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Via e-mail: webmaster-support@ita.doc.gov

PUBLIC DOCUMENT

Ronald Lorentzen
Acting Director, Office of Policy
Import Administration, Room 3713
U.S. Department of Commerce
14th Street and Constitution Ave., NW.
Washington, DC 20230

Re: Comments of International Steel Group Inc. (ISG) in Response to the Federal Register Notice of May 27, 2004 regarding the Unfair Trade Practices Task Force

Dear Mr. Lorentzen:

On behalf of International Steel Group Inc., we hereby respond to the request of the Department of Commerce for public comment on the work of the newly established Unfair Trade Practices Task Force. *See Request for Public Comment--Unfair Trade Practices Task Force*, 69 Fed. Reg. 30285 (May 27, 2004).

International Steel Group Inc. (ISG) is the largest integrated steel producer in North America, based on steel making capacity. ISG operates 13 major steel producing and finishing facilities in eight states, and produces a variety of steel products including hot-rolled, cold-rolled and coated sheets, tin mill products, carbon and alloy plates, wire rod, rail products and semi-finished shapes. ISG's products serve the automotive, construction, pipe and tube, appliance, container and machinery markets.

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Having recently established the Unfair Trade Practices Task Force "to pursue the elimination of foreign unfair trade practices that prejudice or adversely affect U.S. commercial interests," the Department has asked the public to assist the task Force in identifying unfair trade practices of greatest concern and impact that are deserving of the Task Force's attention. 69 Fed. Reg. at 30286. The Department seeks comments "on all types of foreign unfair trade practices, including those practices which currently may not be subject to specific or adequate trade disciplines, as well as comments on the underlying market distortions that may have contributed to or resulted from the practice in question." *Id.* In response to this request, ISG submits the following comments identifying a number of unfair trade practices and underlying market distortions that adversely affect ISG's commercial interests as a major US manufacturer. ISG urges the Task Force to examine these issues in the course of its work.

(1) <u>Excessive Subsidies Abroad</u>

Subsidies provided by foreign governments to their domestic steel industries have, over a long period, distorted competition and been a major unfair trade practice affecting US steel producers. The Department and USTR recognize this reality. In the most recent Subsidies Enforcement Report to Congress, they noted that the "use of trade-distorting subsidies by foreign governments can seriously threaten the interests of American workers and industries."[1] [2] The

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[1] USTR and Dept. of Commerce, *Subsidies Enforcement Annual Report to the Congress* (February 2004) at 1. The report also noted an allegation by US steel producers that the Polish government provided subsidies to its steel sector. Commerce and USTR indicated that they had raised this issue with Poland and the EU. *Id.* at 44.

[2] The American Iron and Steel Institute (AISI) has noted the following examples of government subsidies that have been provided to steel industries in other countries:

- European Union (EU): Billions of dollars in EU government subsidies in the 1990s to steelmakers in France, Italy, Spain and elsewhere in Western Europe.
- South Korea: $6 billion in subsidies to (now bankrupt) Hanbo Steel, and continued preferential access by POSCO (world's largest steelmaker) to low-interest loans.

Task Force should address how trade-distorting steel subsidies disadvantage US steel producers and should consider practical strategies to remedy this problem.

The problems caused by steel subsidies are succinctly summarized in the following excerpt from the OECD:

> Subsidies have seriously damaged the interests of efficient steel firms worldwide. Some subsidies have provided performance-enhancing advantages to failing enterprises, transforming them into "winners" that have stolen market share from well-managed, competitive steel companies. Other subsidies have helped fuel overinvestment in new steel facilities, contributing to the overcapacity that has dragged the industry's overall financial performance down for decades. The effects on trade have been significant, with steel the object of a disproportionately large number of trade actions during the past 30 years. These have included a large number of antidumping and countervailing cases, as well as formal and informal safeguard actions.[3]

An example of a country that uses subsidies to support its steel industry is China. China's steel industry is now the largest in the world and it has been the beneficiary of massive government aid. China has subsidized its steel industry through a variety of measures, including government-planned investments, loan forgiveness, and debt for equity swaps. China provided more than $11 billion in forgiven debt to the steel industry in 1999-2000.[4] In its July 2000 global steel study, the Department noted that China was to spend $6 billion to "upgrade and

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- Brazil: Steel industry eligible for special aid related to imports, and government is spending over $350 million to improve a port for a major steel exporter, CSN.

