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Public Document

January 16, 2007

VIA HAND DELIVERY

The Honorable Carlos M. Gutierrez
Secretary of Commerce
U.S. Department of Commerce
Attn: Import Administration
Central Records Unit, Room 1870
Pennsylvania Avenue and 14th Street, NW
Washington, D.C. 20230

Attn: Susan H. Kuhbach

Re: Application of the Countervailing Duty Law to Imports From the People's Republic of China: Request for Comment

Dear Mr. Secretary:

Schagrin Associates, an international trade law firm that represents domestic steel companies who produce cut-to-length steel plate, hot-rolled sheet, steel pipe and tube, abrasives, iron pipe fittings, and foundry coke, hereby submit our comments in the above referenced request for comments.

Should you have any questions regarding this submission, please contact the undersigned.

Respectfully submitted,

Roger B. Schagrin
SCHAGRIN ASSOCIATES

Public Version

BEFORE THE
UNITED STATES DEPARTMENT OF COMMERCE

APPLICATION OF THE COUNTERVAILING DUTY LAW TO IMPORTS FROM THE PEOPLE'S REPUBLIC OF CHINA: REQUEST FOR COMMENTS

SCHAGRIN ASSOCIATES COMMENTS

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January 16, 2007

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EXECUTIVE SUMMARY

China maintains many subsidies benefitting its producers which are either outright prohibited, or are countervailable when the exports they encourage materially injure the domestic industry in an export target. Indeed, in the context of China's accession to the WTO, China acknowledged subsidies and undertook obligations to terminate them. Indeed, China's Accession anticipated that the Department would apply the U.S. countervailing duty statute to China. Moreover, it is readily apparent that, without enforcement, there will be no compliance. The period since China's accession demonstrates that U.S. industry cannot rely merely on the goodwill of the Chinese government to comply with its WTO obligations.

U.S. producers, including the domestic pipe and tube industry, have been materially injured by illegal subsidies which the Chinese government, including regional and local principalities, continue to provide Chinese pipe and tube producers. The Department should move aggressively to identify illegal subsidy practices which benefit Chinese producers.
As in basic steel production, rapid expansion of Chinese pipe and tube capacity has been encouraged by market distorting subsidies. China's pipe and tube industry has grown to be the largest in the world, with current growth driven significantly by exports. Demand for pipe and tube in China has grown much more slowly than the rapid increase in Chinese pipe and tube capacity. As a result of the massive over-capacity in the Chinese pipe and tube sector, China has become one of the largest pipe and tube exporters in the world, and the largest exporter of pipe and tube to the U.S. market.

In contrast to the rapid expansion of new pipe and tube companies and production capacity in China, the U.S. pipe and tube industry has consolidated and rationalized capacity over the past decade. There have been numerous major mergers within the U.S. industry. In addition, many U.S. companies have gone out of business and other companies have closed plants. There is a direct link between the growth of imports from China into the U.S. market and the closure of U.S. capacity and other evidence of injury to the U.S. industry.

Chinese policies which encourage expansion of pipe and tube production capacity and well as policies which subsidize exports must be immediately eliminated in order to prevent further injury to the U.S. producers of pipe and tube. Only after the Chinese government discontinues its incentives for capacity increases and increased exports will U.S. producers have a chance to compete fairly with Chinese producers.

I. APPLICATION OF THE COUNTERVAILING DUTY STATUTE TO CHINA IS CENTRAL TO IMPLEMENTATION OF CHINA'S WTO COMMITMENTS

A. Enforcement Of the Countervailing Duty Statute is Essential to the U.S. Trade Relationship with China

The Accession of China to the WTO explicitly recognizes the appropriateness of countervailing duty / subsidies investigations of Chinese imports into a WTO Member. WTO Doc. WT/L/432, Accession of the People's Republic of China, November 23, 2001, Part I, Paragraph 15.[1] Similarly, the USTR's December 11, 2001 background paper on the China's WTO Accession explicitly recognized that measurement of Chinese government subsidies in enforcement actions could involve use of "foreign or other market-based criteria rather than Chinese government benchmarks."

As noted in the November 2005 Economic and Security Commission Report to Congress:[2] "Given the significant and persistent trade concerns with China, it is critical that

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[1] The White House Public Liaison Briefing summarizing the U.S.-China Bilateral WTO Agreement explicitly anticipated application of the countervailing duty law to China. Summary of U.S--China Bilateral WTO Agreement (November 17, 1999).

