

House Committee on Ways and Means

Statement of John H. Goodish, Executive Vice President and Chief Operations Officer, United States Steel, Pittsburgh, Pennsylvania

Testimony Before the Subcommittee on Trade
of the House Committee on Ways and Means

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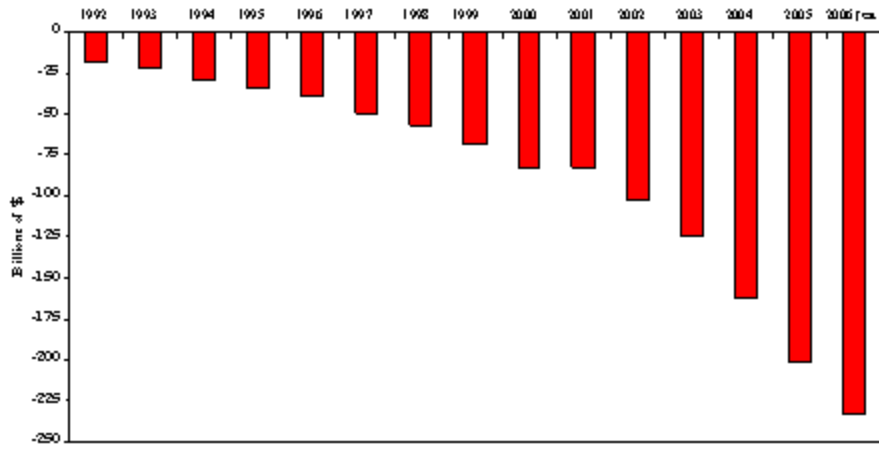
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I am pleased to be here today and to have the opportunity to testify about a topic that is crucial not only to the U.S. steel industry, but to all American manufacturers – that is, the growing concern about subsidies and state support of industrial capacity in China, and the extreme impact we are seeing on global markets as a result of these policies.

Introduction

At the outset and to put this issue in context, it is worth keeping in mind the massive and growing U.S. trade imbalance with China. The U.S. trade deficit with China soared from around \$84 billion in 2000 to over \$225 billion in 2006 (Figure 1). This exploding deficit is having a devastating impact on U.S. manufacturing. Industries like ours are losing core customers in this market, seeing basic industrial capabilities evaporate, and witnessing the loss of whole industries. The China problem with regard to the steel industry is especially grave, but is really just one of the most vivid examples of a crisis impacting American manufacturing generally.

U.S. Trade Balance with China

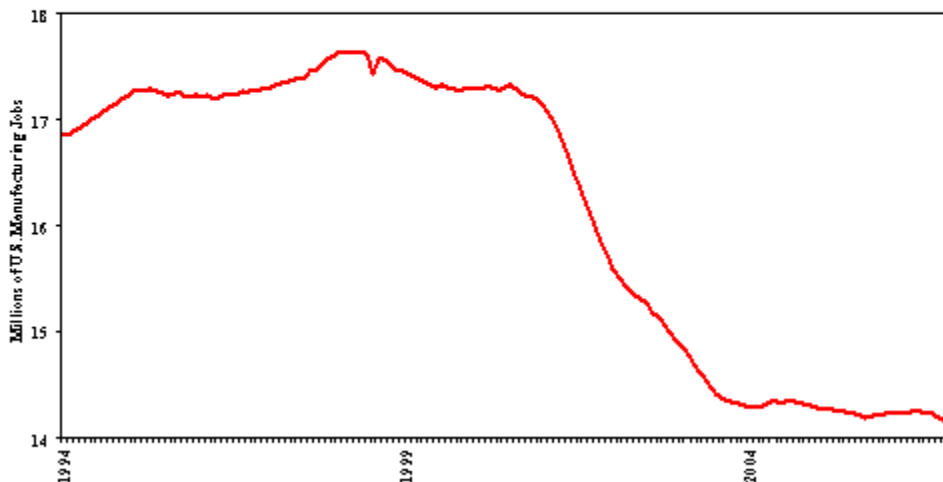


Source: U.S. Census Bureau, Commerce for 2006 based on data from January to November...

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The trade imbalance with China and the rest of the world is having especially grave effects on employment here in the United States, as foreign exports – often unfairly traded – are costing American industries both customers and capacity. Since 2000, the year we granted China permanent normal trade relations ("PNTR"), the jobs of over 3 million American workers have disappeared (Figure 2). What's especially troubling is that these jobs have still not returned, despite consecutive years of apparent economic recovery. This impact is due in no small measure to the export-inducing industrial policies of countries like China, which refuse to play by the rules.

