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PRESIDENT AND CEO, AMERICAN IRON AND STEEL INSTITUTE
U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
HEARING ON EVALUATING THE FINANCIAL RISKS OF CHINA
JULY 14, 2016

Chairman Shelby, Ranking Member Brown, and members of the Committee, thank you for your invitation to appear today to discuss the financial risks of China and in particular to provide you with an illustration of how the state-run nature of the Chinese economy has impacted the U.S. steel industry. I am Tom Gibson, President and CEO of the American Iron and Steel Institute. AISI serves as the voice of the North American steel industry in the public policy arena and advances the case for steel in the marketplace as the preferred material of choice. AISI is comprised of 19 producer member companies, including integrated and electric furnace steelmakers, accounting for approximately 70 percent of U.S. steelmaking capacity with facilities located in 41 states, as well as Canada and Mexico, and approximately 125 associate members who are suppliers to or customers of the steel industry.

I. State of the U.S. Steel Industry

The steel industry in the United States is currently suffering from a dramatic surge in imports from a number of countries around the world, many of which are dumped and subsidized. Finished steel imports increased by 36 percent in 2014 and captured a record 28 percent of our steel market. In 2015, as apparent steel demand in the United States decreased by over 10 percent, the share of the market taken by imports increased further to a new record of 29 percent. See Appendix Figure 1.

As a result of the large increase in import market share in 2014 and 2015, domestic steel shipments declined by 12.2 percent in 2015. Capacity utilization in the industry averaged just 70.1 percent for 2015, and the industry continues to operate at only 72.4 percent capacity utilization in the first half of 2016. See Appendix Figure 2. The seriousness of the import crisis affecting the U.S. industry is demonstrated by the fact that several steel companies have been forced to temporarily close major steel-making facilities, including mills in Fairfield, Alabama, Ashland, Kentucky and Granite City, Illinois, as well as a number of iron ore mines in Minnesota. Bureau of Labor Statistics data indicates that employment in the steel industry has declined by approximately 13,900 jobs since January 2015.

*Representing steel producers
in Canada, Mexico and the United States*

II. Global Steel Overcapacity Major Cause of U.S. Import Crisis

A recent analysis by the OECD shows that the global excess steel capacity in 2015 was estimated to be about 700 million metric tons.¹ The overcapacity crisis plaguing the global steel industry is largely a result of foreign government interventionist policies and practices. As the Department of Commerce found in 2000 in connection with the steel import crisis of the late 1990s and early 2000s, “government practices and policies that forestall adjustments mandated by the market” are a major cause of excess capacity in the steel industry.² This remains true today, as many governments continue to subsidize the start-up of additional, unnecessary capacity and prevent obsolete capacity from closure.

III. The Role of China in the Global Steel Crisis

Since 2000, Chinese government industrial and trade policies have produced a dramatic increase in the size of the Chinese steel industry, to the point that it today represents almost half of all global steel production.³ Chinese crude steel production soared from 128 million MT in 2000 to 823 million metric tons (MT) in 2014 – an increase of 695 million MT – before declining slightly to 804 million MT in 2015.⁴ See Appendix Figure 3.

For many years Chinese steel consumption was increasing, and in recent years a significant portion of China’s excess steel production was absorbed by the Chinese government’s stimulus spending on fixed asset investment. But Chinese steel demand appears to have peaked in 2013. The World Steel Association has reported that Chinese steel consumption (apparent steel use) declined by 3.3 percent in 2014⁵ and by 5.4 percent in 2015.⁶ See Appendix Figure 4. Furthermore, the demand situation in China is expected to worsen over the coming decade. The POSCO Research Institute forecasts

¹ OECD, *The Capacity Outlook for the Global Steel Industry: Preliminary OECD Estimates*, presented at worldsteel ECON meeting, Madrid, 9 September 2015.

² 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 4.

³ World Steel Association, “World crude steel output decreases by -2.8% in 2015,” January 25, 2016.

⁴ *Id.* World Steel Association, “Monthly Crude Steel Production 2015”; World Steel Association, “Monthly Crude Steel Production 2000.”

⁵ World Steel Association, 2015 Short Range Outlook, found at <http://www.worldsteel.org/dms/internetDocumentList/press-release-downloads/2015/Short-Range-Outlook-table-by-Region-2015-2016-12Oct2015/document/Short%20Range%20Outlook%20table%20by%20region%202015-2016.pdf>.