[2] In response to the debate that led the Congress to approve Permanent Normal Trade Relations for China and China's admission to the World Trade Organization, Congress established the U.S. - China Economic and Security Review Commission to consider the trade relationship between the two countries and examine issues of "growing concern over the general direction of the U.S. - China relationship." Review Commission Report at iv. The Economic and Security Review Commission Report is worthy of high regard as the Review Commission conducted an extensive set of fourteen hearings, "taking testimony from over 150 witnesses from the Congress, the executive branch, industry, academia, policy groups and other experts." Review Commission Report at iii. Moreover, the Review Commission Report observed "the level of bipartisan consensus the Commission achieved {was} noteworthy, given the range of important matters the Congress directed {the Commission} to investigate...." *Id.* at iv.

the U.S. government and U.S firms make use of the tools available under U.S. law and the WTO to combat unfair trade practices and import surges." Review Commission Report at 49. As recognized by the Department, one aspect of U.S. policy that can be immediately rectified without Chinese involvement is the Department of Commerce's policy of not applying the countervailing statute to China. As noted by the Review Commission, the Department's practice has been upheld as permissible, "but is not required by law." Commission Report at 52. To the contrary, the Department's failure to apply the countervailing duty statute to China is not legally tenable. As the Review Commission noted subsequent to the Department's "original decision...the 1994 WTO Agreement on Subsidies and Countervailing Measures provided a definition for subsidies that does not preclude their existence in nonmarket economies. Moreover, China's accession agreement explicitly recognized that subsidies exist in China." *Id.* The Department's recalcitrance on this issue is not in accord with U.S. government policy or the WTO Accession of China.

As recognized by the Economic and Security Review Commission, notwithstanding China's entry into the WTO, "while China's economic growth profits from a liberal and open international economic order, it is far from certain that the Chinese government either accepts the rules of this system or intends to comply fully with them." *Id.* at 24. Rather, "the challenge is to bring China into the international order as a responsible actor rather than, by inaction or acquiescence, condone its behavior." *Id.* at 24.

The WTO's Trade Policy Review Body's February 2006 Report on China observed that "emphasis in the manufacturing sector has been placed on investment in export-oriented, capital intensive activities, including through government assistance and public investment. The result is that manufacturing, especially export-oriented manufacturing, has developed more rapidly than other sectors." WTO, Trade Policy Review Body, *Trade Policy Review, Report by the Secretariat, People's Republic of China* (WT/TPR/S/161) (February 28,

2006) at xiii. Thus, the Economic and Security Review Commission's characterization of China's trade policy as "a modern form of mercantilism" correctly characterizes China's adoption of policy which "emphasizes strategic accumulation of productive capacity" and "export-led growth." Review Commission Report at 24. The Review Commission Report recommended that the focus of U.S. trade policy should be "readjusted" to achieve "increased effectiveness" in getting China to make "needed structural reforms" and to address "subsidies practices." *Id.* at 95.

It is clear that China will not adhere to its WTO commitments absent enforcement of unfair trade laws by the Department. Certainly debating with the Chinese in WTO forums is ineffective. The Protocol of Accession for China provided for transitional review of China's commitments under the WTO Agreement by other WTO Members and provided that China would submit relevant information in advance of these reviews. "Article 18 of China's WTO Accession Protocol sets up a Transitional Review Mechanism (TRM) for reviewing China's compliance with its WTO commitments. The TRM takes place annually for eight years following accession, with a final review in year ten or at an earlier date decided by the General Council. *See* WTO, Trade Policy Review Body, *Trade Policy Review, Report by the Secretariat, People's Republic of China* (WT/TPR/S/161) (February 28, 2006) at 45. As noted by the Economic and Security Review Commission, "China has frustrated the intent of the TRM by refusing to answer questions in writing posed by trading partners during the TRM process and by preventing production of a meaningful TRM report." Commission Report at 48. Indeed, "China has effectively marginalized the WTO's annual review of its progress in meeting its WTO accession commitments." *Id.* at 4. As indicated by the WTO SCM Committee Chairperson's Report, China began withholding information from the outset. WTO, Committee on Subsidies and Countervailing Measures, Chairperson's Report to the Council for Trade in Goods on Transitional Review of China, No. G/SCM/118 (November

9, 2005) at 2. China's excuse for delay in filing the required Notification of its existing subsidies was that "there had been intense discussion on all the technical details of the information gathered to determine whether particular measures fell within scope of the notification obligation, in view of the fact that the SCM measures required notification of subsidy programmes which were specific, as defined by the Agreement." *See* WTO, Committee on Subsidies and Countervailing Measures, Chairperson's Report to the Council for Trade in Goods on Transitional Review of China, No. G/SCM/118 (November 9, 2005) at 6. In other words, the Chinese government took extra care in preparing the Notification list of subsidies so as not to inadvertently include any subsidy which the Chinese government believed it could characterize as "not specific."

