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Anti-Dumping Commission  
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## Review 229: Non-market costs

This submission is made on behalf of Capral Ltd, a member of the Australian aluminium extrusions industry, in relation to Review 229 of certain aluminium extrusions exported to Australia from China by Alnan Aluminium Co Ltd (Alnan). We specifically refer to the cost to make aluminium extrusions in China and submit that a number of Alnan's production costs do not reasonably reflect competitive market costs in terms of the requirement of r.180(2)(b)(ii) of the *Customs Regulations 1926* (the Regulations).

## Primary aluminium

In the original aluminium extrusions investigation (investigation 148) Customs determined that, with respect to the cost of primary aluminium, the conditions of r.180(2) had not been fulfilled. Customs found that "the cost of primary aluminium reflected in the records of the exporters do not reasonably reflect competitive market costs" because "distorting influences stemming from the Chinese government's intervention in the domestic aluminium market on the price of primary aluminium ultimately paid by producing exporters of aluminium extrusions were identified".<sup>1</sup>

More recently in the aluminium road wheels investigation (investigation 181) Customs continued to find that the costs incurred by manufacturers in China for aluminium did not reasonably reflect competitive market costs.<sup>2</sup> We submit that Alnan's costs for primary aluminium during the current review period also do not reasonably reflect competitive market costs, on the basis that there is no evidence that the conditions in the Chinese market identified in investigations 148 and 181 have changed.

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<sup>1</sup> REP 148 at 6.1.3, p.31

<sup>2</sup> REP 181, p.37

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During investigation 148 Capral submitted that Customs should only substitute an exporter's actual aluminium cost for the benchmark aluminium cost where the actual cost is lower than the benchmark. Senior Counsel legal opinion supports this approach.<sup>3</sup> At no point during investigation 148 did Customs explain why it is reasonable to determine a cost of production that is likely to be lower than the actual cost of production incurred. It is not clear that such a result is authorised by legislation and it is unlikely that Parliament ever considered this would occur.<sup>4</sup> We therefore submit that it is unreasonable to substitute Alnan's actual aluminium cost for the benchmark aluminium cost where the actual cost is lower than the benchmark.

The benchmark used in investigation 148 was the LME plus actual 'premiums' paid in China. Capral has more recently submitted that this benchmark is flawed, in that it does not represent a cost for primary aluminium in a competitive market.<sup>5</sup> The Commission's response to this submission was only published on 18 December 2013.<sup>6</sup> We are considering the Commission's response and will make a further submission on this issue during this review.

### Land-use fees

The US has countervailed the provision of land-use rights for less than adequate remuneration (LTAR) in most cases against China since 2008, including in relation to aluminium extrusions.<sup>7</sup> In determining an appropriate benchmark as part of its subsidy investigations, the US has found that the purchase of land-use rights in China is not conducted in accordance with market principles due to the overwhelming presence of government involvement in the land-use rights market and the widespread and documented deviation from the authorised methods of pricing and allocating land.<sup>8</sup>

The US conducted an in-depth study of the Chinese land sector, including verification meetings with relevant government of China (GOC) officials at central and local levels, and a review of reports from other organisations on the subject.<sup>9</sup> The US found a wide divergence between China's land laws, regulations and statements, which purport to provide an open, transparent system for transferring commercial land-use rights, and the operation of the market in practice.<sup>10</sup> In aluminium extrusions and subsequent investigations the GOC has not submitted any evidence to the US to call this finding into question.<sup>11</sup>

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<sup>3</sup> Stephen Lloyd, pp.7-11

<sup>4</sup> *ibid.*

<sup>5</sup> *Capral Submission*, pp.1-3 at 'Primary aluminium'

<sup>6</sup> *REP 214*, p.17 at 4.2.2

<sup>7</sup> *Laminated woven sacks (US)* at VI.A.1; *Aluminium extrusions (US – CVD)* at VII.T & VII.U

<sup>8</sup> *Laminated woven sacks (US)* at VI.A.1, p.16

<sup>9</sup> *Photovoltaic cells (US)* at Comment 11, p.42

<sup>10</sup> *ibid.*

<sup>11</sup> *Aluminium extrusions (US – CVD)* at VII.T; *Photovoltaic cells (US)* at Comment 11, pp.42-43

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The EU has also recently found that there is no functioning market for land in China.<sup>12</sup> The EU found that the supposed system of bidding, auction and competition for land-use rights does not work in practice, and that land provision and acquisition in China is unclear and non-transparent and the prices are often arbitrarily set by the authorities.<sup>13</sup>

This evidence clearly supports a finding that the cost of land-use rights in China does not meet the conditions of r.180(2). Both the US and EU have found that no market-determined prices exist in China, therefore any cost for land-use rights incurred by Alnan would not reasonably reflect a competitive market cost.

