CHINESE STEEL OVERCAPACITY

A Legacy of Broken Promises

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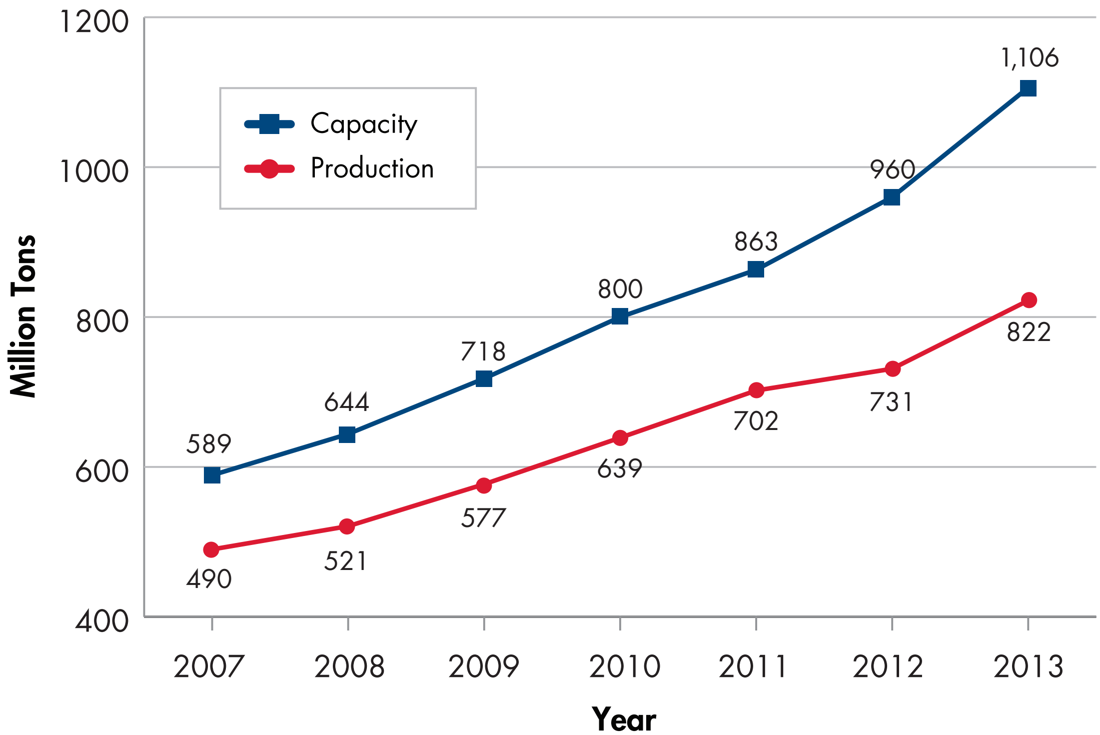
The American steel industry and the hundreds of thousands of jobs it supports are facing an unprecedented threat from excess global capacity. This critical issue is often overlooked as a driver of import growth into the United States.

Each year, the world's steel producers are making hundreds of millions of tons beyond what global demand suggests would be the appropriate amount of production. This practice is commonly referred to as "overcapacity," and in the steel industry the term has become synonymous with China, which is responsible for hundreds of millions of tons of global excess capacity in steel.[1] Driven by significant government intervention, subsidies, and currency manipulation, China's steel industry has grown at an extraordinary rate over the past fifteen years.[2] This growth has taken place at a rate far faster than domestic and international demand would dictate. And this capacity is not sitting idle. China's steel industry is utilizing it to maintain its domestic employment and social stability, and to actively and deliberately flood the global market with over a hundred million tons of steel each year. Steel plants in the United States and around the world are being forced operate at a loss and even to close, laying off thousands of workers in the face of China's torrent of excess steel.[3]

Since 2000, China's steelmaking capacity4 and production[5] increased dramatically. (See Figure 1).[6] Over that time, China went from having roughly the same annual steelmaking capacity as the United States to ten times as much capacity as the United States. China now has a capacity of 1.2 billion tons per year.[7] In fact, China accounted for more than 75 percent of global steelmaking capacity growth, and in 2015 China's steelmaking capacity exceeded the *combined* capacity of the United States, European Union, Japan, and Russia.[8] This growth has been far beyond what China's domestic and international market demand requires. In the face of international pressure, the Chinese government has repeatedly pledged to curb this rampant overcapacity since 2007. Despite these promises, Chinese steelmaking overcapacity continues to persist and, remarkably, continues to expand. As a result, the American steel industry announced 14,500 more layoffs from January 2015 through June of last year.[9]