U.S. Manufacturers Have Suffered Massive Job Losses



Source: Bureau of Labor Statistics, from ECRI SOURCE

2

The steel industry, and indeed U.S. manufacturers generally, should not and do not object to new manufacturing capacity overseas that results from real-world investors putting their hard-earned money into new facilities that are driven by market demand. But that is not what is happening, particularly with regard to China. The invisible hand of the market is not driving China's exploding exports. Rather, the Sino-U.S. trade imbalance reflects the hand of Chinese government, and the massive resources it has devoted to assisting its national industries.

As this committee well knows, China uses a wide variety of policy tools to support industry and exports. Among these, deliberate suppression of the Chinese currency's value is one of the most significant. Indeed, in the view of many, currency manipulation represents the biggest single subsidy provided to Chinese producers. From 1994 until July 21, 2005, China pegged its currency ("yuan" or "RMB") to the U.S. dollar at an exchange rate of roughly 8.28 yuan to the dollar.[1] The Chinese central bank maintained this peg by buying as many dollar-denominated assets in exchange for newly-printed yuan as needed to eliminate excess demand for the yuan.[2] On July 21, 2005, China made a slight modification to this peg, raising the value of its currency by 2.1 percent, tying the value of the yuan to a basket of currencies, and allowing the yuan to fluctuate by 0.3 percent on a daily basis against the basket.[3] The effects of this change have been minor; as of this week the dollar was still worth 7.75 yuan.[4] Given that some experts believe that yuan was undervalued by as much as 40 percent,[5] it is clear that the yuan is still not trading in line with its true market value. This manipulation is at once a substantial export subsidy and import barrier, making Chinese exports cheaper abroad and increasing the price of U.S. goods in China.

Other examples of Chinese industrial policy and market-distorting behavior could easily be provided. These range from failure to enforce intellectual property rights, to manipulation of raw material markets, to limitations on trading rights, to requirements for technology transfer, to a whole range of other unfair practices, many of which explicitly violate WTO commitments. These market-distorting mechanisms have been well-documented in government filings by the steel industry, and many other industrial sectors.[6]

Clearly, however, one of the most troubling and distortive aspects China's trade regime is the topic of this panel: namely, China's industrial subsidies. These are at once among the most blatantly unfair and illegal aspects of China's policy, and the impact on world markets is becoming more apparent every day. In short, the matter of Chinese subsidies is one of the most crucial issues facing the global steel industry, as well as many other industries, today.

Chinese Subsidies to the Steel Industry

There can be little doubt that, without subsidies past and present, China's steel enterprises would look very different than they do today. In the early 1990s, Chinese steel companies were widely viewed as utilizing low technology equipment and suffering from low productivity. Nonetheless, the Chinese government decided to inject massive funds into these mostly state-owned companies in an attempt to create export-oriented steel giants, with little or no regard for principles of global supply and demand. According to published reports and independent experts, very significant subsidies were granted during 1999 and 2000. Just to give a few examples:

- In the late 1990s, the Chinese government reportedly allocated \$7.25 billion (RMB 60 billion) to fund bargain-rate subsidized loans to state-owned steel enterprises for major technology upgrades. [7] According to this policy, discount loans were targeted to certain "key" technology projects specified by the state's industrial policies. In particular, the government reportedly aimed to encourage production of high value-added steel products, including galvanized sheet, cold-rolled sheet, and oil country tubular goods.[8]

- Estimates suggest that at the end of the 1990s, over 50% of China's steel firms were losing money.^[9] According to an OECD report, the Chinese government bailed out several unprofitable state-owned steel enterprises by transferring extensive debts the firms couldn't repay. To accomplish these debt-to-equity swaps, the government established and capitalized four "Bank Asset Management Companies."^[10] These companies took on the enterprises' non-performing loans, exchanging them for stakes in the failing producers of dubious real value.^[11] Indeed, in 2000, the OECD expressed concern that the swaps were nothing more than a "free lunch" for China's largest state-owned enterprises.^[12] Estimates suggest that this "free lunch" was enormous. In 2000 alone, 37 Chinese steel enterprises reportedly took advantage of \$7.53 billion in government-directed financing through debt-to-equity swaps.^[13]
- Press reports from this period also describe the Chinese government's effort to essentially force many steel enterprises to merge, after which debts of the resulting merged entities held by China's state banks were cancelled. In 2000, for example, reports suggest that the write-off of debts following forced mergers saved China's 100 largest steelmakers an estimated RMB 1.5 to 2 billion (\$181 to \$242 million) in interest payments.^[14]
- Also in 2000, China's government announced that \$6 billion would be spent over the following few years to upgrade and transform the steel industry.^[15]