In April 2006, China filed its long delayed "Full Notification" of existing subsidies with the WTO. World Trade Organization, New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement, No. G/SCM/N/123/CHN (April 13, 2006). Although the Notification is a long document and identifies many programs, it seems designed primarily to demonstrate China's desire to foster social equality and environmental improvement as well as an openness to foreign investment. With a few notable exceptions (including a program related to foreign invested enterprises discussed below), the Notification does not describe many of the subsidies known to exist that are provided by the central and local governments in China. Moreover, the extent of China's market distortive subsidization practices goes well beyond those subsidies which are apparent to those outside the Chinese government. Finally, as detailed below, the Department should have little confidence in the Chinese government's judgement as to whether a subsidy is permitted under China's WTO obligations.

B. China Continues to Maintain Actionable Subsidies In Violation of Its WTO Commitments

As noted in the United States Trade Representative's 2006 Report on Foreign Trade Barriers, China has "continued to use an array of industrial policy tools in 2005 to promote or protect favored sectors and industries...." USTR, *2006 National Trade Estimate Report on Foreign Trade Barriers* (March 2006) at 120. As detailed below, the growth of excess pipe and tube production capacity and the parallel phenomenal growth of pipe and tube exports from China has been fostered by Chinese government policies subsidizing such production and export. Elimination of these subsidies is essential for the survival of the U.S. industry and is also the proper objective for a stable international economic environment.

1. Foreign invested enterprise export promotion

Foreign investment, mostly in the form of foreign direct investment, has underwritten much of China's economic development. Review Commission Report at 3. Unlike the steel industry in general, in which no foreign ownership is permitted, foreign nationals can own all or part of a pipe mill. Foreign investment in production capacity and export production is subsidized by Chinese income tax provisions which provide that foreign invested enterprises (FIEs) that export more than 70 percent of their annual sales receive a 50 percent reduction in corporate income taxes (once the applicable exemption from income tax expires).[3] Article 75(7) of the Rules for the Implementation of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises.

This is a direct and incontrovertible example of China's violation of its WTO

[3] As noted in the WTO Trade Policy Review Report, "FIEs involved in manufacturing with an operating period of longer than ten years may enjoy an income tax exemption during the first two years after becoming profitable, followed by a 50% reduction for the next three years." WTO, Trade Policy Review Body, *Trade Policy Review, Report by the Secretariat, People's Republic of China* (WT/TPR/S/161) (February 28, 2006) at 56. "Export-oriented FIEs enjoy the same two-year exemption and the 50% reduction as long as the volume of annual exports accounts for more than 70% of the general sales of the enterprise." *Id.*

Accession Agreement. Paragraph 167 of the Working Party Report on the Accession of China states that:

> China would, by accession, cease to maintain all pre-existing export subsidy programmes and, upon accession, make no further payments or disbursements, nor forego revenue or confer any other benefit under such programmes. This commitment covered subsidies granted at all levels of government which were contingent, in law or in fact, upon an obligation to export.

Working Party Report on the Accession of China (WT/ACC/CHN/49) Paragraph 167. As emphasized by the WTO's SCM Committee's TRM Report, "the commitment made by China did not allow for the phase-out of such subsidies or for the continued allowance of programmes already in place for a specific period of time." WTO, Committee on Subsidies and Countervailing Measures, Transitional Review Mechanism Pursuant to Section 18 of the Protocol of the Accession of the People's Republic of China, No. G/SCM/Q2/CHN/8 (October 6, 2004) at 1-2. Yet, even China's belated subsidies Notification to the WTO lists the clearly prohibited subsidy as one of its current programs.

Before the WTO, the delegate of the European Communities objected that Article 75(7) of the Rules for the Implementation of Income Tax of the People's Republic of China "clearly provided that companies that exported more than 70 percent of their production would receive the benefit of 50 percent reduction of the company tax." WTO, Committee on Subsidies and Countervailing Measures, Chairperson's Report to the Council for Trade in Goods on Transitional Review of China, No. G/SCM/118 (November 9, 2005) at 11. The European Communities' delegate described this to be a prohibited subsidy, which was "specific by its very nature, even if available to all companies." *Id.* The delegate from the United States agreed and found it "somewhat disturbing" to hear China's defense that the "tax benefits that were provided only to exporters were widely available, and therefore were not specific, when in fact, according to the SCM Agreement, benefits that were contingent upon export performance were deemed specific. *Id.* at 12. The U.S. delegate stated that there could be no question the that tax benefits which were contingent upon exports were "prohibited subsidies" and must be terminated. *Id.* Further, the U.S. delegate registered a broader "chief concern" of the United States which "emanated from China's continuing and seemingly growing use of subsidies, including prohibited subsidies." WTO SMC Comm. Chairperson's Report at 3. China's inability to understand a clear export subsidy raises a serious question as to whether China is competent to evaluate its own programs and to comply with its WTO obligations.