### Benchmark – land

The finding that no market-determined prices for land-use rights exist in China precludes the use of an in-country benchmark.<sup>14</sup> The long-standing practice in the US is to base benchmark prices for land-use rights on rental rates and rates paid for land purchased in industrial parks outside Bangkok.<sup>15</sup> Thailand was chosen as a suitable surrogate country because:

- China and Thailand have similar levels of per capita gross national income
- population density in China and Thailand are roughly comparable, and
- producers consider Thailand as an option for diversifying production bases in Asia beyond China.

We submit that the Commission adopt the methodology applied by the US to calculate appropriate benchmark prices for land use rights in China.

### Depreciation on buildings

Construction costs in China are one of the lowest in the world. An independent study in 2013 found that the cost to build a basic factory in China is the third lowest of the 23 countries surveyed, behind only South Africa and Uganda.<sup>16</sup> The industry in China is dominated by the GOC with most construction activity undertaken by state-owned enterprises, of which there are as many as 9,000.<sup>17</sup>

In addition to its role in the construction industry itself, the GOC also controls production of construction materials, which account for around 60% of construction costs.<sup>18</sup> The major materials used in factory construction are steel and cement. Relevant photographs on Alnan's website appear to show Alnan's aluminium extrusions and processing plants are predominantly made of

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<sup>12</sup> *Coated steel (EU)* at 3.3.1.2, p.32 at (118)

<sup>13</sup> *ibid.* at (113)-(116)

<sup>14</sup> *Laminated woven sacks (US)* at VI.A.1, pp.15-17; *Coated steel (EU)* at 3.3.1.2(f), p.33 at (120)

<sup>15</sup> *Photovoltaic cells (US)* at II.E, p.6 & Comment 11, p.43

<sup>16</sup> *ICC survey*, Comparison of key costs

<sup>17</sup> *China Analyst*

<sup>18</sup> *Ahmad & Yan* at 3.11

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concrete with some structural steel.<sup>19</sup> Both of these materials are heavily subsidised in China.

Australia has recently found the markets for numerous steel products, including structural steel sections, to be influenced by the GOC. In 2012 Customs found that the GOC materially distorted competitive conditions within the Chinese iron and steel industry such that prices of structural steel sections were likely to be artificially low.<sup>20</sup>

The cement industry in China is also distorted by GOC influence. The GOC, through the National Development and Reform Commission (NDRC), has:

- imposed strict controls on new capacity
- controlled mergers and acquisitions
- eliminated out-dated capacity, and
- fast-tracked industry upgrades.<sup>21</sup>

Overcapacity in the cement industry has been driven largely by GOC subsidies at the local level. Earlier this year China's Vice Minister of Industry described 'administrative interference' by local governments encouraging capacity expansions through subsidies, access to credit and favourable contracts.<sup>22</sup>

Further evidence of GOC interference in the cement industry includes that:

- in 2012, of 182 'obsolete' companies closed down due to backward production capacity, 29% were from the cement industry<sup>23</sup>
- the GOC aims to increase the market share of the top ten cement manufacturers from 26% to over 35% by 2015 through inter-provincial acquisitions,<sup>24</sup> and
- some provinces have imposed price caps on cement.<sup>25</sup>

This evidence clearly supports a finding that construction costs in China are distorted by GOC influence. The GOC plays a major role in the construction industry directly, and influences prices of the two major construction materials—steel and cement. As a result the cost of buildings recorded in the accounts of Chinese manufacturers, including Alnan, and the depreciation costs thereon, do not meet the conditions of r.180(2).

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<sup>19</sup> *Alnan website*, 'Technic equipment' pages

<sup>20</sup> *REP 177*, p.166

<sup>21</sup> *Global Cement; BOCI Equity Research*, p.16; *Directory Catalogue* items I.(X)1, I.(X)12-15, II.(IX)4, III.(VIII)3 and III.(VIII)8-10

<sup>22</sup> *IB Times*

<sup>23</sup> *Morning Whistle*

<sup>24</sup> *Forward BI*

<sup>25</sup> *BOCI Equity Research*, pp.40 & 55

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### Benchmark – buildings

In its countervailing investigation of aluminium extrusions the US used Thailand as a surrogate country for benchmark land prices as outlined earlier. We submit that data from Thailand would similarly provide a suitable benchmark for building depreciation costs in this review.

