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Where Trump is right on China: It's dumping steel

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By Charles P. Wallace | Yahoo Finance – Thu, Apr 14, 2016 20:31 BST

Donald Trump wasn't in the Washington hearing room Wednesday, but the testimony in front of U.S. Trade Representative Michael Froman could have been taken from one of the presidential candidate's stump speeches: a steady drumbeat of accusations that China and other countries have violated global trade agreements and dumped steel, aluminum and industrial products in the U.S., causing thousands of American job losses and pushing U.S. manufacturers to the wall.

The two days of testimony at the International Trade Commission (ITC) office underlined that Trump, who has mobilized a sizeable following among irate blue collar workers and their families, actually gets something right about China: that Beijing has used free trade to export illegally government-subsidized manufactured goods to the United States, upending major industries. Similar charges against China are now also roiling the steel industry in Europe.

Economists often point out that U.S. consumers benefit from the cheap imports in the form of less expensive cars and other products made with cheap imported steel. But critics say China's state companies now produce so many exports that they dominate the global market, set de facto market prices and use things like free government electricity and state loans that never have to be repaid to force global competitors out of business.

Thomas Gibson, president of the American Iron and Steel Institute, said steel exports by China and other nations have "severely impacted" American industry, forcing the closure of major domestic production facilities and the loss of 13,500 jobs in the industry since January 2015.

"The overcapacity crisis plaguing the global steel industry is largely a result of foreign government interventionist policies and practices," Gibson told the panel. "China for decades has directly subsidized its steel industry and Chinese provincial governments continue to prevent obsolete capacity from closing. And this Chinese model of government intervention is now being emulated in other countries as well."

Supplying half the world's steel

While a number of other countries, including Brazil, Russia, South Korea and India, have also been accused of dumping steel in the U.S. market, it quickly became clear that China's exports are the main cause of global concern about disruption in the steel industry and is the primary target for demands for action.

"With an explosion of steel-making capacity over the last 15 years, China is now home to half of the global supply of steel and the principal source of the world's overcapacity," said Froman, who is President Obama's main trade negotiator. While he didn't name China specifically, Froman said "many governments" have provided subsidies to expand their capacity and without considering the "adverse trade effects."

Froman said Thursday that China was dropping some export subsidies on a range of products, but it's unclear how steel prices would be affected. Industry leaders said they were skeptical about a major change.

Although the U.S. and China don't have a bilateral free trade agreement, China joined the World Trade Organization in 2001, agreeing to abide by the WTO's rules against government subsidies for domestic industries that hurt other countries' trade.

Trump has accused China of manipulating its currency, the yuan, to increase exports, but most experts say he's wrong on that front. The Chinese government has actually allowed its currency to appreciate substantially against the dollar recently, so currency manipulation isn't considered a serious issue.

"Compared to the yuan, which is not an issue, steel is a real issue, because China treats their state-owned enterprises as different than everything else," says Derek Scissors, a China expert at the right-leaning American Enterprise Institute, who published a paper Wednesday on how to fix U.S.-China trade and investment. "They are dumping steel not just in the U.S., but around the world. These non-commercial entities are distorting the global economy and that is a legitimate target for U.S. sanction."

China exported 92 million metric tons of its total 822 million tons of steel production in 2014, According to the World Steel Association. U.S. Steel estimates that China produces 425 million tons of "excess capacity," or more than it can use domestically, each year and is flogged overseas. The excess is likely to increase this year because China's domestic economy is cooling sharply.

Rank	Total Exports	Mt
1	China	92.9
2	Japan	41.3
3	European Union (28) (1)	37.1
4	South Korea	31.9
5	Russia	27.0
6	Germany (2)	24.8
7	Ukraine	21.5
8	Italy (2)	17.3
9	Turkey	16.2
10	France (2)	14.9
11	Belgium (2)	14.2
12	Taiwan, China	12.1
13	United States	12.0
14	India	10.4
15	Brazil	9.8
16	Netherlands (2)	9.7
17	Spain (2)	9.7
18	United Kingdom (2)	8.6
19	Austria (2)	7.3
20	Canada	6.2

Rank	Total Imports	Mt
1	United States	41.4
2	European Union (28) (1)	32.4
3	Germany (2)	24.3
4	South Korea	22.4
5	Italy (2)	16.6
6	Thailand	15.1
7	China	14.9
8	France (2)	13.4
9	Turkey	13.4
10	Viet Nam	12.4
11	Mexico	11.6
12	Indonesia	11.0
13	Belgium (2)	10.7
14	Canada	10.3
15	India	9.5
16	Poland (2)	9.1
17	Taiwan, China	8.9
18	Spain (2)	8.1
19	United Kingdom (2)	7.4
20	Netherlands (2)	7.0

MT=Metric tons. (Via World Steel Association)

China's exports were more than the entire 89 million metric tons of steel produced by the U.S. steel industry, which registered a 10% decline in output last year, according to Froman. He said the Obama administration has brought 11 complaints against China before the WTO about its trade practices and 149 anti-dumping actions against Beijing and other governments, which resulted in a number of punitive tariffs, including one on steel from China in March.

While tariffs have reduced imports of Chinese steel in the last year, John Packard, publisher of Steel Market Update, which analyzes industry trends, said the concern now was that China's market share is so large that its producers set the world price. These are often so low that American firms have difficulty competing.

"If the Chinese were to sell hot roll steel for $400 a ton and the U.S. market is at $500 a ton, what happens is the U.S. ultimately has to compete with those prices as do other foreign suppliers," Packard said.

Trump is right on China's steel

Where Trump is right is on the extent to which China subsidizes state-owned steel mills and has used trade to expand its steel industry. In 1990, China produced just 66 million tons of steel, about 8% of today's production. Because many enterprises are owned by regional and state governments, the primary objective appears to be to employ as many people as possible, not to make a profit.

Usha Haley, a management professor at West Virginia University, has spent more than five years in China researching state subsidies. She reckons that China's steel industry loses between $9 billion and $10 billion every year.

"The bulk of Chinese companies we looked at are inefficient, small, have no technological advantage and labor represents a small part of their costs," Haley said. "Their prices are routinely about a third less than U.S. companies and there is no other explanation for this other than subsidies."

Among the subsidies she said she and her co-researcher discovered were free electricity to steel plants, loans from government agencies that have no repayment term, gifts of state land on which to build or expand factories, relaxation of pollution rules to allow firms to use less expensive materials, and subsidized purchases of commodities.

Haley noted that steelmaking is not particularly labor intensive so China's abundant labor force really doesn't contribute significantly to lower prices, as it does for things like making iPhones and T-shirts, where labor is a major component of costs.

China also has no particular natural resources in iron ore or coking coal, two of the key ingredients in steel manufacturing. So Chinese firms must import these items from Brazil and Australia, process them and ship the finished product halfway around the world. Yet their prices are much cheaper than U.S. producers, which get their raw materials only a couple of hundred miles from home.

"Things like free electricity provided by the government accounted for 88% of the profits of listed steel companies in China last year," Haley said.

The U.S. is not the only place being affected by cheap imports of steel. India's Tata Steel announced that it was putting's its U.K. operations, which have lost $5 billion, up for sale and might close them if no acceptable buyer is found, threatening 15,000 jobs.

In February, ArcelorMittal Steel (MT), the world's largest steel company, stunned investors by announcing an $8 billion annual loss after a 20% decline in sales. "Although demand in our core markets remained strong, prices deteriorated significantly during the year as a result of excess capacity in China," CEO Lakshmi N. Mittal said at the time.

Charles P. Wallace is a New York-based writer who has written about financial services for Institutional Investor, Fortune and Money magazines.