See http://www.steel.org/policy/trade/msa.asp.

[3] OECD Directorate For Science, Technology And Industry, OECD Special Meeting at High-Level on Steel Issues: Ideas For Advancing The Steel Subsidy Talks, SG/STEEL(2004)5, at 6, para. 3 (June 2004). At the OECD, multilateral negotiations (involving nearly 40 governments) to develop an agreement to reduce or eliminate trade distorting government subsidies to the steel sector have been going on since 2001 but, so far, a consensus on the scope of an agreement has not emerged. *See Aldonas Says Steel Talks May Have Gone As Far As Possible In OECD*, INSIDE U.S. TRADE, April 23, 2004.

[4] *See Request for the Inclusion of Steel in the National Trade Estimate Report on Foreign Trade Barriers in China*, Submission of Bethlehem Steel, LTV Steel and US Steel to U.S. Trade Representative, December 17, 2001, at 4.

transform the steel industry," and that "nearly $3.4 billion" would be in the form of low-interest loans.[5]

Many of China's steel companies remain under government control as state-owned enterprises and the Chinese government has targeted the steel sector as a recipient of subsidies through low-interest loans. The American Iron and Steel Institute (AISI) has observed

> Of particular concern is that many Chinese steel companies -- at least 65 by the end of 2002 -- remain under the de facto control of the government. These state-owned-enterprises (SOE's) accounted for around 50 billion RMB (about $6 billion) in capital expansion expenditures in the Chinese steel industry in 2002, which continued to contribute to the Chinese steel industry's overcapacity in key steel product lines.
>
> Low-interest-rate financing continues to be a concern in China's steel industry. The government of China recently targeted six industries to receive interest-rate subsidies, including steel, which was the largest recipient of the interest-rate subsidy. Both private and state-owned steel companies continue to have access to low-cost funds from state-owned banks that have a strong incentive to lend to a "designated industry" such as steel.[6]

The effect of government subsidies like China's is to encourage expansion of capacity and overproduction – consequences that only exacerbate the market distortions caused by trade-distorting subsidies. "Caving in to pressures to provide subsidies will only serve to ensure that the least efficient firms are given added time and incentive to further distort domestic and international markets."[7]

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[5] U.S. Dept. of Commerce, *Global Steel Trade* (July 2000) at 146.

[6] Statement of the American Iron and Steel Institute (AISI) to the House Committee on Ways and Means regarding U.S.-China economic relations, October 30, 2003.

[7] OECD Directorate For Science, Technology And Industry, OECD Special Meeting at High-Level on Steel Issues: Ideas For Advancing The Steel Subsidy Talks, SG/STEEL(2004)5, at 6, para. 4 (June 2004).

(2) Irrational Behavior by State-owned or State-invested Entities

Irrational economic behavior by state-owned or state-invested enterprises is an unfair trade practice that disadvantages US manufacturers. This problem is particularly evident in China, as recently acknowledged by a senior U.S. trade official, when, in a teleconference concerning the work of this Task Force, he said that:

> an example of an unfair trade practice that cannot be clearly classified as either subsidy or dumping is the practice in China of providing state-owned companies with loans from state-owned banks, with the understanding that these loans do not necessarily need to be paid back. When the cost of capital to those companies essentially amounts to zero, U.S. manufacturers cannot compete with them on the same basis, the official said. "And this happens in a variety of different settings around the world, it's not just China," he said.[8]

Major parts of the Chinese economy are still dominated by state-owned or state-invested enterprises. The US State Department reports that "state-owned or state-controlled entities continue to play the leading role in the Chinese economy. For example, traditional state-owned enterprises and corporations with majority of shares held by the state accounted for just under 42 percent of gross industrial output for the year {2002}."[9] And, the *Economist* reported:

> In 2002, the state controlled half of industrial output, and SOEs still account for 35% of urban employment, despite having halved their workforce in the past 12 years. Virtually all of China's heavy industry and much of its technology is in state hands. Half of all bank loans go to SOEs. This crowds out the private sector, China's growth engine, and threatens the entire financial system, because most of those loans will never be repaid.[10]

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[8] Embassy of the United States, Japan, Issues Notice, *U.S. Urges Stronger Enforcement of Trade Obligations*, *available at* http://japan.usembassy.gov/e/p/tp-20040120-13.html.

[9] US Dept. of State, CHINA COUNTRY COMMERCIAL GUIDE FY 2004 (2004) at 8.

[10] *We are the champions*, THE ECONOMIST, March 20, 2004.

Most of China's SOEs operate at a loss. China recently announced that it was writing off bad loans to SOEs amounting to 224 billion yuan.[11] It is irrational economic behavior for China's government to support such non-performing SOEs through low-interest loans or by writing off bad loans to SOEs. Moreover, government intervention to support state-owned steel companies that are operating at a loss makes the problem of global excess capacity even worse.

(3) <u>Excess Global Capacity in Steel</u>

Excess global capacity in the steel industry is an underlying market distortion and a catalyst for unfair trade practices. Excess capacity is the consequence of a failure to shut down inefficient steel facilities in foreign countries, and from government subsidies that continue to flow to inefficient steel companies in foreign countries despite weak demand and lack of genuine market signals. Over time, excess capacity erodes prices and stimulates unfair trade practices, such as dumping when foreign steel firms "dump" their excess inventories in other markets (e.g., the US) in classic beggar-thy-neighbor conduct. Excess global capacity in the steel industry was a major contributor to the import surges that caused serious injury to the US steel industry from 1998 through 2002. The US industry still feels the negative effects of that unprecedented import surge today.

In response to the steel crisis, the OECD has been conducting ongoing negotiations between government officials from major steel producing economies as well as industry representatives with the goal of reaching a multilateral agreement to eliminate inefficient overcapacity and to restructure the steel sector. ISG appreciates the Administration's efforts to

[11] The China Commission for Supervision and Management of State-owned Properties announced that it had allocated 49.3 billion yuan as SOE bankruptcy subsidies and allowed state-owned banks to write off a total of 223.8 billion yuan of bad loans caused by the bankruptcies of SOEs. *China to Bail out Last Group of Money-*

work with our trading partners to address the massive excess capacity and to increase disciplines on subsidies to the sector – two major underlying problems facing US steel producers. However, given efforts by various countries to exclude themselves from solving the global problem or to maintain large subsidies, no meaningful breakthroughs have been achieved at the OECD as yet.

As a critical objective, the US steel industry continues to seek a comprehensive set of disciplines and the elimination of existing excess capacity from other steel-producing nations. Given the seriousness of the problem of excess global capacity to the US steel sector, the Task Force should consider strategies for helping to move the OECD negotiations on eliminating excess steel capacity toward a successful conclusion, as well as alternative strategies if the OECD effort stalls.

(4) Cartel Behavior By Foreign Steel Producers

The Task Force should address anti-competitive business practices that distort and restrict trade and act as unfair trade barriers for US manufacturers. One such unfair anti-competitive practice is cartel behavior, either formal or informal. Cartels are "arrangements between firms which have substituted an agreement on prices, output or related matters for independent decision-making in relation to goods or services to be exported to foreign markets."[12] Cartels are unfair trade practices because they restrict access to markets and weaken competition.[13]

Losing SOEs, CHINA DAILY (June 21, 2004). The Commission report also showed that by April 2004, China had closed 3,377 insolvent SOEs through administrative intervention and resettled 6.2 million employees. *Id.*

[12] *See* Organization of Economic Cooperation and Development (OECD), *Competition and Trade Policies – Their Interaction*, at 11 (1984).