### Interest on loans

The US has countervailed preferential lending or ‘policy loans’ in nearly all subsidy cases against China since 2007, including in relation to aluminium extrusions.<sup>26</sup> In determining an appropriate benchmark as part of its subsidy investigations, the US has found that no fully market-determined rates exist in China due to the continued significant intervention of state-owned banks in China's banking sector.<sup>27</sup>

The US conducted an extensive study into the GOC's role in commercial bank lending, including verification meetings with GOC banking and regulatory officials and a review of material from the OECD and other organisations.<sup>28</sup> The US has found that China's banking sector does not operate on a commercial basis and is subject to significant distortions, primarily arising out of the GOC's continued dominant role in the sector, including through:

- predominant state ownership of banks
- limiting foreign ownership of state-owned commercial banks to 25%, and
- simultaneously setting a deposit rate cap and lending rate floor.<sup>29</sup>

The EU has also recently found that the Chinese financial market is characterised by GOC intervention, highlighting the Chinese central bank's role in setting specific limits on the way interest rates are set and fluctuate.<sup>30</sup>

This evidence clearly supports a finding that interest paid on loans in China does not meet the conditions of r.180(2), however we understand that Alnan's borrowing costs, including interest on loans, may be determined in accordance with r.181 as an administrative, selling or general cost. We note that r.181(2)(b)(ii) does not refer to competitive market costs, however it does require Alnan's records to reasonably reflect the administrative, general and selling costs associated with the sale of aluminium extrusions in China. We submit that GOC distortion of the banking sector renders all borrowing activity in China to be unreasonable by global standards. Both the US and EU have found that no market-determined interest rates exist in China, therefore any interest

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<sup>26</sup> *Coated paper (US)* at I.A; *Aluminium extrusions (US – CVD)* at VII.G

<sup>27</sup> *Coated paper (US)* at Comment 10, pp.67-72; *Wind towers (US)* at Comment 5, p.38

<sup>28</sup> *Wind towers (US)* at Comment 5, p.38

<sup>29</sup> *Coated paper (US)* at Comment 10, pp.67-68

<sup>30</sup> *Coated steel (EU)* at 3.3.2(c), pp.38-39 at (165)-(169)

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costs incurred by Alnan do not *reasonably* reflect costs associated with the sale of aluminium extrusions.

### Benchmark – loans

The finding that no market-determined interest rates exist in China precludes the use of an in-country benchmark.<sup>31</sup> The long-standing practice in the US is to base benchmark interest rates on data from the International Monetary Fund (IMF), World Bank and other publicly available sources. Rates are calculated from IMF interest rates (or LIBOR and corporate BB bond rates for foreign currency denominated loans) for countries in similar World Bank economy groupings to China, with an adjustment for 'governance indicators' and a further adjustment applicable to long-term loans.<sup>32</sup>

The benchmark interest rates calculated by the US and EU also include an upward adjustment to reflect normal market risk and the unreliability of the creditworthiness of Chinese exporters.<sup>33</sup>

We submit that the Commission adopt the methodology applied by the US, including an upward credit risk adjustment, to calculate appropriate benchmark interest rates for short-term, long-term and foreign currency loans in China.

### Other fixed production costs

Earlier this year two experts on the Chinese economy published a book on GOC subsidies that discusses the economic rationale for subsidies to Chinese industry and highlights subsidies to key sectors.<sup>34</sup> They have found that cheap loans from state-controlled banks and other subsidies have contributed to an extraordinary rise in fixed-asset investments that has led to excess capacity in key industries including aluminium. China has exported its excess production, depressing international prices and driving down global industrial efficiencies.<sup>35</sup>

The authors also find that subsidies have inhibited the consolidation of manufacturing and reduction of excess capacity in China that normally would result from efforts to increase competitiveness in global markets. As a result, many Chinese manufacturers are actually economically inefficient in relation to their overseas competitors.<sup>36</sup>

It is clear that Chinese manufacturers operating in sectors heavily influenced by GOC policies and subsidies would not exist in the same form in a truly competitive market. We have previously submitted in this review that the

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<sup>31</sup> *Coated paper (US)* at Comment 10, p.70

<sup>32</sup> *Frozen shrimp (US)* at IV.E, pp.7-10

<sup>33</sup> *Photovoltaic cells (US)* at VI.A.2, p.12 & Comment 17, pp.55-58; *Coated steel (EU)* at 3.3.2(h), p.42 at (191)