Moreover, these historical subsidies correspond to what is apparently a longstanding official policy of the Chinese government to artificially support the steel industry. China's five-year plans, which address virtually every aspect of the country's economy, have reportedly ordered governments at all levels to support the expansion and technological renovation of the steel industry. China's ninth five-year plan, covering the years 1996 to 2000, openly called for the development of certain key production technologies, including automobile, oil, and other advanced types of steel.^[16] The tenth five-year plan, for 2001 to 2005, laid out a very detailed outline to upgrade the entire steel industry.^[17] The plan designated "core" regional steel enterprises to be targeted with government support, and even set export goals for each such enterprise.^[18] For example, the plan designated Baosteel Corporation, now China's largest steel producer, as the "core" enterprise for China's Eastern region, and set an export goal of 3 million MT per year by 2005 for the producer.^[19]

This explicit state planning, along with an apparent *policy* to engage in widespread subsidization of the Chinese steel industry, continues in China's most recent steel plan. In fact, in July 2005, China's National Development and Reform Commission adopted a new National Steel Policy to guide the industry's development over the next 15 years.^[20] Several of the policy's provisions indicate that China continues—and will continue—to artificially support its steel enterprises, placing particular emphasis on producing and exporting high-technology steel products:

- The policy states, "there shall be supported and organized the implementation of localization of steel industry installations so as to improve China's research and development, design and manufacturing ability of key steel industry technological installations. The state will provide tax support, interest subsidization support, scientific research funding support and other policy support to support key steel projects constructed in reliance of new domestically-developed installations."^[21]
- Further, "{t}he state provides export credit support to encourage steel manufacturing and equipment manufacturing enterprises to export domestic superior technologies and complete sets of metallurgy equipments by means of combining industry and trade or combining technology and trade."^[22]
- The policy contains detailed plans for the shape and composition of the Chinese industry, calling, for example, for a reorganization of the steel industry by 2010 into a structure comprised of two 30 million MT steel groups and several 10 million MT groups.^[23]
- The policy micromanages many aspects of the Chinese steel industry, including the size of new

steel plants, the location of such plants, and even the minimum size of blast furnaces to be installed.[24] The policy also bans all foreign companies from controlling Chinese steel companies.[25]

- The policy declares that "{m}ineral resources belong to the state,"[26] and that "{t}he export of primarily processed products of coke, iron alloy, cast iron, scrap steel, steel billet (ingot) with high level of energy consumption and heavy pollution shall be restricted." [27] Such restrictions suppress the price of steel inputs for Chinese producers.