[13] The AISI has noted regarding foreign private cartel activity:

> Agreements among foreign steel producers to create high-priced profit sanctuaries abroad foster dumping into the U.S. and unneeded steel capacity buildups abroad.
>
> - Japan: Firms operate strict production cartel that ensures members high prices, stable market shares and low imports

In the past, the US steel industry has raised concerns about cartel-type activity between foreign steel producers. For instance, the US steel industry identified a cartel that has existed between European and Japanese steel producers for many years. The agreement – known as the East of Burma agreement—effectively divides up the world steel market between the Asian and European steel producers. Under this agreement, European and Asian producers limit their exports to the other's market. Violations of the export limits are punished by allowing dumping of twice the authorized tonnage in the home market of the offending company. Although not publicly acknowledged by the players, the existence of the cartel agreement has been reported in the press and written about by commentators, trade officials, and businessmen.[14] The effect of the European/Asian cartel on the US steel industry has been injurious in that it has "fostered endemic dumping into the U.S. market which has kept the industry in a state of crisis for decades, depressing operating rates, profits, and ultimately investment levels, while

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- International Cartels: Low steel imports into Japan aided by agreements between mills in Japan, Korea, Taiwan, Brazil, Australia & South Africa. EU & Japanese mills have "understanding" to respect each other's market spheres.

See http://www.steel.org/policy/trade/msa.asp.

[14] *See* Seth T. Kaplan, *An Analysis of the EU's Claim of Adverse Trade Effects Following the Steel 201 Program*; *available at* www.steel201.org/about/images/KaplanEUReport.pdf; Alan Wm. Wolff, *Market Access in the Global Economy: The Problem of Cartels*, JPRI Working Paper No. 6 (January 1995); *available at* www.jpri.org/publications/workingpapers/wp6.html; Mark Tilton, Steel's Divided Markets: Japan & Europe (June 28, 2002) (Japan Information Access Project Working Paper); *available at* www.jiaponline.org/whatsnew/events/2002/june28/Steel,%20Mindy's%20version,%20June%202002.pdf.

In a 2001 speech, a French representative to the WTO said:

> {T}he third feature of this cartel is that dumping is very often used, either as a mechanism to eliminate some competitors, as I have just mentioned, or as a retaliatory mechanism when some of the cartel members do not behave according to the rules of the cartels. And we have many examples of this. The most famous one, because it's a current one, is the East of Burma Agreement in steel, which divides the world between the European mills and the Asian mills along the line, which is East of Burma. Each side cannot export more than four hundred thousand (400 000) tons to the other side. If any violators are found out then the manufacturers of the other side have the right, according to the cartel rule, to dump steel in their country up to twice the amount that the violator has exported above and beyond his quota. At the same time, of course, the increase of prices twice a year in meetings of those steel mills. {Emphasis added}.

strengthening its foreign competitors."[15] ISG requests that the Task Force determine whether such cartel-type practices continue and develop approaches bilaterally and for corrective action.

(5) Export Restraints on Raw Materials

In its work, the Task Force should examine export restraints on raw materials imposed by a foreign government. Such practices constitute anticompetitive behavior that can unfairly provide advantages to its domestic industry and unfairly prejudice the ability of US manufacturers to access needed raw materials. A current example of an export restraint that has adversely affected steel producers is China's export restraint on coke, a key raw material in the production of steel. The effect of such export restraints is to raise the price of the raw material and thus the cost of production. A recent report in *China Daily* indicated that "China will scrap tax rebates for coke and coking coal starting from today to further lessen exports," which is expected to raise international prices for coke.[16]

Export controls affecting the steel sector, however, have not been limited to China. Other countries that have imposed export restraints include Venezuela (which recently set export controls on steel scrap) and Argentina (which decided to "temporarily retain 40 percent of scrap export revenue."[17] In addition, South Korea, Russia, Belarus, and the Ukraine maintain or are considering similar export restraints on ferrous scrap used in steel production.[18]

Frederic Jenny, Vice-President, French Competition Authority and Chairman of the WTO Working Group, *The Impact of Globalisation on Competition: A WTO Perspective*; *available at* www.compcom.co.za/events/Last%20year%20conference%20speeches%202001/Frederic%20Jenny.htm.