<sup>34</sup> *Hayley & Hayley*

<sup>35</sup> *ibid.*, pp.26-27

<sup>36</sup> *ibid.*, pp.179-180

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market for aluminium extrusions in China is distorted by the GOC to such an extent as to render domestic selling prices of extrusions unsuitable for establishing normal value.<sup>37</sup> We have also submitted that Alnan has received significant subsidies in the form of cheap loans to fund its business.<sup>38</sup>

We submit that the same government distortions and subsidised capital have allowed manufacturers of aluminium extrusions, including Alnan, to become established and grow their business in a way that would not have occurred in the absence of GOC influence and subsidies. The economies of scale provided by these distortions have rendered fixed production costs lower than what they would otherwise have been in a competitive market. We therefore submit that all of Alnan's fixed costs of production do not meet the conditions of r.180(2).

### Benchmark – other costs

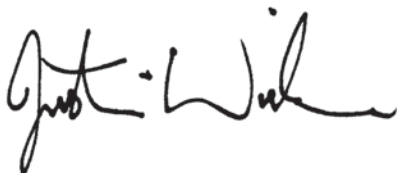
In its anti-dumping investigation of aluminium extrusions the US used India as a surrogate country for benchmark prices because:

- it is a significant producer of aluminium extrusions
- it is at a level of economic development comparable to that of China, and
- the US had reliable data from India that it could use to value the factors of production.<sup>39</sup>

We submit that data from India would similarly provide a suitable benchmark for fixed production costs in this review.

### Conclusion

There is strong evidence that certain costs incurred by Chinese producers of aluminium extrusions, including Alnan, do not reasonably reflect competitive market costs and therefore do not meet the conditions of r.180(2) of the Customs Regulations. As such it is appropriate for the Commission to substitute benchmark costs from surrogate countries. We submit that the Commission investigate the cost issues identified above as part of Review 229 and we look forward to participating further in the review.



Justin Wickes  
Director

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<sup>37</sup> Capral submission dated 20 November 2013, item no. 004 on EPR 229

<sup>38</sup> Capral submission dated 28 November 2013, item no. 005 on EPR 229

<sup>39</sup> *Aluminium extrusions (US – AD)*, p.18526

List of evidence

Short title	Full title and document location
<i>Ahmad &amp; Yan</i>	Daud Ahmad & Zong Yan, 'An overview of the construction industry in China', World Bank Resident Mission in China <a href="http://cibworld.xs4all.nl/dl/ib/9701/pages/31.htm">http://cibworld.xs4all.nl/dl/ib/9701/pages/31.htm</a>
<i>Alnan website</i>	'Technic equipment' pages <a href="http://www.alnan.com/en/product/jishu4.asp?jt">http://www.alnan.com/en/product/jishu4.asp?jt</a> 4 <a href="http://www.alnan.com/en/product/jishu5.asp?jt">http://www.alnan.com/en/product/jishu5.asp?jt</a> 5
<i>Aluminium extrusions (US - AD)</i>	Aluminium extrusions from the People's Republic of China: Final determination of sales at less than fair value, 76 FR 18524, 4 April 2011 <a href="http://enforcement.trade.gov/frn/summary/prc/2011-7927.txt">http://enforcement.trade.gov/frn/summary/prc/2011-7927.txt</a>
<i>Aluminium extrusions (US - CVD)</i>	Aluminium extrusions from the People's Republic of China: Issues and decision memorandum for the final determination in the countervailing duty investigation, 28 March 2011 <a href="http://enforcement.trade.gov/frn/summary/prc/2011-7926-1.pdf">http://enforcement.trade.gov/frn/summary/prc/2011-7926-1.pdf</a>
<i>BOCI Equity Research</i>	'China cement sector: Cementing growth over the twelfth five-year period', Bank of China International (BOCI) Equity Research, 25 May 2011 <a href="http://www.bocigroup.com/pub/sc/vision/yjbg/201105/P020110526414041955721.pdf">http://www.bocigroup.com/pub/sc/vision/yjbg/201105/P020110526414041955721.pdf</a>
<i>Capral submission</i>	Capral submission to Review 214, 12 August 2013 <a href="http://www.adcommission.gov.au/cases/documents/005-Submission-AustralianIndustry-CapralLimited.pdf">http://www.adcommission.gov.au/cases/documents/005-Submission-AustralianIndustry-CapralLimited.pdf</a>
<i>China Analyst</i>	'China's construction industry: Strategic options for foreign players', The China Analyst, March 2011 <a href="http://www.thebeijingaxis.com/tca/editions/the-china-analyst-mar-2011/2">http://www.thebeijingaxis.com/tca/editions/the-china-analyst-mar-2011/2</a>
<i>Coated paper (US)</i>	Coated free sheet paper from the People's Republic of China: Issues and decision memorandum for the final determination in the countervailing duty investigation, 17 October 2007 <a href="http://enforcement.trade.gov/frn/summary/prc/E7-21046-1.pdf">http://enforcement.trade.gov/frn/summary/prc/E7-21046-1.pdf</a>
<i>Coated steel (EU)</i>	Certain organic coated steel products originating in the People's Republic of China: Council Implementing Regulation (EU) No 215/2013 imposing a countervailing duty, 11 March 2013 <a href="http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:073:0016:0097:EN:PDF">http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:073:0016:0097:EN:PDF</a>
<i>Directory Catalogue</i>	Directory Catalogue on Readjustment of Industrial Structure, Chinese National Development and Reform Commission, 2 December 2005 (Attachment 42 to the GOC's response to the government questionnaire in Investigation 181 – the GOC did not provide a full translation of the 2011 Directory Catalogue) <a href="http://www.adcommission.gov.au/cases/documents/083-submission-GovernmentofChina.pdf">http://www.adcommission.gov.au/cases/documents/083-submission-GovernmentofChina.pdf</a>
<i>Forward BI</i>	'China cement industry production and marketing demand and investment strategy report 2012-2016', Forward Business Intelligence Co. Ltd, Preface <a href="http://en.qianzhan.com/report/detail/2db6c053d33541e7.html">http://en.qianzhan.com/report/detail/2db6c053d33541e7.html</a>