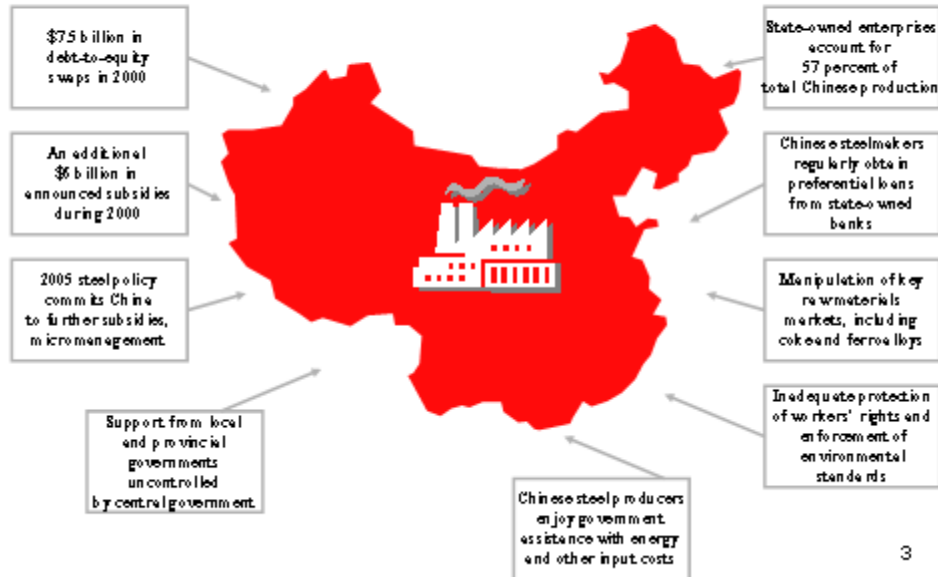
Available evidence suggests that significant government resources are indeed continuing to flow to Chinese industry through the very kinds of subsidies identified in the steel policy. For example, the central government reportedly allows substantial income tax credits for companies that purchase domestically made equipment for technology upgrades.[28] Moreover, the central and provincial governments provide tax incentives for producers located in development zones. The U.S. State Department reports that five special economic zones, 14 coastal cities, hundreds of development zones and designated inland cities all promote investment with "unique packages of investment and tax incentives." [29] Steel producers also reportedly receive subsidized raw materials and energy. In this regard, China's government controls the price of gasoline and electricity, allowing manufacturers to obtain these vital items at subsidized prices.[30] And, government control of state-owned enterprises in a number of different sectors means these enterprises can make below-cost sales to one another. [31] Provincial governments also reportedly subsidize steel inputs. In fact, just last year, the government of Shanxi province agreed to provide state-owned producer Shougang with coke and iron ore at a fraction of market value.[32]

China's widespread intervention in raw material markets is another area that has given rise to substantial concerns regarding ongoing benefits to, and effective subsidization of, Chinese steel producers. For example, China's steel policy provides that China's government may block "cut-throat competition" for resources.[33] In early 2006, there were numerous press reports regarding efforts by the Chinese government to influence negotiations between Chinese producers and global suppliers of iron ore – making clear that the government would "take necessary measures if prices were unacceptable and unreasonable." [34] China's imposition of export restrictions on coking coal in 2005 also caused extensive disruptions on world markets, and led the EU to threaten potential action under the WTO to deal with the problem[35] – which clearly served to artificially lower input costs for Chinese producers. [36]

China's continuing policy to subsidize its steel industry is further reflected in the recent decision of the United States Trade Representative to commence WTO consultations with China with regard to nine WTO-prohibited export performance and import substitution subsidies. It is noteworthy that the Chinese steel industry was specifically identified as one of the key industries receiving support under these programs. These programs involve, among other things, preferential income tax and VAT treatment, below-market loans, and policies to encourage the use of domestic, rather than imported, materials.[37] While the specific WTO-prohibited subsidies identified by USTR represent only a small portion of the enormous level of state support that has been provided by the Chinese government, they are indicative both of the ongoing nature of the problem and the very clear evidence of WTO violations. [38]

In sum, the evidence suggests that China's steel industry is the most heavily subsidized in the world (Figure 3).