⁶ World Steel Association, 2016 Short Range Outlook, found at <https://www.worldsteel.org/dms/internetDocumentList/press-release-downloads/2016/Short-Range-Outlook-Table-by-Region-2016-2017/document/Short%20Range%20Outlook%20Table%20by%20Region%202016-2017.pdf>

that steel demand in China will decrease steadily until 2025, due to the slowdown in the Chinese construction and manufacturing industries.⁷

With China's domestic steel demand declining, the Chinese steel industry has increasingly relied on exports to consume surplus production. China exported a record 94 million MT of steel products in 2014, an increase of 52 percent from 2013.⁸ That trend accelerated in 2015 with Chinese steel exports rising to 112 million MT, "an amount big enough to feed demand in Germany and Japan for a year and leave almost 9 million metric tons to spare."⁹ Through May 2016, Chinese producers exported 46.3 million MT of steel to the world,¹⁰ and when annualized at 111.1 million MT, will nearly match the record export levels in 2015.

This increase in Chinese exports to the world has resulted both in increased imports of Chinese steel into the United States and in increased imports from third countries that have themselves received increased Chinese steel imports. In some cases, Chinese steel imports in third countries are being further processed into downstream steel products that are then exported to the United States. For example, Chinese billets may be further processed in Turkey into long products which are then exported to the United States, while Chinese flat-rolled steel may be converted into pipe products in Korea which are then exported to the U.S. market. The increase in Chinese steel production cannot be explained by associated market forces and has caused the U.S. industry significant injury.¹¹

A. Capacity Growth is Not Supported by Profitability

In addition to the excess steel capacity growth not being supported by demand, it is also not supported by profitability. The low profits of steel companies worldwide also illustrate the disconnect between steel capacity growth and market forces.¹² The Chinese steel industry provides the best example of this as China's dramatic increase in steel capacity has occurred despite financial returns that are well below those achieved by other steel industries, and even other industries in China. "China's steel industry has one of the lowest operating margins compared not only to the steel industries of many other economies but also relative to other domestic industries. China's steel industry is ranked 85th out of 94 Chinese service and manufacturing sectors, but is last amongst all

⁷ POSCO Research Institute, *Asian Steel Watch* (January 2016) at 99-103.

⁸ Ruby Lian and David Stanway, "Chinese Steel Exports to Stay High This Year - Industry Group," Reuters (Apr. 29, 2015).

⁹ "China's steel exports now outstrip demand in any other country" Bloomberg (Jan. 13, 2016), found at <http://www.mineweb.com/news/iron-and-steel/chinas-steel-exports-now-outstrip-demand-in-any-other-country>.

¹⁰ "China's Steel Exports Rise, Defying Japan, U.S. Call for Curb" Bloomberg (June 8, 2016), found at <http://www.bloomberg.com/news/articles/2016-06-08/china-s-steel-exports-climb-after-mills-ramp-up-output-to-record>

¹¹ Wiley Rein LLP Report "Unsustainable: Government Intervention and Overcapacity in the Global Steel Industry" (April 2016) at 11, available [online](#).

¹² *Id.* at 12.

domestic manufacturing industries.”¹³ China’s major steel firms reportedly lost more than \$15.5 billion last year alone, and many believe the actual figures are likely much greater. Additionally, the debt ratio of China’s major steel mills is reported to have risen by 1.6 percentage points in 2015 to 70.1 percent, bringing the total debt of only the country’s “big mills” to \$499 billion, while another estimates that “the Chinese steel industry has roughly \$520 billion in total debt held largely by Chinese [state-owned] banks.”¹⁴ China is creating a massive, growing and unsustainable debt bubble which is linked to the government interventions and practices that have led to its enormous excess steel capacity.¹⁵

Unlike a market-based company, Chinese companies can run these massive debts because the Chinese government will often direct the banks to continually refinance the debt, and “ultimately sweep it off the books and into “asset management companies” or other state-created financial firms designed exclusively to absorb bad corporate debts and cover losses in Chinese enterprises.”¹⁶ For its own sake and that of the global economy, China really needs to implement steps to promote the exit of overcapacity and to deflate the country’s debt bubble, before the world economy becomes even more vulnerable to a massive Chinese debt crisis. The steel industry should be viewed as an example of what can happen to the broader global economy if China does not address its market distortions. These non-market based decisions and the resulting overcapacity and massive exports have severely hindered the ability of steel producers around the world to operate profitably, tanking the world steel market.¹⁷ Market oriented steel producers make decisions based on commercial considerations where earning profits and a decent return on capital is essential, that clearly is not the case for Chinese steelmakers. “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 growing capacity. Despite increasingly nonexistent profits, Chinese steel producers continue to boost production and add capacity largely as a result of governmental control over and intervention in the industry.”¹⁸

B. Overcapacity Driven by Government Policies

China leads the world not just in capacity increases, but in *excess* capacity levels. China’s official steel capacity levels reached 1,160 million metric tons in 2014,¹⁹ meaning it had excess capacity of at least 337 million metric tons. CISA estimates that there is

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 12-13.