2. Financial system subsidies

The February 2006 report by the WTO's Trade Policy Review Body notes, in China:

> the capital market remains heavily dependent on the banking system, which is still under-developed and relatively inefficient; it is dominated by the same four state-owned institutions, whose combined market share is 54%. Leaving so much of China's large domestic savings in the hands of such banks, which have lent mainly to SOEs (accounting for roughly one-half of outstanding bank credit in 2000) has resulted in considerable over-investment in certain sectors, with insufficient regard to returns on capital.

WTO, Trade Policy Review Body, *Trade Policy Review, Report by the Secretariat, People's Republic of China* (WT/TPR/S/161) (February 28, 2006) at 21. Likewise, in the WTO SCM Committee Chairperson's Report, the U.S. delegate stated that "it also appeared quite clear that the Chinese Government continues to provide massive subsidies to state-owned banks and the state-owned enterprises to which they lend, despite China's contention that these banks and enterprises operated on a commercial basis and were responsible for their own profits and losses." WTO SCM Comm. Chairperson's Report at 3. The WTO SCM Committee Chairperson's Report noted that the OECD 2005 Economic Survey of China was "one new source" which "could be added to the long and varied list of publicly available sources describing China's continued subsidization of loss-making state-owned enterprises." *Id.*

In considering the provision of financial subsidies it is important at the outset to recognize the fundamental distinctions between China's financial system and those of the developed world. As a recent case study of China's financial system by officials of the World Bank and the IMF notes:

> While Europe and North America had relied largely on a private-sector-driven financial system during their economic take-offs (albeit with differential reliance on banks versus stock markets), China has maintained a government-dominated financial system. There are two categories of government domination. First, entry barriers to commercial banking, investment banking and other financial services are tightly controlled so that the concentration of the financial sector in state-owned entities remains extraordinarily high despite twenty-five years of reforms in most other areas of the economy. Second, the central government and especially local governments at various levels actively interfere with the functioning of the capital market by directing and encouraging some bank loans or stock listings while discouraging or even prohibiting others.

Genevieve Boyreau-Debry (World Bank) and Shang-Jin Wei (Chief, Trade and Investment Division, IMF), "Pitfalls of a State-dominated Financial System: The Case of China" at 2. The study noted that "state-owned enterprises (SOEs) may act as bottomless pits in sucking government-channeled investment funds." *Id.* at 18. The study saw two possible reasons for continuation of this activity. First, "SOEs may be politically more powerful than private (or other non-state) firms. Consequently, they are able to obtain more investment funds from the government, particularly through government budget allocation, even if they are not productive. *Id.* Second, "precisely because SOEs are less productive on average and have trouble competing for funds in a well-functioning and integrated capital market, the government, out of concern for unemployment consequences of SOE bankruptcy, may choose to channel the capital systematically to SOEs even if they are not productive." *Id.* at 18.

The observations of a study published in 1998 by the Brookings Institution (prepared by Nicholas R. Lardy) entitled "China's Unfinished Economic Revolution," also remain relevant today. The Brookings study noted that while "China has abandoned the heavy reliance on budgetary financing of investment" which is "now financed primarily through banks," these institutions "are state-owned and embedded in a financial system that impedes the efficient allocation of capital." The newly "commercialized" banks have been forced to underwrite the policy loans of the Chinese government. Specifically, State Development Bank bonds are forced on the banks "at interest rates well below the prevailing rate of inflation, and more important, also well below the rates prevailing on state treasury bonds or comparable maturity." Because "the policy banks are thinly capitalized," they rely on "the existing banks as their principal source of funds, precluding true separation of policy and commercial lending."