China Has the Most Heavily Subsidized Steel Industry in the World

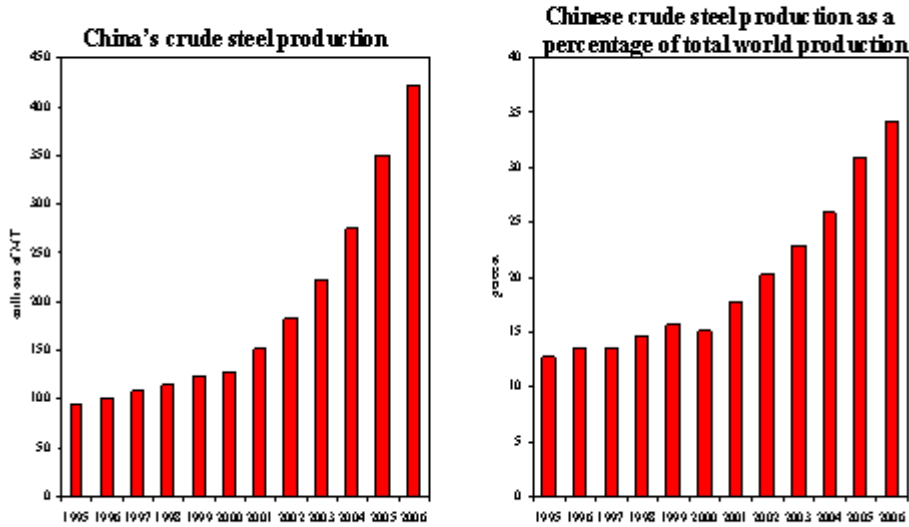


Impact of Subsidies on World and U.S. Steel Markets

With all of this past and ongoing government support, it is not surprising that China's steel production expansion is unprecedented in the history of the global industry. In the time remaining today, I would like to focus my remarks on the impact of government support for Chinese steel industry – both on global and U.S. markets – and the steps needed to combat further distortion of global steel markets. The fact is that subsidies make a huge difference in the capacity and production decisions of companies, and can and do act to badly distort market outcomes. That is why it is imperative that policy makers take the problem seriously and act aggressively to combat it.

Chinese steel production has exploded over the course of the last decade – i.e., at the same time that many of the subsidies described above were reportedly granted (Figure 4). In fact, Chinese crude steel production more than quadrupled in the last ten years, growing from an estimated 100 million MT in 1996 to approximately 420 million MT in 2006. This is the rough equivalent of building three entire American steel industries in just one decade. Moreover, China's production growth has far outpaced growth in the rest of the world. China's share of world steel production skyrocketed from an estimated one-eighth in 1996 to over one-third in 2006, underscoring the unprecedented nature and enormous magnitude of what China is doing.

China's Crude Steel Production Is Exploding

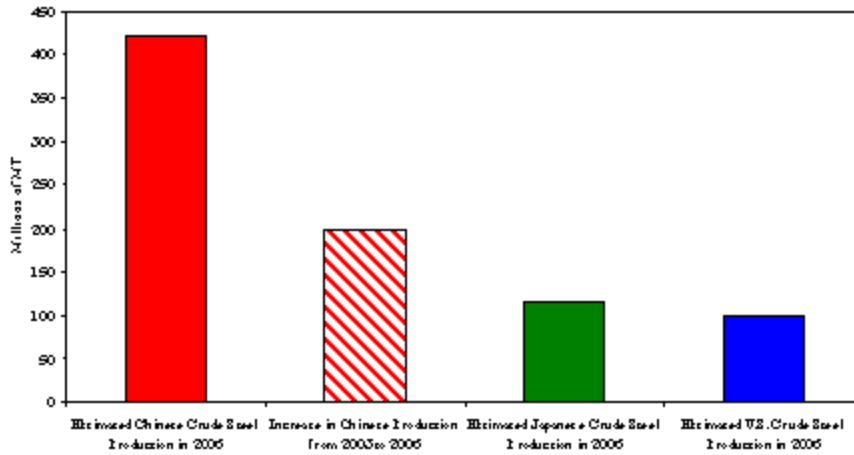


Source: World Steel Dynamics, Steel Times/Verderf 11 (Dec. 31, 2006)

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And the situation is quickly deteriorating. In fact, the most colossal portion of China's steel production growth has occurred in just the last few years. Between 2003 and 2006, it is estimated that the increase in China's crude steel production alone was roughly equal to the total production of Japan or the United States in 2006 (Figure 5). It is likely no coincidence that these are the years immediately following some of the largest reported Chinese government payouts to the steel industry. Though we are still working to understand the full implications of this absolutely unprecedented industrial expansion, one fact is clear: the Chinese market is not able to support the hundreds of millions of tons of production capacity added in the last few years.

Over the Last Three Years, China's *Increase* in Steel Production Is Roughly Twice the *Total* Production in the United States or Japan

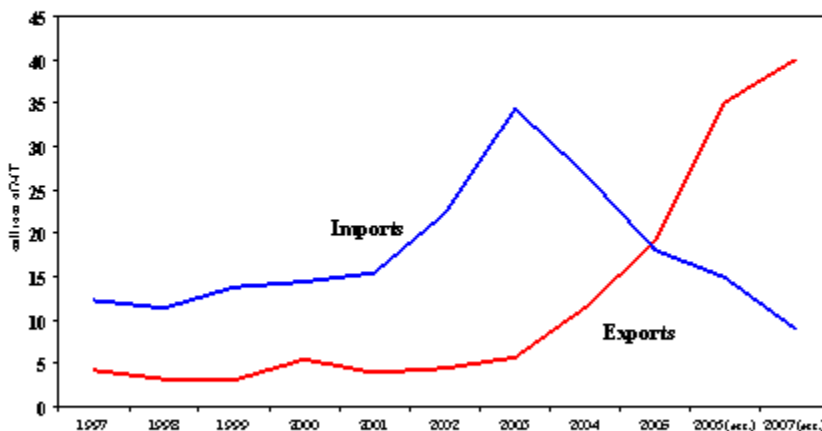


Source: Data for China from World Steel Dynamics, 2nd Edition (November 2006), (pp. 3, 284). Data for Japan and the United States from the International Iron and Steel Institute web page. U.S. and Japanese administrative production base (capacity) by November 2006.