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<i>Frozen shrimp (US)</i>	Certain frozen warmwater shrimp from the People's Republic of China: Issues and decision memorandum for the final determination in the countervailing duty investigation, 12 August 2013 <a href="http://enforcement.trade.gov/frn/summary/prc/2013-20170-1.pdf">http://enforcement.trade.gov/frn/summary/prc/2013-20170-1.pdf</a>
<i>Global Cement</i>	'Same old story: cement overcapacity in China', Global Cement, 7 November 2012 <a href="http://www.globalcement.com/news/item/1246-same-old-story-cement-overcapacity-in-china">http://www.globalcement.com/news/item/1246-same-old-story-cement-overcapacity-in-china</a>
<i>Hayley &amp; Hayley</i>	Usha C.V. Hayley & George T. Hayley, <i>Subsidies to Chinese Industry: State Capitalism, Business Strategy and Trade Policy</i> , Oxford University Press, 2013 (relevant extracts at Attachment A)
<i>IB Times</i>	'China's overcapacity: new projects banned in steel, cement and aluminum', International Business Times, 15 October 2013 <a href="http://www.ibtimes.com/chinas-overcapacity-new-projects-banned-steel-cement-aluminum-1426084">http://www.ibtimes.com/chinas-overcapacity-new-projects-banned-steel-cement-aluminum-1426084</a>
<i>ICC survey</i>	'A brighter outlook: International construction cost survey 2013', Turner & Townsend, 2013 <a href="http://www.turnerandtowntsend.com/ICC-2013/21145.html">http://www.turnerandtowntsend.com/ICC-2013/21145.html</a> (Comparison of key costs at Attachment B)
<i>Laminated woven sacks (US)</i>	Laminated woven sacks from the People's Republic of China: Issues and decision memorandum for the final determination in the countervailing duty investigation, 16 June 2008 <a href="http://enforcement.trade.gov/frn/summary/prc/E8-14256-1.pdf">http://enforcement.trade.gov/frn/summary/prc/E8-14256-1.pdf</a>
<i>Morning Whistle</i>	'Cement industry: most obsolete, massive over-capacity, rocketing on stock market', morningwhistle.com, 7 September 2012 (Attachment C)
<i>Photovoltaic cells (US)</i>	Crystalline silicon photovoltaic cells, whether or not assembled into modules, from the People's Republic of China: Issues and decision memorandum for the final determination in the countervailing duty investigation, 9 October 2012 <a href="http://enforcement.trade.gov/frn/summary/prc/2012-25564-1.pdf">http://enforcement.trade.gov/frn/summary/prc/2012-25564-1.pdf</a>
<i>REP 148</i>	Report to the Minister No.148: Certain aluminium extrusions exported to Australia from the People's Republic of China, 15 April 2010 <a href="http://www.adcommission.gov.au/notices-reports/final/documents/MicrosoftWord-Report148_Final_withnotices-published.pdf">http://www.adcommission.gov.au/notices-reports/final/documents/MicrosoftWord-Report148_Final_withnotices-published.pdf</a>
<i>REP 177</i>	Report to the Minister No.177: Certain hollow structural sections exported to Australia from the People's Republic of China, the Republic of Korea, Malaysia, Taiwan and the Kingdom of Thailand, 7 June 2012 <a href="http://www.adcommission.gov.au/notices-reports/final/documents/REP177-FINAL.pdf">http://www.adcommission.gov.au/notices-reports/final/documents/REP177-FINAL.pdf</a>
<i>REP 181</i>	Report to the Minister No.181: Aluminium road wheels exported to Australia from the People's Republic of China, 12 June 2012 <a href="http://www.adcommission.gov.au/notices-reports/final/documents/ARWFinalReport181PUBLICFILE.pdf">http://www.adcommission.gov.au/notices-reports/final/documents/ARWFinalReport181PUBLICFILE.pdf</a>
<i>Stephen Lloyd</i>	Stephen Lloyd SC, Legal opinion in the matter of the dumping investigation into certain aluminium extrusions exported from China, 19 April 2011 <a href="http://www.adcommission.gov.au/cases/documents/35CapralSubmission-Attachment01-StephenLloydAdviceonSEF148A.pdf">http://www.adcommission.gov.au/cases/documents/35CapralSubmission-Attachment01-StephenLloydAdviceonSEF148A.pdf</a>