[15] Alan Wm. Wolff, *Market Access in the Global Economy: The Problem of Cartels*, JPRI Working Paper No. 6 (January 1995); *available at* http://www.jpri.org/publications/workingpapers/wp6.html.

[16] *See Gov't Warns of Overheating in Coke Industry*, CHINA DAILY (May 24, 2004) (explaining that China cut its export quota on coke to 9 million tons in 2004, down from 12 million in 2003); *available at* http://www.chinadaily.com.cn/english/doc/2004-05/24/content_333142.htm.

[17] *See Colombia Trade Group Lobbies for Scrap Controls*, AMERICAN METAL MARKET (Feb. 27, 2004).

[18] *See S. Korea Plans to Restrict Steel Scrap Exports*, AMERICAN METAL MARKET (Mar. 5, 2004).

(6) Currency Manipulation

A serious market distortion that the Task Force should examine is currency manipulation by foreign governments. Currency misalignment creates trade distortions, results in misallocation of economic resources through false market signals, undermines stability, and provides an unfair price differential to goods imported from a country that has undervalued its currency. A number of countries have engaged in currency manipulation or intervention in the currency market to maintain their currency level. Since 1994, for example, China has pegged its currency exchange rate at 8.28 yuan to the dollar. As has been detailed by various economists and by the Fair Currency Alliance, China's yuan is significantly undervalued. As a result, Chinese goods are less expensive than US goods and US manufacturers are forced to compete with imports that enjoy an artificial price advantage through the effect of currency manipulation.

In addition to China, other countries that have been active in the currency markets to maintain their currencies at certain levels include Japan, South Korea, and Taiwan. In recent years, China, as well as Japan, South Korea and Taiwan, have made massive purchases of US dollars to maintain their exchange rates or minimize their currencies' appreciation.[19] Together,

[19] In 2002, China purchased $165.6 billion in US dollars. By July 2003, this amount doubled to $356.5 billion with at least 30 percent ($70.1 billion) of the increase occurring in 2003. Similarly, in order to compete with the undervalued Chinese yuan, Japan, Taiwan, and Korea also intervened in the currency market by increasing their purchases in 2001 and 2002. Treasury reported that Japan's intervention in the currency market the first half of 2003 totaled $59 billion with an additional $22.7 billion in July and August. *See* US Dept. of Treasury, *Report to Congress on International Economic and Exchange Rate Policies* (JS-954) at 9 (October 30, 2003). Respecting Taiwan, Treasury said in 2002: "Taiwan's monetary authorities exert a strong influence on the foreign exchange market through heavy and frequent intervention, the use of various capital controls and close monitoring of trading." *See* US Dept. of Treasury, *Report to Congress on International Economic and Exchange Rate Policies, Reporting Period: July 1, 2000 through December 31, 2000.*

these four countries account for about 60% of the US trade deficit, and hold $1.2 trillion of official reserves, with at least a $188.4 billion increase since 2002.[20]

The adverse effects of currency manipulation on the US economy in general and on US manufacturers in particular have been substantial. Since 2000, manufactured goods shipments fell by $270 billion, and 2.8 million factory jobs have been lost.[21] Economists estimate that China's yuan is undervalued by 40% or more[22] and that the US trade deficit would be about $100 billion less but for the effect of currency undervaluation by China, Japan, South Korea, and Taiwan.[23]

While currency manipulation is not defined by the International Monetary Fund Agreement or under IMF or US law, there are potential WTO and IMF remedies available to address the problem, and clarification by the US and the IMF would help to encourage trading partners to establish sustainable currency policies.

In any event, there is a need for a revaluation of China's currency now.[24] The Task Force should ensure that this problem is acknowledged and urgently addressed. In addition, the Task

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20 *See* Testimony of Franklin J. Vargo, National Association of Manufacturers, before the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology of the House Committee on Financial Services, *Hearing on China's Exchange Rate Regime and Its Effects on the U.S. Economy* at 2, 5 (October 1, 2003).