¹⁷ *Id.* at 13.

¹⁸ *Id.*

¹⁹ The Ministry of Industry and Information Technology (MIIT) announced Chinese capacity of 1.16 billion metric tons (1.277 billion net tons) in 2014. Chinese steel production in 2014 was 823 million MT.

even more steelmaking capacity in China than the official government statistics report – approximately 1.25 billion metric tons of crude steel production capacity in China in 2014, compared with 823 million metric tons of actual production in 2014. That equals more than 425 million metric tons of excess capacity²⁰ out of OECD’s estimated global total of 700 million metric tons.

While China is not the only source of the overcapacity problem, AISI believes that overcapacity in China is the greatest challenge facing the global steel industry today and is a significant factor in the surge in steel imports into the U.S. market in the past several years.

Additionally, 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.²¹

Nine of the ten largest steel producers in China are state-owned and the top two produced more steel in 2014 than the entire U.S. steel industry. The Chinese government owns and controls most of its major steel producers intervening extensively in their operations. For instance, reports often surface that indicate local Chinese governments will direct their steel mills to increase their exports and foreign exchange earnings regardless of their order books. Similarly, we also know that the Chinese government often intervenes to prevent the closure of capacity. Many older 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. It is the Chinese government’s significant involvement in its steel industry that has contributed to both the enormous increases in new capacity and the prevention of the closure of inefficient capacity.²² 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

²⁰ China Iron and Steel Association (中国钢铁协会), *Analysis of Key Points for the Development of Steel Enterprises in the Thirteenth Five Year Plan Period* (钢铁企业“十三五”发展重点分析) (Mar. 19, 2015), <http://www.chinaisa.org.cn/gxportal/DispatchAction.do?efFormEname=ECTM40&key=AmEIN1oxUDFRMAI1A2QHZg1pAGBRNVVjAzRSYAVnBDMGFQ9ADhVVZQMSD0hVQgVn>.

²¹ 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.”).

²² Wiley Rein LLP Report “Unsustainable: Government Intervention and Overcapacity in the Global Steel Industry” (April 2016) at 14.

restrictions on foreign investment.²³ The Chinese government has created the world's largest steel industry²⁴ because of these types of policies and its significant ownership stakes.

IV. State Ownership and Control of Financial Institutions in China

A number of the world's largest banks measured by market capitalization are based in China, "yet these banks are conspicuously absent from most of the world's markets for financial services." This is "symptomatic of the non-market foundation for China's financial system" and suggests the real objective function of China's massive financial institutions is to serve "the needs of national economic development." Contrary to the market-oriented nature of many of the largest banks headquartered elsewhere in the world, China's banks "appear to have little interest in expanding into new, foreign markets for financial services – except, perhaps, to provide financial services in support of SOEs that are "going out" with direct investment in overseas markets."²⁵

For example, China's official government system of export financing is supplemented by lending from commercial banks that are owned or otherwise controlled by the government.²⁶ The China Development Bank is directed to extend loans that are consistent with the goals of China's economic plans, which include producing "national champions," in sectors like steel, that are able to compete on a global scale.²⁷ In addition, the China Export and Credit Insurance Corporation ("SINOSURE") was created in 2001 to "fulfill the Chinese government's diplomatic, international trade, industrial, fiscal and financial policies."²⁸

"The Chinese state directly owns the vast majority of the country's financial institutions – its banks, brokerages, insurance, and investment firms" – and is also the largest actor in China's financial markets. It owns a controlling majority of corporate shares in publicly listed companies and dominates "origination and trading of financial assets in bonds, derivatives, and foreign exchange markets."²⁹

²³ 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).

²⁴ Wiley Rein LLP Report "Unsustainable: Government Intervention and Overcapacity in the Global Steel Industry" (April 2016) at 14.

²⁵ Adam S. Hersh, "Is China a Market Economy? Making Progress but still falling short of international norms for the global marketplace" (2015) at 18.

²⁶ Anna Tucker, "Export Assistance and the China Challenge," *USCC Staff Research Backgrounder* (Apr. 27, 2012) ("Export Assistance and the China Challenge") at 4.

²⁷ *Id.*

²⁸ *Id.*

²⁹ Adam S. Hersh, "Is China a Market Economy? Making Progress but still falling short of international norms for the global marketplace" (2015) at 19.