5

This is evidenced by the fact that Chinese imports are bottoming out while exports are skyrocketing, as Chinese producers seek markets for their surplus production (Figure 6). In 2003, China was a net importer of steel. Three years later, the situation flipped completely, and China became a net exporter. Indeed, China's steel trade balance shifted by nearly 50 million MT between 2003 and 2006 (Figure 7).

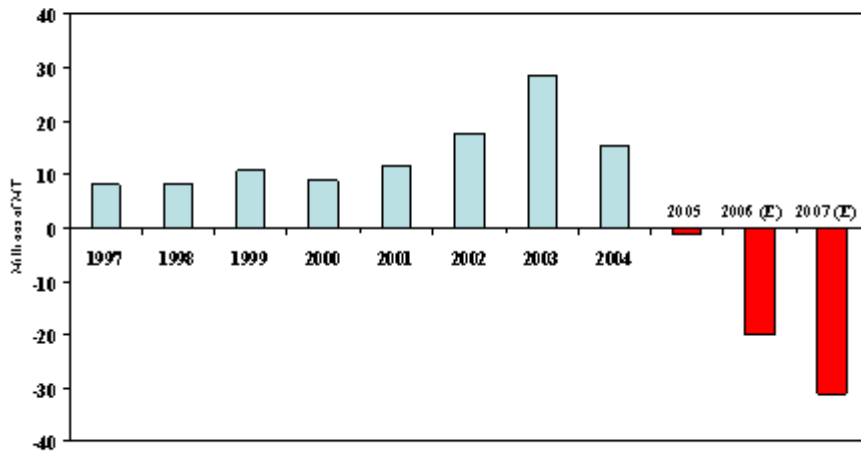
As Chinese Imports Fall, Chinese Exports Continue to Rise



Source: World Steel Dynamics.

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China's Net Imports of Steel Products, 1997 to 2007



Source: World Steel Dynamics, Global Steel Outlook 2008 (Feb. 14, 2008).

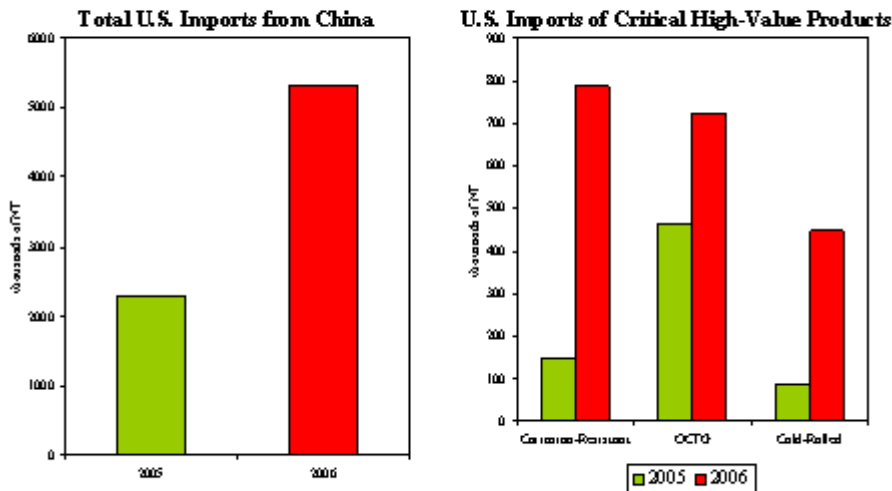
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I cannot emphasize enough how extraordinary, unprecedented, and threatening these developments are. Let me walk you through the serious, real-world consequences for our industry. We are being inundated with surging volumes of Chinese imports. China shipped over 5 million NT of steel products to the United States in 2006, more than double the level of Chinese imports in 2005 (Figure 8). By the end of last year, we were importing more steel from China than from any other country – including Canada. In fact, we were importing more steel from China than from all 25 members of the EU combined.