The delegate of the United States to the WTO SCM Committee pointed out that Paragraph 172 of the Working Party Report on China's accession provides that "when state-owned enterprises, including banks, provide financial contribution they are doing so as government actors" and Paragraph 173 provides that "Members of the Working Party have identified {Chinese} state support through the banking system, notably government-owned banks in form of policy loans, the automatic roll-over of unpaid principal and interest, forgiven and non-performing loans and the selective use of below-market interest rates." WTO, Committee on Subsidies and Countervailing Measures, Chairperson's Report to the Council for Trade in Goods on Transitional Review of China, No. G/SCM/118 (November 9, 2005) at 11. Moreover, the U.S. delegate noted that "it was widely recognized that state-owned banks were, in essence, acting as the government when they were providing loans, and that, to the extent that these loans were preferential or below market rates, that constituted a subsidy." *Id.* Indeed, the U.S. delegation to the WTO has recognized that "bank lending on terms inconsistent with commercial considerations has continued unabated and government bailouts of the banks have grown over time in frequency and magnitude."

WTO No. G/SCM/Q2/CHN/14 at 3 (September 29, 2005).[4] A December 2005 OECD analysis estimated that: "Overall, two-thirds of state held firms in the industrial sector earn less than a 5% rate of return on assets prior to payment of interest." OECD Working Paper No. 471 at 19. Moreover, "a significant group of state firms are insolvent despite improvements in the aggregate state sector indicators. For many, returns on assets are also negative suggesting that even conversion of debt to equity would not save them." *Id.* at 20.

The Economic and Security Review Commission's Report warns of a broader and continuing problem concluding that:

> a number of reasons for pessimism about Chinese banks remain. While the large state-owned commercial banks are working to improve their lending practices, over 60 percent of incremental lending in China between the last quarter of 2002 and the second quarter of 2004 came from small banks, most owned by local governments. Reform efforts at these smaller banks are less well developed or absent altogether.

Review Commission Report at 64. As the Congressional Research Service recently reported to Congress, "many of {China's steel companies} are strongly supported by provincial governments, including with subsidized loans, so that they can stay in production, because of their social importance in the regional economic structure." Congressional Research Service Report to Congress, "Steel: Price and Policy Issues," (Updated June 26, 2006) at 20.

The Economic and Security Review Commission stated that it:

> believes that one the most pervasive forms of subsidies in the Chinese economy is the low and no-cost financing often available to Chinese domestic firms from state-owned banks. The system of `policy lending' whereby capital is allocated for political or strategic reasons using subsidized interest rates and other noncommercial terms arguably mounts to a massive government subsidy for Chinese firms that is used both to bolster their operations and fund acquisitions.

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[4] The U.S. delegation estimated that since 1998 Chinese banks collectively have "benefitted from repeated government capital injections and non-performing loan purchases in excess of $250 billion." *Id.* Similarly, the 2005 report of the U.S.-China Economic and Security Review Commission recognized that "policy lending" can reasonably be seen as "a massive government subsidy." 2005 Report to Congress of the U.S. -- China Economic and Security Review Commission (November 2005) at 39.

Commission Review at 39. Moreover, the USTR has stated that China's continuing subsidy programs can "take a variety of forms, including mechanisms such as credit allocations, low-interest loans, debt forgiveness." USTR, *Foreign Trade Barriers* at 120. Chinese pipe producers have undoubtably benefitted from pervasive national and local government policies intended to foster industrial development, and particularly steel production.

3. Subsidization of electrical costs for production

Hailing China's progress in creating an "increasingly diversified" private sector, a December 2005 OECD study of China notes that "the state remains dominant only in mining and utilities." OECD Economics Department Working Papers No. 471, "Fast-Falling Barriers and Growing Concentration: The Emergence of a Private Economy in China" (December 15, 2005) at 10. Nonetheless, the continued Chinese government domination of mining and energy is highly relevant to pipe and tube production because of the power used by such mills.

China's State Development Bank inherited almost all of the lending programs of the State Planning Commission. Brookings Study. As noted in the Brookings study, in 1994, the largest category of loans (RMB 24 billion or more than one-fourth of all loans) were for electric power plant projects. These projects had been developed initially by the State Energy Investment Corporation, one of the State Planning Commission entities absorbed by the new bank. The subsidized electrical utilities now provide subsidized energy to China's industrial sector. To the extent that the electric power prices paid by the Chinese pipe and tube producers are inconsistent with "market principles" a subsidy is being provided. *See* 19 C.F.R. §351.511(a)(2)(iii). The market principles analysis "is an examination `of such factors as the government's price-setting philosophy, costs (including rates of return sufficient to ensure future operations), or possible price discrimination." *Id.*

Currently there are constraints in China's electrical supply, which should make electricity relatively expensive. Indeed, it has been reported that blast furnace steel production is currently favored over electric arc furnace production in China for this reason. Nevertheless, it is virtually certain that the price of electricity to pipe and tube producers does not fully reflect a price determined by market principles. Provision of subsidized electricity violates China's WTO obligations and should be terminated.

