of a steel industry built with government support. The Turkish steel industry has grown rapidly, jumping from the 17<sup>th</sup> largest crude steel-producing country in the world in 2000 to the 8<sup>th</sup> largest by 2012,<sup>125</sup> and the 7<sup>th</sup> largest net exporter of steel.<sup>126</sup> Such dramatic growth has been facilitated by significant subsidies from the Turkish government, including low-interest development bank loans,<sup>127</sup> export credits and insurance,<sup>128</sup> tax benefits, and upstream subsidies to suppliers.<sup>129</sup> In addition, Turkish steel producers that generate power with their own coal-fired or natural gas power plants benefit from state-controlled pricing schemes, resulting in artificially low energy costs for such producers.<sup>130</sup>

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<sup>121</sup> See generally Wiley Rein & Fielding LLP, *The China Syndrome: How Subsidies and Government Intervention Created the World's Largest Steel Industry* (July 2006); Wiley Rein LLP, *The Reform Myth: How China Is Using State Power to Create the World's Dominant Steel Industry* (Oct. 2010).

<sup>122</sup> See *Local resistance to Beijing's steel consolidation*, CRU Steel News Daily (Feb. 27, 2013).

<sup>123</sup> *Morgan Stanley Global Steel Report* at 16.

<sup>124</sup> *Id.* at 9.

<sup>125</sup> Turkish Steel Exporters' Association, *A Growing Industry*, <http://www.turkishsteel.eu> (follow "Growing Industry" hyperlink) (last visited June 19, 2013); *World crude steel output increases by 1.2% in 2012*, World Steel Association (Jan. 22, 2013).

<sup>126</sup> *World Steel in Figures 2013*, World Steel Association (May 30, 2013) at 26.

<sup>127</sup> See, e.g., Kalkinma Development Bank of Turkey, *2011 Annual Report* at 9-10, <http://english.kalkinma.com.tr/annual-reports.aspx> (last visited June 25, 2013).

<sup>128</sup> See *New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Turkey*, G/SCM/N/220/TUR (Mar. 21, 2012) at 58-69.

<sup>129</sup> Issues and Decision Memorandum accompanying *Welded Carbon Steel Standard Pipe from Turkey*, 70 Fed. Reg. 62,097 (Dep't Commerce Oct. 28, 2005) (final results of expedited sunset review).

<sup>130</sup> See Report by the Secretariat, *Trade Policy Review: Turkey*, WT/TPR/S/259 (Jan. 17, 2012) at 91-92.

Similarly, the Indian government has fostered the rapid expansion of its steel industry through intervention and subsidies. There, the government owns at least 80 percent of the Steel Authority of India Ltd. (“SAIL”), India’s largest steel producer.<sup>131</sup> Outside of ownership, the Indian government has historically intervened in its domestic steel market by promoting investments and propping up struggling enterprises with government loans, loan guarantees, debt write-offs, and tax breaks, in addition to imposing import duties and licensing requirements and raw material export restrictions to protect domestic producers.<sup>132</sup>

Governments in countries with smaller steel outputs are also learning from the Chinese example and intervening to protect and expand their steel industries. For example, “[c]ompanies in Vietnam, Argentina, Ecuador, Peru and Bolivia, all backed in some way by their governments, are building or planning new mills,”<sup>133</sup> which will contribute to the excess capacity plaguing the global steel industry. The following governments also own significant shares of the large (if not the largest) steel companies in their countries, thereby playing a role in increased production in these countries: Indonesia (PT Krakatau Steel), Libya (Libyan Iron and Steel Company), Venezuela (Siderúrgica del Orinoco and Siderúrgica del Turbio SA), Pakistan (Pakistan Steel Mills Corporation), Saudi Arabia (Saudi Basic Industries Corporation), and the United Arab Emirates (Emirate Steel Industries PJSC). Indeed, the OECD has found that 17 of the largest 50 steel companies in the world are state-owned.<sup>134</sup>