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<i>Wind towers (US)</i>	Utility scale wind towers from the People's Republic of China: Issues and decision memorandum for the final determination in the countervailing duty investigation, 17 December 2012 <a href="http://enforcement.trade.gov/frn/summary/prc/2012-30947-1.pdf">http://enforcement.trade.gov/frn/summary/prc/2012-30947-1.pdf</a>

70 percent of urban jobs in China (*China Daily*, January 20, 2009). In 2010, many SOEs with subsidized balance sheets were buying smaller private-sector competitors and extending the reach of the state.

In the hierarchy of SOEs, pillar or key industries serve as China's national champions, with access to priority funding, including subsidies. China chooses pillar industries on the following criteria (G. T. Haley, 2009): (1) defense, (2) job creation, (3) technology acquisition, and (4) competitive advantage. Several industries fall under more than one criterion. Fifteen industries constitute pillar industries for China, as promulgated in China's Tenth and Eleventh Five-Year Plans: (1) aerospace, (2) autos and auto parts, (3) banking and insurance, (4) biotechnology, (5) computer chip design and manufacture, (6) computing and computer hardware, (7) information technology, (8) iron and steel, (9) logistics, shipping, and storage, (10) machinery and mechanical equipment, (11) oil and petrochemicals, (12) software, (13) telecommunications and telecom equipment, (14) utilities and power equipment, and (15) wholesaling and retailing. Individual provinces also have their own SASACs and may anoint their own pillar industries for provincial development from the central list; as indicated in the previous section, the provinces often support their local champions from extrabudgetary sources of revenue that they do not share or divulge to the central government. Consequently, many firms in pillar industries receive subsidies from both central and provincial sources.

In October 2010, the CPC Central Committee's Proposal for Formulating the Twelfth Five-Year Program for China's Economic and Social Development (2011–2015), stated that over the next five years, Beijing planned to nurture an additional seven new strategic industries and to develop these into pillar industries. The industries included (1) new-generation information technology, (2) energy-saving and environment protection, (3) new energy, (4) biology, (5) high-end equipment manufacturing, (6) new materials, and (7) new-energy cars. The proposal indicated that to develop these industries, Beijing would increase available R&D funds; implement fiscal, tax, and financial policies to support major state-level science and technology projects; promote indigenous innovation to improve industry core competitiveness and economic efficiency; and "adjust" tax and pricing systems for land, water, and electricity so that their share of GDP would rise from less than 2 percent in 2011 to 8 percent in 2015.