Figure 1. Chinese Steelmaking Capacity and Production, 2001-2014



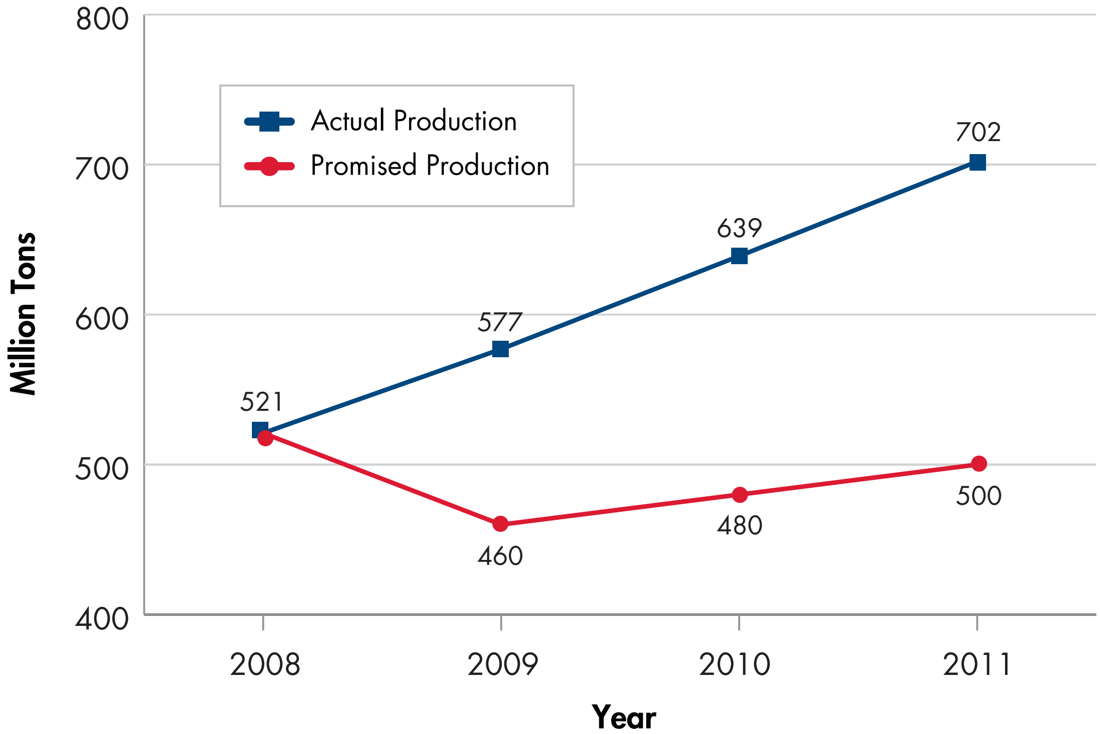
Source: German Steel Federation and World Steel Association. See: Note 6

Broken Promise #1: The Steel Industry Revitalization Plan, 2009

In 2009, the Chinese government released its Steel Industry Revitalization Plan (SIRP) with the goal of modernizing steel production and eliminating excess capacity. This plan pledged to cut Chinese steel output in 2009 to 460 million tons, down from 521 million tons in 2008.[10] From that lower baseline, production would slowly rise to 500 million tons in 2011.[11] Instead of that promised reduction, Chinese steel production in 2009 increased to 577 million, and in 2011 had surpassed 700 million tons.[12] (See Figure 2).[13]

The 2009 SIRP and the actual behavior of the Chinese government and steel industry is a pattern that continues to be repeated. Promises are made that purport to bring the Chinese industry into line with global market trends, and then those promises are immediately broken and the massive overcapacity increases and overproduction continues unabated.

Figure 2. Actual vs. Promised Chinese Steel Production Under SIRP, 2008-2011



Source: : Congressional Research Service and World Steel Association. See Note 13.