V. Chinese Currency Manipulation

AISI members, along with other U.S. manufacturers, have long expressed concern over China's policy of controlling the exchange rate between its currency (known as the renminbi ("RMB") or the yuan) and the U.S. dollar.³⁰ In February 2014, the Economic Policy Institute performed an analysis of the impact of currency manipulation of the yuan and other currencies that remain undervalued to compete with the yuan.³¹ This analysis showed that the elimination of currency manipulation would reduce the U.S. trade deficit between \$200 billion and \$500 billion in three years.³² This would increase annual U.S. GDP by between \$288 billion and \$720 billion (between 2.0 percent and 4.9 percent).³³ The reduction of the U.S. trade deficit and expansion of U.S. GDP would create 2.3 million to 5.8 million jobs, reducing the U.S. jobs deficit by between 28.8 percent and 72.5 percent.³⁴ Other recent analyses have likewise recognized the harmful impact of China's currency manipulation.³⁵

On August 11, 2015, China's central bank devalued the yuan by 1.9 percent, while simultaneously announcing a change in the calculation of the yuan's daily trading band. This caused the value of the currency to fall nearly 3 percent against the dollar, the largest two-day drop in 20 years.³⁶ Under the new rules, the mid-point for the value of the yuan would be set utilizing the previous day's closing value. While Beijing claims the devaluation was a result of an effort to move towards a more market-determined exchange rate, many observers claim it was likely meant to boost China's export economy which had declined in recent weeks.³⁷ It is our view that there is every indication that China has no intention of ending the manipulation of its currency.

³⁰ In 2004, for example, AISI joined a coalition of U.S. industrial, service, agricultural, and labor associations seeking relief under Section 301(a) of the Trade Act of 1974, as amended, from China's manipulation of the renminbi. Petition for Relief under Section 301(a) of the Trade Act of 1974 on behalf of the China Currency Coalition (Sept. 9, 2004), *available at* <http://www.aflcio.org>. This petition demonstrated that China's exchange-rate policy constitutes a prohibited export subsidy within the meaning of Articles 1, 2, and 3 of the SCM Agreement and Articles VI and XVI of the GATT 1994. *Id.* at 50.

³¹ See Robert E. Scott, "Stop Currency Manipulation and Create Millions of Jobs," *Economic Policy Institute* (February 26, 2014) ("Stop Currency Manipulation").

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ See, e.g., C. Fred Bergsten, "Currency Wars, the Economy of the United States, and Reform of the International Monetary System," *Peterson Institute for International Economics* (May 16, 2013) ("Currency Wars") at 5 (finding that currency manipulation is responsible for up to \$500 billion of the U.S. trade deficit and the loss of up to 5 million U.S. jobs); Lawrence Edwards and Robert Z. Lawrence, *Rising Tide: Is Growth in Emerging Economies Good for the United States?* Peterson Institute for International Economics (2013) at 83 (concluding that currency manipulation was responsible for the loss of 2.7 million jobs in 2010).

³⁶ CNN Money, "Yuan Tumbles for Second Day as China Devalues," (Aug. 12, 2015)

³⁷ *Id.*

While we recognize and appreciate the changes that Congress made in the recently enacted Trade Facilitation and Trade Enforcement Act of 2015 with respect to Treasury's reporting requirements in its biannual report on exchange rates, AISI believes the U.S. government could take far more aggressive and creative action on this important issue. A number of proposals have been put forward in this regard but one that Congress could act on now is Senator Sessions' and Brown's bill, S. 433, the Currency Undervaluation Investigation Act, which has the support of many on this Committee and would explicitly provide the Administration with the authority to treat currency manipulation of the type practiced by China as actionable under U.S. trade remedy laws.

VI. Role of Multilateral Development Banks

The activities of multilateral development banks and national export promotion agencies have exacerbated the government interference in the global steel market. These organizations have loaned steelmakers around the world billions of dollars, often ostensibly to increase energy efficiency, to reduce pollution, and even to promote the export of steelmaking machinery. Regardless of the goal, the end result is the same – lending at below-market rates which leads to the creation and maintenance of capacity that would not otherwise occur, fueling the overcapacity crisis.³⁸

VII. Policy Recommendations

In order to mitigate some of the causes of the global crisis in the steel sector and provide relief to domestic industry, AISI recommends the following:

1. Vigorously enforce U.S. trade laws. As a first step, it is essential that the U.S. government use all means available under our trade laws to provide immediate relief to the U.S. Industry from the injurious effects of the surge in imports into the U.S. market in recent years. In pending and future antidumping and countervailing duty investigations on steel products, the Department of Commerce should use all tools available under the trade laws, including the improvements made to these laws by Congress last year in the Leveling the Playing Field Act enacted as part of the TAA legislation, to offset the full amount of dumping and subsidization currently benefitting unfairly traded imports under investigation. Likewise, Customs and Border Protection (CBP) should also use all the tools made available under the recently enacted ENFORCE Act to prevent and address any and all instances of evasion of existing and new AD/CVD orders on steel products.