Cheap loans from state-controlled banks and other subsidies have contributed not just to the extraordinary rise in fixed-asset investments outlined in table 1.4, but also to enormous excess capacity in China. From 2003 to 2008, the overall ratio of China's gross industrial output almost doubled to 160 percent of GDP, while the relative size of heavy industrial

production in the economy nearly tripled (Komesaroff 2009). As has become apparent in solar-panel production, China exported its excess production, depressing international prices and driving down global industrial efficiencies (Haley and Haley 2012). National Bureau of Statistics data show that in 2009, China's steel industry, already the world's largest, had the capacity to produce 660 million tons per year, with excess capacity of 22 percent; yet another 70 million tons of capacity was under construction. True excess capacity in this industry appears even higher, as recent central government audits have identified many small, unapproved mills with a combined capacity of 30 million tons. Thus by the end of 2010, China likely had steel capacity of around 760 million tons—far in excess of annual steel demand, which is now running at about 574 million tons. China's surplus capacity of almost 200 million tons looms larger than total output from Japan, the world's second-largest producer (Komesaroff 2009). Similarly, China is the world's largest producer of polysilicon for solar panels, but has excess capacity of over 80 percent in this industry. As the industrial case studies in this book highlight, overcapacity extends across the board in China. Besides steel, polysilicon, and solar panels, China is also the world's largest producer of aluminum, autos, cement, plate glass, coal, chemicals, wind power equipment, ships, crushed soybeans, and fertilizer; according to the State Council, all these industries also suffer from great overcapacity (Komesaroff 2009).

Researchers have isolated underpriced distorted factor inputs, predominantly cheap capital that subsidizes production and investment, as a primary cause for China's extraordinary growth and excess capacity (Huang and Wang 2010). Excess capacity in Chinese heavy industry has contributed to global economic imbalances. Heavy industrial exports accounted for 39 percent of China's total exports in 2008, up from 29 percent in 2002. As a European Chamber (2009) report described, China's growth model requires that external demand from the European Union (EU) and the United States continue to absorb the overcapacity it produces. Despite the impact of the financial crisis on these major global consumers, investments in excess capacity continue unabated in China.

Theories of subsidies drawing on international trade and international law fail to explain fully the modern economic rise of China. Developed in times when state capitalism did not constitute a major player in the global economy, they provide skeletal, sometimes misleading guidance on corporate or governmental policies. During the thirteenth century, professors at the University of Paris decided to investigate if oil would congeal if left out overnight. For them, research meant searching through Aristotle's writings. However, as Aristotle had never addressed the issue,

foreigners. However, Chinese producers' low costs stemming from extensive, systemic government subsidies will continue, contributing substantially to their competitiveness in global markets.

The extent of Chinese industrial subsidies, the political processes that underlie their disbursement, and the meshing of Chinese production into global supply chains also augur a period of heightened uncertainty as well as international booms and busts. In August 2012, the *New York Times* (Bradsher 2012) reported on some of the effects of these subsidies on Chinese industries and the intertwined, global economy. Unsold goods were piling up in China at the fastest rate since surveys of inventories began in April 2004. The glut of products, which included steel, glass, paper, autos, and solar panels, had produced price wars and led manufacturers to redouble efforts to export what they could not sell domestically. As we have highlighted in previous chapters, the overcapacity that stems from government subsidies appears a primary source of these developments. In the auto industry, manufacturers refused to cut production and were pressuring financially struggling dealers to accept delivery of cars under their franchise agreements. The Chinese government responded by blocking or adjusting economic data so the severity of inventory overhang would not affect investors' confidence. China's Public Security Bureau, for example, halted the release of data on falling demand in autos reflected in new-car registrations. In 2012, the government also repeatedly revised data on the steel industry after a new method showed a steeper downturn than the government had acknowledged. Similarly, the government had not released information about the number of empty apartments (which affected new construction and therefore glass demand) since 2008. Enormous and unpredictable amounts of steel, glass, and paper on the global market, and the commoditization of products such as cars, appear inevitable. The price for solar PV cells fell 66 percent from mid-2010 to the mid-2012, mostly because of Chinese overproduction and worldwide glut. In the United States over 13 firms went bankrupt (Haley and Haley 2012b). The impact has extended to Germany, Australia, India, and China. Jigar Shah, who put together CASE, said all major Chinese solar companies expected economic difficulties because of overproduction. "Everything's crashing right now. The Chinese are maybe overplaying their hand" (Kilzer 2012).

The subsidies provided by the central, provincial, and local governments have inhibited the consolidation of manufacturing facilities and the reduction of excess capacity that normally would result from Chinese firms' efforts at lowering costs to increase competitiveness in global markets. The provision of lower costs through subsidies has removed

firms' incentives to lower costs through economically sound actions that result in achieving economies of scale and in shedding excess production capacity. Thus, many Chinese firms are economically inefficient in relation to their non-Chinese competitors, but Chinese subsidies overcome those inefficiencies and make those firms globally competitive (see Doom 2012).