Even in countries with historically market-based economies, governments are intervening in the steel sector. In Europe – a critical region with respect to steel overcapacity – the European Commission recently released an action plan to strengthen its ailing steel industry, but “[o]n the key issue of overcapacity, the report has little to offer.”<sup>135</sup> At the same time, as detailed below, some European governments have intervened to delay or prevent plant shutdowns, in order to avoid potential social and economic consequences, and many expect them to continue to do so in the future. “European governments will likely continue to pressure European steelmakers to keep steel production facilities open, and not downsize their European operations.”<sup>136</sup> So-called “zombie mills” – “dead mills being almost entirely propped up by state assistance through direct subsidies or indirect arrangements” – exist across Europe.<sup>137</sup> As Morgan Stanley notes, “[e]xit

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<sup>131</sup> *SAIL share auction: government raises \$279 million*, Reuters (Mar. 22, 2013).

<sup>132</sup> *See, e.g.*, Commerce Global Steel Report at 163; Memorandum to Paul Piquado, Assistant Secretary for Import Administration, from Christian Marsh, Deputy Assistant Secretary for Antidumping and Countervailing Duty Operations, re: *Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Circular Welded Carbon-Quality Steel Pipe from India* (Oct. 15, 2012); U.S. Trade Representative, *2013 National Trade Estimate Report on Foreign Trade Barriers: India* (Mar. 2013) at 1, 11-12.

<sup>133</sup> John W. Miller, *Global Steel Industry Faces Capacity Glut*, Wall Street Journal (Nov. 27, 2012).

<sup>134</sup> OECD State Ownership Report at 4, 6-7. Even this estimate is conservative, as the OECD limits its definition of an SOE to an entity with state ownership that exceeds 50 percent. This definition, therefore, does not take into account entities that are otherwise owned, controlled, or effectively influenced by the government (through, for example, controlling minority shares, golden shares, the ability to appoint board members, or the ability to otherwise influence the management or operations of the entity).

<sup>135</sup> Silvia Antonioli and Philip Blenkinsop, *CORRECTED-UPDATE 2-EU unveils action plan for Europe’s ailing steel sector*, Reuters (June 12, 2013).

<sup>136</sup> *ArcelorMittal: Problems in Europe and Regaining Investment Grade Status*, Seeking Alpha (Jan. 21, 2013).

<sup>137</sup> Silvia Antonioli, *INTERVIEW-Steel producers face survival struggle in 2013*, Reuters (Jan. 22, 2013).

from European overcapacities remains difficult as most of the potentially affected plants are in low-income areas with already high unemployment rates. The European steel industry has already seen several forms of government intervention over the last couple of months to prevent workforce reductions.”<sup>138</sup> For example:

- In Italy, the government recently passed the so-called “Save ILVA” decree<sup>139</sup> and appointed a special administrator to oversee steelmaker Ilva SpA, which runs Europe’s largest steel plant in Taranto, Italy.<sup>140</sup> The Italian government prevented the closure of the Ilva plant, which produced 30 percent of Italian steel output in 2012,<sup>141</sup> out of concern that such closure would be “an enormous shock” for the country’s economy, including in terms of jobs.<sup>142</sup>
- The French government recently threatened to nationalize two ArcelorMittal blast furnaces when the company announced it would mothball the furnaces as a result of chronic overcapacity in the industry.<sup>143</sup>
- Similarly, ArcelorMittal announced plans to shut down many of its facilities at its steelworks in Liege, Belgium, and the Belgian government is now considering whether to pass a law to nationalize the site and prevent the plant’s closure.<sup>144</sup>

These examples demonstrate that, just as the Department of Commerce found in its 2000 report, growing overcapacity in the global steel market continues to be due in large part to government subsidies to and intervention in steel industries around the world, particularly in those countries outside of North America that are referenced above.<sup>145</sup> Even more so than in previous periods, direct and indirect government subsidies continue to help create massive steel capacity worldwide and to prevent much-needed capacity closures and reductions in response to oversupply and weakening demand conditions.