The Administration must also continue to treat China as a non-market economy for antidumping purposes and not give in to Chinese demands that it be automatically graduated to market economy status in December 2016.

³⁸ Wiley Rein LLP Report "Unsustainable: Government Intervention and Overcapacity in the Global Steel Industry" (April 2016) p. 21.

2. Congress should pass S. 433, the Currency Undervaluation Investigation Act, which would explicitly provide the Administration with the authority to treat currency manipulation of the type practiced by China as actionable under U.S. trade remedy laws.

3. Work with the Administration to secure commitments by other countries to eliminate steel overcapacity. AISI appreciates the continued efforts of the U.S. government to make addressing the steel overcapacity issue a priority by having it on the agenda at a number of recent high-level meetings including the G7 Summit in Japan, the U.S.-China Strategic and Economic Dialogue (S&ED), and the North American Leaders Summit. Given how much of the steel overcapacity resides in China it is critical that the Administration continue to engage China at the highest levels. While Chinese leaders made commitments at the S&ED meeting to adopt measures to: strictly contain steel capacity expansion; reduce net steel capacity; eliminate outdated steel capacity; and dispose of 'zombie enterprises' through restructuring, bankruptcy and liquidation, these commitments will only be meaningful if they lead to real results that produce a significant net reduction in excess steel capacity in China. For example, we remain concerned that prior Chinese government commitments to reduce capacity by 100 to 150 MT, repeated by China at the recent S&ED, are not sufficient given the size of the problem. This would require the net elimination of 337-425 million MT of excess capacity in China. Likewise, China has failed to specify how it proposes to achieve these reductions.

Promises of future action to reduce capacity by China and other governments are not enough, as there have been instances in the past where capacity reduction plans were offset by new capacity additions, especially in China.

While action by China is critical, the Administration should also seek such commitments by other countries that have relied on government policies to subsidize the development of new steel making capacity in recent years and should pursue those efforts at the OECD.

4. Work with the Administration to secure commitments by all steelmaking countries to eliminate and not introduce subsidies and other market-distorting policies related to steel. The Administration should seek commitments by all major steelmaking nations to eliminate current market-distorting subsidy programs specific to the steel sector and to refrain from introducing new subsidy programs in the future. These commitments must apply not only to central governments, but also to provincial/state and local programs. As this should be a common goal of all

steelmaking nations, AISI supports U.S. federal, state and local governments being bound by the same commitments.

5. Impose a strict prohibition on multilateral and export bank lending on steel projects, which has been a significant source of funding for unnecessary capacity survival and expansions.

VIII. Conclusion

The U.S. steel industry has been severely impacted by the surge in dumped and subsidized imports that have flooded the U.S. market in recent years. This surge is the result of foreign government interventionist policies in the steel sector that have fueled massive and growing global overcapacity in steel, particularly in China. AISI therefore greatly appreciates the attention being given by the Administration and Congress to the global steel industry crisis and its impact on the U.S. industry, and urges you to work with us to secure commitments from China to eliminate steel overcapacity and its market-distorting policies and practices, while vigorously enforcing our existing trade laws.