It is also very important to note that Chinese imports are no longer limited to low-end items. China is moving up the value chain, increasingly competing with some of our most advanced products, including corrosion-resistant sheet, oil country tubular goods, and cold-rolled sheet. These products are among the most valuable to the U.S. industry. And, as I discussed a few moments ago, Chinese state policy explicitly targets these high-value products for subsidization.

The U.S. industry is very competitive, especially with regard to these critical, high-value products. To give one example, U.S. corrosion-resistant steel producers increased their productivity by 78 percent from 2000 to the first half of 2006. We can compete with any steel producer in the world on market terms. But we simply cannot compete with China's government resources. And we should not have to. If China wants access to the markets of the world, it must play by the rules—and put a stop to market-distorting subsidies.

Within the Last Year, U.S Producers Have Been Hit with a Flood of Chinese Imports



Source: USTR and U.S. DOE.

8

Need for Policy Action

In short, the China trade problem is grave, and the current trade imbalance – fueled by unfair practices – is unsustainable. The last thing we want is a repeat of the Asian crisis of the late 1990s, when overproduction abroad resulted in a flood of cut-rate imports that put the entire American steel industry at risk. The time for strong policy action to prevent another crisis is now.

USTR's recent initiation of WTO consultations with regard to certain Chinese subsidy programs is a step in the right direction. But I would like to again underscore that the nine subsidy programs identified by USTR are a very limited subset of the problem. In particular, the USTR's action involves only WTO-prohibited subsidies (i.e., so-called "export" or "import substitution" subsidies), the majority of which relate solely to foreign-invested enterprises. The USTR action does not in any way address the vast evidence of enormous "domestic" subsidies that built up many of China's largest steel enterprises over the past several years and continue to unfairly benefit Chinese producers today.

Again, the time to act is now, before the situation deteriorates beyond our ability to meaningfully address it. There are a number of crucial policy actions we believe Congress and the Administration must take to address this problem:

- First, it is absolutely critical that we strictly enforce our trade laws. With regard to China and all of the other trade threats America faces, this must be our highest priority. Our anti-dumping and anti-subsidy laws constitute in most instances our only practical line of defense against severe market-distorting practices that would otherwise allow foreign producers to overrun this market. In this regard, we need to ensure that China continues to be treated as a non-market economy for purposes of our anti-dumping law – particularly given the extensive evidence that China continues to control many fundamental aspects of its economy. The first step of any China policy – and indeed any manufacturing policy – should be a "zero tolerance" policy for unfair trade.
- Second, we also urgently need real China legislation. There are some very obvious, easy steps

that can be taken, such as applying our anti-subsidy laws to China. It simply makes no sense to exempt Chinese producers, particularly given the evidence that they are among the most heavily subsidized producers in the world. We also urgently need to do something real on currency manipulation. Letting China string us along with endless talk and tiny adjustments to the value of the yuan is no solution at all, especially in light of the enormous consequences of this flagrant manipulation. There are a lot of good ideas out there to address market-distorting behavior in China, and we sincerely hope that Congress will pursue them.

- Finally, it is imperative that we keep our AD/CVD laws strong in the face of relentless efforts to weaken them as part of international negotiations. We have seen such efforts to weaken our trade laws in the Doha round, and we are also seeing them in free-trade agreement ("FTA") talks, such as the ongoing U.S.-Korea FTA negotiations. Weakening our trade laws as part of these talks could very well make them unworkable to combat unfair trade from China and other countries that disregard global rules. It is imperative that Congress send the clearest possible message that it will reject any agreement that weakens our AD/CVD laws.

Conclusion

We find ourselves at a critical moment. If we act now, we can guard our nation against further unfair Chinese trade and prevent another crisis impacting core American industrial sectors. Thank you for supporting American manufacturing and the American steel industry, and thank you for the opportunity to testify today.

[1] Wayne M. Morrison and Marc Labonte, "China's Currency: A Summary of the Economic Issues" (Congressional Research Service Report for Congress) at 1 (March 17, 2006) ("Morrison and Labonte").

[2] *Id.* To obtain an idea of the magnitude of China's currency manipulation, consider that one expert estimated the value of these asset purchases to be \$15 to \$20 billion every month. See U.S.-China Economic and Security Review Commission (hearing transcript) at 103 (Apr. 4, 2006) (testimony of Dr. C. Fred Bergsten, Director, Institute for International Economics) ("USCC Hearing").