## **V. FUTURE SOLUTIONS TO THE GLOBAL OVERCAPACITY CRISIS**

Previous efforts to remedy global steel overcapacity – and to eliminate government intervention and other market-distorting practices contributing to overcapacity – have not

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<sup>138</sup> *Morgan Stanley Global Steel Report* at 8.

<sup>139</sup> See *Press Release: Ilva, Clini: The law must be applied, however, at-risk measures to protect health and environment*, Italian Ministry of Environment (Jan. 15, 2013) (translated from original Italian using Google Translate).

<sup>140</sup> Chiara Vasarri, *Italy to Put Ilva Steelmaker Under Special Administration*, Bloomberg (June 4, 2013); *Morgan Stanley Global Steel Report* at 15.

<sup>141</sup> *Morgan Stanley Global Steel Report* at 15.

<sup>142</sup> Chiara Vasarri, *Italy to Put Ilva Steelmaker Under Special Administration*, Bloomberg (June 4, 2013).

<sup>143</sup> Andrew Saunders, *From the Caribbean to global steel giant: The rise of ArcelorMittal*, Management Today (Jan. 1, 2013); *ArcelorMittal: Problems in Europe and Regaining Investment Grade Status*, Seeking Alpha (Jan. 21, 2013).

<sup>144</sup> Ben Deighton, *Belgium considers nationalization of ArcelorMittal plant*, Reuters (May 30, 2013); Silvia Antonioli and Philip Blenkinsop, *CORRECTED-UPDATE 2-EU unveils action plan for Europe's ailing steel sector*, Reuters (June 12, 2013).

<sup>145</sup> *Commerce Global Steel Report* at 4.

achieved long-term results. Despite the clear lessons from previous down cycles, including the 1997-2001 crisis, steel producers in certain regions have continued to add capacity far in excess of demand. Due in large part to massive government subsidies and other non-market forces, global steel capacity has grown exponentially over the last decade. Indeed, instead of retreating from involvement in the steel industry, certain governments have increasingly intervened in steel industries around the globe, leading to unprecedented levels of overcapacity and other market-distorting practices.<sup>146</sup> Unless immediate action is taken to reduce global overcapacity, the U.S. and global steel industries could face a crisis far greater than in the 1997-2001 period.

The potential solutions to the current crisis could be similar to those that have been previously suggested by OECD countries and industries, as the underlying causes of overcapacity have not changed. To address overcapacity, policy makers should reduce or eliminate the underlying market-distorting practices that serve to increase and/or maintain inefficient capacity.

First, and most importantly, the major steel-producing countries should agree to remove government involvement from the steel industry. Specifically, countries should agree to remove government ownership and control over the industry, as well as any other government involvement, direct or indirect, in the industry. This includes:

- Eliminating government subsidies and other assistance to the steel industry, including assistance to prop up loss-making, inefficient capacity. The only potential exception would be for certain government assistance necessary to facilitate the permanent closure of inefficient excess steel capacity;<sup>147</sup>
- Eliminating government practices and policies that prevent or forestall adjustments mandated by the market. For example, companies must be permitted to lower production levels and/or cease production when demand, profitability, or other market conditions warrant. Government policies or assistance that impose barriers to exit the industry should also be removed. As Ernst & Young recently concluded, “[t]he politicization of otherwise rational commercial decisions can only negatively impact the recovery of the entire global steel sector by delaying the removal of ineffective loss making excess capacity”;<sup>148</sup>
- Removing government industrial planning and decision-making from the steel industry;
- Removing export restrictions on critical raw materials and other government intervention in raw materials markets – raw materials trade should be based on market principles; and
- Removing import tariffs and trade-distorting non-tariff barriers on steel products.

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<sup>146</sup> See e.g., *OECD Excess Capacity Report* at 7 (showing growing levels of global overcapacity from 2007-2014).

<sup>147</sup> Indeed, there is a clear distinction between government assistance designed to increase and maintain steel-making capacity, and government support designed to help close inefficient capacity or to encourage industry restructuring and consolidation.

<sup>148</sup> *E&Y Global Steel 2013 Report* at 14.