21 *See* Testimony of Franklin J. Vargo, National Association of Manufacturers, before the House Committee on International Relations, *Hearing on U.S.-China Ties: Reassessing the Economic Relationship* at 2 (October 21, 2003).

22 *See* Testimony of Franklin J. Vargo, National Association of Manufacturers, before the House Committee on International Relations, *Hearing on U.S.-China Ties: Reassessing the Economic Relationship* at 4 (October 21, 2003).

23 *See Chinese Currency Manipulation and the U.S. Trade Deficit*, Statement Before the U.S.-China Economic and Security Review Commission by Ernest H. Preeg, Senior Fellow in Trade and Productivity, Manufacturers Alliance/MAPI (September 25, 2003).

24 The Fair Currency Alliance, a group of trade associations and unions representing manufacturing, agriculture and labor, prepared a "Section 301 Petition" to address the problem of Chinese currency manipulation but has not filed the petition with USTR. *See Fair Currency Alliance Says China Understating Global Trade Surplus*, INSIDE US-CHINA TRADE (June 16, 2004) ("Zoellick and other cabinet officials said in late April that they would reject a Section 301 petition on China's currency policies if it were filed. However, the Alliance has said

Force should address how the US can work with its trading partners, including Japan, Korea and Taiwan to ensure that exchange rate equilibrium is restored for their currencies vis-à-vis the US dollar.

(7) Border Tax Adjustments

The Task Force should examine disadvantages that US exporters face from the effect of countries' different tax systems and how border tax adjustments are treated by the GATT and WTO. The Department's report, *Manufacturing in America*, summarized the problem of the underlying inequity between the tax treatment of most foreign manufactured goods and those produced in the United States as follows:

> {T}here is broad recognition of the advantage conferred on foreign manufacturers by the interrelationship between the current U.S. tax system and international trade rules. American manufacturers are well aware that most of their competitors are located in countries that rely more heavily on consumption, rather than income, as the basis for taxation. In practical terms, foreign governments apply taxes solely to income earned on sales in their jurisdictions and will rebate any taxes that apply to exports.
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> By relying more heavily on income as the basis for taxation, and in taxing U.S. manufacturers on their worldwide income, the U.S. system contains no simple means of ensuring that U.S. exporters receive comparable treatment. The international trade rules reinforce that disparity because they allow the rebate of indirect taxes (that is, taxes on consumption such as value-added taxes) but prohibit the rebate of any direct taxes on income, on which the U.S. system relies so heavily.[25]

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it might still file the petition, and will monitor the Bush Administration's progress on the issue over the summer before deciding how to proceed.").

[25] U.S. Dept. of Commerce, *Manufacturing in America: A Comprehensive Strategy to Address the Challenges to U.S. Manufacturers* (January 2004) at 46-47.

The revision of border tax adjustments has been a trade negotiating objective of the US since 1988.[26] Moreover, in its recent report, *Manufacturing in America,* the Department of Commerce said that, in future negotiations, the US "should pursue the elimination of the border adjustability of indirect taxes to address the disadvantages to countries relying primarily on direct taxes."[27]

ISG appreciates the opportunity to present its views and comments to the Task Force concerning foreign unfair trade practices and underlying market distortions that adversely affect its commercial interests as a major US steel producer.

Respectfully submitted,

Terence P. Stewart
Patrick J. McDonough
Sarah V. Stewart
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Special Counsel to ISG

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[26] *See* Omnibus Trade and Competitiveness Act of 1988, Pub. L. 100-418, Title I, Sec. 1101, Aug. 23, 1988, 102 Stat. 1121; 19 U.S.C. § 2901(b)(16); Trade Act of 2002, Pub. L. 107-210, Div. B, Title XXI, Sec. 2102, Aug. 6, 2002, 116 Stat. 994; 19 U.S.C. § 3802(b)(15).

[27] U.S. Dept. of Commerce, *Manufacturing in America: A Comprehensive Strategy to Address the Challenges to U.S. Manufacturers* (January 2004) at 76.