4. The currency manipulation subsidy

The Department should not defer to the Department of Treasury's inaction on the subsidy conferred by China's manipulation of currency exchange rates. As noted in the WTO's Trade Policy Review Report, China's currency "was *de facto* fixed to the U.S. dollar from 1997 until July 2005, with the authorities purchasing or selling foreign currency according to market demand to keep the exchange rate almost constant at y8.28 to the U.S. dollar." WTO, Trade Policy Review Body, *Trade Policy Review, Report by the Secretariat, People's Republic of China* (WT/TPR/S/161) (February 28, 2006) at 12. "The real effective rate of the RMB has depreciated in line with the weakening of the U.S. dollar during the past 3-4 years." WTO, Trade Policy Review Body, *Trade Policy Review, Report by the Secretariat, People's Republic of China* (WT/TPR/S/161) (February 28, 2006) at 12.

In joining the WTO, China consented to be bound by GATT Article IV, which states that "Contracting parties shall not, by exchange action, frustrate the intent of the provision of this Agreement, nor, by trade action, the intent of provisions of the Articles of Agreement of the International Monetary Fund." Thus, the Review Commission Report concluded: "At a minimum, China's currency practices appear to frustrate the intent of GATT articles VI and XVI that prohibit export subsidies." Commission Report at 48. Moreover, the Report found that "China's actions also violate IMF Article IV, which charges members to `avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.'" *Id.*[5]

China's manipulation of its currency is a long-standing, well-recognized and serious problem on which the Chinese government has indicated its intransigence. Accordingly, the U.S. government should act to impose duties which off-set the exchange rate manipulation subsidy engineered by the Chinese government to the benefit of Chinese pipe and tube producers which export to the United States.

5. Upstream subsidized goods input subsidy

Chinese pipe and tube producers have long benefitted by obtaining hot-rolled sheet from Chinese producers at subsidized prices. The lower hot-rolled prices to Chinese pipe and tube producers are made possible due to the enormous Chinese government support for Chinese steel producers at both the national and local level. The subsidies built into Chinese hot-rolled production are a competitive disadvantage to U.S. pipe and tube producers when that subsidized hot-rolled is exported in the form of pipe and tube. Similarly, when Chinese pipe and tube producers purchase hot-rolled from market country suppliers, the applicable purchase price is a below market price because exporters to China must compete with subsidized Chinese hot-roll producers for sales in the Chinese market.[6]

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[5] The Economic and Security Review Commission Report concluded that China's July 2005 revaluation of the RMB was "insufficient to address current market distortions..." Review Commission Report at 37. Thus, "during the past year, along the lines of Commission recommendations to Congress, a Congressional consensus emerged over the strategic consequences for the U.S. economy of China's continued manipulation of its currency." Review Commission Report at iv. First among the Review Commission's "Key Findings" was that China's exchange rate reform announced in July 2005 "was an extremely limited step amounting to a 2.1 percent change in value." *Id.* In contrast, the Review Commission found "a growing consensus of economists generally assessing the RMB to be between 15 and 40 percent undervalued." *Id.* at 37.

[6] A similar affect on antidumping calculations undermines the reliability of the Department of Commerce's surrogate valuation methodology. Specifically, subsidized export prices for goods from China have an effect on market country exports to such typical surrogate

II. ILLEGAL SUBSIDIES CREATE EXCESS CAPACITY FOR EXPORT PRODUCTION AND MATERIAL INJURY TO THE U.S. INDUSTRY

China's accession to the WTO is meaningless to U.S. producers if unfair subsidies are permitted to materially injure U.S. producers but no means of offsetting those subsidies is available. The pipe and tube industry in China has experienced phenomenal growth in recent years. Total welded and seamless Chinese pipe and tube capacity is approximately 35 million tons, and likely much greater, a total which greatly exceeds U.S. domestic production capacity of less than 10 million tons. Moreover, the trends for Chinese producers and U.S. producers are markedly different; while China continues to expand production capacity, the U.S. industry has been contracting.

The growth in Chinese production capacity and exports has been extraordinarily rapid. In just a few years' time, China has become a major net exporter of pipe and tube. An export orientation and economic growth built on exports are fundamental aspects of China's development strategy. But as important is the structural imperative to export which results from massive amounts of excess production capacity in China. As the gap between Chinese home market demand and production grows, the imperative for Chinese producers to export becomes even more compelling. As a result of the growing imbalance between production and demand in China, there has been a steep increase in China's steel exports, and a massive surge of imports of pipe and tube from China into the U.S. market.