APPENDIX

Figure 1: U.S. Finished Steel Import Volume and Market Share

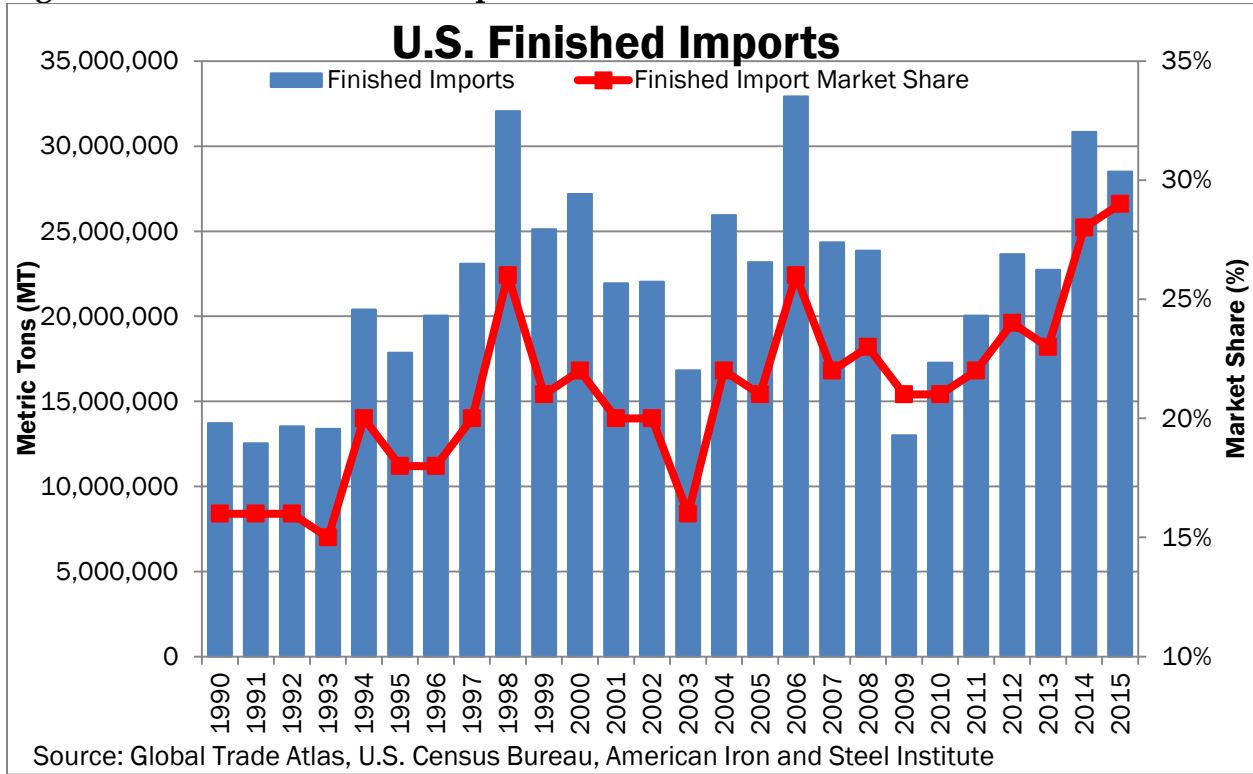


Figure 2: U.S. Raw Steel Making Capacity Utilization

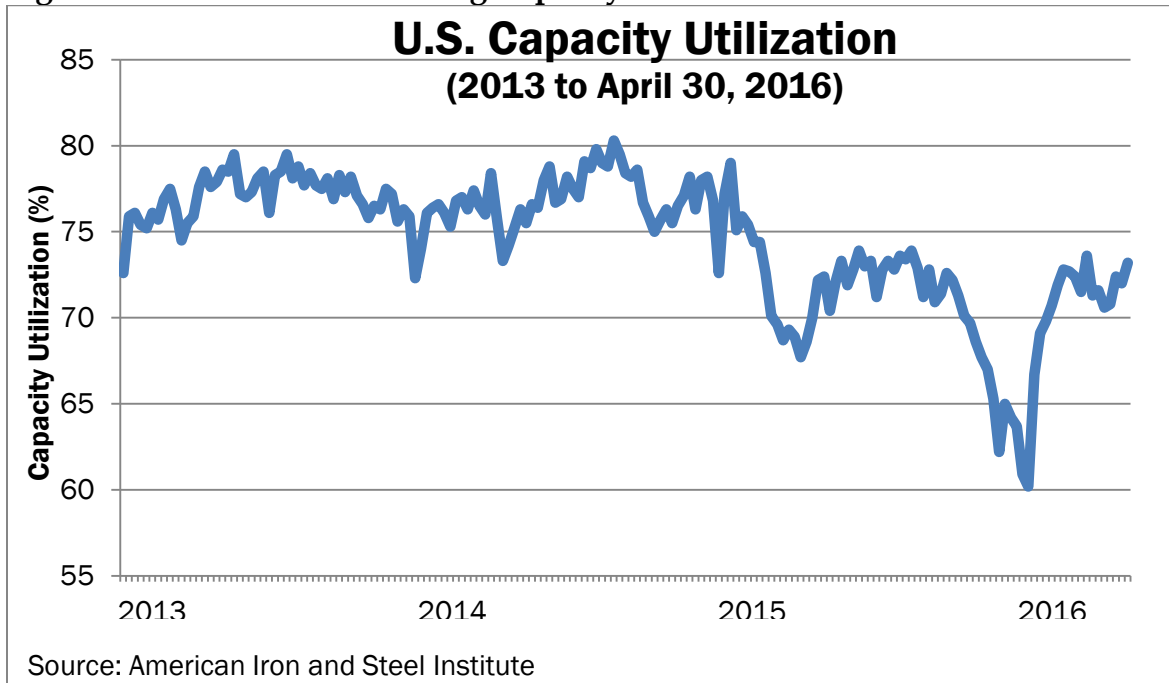


Figure 3: Chinese Steel Production vs. U.S. Steel Production

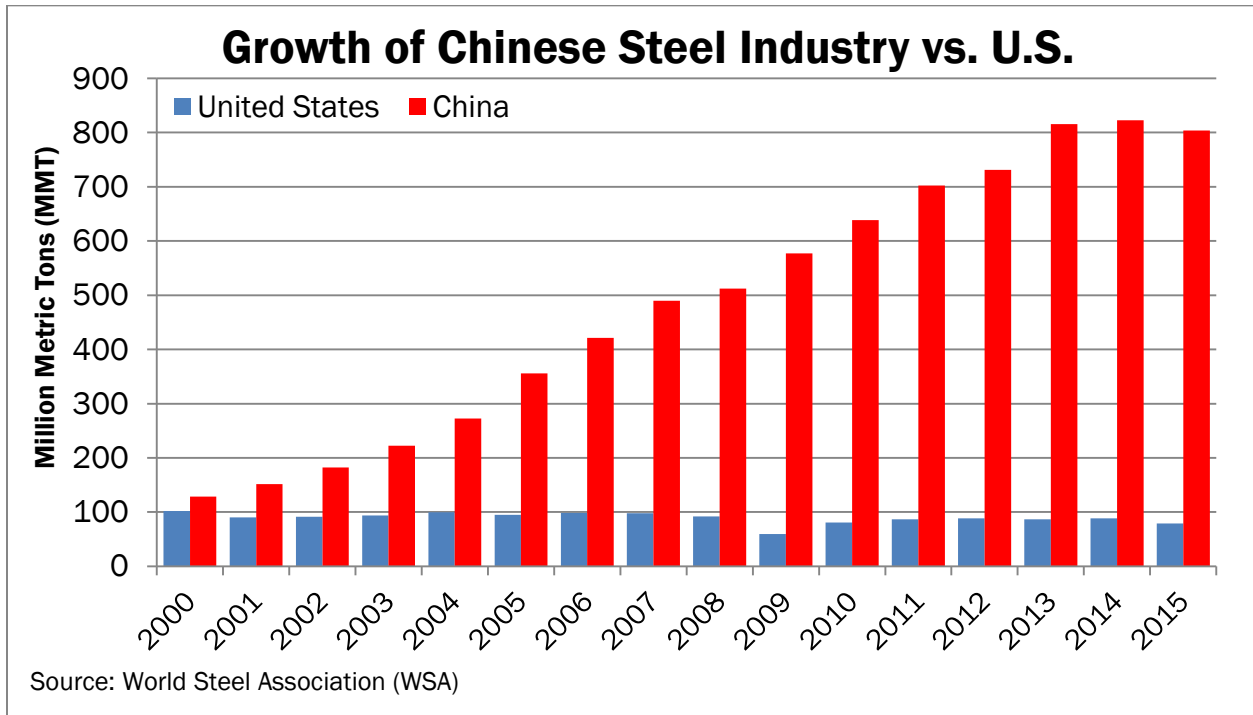