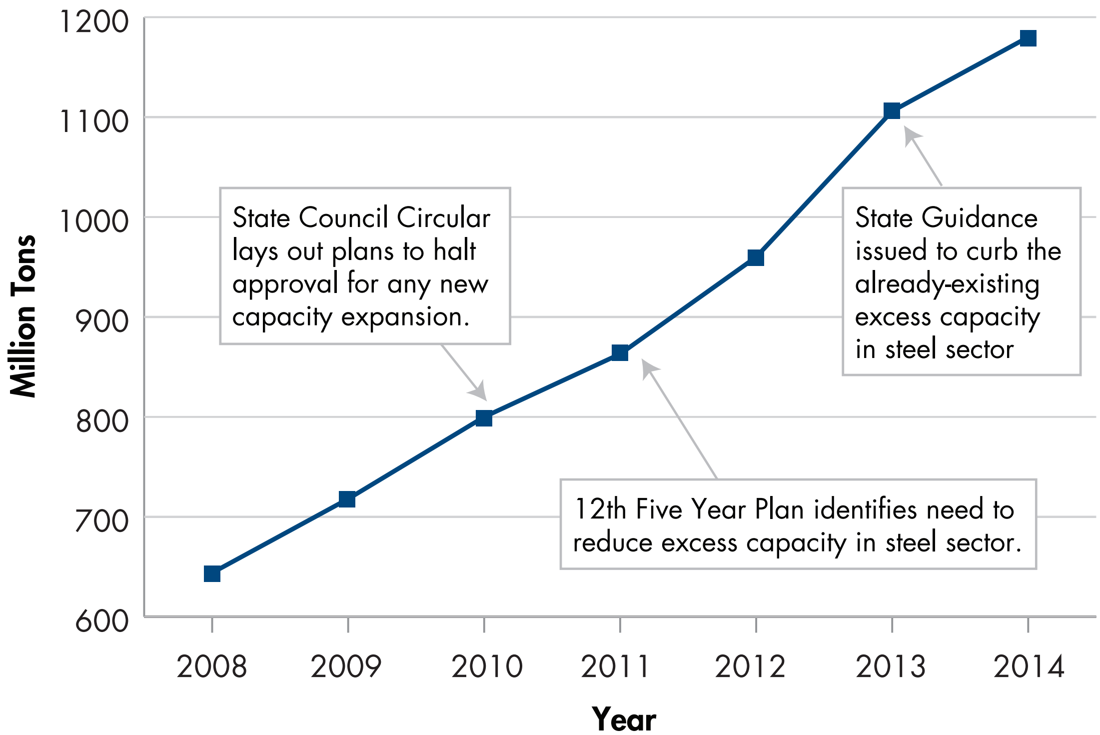
Broken Promise #2: The State Council Circular, 2010

Even as China was in the midst of breaking its promises of slowing production growth in the 2009 SIRP, it was already making more promises with regard not just to production, but to capacity. In 2010, China's State Council issued a 'Circular' in which it laid out plans to halt approval for any new capacity expansion projects in the steel sector.[14] At the time, China's existing capacity was approximately 800 million tons.[15] By 2011, despite this plan to prevent the development of any more steelmaking capacity, an additional 60 million tons per year of capacity had been brought online.[16]

Broken Promise #3: The 12th Five Year Plan, 2011

A year after China's State Council Circular laid out its plan to halt approval of new capacity, and the 60 million tons of new capacity that nevertheless followed, in 2011 the Chinese government released its 12th Five Year Plan.[17] The Plan, which laid out a roadmap of priorities for the Chinese Communist Party over the next five years, identified the need to suppress and channel off excess capacity in the steel and other sectors. Despite this call for reducing steelmaking capacity, another additional 96 million tons of capacity had been brought online by 2012.[18]

Figure 3. Chinese Steelmaking Capacity and Selected Government Actions, 2008-2014



Source: German Steel Federation and World Steel Association. See: Note 6

Broken Promise #4: State Council Guidance on Excess Capacity, October 2013

In October 2013, Beijing once again identified overcapacity in steel as a serious problem and issued new guidance to curb the excess capacity of steel and four other sectors.[19] This guidance instructed the steel industry to effectively absorb the already-existing excess steel by both boosting domestic demand and increasing exports. Despite this call to employ the existing overcapacity, yet another additional 70 million tons of capacity had been brought online by 2014.[20]

Broken Promise #5: Bilateral Negotiations and Further Chinese Government Announcements, 2014-2016

Since 2014, the U.S. has been pressing the Chinese government on overcapacity in bilateral dialogues, and China has been making further pledges to curb it.

First, during the Sixth Meeting of the U.S-China Strategic and Economic Dialogue (S&ED) in 2014, eliminating excess production was identified as a key to fostering an economy in which resource allocation is market-driven. As part of those discussions, China once again pledged to establish "mechanisms that strictly prevent the expansion of crude steelmaking capacity and that are designed to achieve, over the next five years, major progress in addressing excess production capacity in the steel sector.[21]

Second, at the 26th meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT) in 2015, U.S. and Chinese authorities announced that discussions would be held the following year (in 2016) to review what progress has been made in addressing steel overcapacity since the 2014 S&ED agreements.[22]

Third, China's Ministry of Industry and Information Technology (MIIT) announced a new effort to cut capacity and consolidate the Chinese steel industry.[23] And the Chinese Communist Party's State Council – last seen earlier in this paper breaking a 2010 promise to halt approval for any new capacity expansion – announced it would eliminate between 100 million and 150 million tons of annual steel capacity by 2020.[24]

Finally, during the promised JCCT discussions in the fall of 2016, China agreed to the establishment of a Global Forum to address "the challenges of global excess capacity."[25] However, China's representatives to the Forum's most recent meeting in March of 2017, reportedly pushed back against attempts to elicit needed data on the realities of China's steel production and capacity.