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countries as India.

The oversupply situation in China and the disruptive impact of welded pipe and tube exports received relatively high visibility due to the Section 421 investigation. After the International Trade Commission's strong recommendation for relief in its Section 421 report, but prior to the President's denial of relief, Li Lixia, a researcher with China Steel Union Net, affiliated with the China Iron and Steel Association indicated that Chinese pipe producers were "too focused" on the U.S. market and should expand to target other foreign markets. Nevertheless, it was conceded that the "steel product oversupply in the {Chinese} domestic market is still an issue right now, and the only way to ease the pressure is to boost exports." Interfax New Agency (October 2005).

The massive size of the pipe and tube industry in China is indicated by the belief of Chinese industry officials that "they had some flexibility in the segment of welded pipe" because, as noted by Li Lixia, "compared to seamless pipe exports, the volume on welded pipe export is rather small." Interfax New Agency (October 2005). Similarly, an official with Tianjin Pipe International Economic & Trading Corporation (TPCO), one of China's largest producers and exporters of pipe and tube, indicated that since welded pipe export was "just a small part of China's steel pipe exports" any trade relief granted pursuant to the Section 421 determination "would not significantly impact China's pipe sector." *Id.* Of course, in the eyes of U.S. producers, as well as the International Trade Commission, imports from China were not "small." In any event, TPCO also was concerned that "since China increases the export of steel products to overseas markets to alleviate domestic oversupply, such increases would cause protests not only from the U.S. but other countries as well." *Id.*

The growth of China's seamless pipe and tube exports was relevant in the recent sunset review investigations by the International Trade Commission of seamless pipe imports into the United States from other countries. The Commission noted that "China's production growth of seamless pipe and tube has outpaced all other regions {of the world}, with China's share of world seamless pipe and tube production increasing from approximately 20 percent in 1995 to almost 46 percent in 2004." *Carbon and Alloy Seamless Standard, Line, and Pressure Pipe from the Czech Republic, Japan, Mexico, Romania, and South Africa*, Inv. Nos. 731-TA-846-850 (Review), Pub. 3850 (April 2006) at IV-19. Indeed, China's production alone now far exceeds the production of each other region of world. *Id.* at IV-20 (Table IV-28). Specifically, Chinese production of seamless pipe and tube in 2004 was 3.6 times that of North American production and 2.5 times that of the European Union production. *See id.*

Similarly, China's status as a major exporter in the world's stainless steel pipe market was similarly detailed in the International Trade Commission Report prepared in the context of the recently completed sunset review of stainless pipe from Korea and Taiwan. In the Commission report it noted that "China has become the second leading exporter of stainless steel pipe and tube in the world, as its exports have increased from 4,000 metric tons in 2000 to 45,000 metric tons in 2005." *Certain Welded Stainless Steel Pipe from Korea and Taiwan*, Inv. Nos. 731-TA-540 and 541 (Second Review), Public Staff Report at IV-16. "One third of China's exports (15,000 metric tons) were to the United States, and the remainder to other markets, primarily in Asia." *Id.* at IV-17.

Of course, the growth of imports from China and their disruptive and distortive impact in relation to U.S. producers are most specifically detailed in the record of the recent Section 421 case on welded pipe. The investigation there and the data submitted by the reporting Chinese producers in the Section 421 proceeding "indicate that Chinese producers of circular welded non-alloy steel pipe currently have significant unused capacity and expect this condition to continue through 2006." *Circular Welded Non-alloy Steel Pipe from China*, Inv. No. TA-421-6, Pub. 3807 (October 2005) ("*Welded Pipe from China*") at 33 (Views of

Chairman Koplan and Commissioner Lane). Moreover, the Chinese industry possesses the ability to greatly increase export volume to the United States and could easily displace almost all domestic production.[7]

Importantly, "China became the largest single supplier country {to the U.S. market} for the first time in 2004, and was the largest supplier in the first half of 2005." *Welded Pipe from China* at 24 (Views of Chairman Koplan and Commissioner Lane). Moreover, the data submitted to the Commission by the Chinese producers themselves strongly indicated that they rely heavily on exports and have focused significantly on the U.S. market as compared to third country markets. "The U.S. and other export markets grew to account for 27.8 percent of total {reported Chinese} shipments in interim 2005, an almost 10 percentage point increase over the full year 2004 level." *Id.* at 49 (Views of Commissioners Hillman and Aranoff). "The U.S. market is the principal market for shipments of Chinese welded pipe, accounting for over 55 percent of total exports in 2004. *Id.* Thus, export markets, and especially the U.S. market, are gaining in importance in Chinese welded pipe production strategy, and are predicted to continue to account for a growing share of Chinese production." *Id.*

Even though welded pipe products are a relatively small part of China's pipe and tube production capacity, the Chinese nonetheless have enough capacity to overwhelm, not only the U.S. market, but also the world market. China's production capacity and exports are even larger in the other pipe and tube product categories. The data strongly indicate that China is moving to dominate all pipe and tube categories.