[3] Morrison and Labonte at 2.

[4] See Universal Currency Converter, available at <http://www.xe.com/ucc/> (last visited Feb. 12, 2007).

[5] Congressional Research Service Report for Congress, "China's Currency: Brief Overview of U.S. Options" at 2 (Nov. 29, 2005) (available at <http://fpc.state.gov/documents/organization/57797.pdf>).

[6] See, e.g., Letter from Barry D. Solarz, Vice President of the American Iron and Steel Institute, to Gloria Blue, Executive Secretary of the Trade Policy Staff Committee (Sept. 18, 2006).

[7] OECD, "The Reform of the Chinese Steel Industry" CCNM/NIS/DSTI(99)52 (Oct. 1999).

[8] *Id.* at 7.

[9] "Output controls boosting China's steel industry profit," *Asia Pulse* (Aug. 18, 2000).

- [10] OECD, "Reforming China's Enterprises" at 78 (2000).
- [11] *Id.*
- [12] *Id.*
- [13] "China: Debt-to-equity swaps help steel makers," *China Daily* (Mar. 26, 2000).
- [14] "China's Metallurgical Industry Profits Soar in Year to November," *Asia Pulse* (Jan. 23, 2001).
- [15] U.S. Department of Commerce, *Report to the President: Global Steel Trade* at 146 (July 2000).
- [16] National People's Congress, "Outline of the Ninth Five-Year Plan for Economic and Social Development" at Art. 4.2.4.2 (Mar. 17, 1996) (available at <http://www.npc.gov.cn/zgrdw/common/zw.jsp?label=WXZLK&id=3506&pdmc=rdgb>) (Chinese language document).
- [17] State Economic and Trade Commission of China, "Tenth Five-Year Plan for the Metallurgical Industry" (Sept. 5, 2002) (available at <http://www.cas.cn/html/dir/2002/05/09/6332.htm>) (Chinese language document).
- [18] *Id.* at Art. 3.3.1.
- [19] *Id.* at Art. 3.3.1.3.
- [20] China National Development and Reform Commission, "Steel Industry Development Policy" (July 20, 2005).
- [21] *Id.* at Art. 16 (emphasis added).
- [22] *Id.* at Art. 27 (emphasis added).
- [23] *Id.* at Art. 20.
- [24] *Id.* at Art. 12 (providing that the blast furnaces shall be over 3,000 cubic meters, and that steel plants should have a capacity in excess of 8 million MT).
- [25] *Id.* at Art. 23.
- [26] *Id.* at Art. 28.
- [27] *Id.* at Art. 30.
- [28] State Tax Administration, *Technological Renovation of Domestic Equipment Corporate Income Tax Exemption Notice* (Jan. 17, 2000) (available at <http://www.jsjgs.gov.cn/Page/statutedetail.aspx?statuteid=2965>) (Chinese language document).
- [29] U.S. & Foreign Commercial Service and U.S. Department of State, *Doing Business in China: A Country Commercial Guide for U.S. Companies* at 148 (2006).

[30] USCC Hearing at 52 (Statement of Dr. Usha C.V. Haley, Director, Global Business Center, University of New Haven).

[31] *Id.*

[32] "Shougang to Set Up Steel JV in Shanxi Province," *Steel Bus. Briefing* (March 2, 2006).

[33] *See* Steel Industry Development Policy at Art. 30 ("When several domestic enterprises engage in cut-throat competition for overseas resources, the state may exercise executive power to coordinate, organizing {an} industrial alliance or deciding one enterprise to invest so as to avoid cut-throat competition. The enterprises shall obey national executive coordination.")

[34] *See., e.g.,* "China Stance Helped Limit Iron Ore Price Increase," *Dow Jones International News* (June 21, 2006).

[35] *See* "China Continues Restriction Measure on Coke Export," *Asia Pulse* (June 24, 2005).

[36] World Trade Organization, "China's Transitional Review Mechanism: Communication of the United States, G/MA/W/71 at 3, para. 9 (Sept. 6, 2005).

[37] *See* United States Trade Representative, "United States Files WTO Case Against China Over Prohibited Subsidies," Press Release (Feb. 2, 2007).

[38] China's failure to adequately enforce basic labor and environmental standards has also, in the view of many, served to provide Chinese companies with an unfair advantage in international trade – and arguably served as a means of effective state support and subsidization.