Overcapacity in steel is a global problem and a global solution would provide the comprehensive approach that's needed. As the single largest contributor to the overcapacity, China's participation is critical and their commitment and follow through on significant reductions in productive capacity must be the foundation for an acceptable approach. U.S. negotiators have worked hard to create the basis for a global solution but China's continued reluctance to participate in a meaningful way puts U.S. production and employment in continuing jeopardy.

China's government, under pressure from the United States in bilateral negotiations, has repeatedly reaffirmed a pledge to cut excess steelmaking capacity by at least 100-150 million tons by 2020. That deadline is still 3 years away, but already China is showing signs of breaking this promise too. It is halfway through the period of purported reductions that China began promising in 2014, and not only have there been no verifiable reductions in Chinese steelmaking capacity, but both Chinese production and capacity continue to grow. In 2016, China increased its production to 800 million tons[26] and its capacity by 36.5 million tons, in direct contradiction to its pledges.[27]

The Current Situation

Faced with mounting international pressure, Beijing has been doing everything imaginable – issuing plans, writing memoranda and guidance, and making promises in bilateral negotiations – to address its overcapacity in the steelmaking sector for the last ten years. Despite these repeated and empty promises, Chinese overcapacity continues to increase. The American Iron and Steel Institute found in 2014 that global steel production overcapacity was more than 700 million tons.[28] The majority of that amount – 425 million – is specifically Chinese overcapacity.[29]

In assessing the state of the American and the global steel industries, it is important to understand that production and capacity are linked, and that massive overcapacity of the sort that exists today drives overproduction, which in turn unfairly and artificially puts pressure on both American and other foreign steel companies and workers, with increasingly disastrous results. The American steel industry is one of the most efficient in the world, often producing a ton of finished steel in under one man-hour.[30] But even with this world-class performance, plants are closing in the United States as a direct result of this overcapacity and the overproduction that comes with it, at the cost of thousands of American steelmaking jobs.[31]

China's motives in pursuing this buildup of overcapacity are clear and obvious. Chinese officials have long admitted that the nation is not especially well suited to steel production. In fact, in 2009, the Chinese Academy of Sciences reported that China lacks the natural resources and environmental capacity to be the world's steel supplier.[32] Despite these shortcomings, China continues to overbuild its steel industry as a result of being a state-run non-market economy. Beijing has long considered steel a "strategic industry" and fostered national industrial policies designed to help the industry grow - whether the resources, environmental capacity, and market conditions supported that growth or not.[33]

Additionally, China's overcapacity was built and continues to be built with an eye toward social stability rather than long-term market viability.[34] Steel mill jobs and the economic stability they provide to communities have been and continue to be a driving force in keeping unneeded Chinese production online. When the 2008 global recession caused global demand for steel to slow, rather than cutting back on steel production like it promised to in the 2009 SIRP, Beijing poured state capital into the steel industry in hopes of preserving industry employment and, therefore, social stability.

This stability is extremely fragile. Citing fears of instability and a convoluted provincial system of small- and medium-sized steel producers, Beijing has fostered the growth of overcapacity in the Chinese steel sector, breaking promises made to the international community along the way.[35]

Moving Forward

After another year of net increases in its steel output, the Chinese government's most recent pledges to eliminate at least 100-150 million tons of annual steel overcapacity by 2020 are well on their way to being broken. If one thing has been made clear over years and years of broken promises when it comes to the issue of overcapacity, it is that China cannot be trusted to address this problem. And, the American steel industry and its workers cannot afford to wait for actions. A different approach – one that puts consequences in place for broken promises – is necessary.

The Chinese government views its overcapacity as a strategic interest and a driver of domestic social stability. Without consequences of further inaction, it simply will not give up this advantage on its own, no matter how many promises it makes and breaks.

If China will not act on its own, the U.S. government must show leadership and employ a different approach to force China to make meaningful and sustained net steelmaking reductions. It is incumbent on the U.S. government to address the problem if the American steel industry – which is every bit as vital to America's economy as it is to China's – is to survive.

Endnotes

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