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[7] The record in the Commission's Section 421 investigation of welded pipe indicated the existence of numerous Chinese producers currently exporting to the United States. In October 2005, Li Lixia, speaking for the China Iron and Steel Association, stated that there were fifty Chinese pipe producers exporting to the United States (and they were concentrated in Tianjin, Shanghai, Shandong, and Lianoning). Interfax News Agency.

The U.S. pipe and tube industry is now at a critical juncture. In stark contrast to the rapid expansion of the number of pipe and tube producers in China and the consequent massive expanded capacity in China, the U.S. pipe and tube industry has undergone significant consolidation of producers and rationalization of production capacity in the first half of this decade. Thus, in 2001, Laclede Steel Company filed for Chapter 7 bankruptcy liquidation and closed one mill in East Alton, Illinois and two mills in Fairless Hills, Pennsylvania. The Laclede three mills had a combined annual production capacity of 450,000 tons. None of the three mills has ever been restarted. In 2002, Geneva Steel entered into Chapter 7 bankruptcy liquidation and sold a large diameter line pipe mill to a Chinese steel company and a small diameter line pipe mill to an Indian pipe company. The combined mills had a production capacity of approximately 300,000 tons annually (though the large diameter mill had not operated for some years). Also in 2002, Excalibur Tube Company filed Chapter 7 liquidation. Through the bankruptcy process, approximately half of Excalibur's pipe and tube mills were sold to Leggett and Platt. The other Excalibur mills were never purchased. These other mills remain closed and reduced U.S. pipe and tube capacity by approximately 100,000 tons.

In 2004 and 2005, Northwest Pipe Company shut mills producing line pipe, standard pipe, and structural tubing in Portland, Oregon totalling approximately 100,000 tons of capacity. At the same time, Northwest also closed a standard pipe mill Bossier City, Louisiana, which had approximately 40,000 tons of capacity. As indicated earlier, Wheatland Tube Company shut down it Sharon tube plant in May 2006, with a loss of 300,000 tons of capacity.

The U.S. industry has seen a wave of consolidations during the past five years. In 2001, Maverick Tube purchased Prudential Steel of Canada, which operated a plant in the State of Washington. To escape the especially high level of imports on the West Coast, Maverick shut down the Washington plant and moved the equipment to Arkansas. In 2002, Maverick Tube purchased LTV Tubular out of the LTV bankruptcy. Maverick subsequently closed the LTV Tubular plant in Youngstown, Ohio with a decline in standard and line pipe capacity of approximately 175,000 tons. Maverick merged the other LTV Tubular plants into Maverick Tube. In 2003, Wheatland Tube purchased the assets of Sawhill Tube from AK Steel Corporation. In 2004, Copperweld Tube shut down a structural tube mill in Portland, Oregon. This mill was subsequently restarted by Oregon Steel Mills. In 2005, the structural tubing assets of Maverick Tube were sold to Atlas Tube Company. Atlas subsequently purchased all of Copperweld Tube, one of the largest pipe and tube manufacturers in North America, with North American capacity of over one million tons. Atlas subsequently sold certain mechanical tube and stainless tube operations to Dofasco. Finally, we note that Oregon Steel Mills shut down its Napa Pipe large diameter line pipe mill in 2004, with a reduction in capacity of 400,000 tons. In its place, Oregon Steel Mills built a new spiral weld large diameter line pipe mill in Portland, Oregon with the much lower capacity of 180,000 tons. In sum, in the first six years of this new century, some of the largest and oldest names in the U.S. pipe and tube industry have disappeared, including Laclede Steel, Sawhill Tube, and Copperweld and there has been a reduction of approximately 1.5 million tons of total U.S. pipe and tube capacity.

CONCLUSION

Application of the countervailing duty statute to China is warranted by China's Accession to the WTO and is necessitated by existence of illegal subsidies which are injuring U.S. producers and their workers. China cannot be depended on to eliminate illegal subsidies within a meaningful time frame absent the potential for enforcement of the countervailing duty statute. A mutually beneficial trade relationship can only be built on WTO fair trade principles and the Department's enforcement of the countervailing duty statute is an essential foundation to fair trade between the United States and China.