When the central government removes subsidies—for whatever reason—the provincial and local governments fill in the gaps. We have attempted to discuss some of the political dynamics of state capitalism in chapter 1. The provincial and local governments want to support employment, promote import substitution, and build self-sufficiency locally through the use of subsidies, just as the central government wanted to do nationally when initially providing subsidies. While China's central government now wants to position certain domestic firms as price makers, rather than price takers, by moving them up the value chain, local governments do not want to bear the restructuring costs that these efforts entail. The central government may remove a subsidy or subsidies because of trading partners' pressures. However, provincial and local governments replace them, resulting in pursuit of the same objectives by the same means, although in each instance with narrower, geographic focus. This might explain the apparently high tolerance of inconsistent policies between the levels of government in China. The central government can point to national compliance with international trade agreements, with knowledge that much of what it really wants to happen will occur at provincial and local governmental levels.

Government officials from national and regional trading blocs should understand Chinese subsidies' extensive contributions to Chinese firms' global competitiveness, the difficulties of obtaining reliable data on these subsidies, and the frequent replacement by the provincial and local governments of subsidies removed by the central government. Recognition and understanding of these realities about Chinese subsidies should result in national and regional blocs' government officials expending greater effort to identify and to measure them, in setting a very high priority on addressing them, and in including provincial and local governments' policies as well as the central government's policies in trade negotiations with China.

#### **For Researchers**

Future research could incorporate some dynamism into our understanding of both governments' and firms' strategic behaviors. Brander (1995)

## International construction cost comparison

Source: International construction cost survey 2013, Turner & Townsend

Rank	Country	Factory (USD/m2)	Labour (USD/hr)	Concrete (USD/m3)	Steel (USD/tonne)
1	Uganda	350	1	244	2,931
2	South Africa	408	3	136	2,159
3	China	421	2	70	1,403
4	Vietnam	436	6	57	1,028
5	Poland	473	7	85	1,262
6	India	507	1	95	966
7	Malaysia	585	3	73	926
8	Brazil	667	13	110	2,193
9	Ireland	671	29	99	1,644
10	Australia	700	35	205	1,409
11	Russia	810	15	145	1,250
12	Germany	816	37	142	2,368
13	South Korea	832	11	73	1,056
14	US	880	54	125	2,052
15	Canada	883	44	162	2,136
16	Qatar	951	4	79	1,738
17	Oman	1,158	4	70	1,550
18	Netherlands	1,171	30	125	1,759
19	UAE	1,188	4	70	1,536
20	UK	1,292	25	131	2,406
21	Japan	1,578	17	122	817
22	Singapore	1,732	12	85	1,732
23	Hong Kong	1,742	10	84	1,548
	<b>Average</b>	<b>880</b>	<b>16</b>	<b>112</b>	<b>1,646</b>

### Notes

Factory	Industrial: warehouse/factory unit - basic
Labour	General labourer
Concrete	30 Mpa concrete based on a 1,500 m3 job
Steel	Structural steel beams based on a 100 tonne + job

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## Cement industry: most obsolete, massive over-capacity, rocketing on stock market

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Ministry of Industry and Information Technology released on Sept 6 the second list of the obsolete companies of backward productivity in industrial sector in 2012. There are 182 companies in 16 industries on this list, much less than those on the first list (2,358 companies in 19 industries) published earlier this year.

According to this announcement, obsolete companies on the second list will all be closed down by the end of September and be eventually removed out by the end of 2012. It is forbidden to transfer to other regions and neighboring countries.

Among the 16 industries, cement industry performs the worst, to which 53 obsolete companies belong. In fact, on the earlier first list, the number of obsolete companies in this sector has reached high to 1053.

It's not a surprise. In fact, massive excess capacity has become a serious problem that restricts the development of cement industry. In the earlier time, a lot of insiders have appealed for the elimination of backward production equipment in this industry.

Data shows that the overall revenue of cement manufacturing industry reached 22.28 billion yuan in the first of 2012, with a year-on-year growth of 51.4%; cement inventory of key building materials enterprises arrives at 19.7 million tons, increasing by 15.1% year-on-year.

However, cement stocks increased dramatically by 9% today (Sept 7) in the stocks of both Shanghai and Shenzheng and 15 out of total 25 cement stocks climbed by daily limit.

Another main industry suffering with serious over-capacity is metallurgical industry. Obsolete production capacity of iron is 0.3 million tons, of steel 1.11 million tons, of coke 2.25 million tons, and of ferroalloy of 187,600 tons.

[cement industry](#) , [obsolete companies](#) , [over-capacity](#)

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