As the NAFTA industries so aptly articulated more than a decade ago, any effort to address overcapacity and market-distorting practices “should begin with a commitment from governments to get out of the steel business.”<sup>149</sup> No ownership, no control, and no subsidies.<sup>150</sup>

Second, major steel-producing countries should remove other practices that cause market distortions and should take measures to ensure a market-based, competitive home market. For example, countries should ensure the proper enforcement of antitrust and competition rules to prevent “cooperative systems” among domestic producers, and remove import barriers that insulate domestic producers from competition. There is no good justification for countries that have developed steel industries, such as Brazil, India, Russia, and Turkey, to maintain tariffs and other import barriers on steel products or to impose export restrictions on raw materials. Each of these practices can artificially reduce costs and inflate the export competitiveness of domestic producers, leading to surplus capacity and the ability to distort trade.

Third, industries that currently have significant excess capacity should commit to market-based restructuring and consolidation, with the goal of eliminating inefficient and uneconomic capacity. Barriers to consolidation should be removed, as they were in the U.S. industry in the early 2000s. Restructuring should enable companies to adjust production levels commensurate with demand and other market conditions, eliminating the need for companies to produce their way out of a downturn. The restructuring process should also include the implementation and utilization of viable, market-based bankruptcy procedures to ensure a well-functioning exit process. Such procedures will help ensure that uneconomic capacity is removed, keeping non-market based capacity expansion in check. Further, as noted above, governments must allow companies to enter bankruptcy, instead of providing subsidies and other assistance to keep failing companies afloat. Moreover, efforts to restructure and eliminate excess capacity should not be continuously postponed. As the Department of Commerce concluded in 2000, “[t]he longer that normal market restructuring is postponed, the more painful the process will be.”<sup>151</sup>

The 1997-2001 crisis, and others like it, demonstrates that the U.S. and other markets can be adversely affected by overcapacity and market-distorting practices that occur elsewhere. Even after the U.S. industry took the difficult, and often painful, steps to consolidate and restructure, it has not been immune from the adverse effects from imbalances and distortions stemming from the other side of the globe.<sup>152</sup> Indeed, government intervention and other market-distorting activity in one region have significant adverse repercussions throughout the global steel industry. As a result, overcapacity and other market distortions will not be remedied

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<sup>149</sup> Statement of NAFTA-Wide Principles at 3.

<sup>150</sup> Given the fact that China is pursuing an economic model that is based in part on government ownership and support, a potential approach could be to encourage countries to support trade agreement provisions ensuring strong and enforceable disciplines on steel industry SOEs and state-supported enterprises (“SSEs”) in order to limit their market-distorting effects. However, because an international consensus regarding such disciplines has yet to emerge, and in light of past and current difficulties in limiting the market-distorting effects of government involvement in the steel industry, it is not clear that such an approach would be effective or enforceable.

<sup>151</sup> Commerce Global Steel Trade Report at 124.

<sup>152</sup> As Ernst & Young recently concluded “China has massive steelmaking capacity, so even minor increases in its export patterns have the ability to dramatically alter the steel industry in other countries.” *E&Y Global Steel 2013 Report* at 26. For example, “exports of steel from China to other steel-producing countries such as Brazil and the US impose a ceiling on domestic prices.” *Id.* at 25.

unless there is buy-in and cooperation from all major steel-producing countries. Currently, the OECD appears to be the most appropriate international forum through which to address these issues. However, regardless of whether there is an OECD component, China must deal with its state-sponsored overcapacity for any solution to be effective.

If the long-term issues associated with overcapacity and other market-distortions are not addressed in a comprehensive manner, the adverse effects stemming from these imbalances, including unfair trade practices and the resulting trade friction, will undoubtedly occur again. Ensuring open and fair markets that are free from government intervention will reduce the likelihood of overcapacity and other structural imbalances. Taking meaningful, though often difficult, steps now to deal with these issues, governments can help reduce the unprecedented levels of overcapacity and avoid the cycle of import surges and trade actions that have characterized the steel trade for many decades. The issue facing governments is whether they can take proactive steps to address these problems, or whether history is bound to repeat itself.