Figure 4: China Apparent Steel Use



Figure 5: Chinese Steel Exports

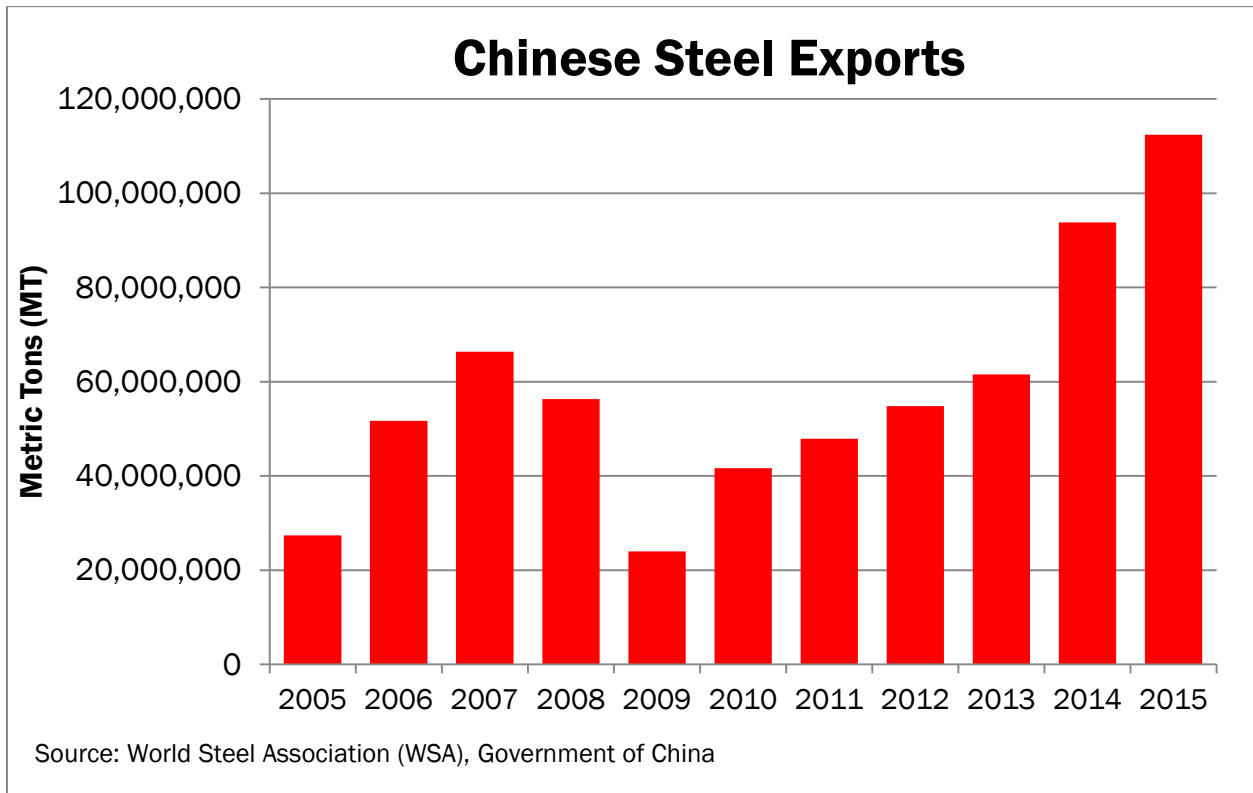
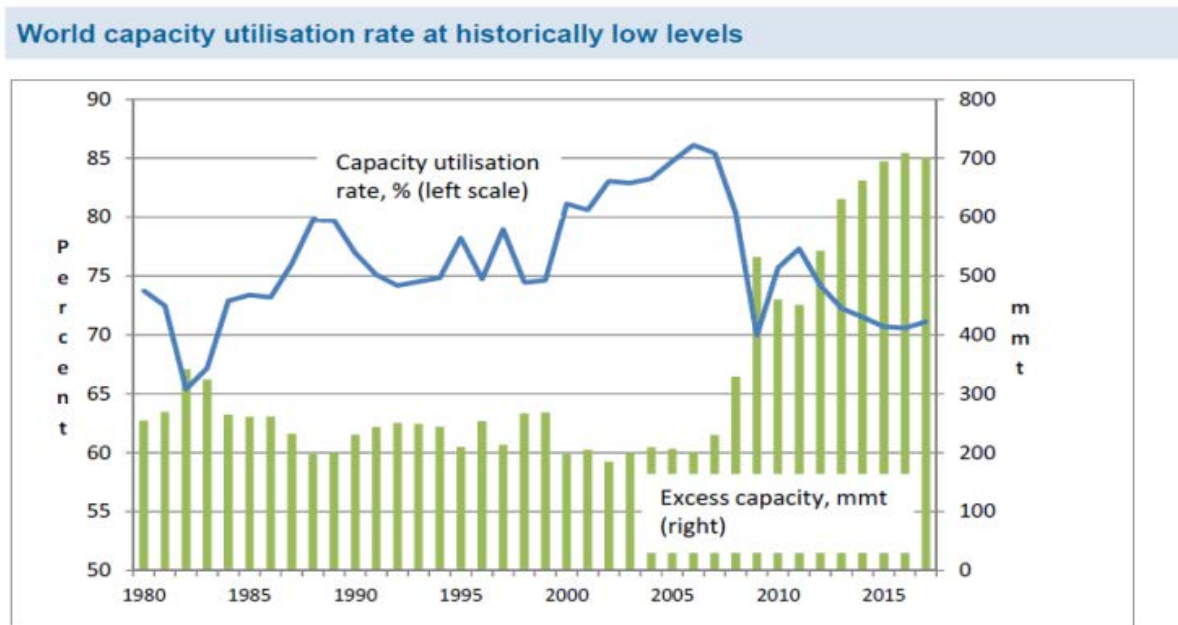


Figure 6: OECD Estimates of Global Steel Overcapacity



Source: OECD for capacity and BREE (for production forecasts)

Figure 7: Top 10 Chinese Steel Producers - 9 of 10 are State-Owned

Firm	2014 Production (MMT)
Hebei Steel Group	47.1
Baosteel Group	43.3
Wuhan Steel Group	33.1
Shagang Group (Private)	35.3
Ansteel Group	34.3
Shougang Group	30.8
Shandong Steel Group	23.3
Tianjin Bohai Steel	18.5
Maanshan Steel	18.9
Benxi Steel	16.3
TOTAL	300.9