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Ministry of Commerce  
Government of the People's Republic of  
China

Investigation concerning hollow structural  
sections from China and other countries

Submission concerning Chinese domestic  
HRC costs and comparisons with other  
markets

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## A Introduction

A letter from John O'Connor and Associates Pty Ltd to Australian Customs and Border Protection Service ("Australian Customs") on behalf of Onesteel Australian Tube Mills Pty Ltd ("the Applicant") dated 28 November 2011 has been placed on the public file maintained for the purposes of this investigation ("the Applicant's letter").

Specifically, the Government of China ("GOC") wishes to address comments made at point 3.2 of the Applicant's letter which relate to HRC prices in China.

The Applicant, at point 3.2 of its letter, intends to establish that *"available evidence supports the allegation... that Chinese HSS manufacturers are benefitting from artificially low HRC prices"*. This is based on the proposition that domestic costs of HRC in China are less than domestic costs of HRC in Japan. The Applicant's intention is to convince Australian Customs that a surrogate HRC cost - derived from domestic sale prices in Japan - should be included into Chinese exporter's constructed normal values. The Applicant's letter asserts that Japanese HRC prices both prove the "artificiality" which is alleged, and are the only non-artificially low prices that can be so included.

In aid of the allegation that Chinese HRC prices are *"artificially low"*, the Applicant makes these claims:

- that a graph provided to Australian Customs to establish similarities between prices includes a 17% VAT in the case of the graphed Chinese prices, and that the 17% VAT must be removed to undertake a proper comparison;
- that south east Asian HRC prices are influenced by HRC producers selling excess production into the region at less than full cost recovery prices; and
- that Chinese HRC pricing cannot be compared with:
  - India's HRC prices, because they are *"influenced by export taxes, high import duties and anti-dumping measures"*;
  - Middle East prices, because they are *"regional prices... reflect[ing] prices that do not reflect full cost recovery"*;
  - Korean prices, because they *"also reflect[ ] excess production for sale at reduced*

prices”.

With all due respect, the Applicant's claims do not make sense, either factually or legally.<sup>1</sup> In that regard, the GOC requests that Australian Customs give its careful consideration to the following submissions.

## **B Surrogacy and benchmarks – the legal tests**

The first issue the GOC would like to address is the question of the relevance of HRC cost comparisons between those in the Chinese market and those in other country markets.

The Applicant openly uses the word “surrogate” in its claim that Australian Customs should use Japanese HRC prices in the normal values for Chinese HSS. No doubt the Applicant recalls the times in the past when investigating authorities practiced untrammelled discrimination against China - when “surrogacy” was the trade weapon of choice for the protection of domestic industries against Chinese exports - and hopes those times will return.

However, Australia stopped making non-market economy findings against China in the early 90s. China is a fully participative member of the World Trade Organization. Australian law excludes China from the operation of any non-market or economy-in-transition laws. Australia, through the Department of Foreign Affairs, has accepted China's full market economy status. In that acceptance Australia has agreed not to apply Article 15 of China's *Protocol on Accession to the WTO* against Chinese exporters. These developments over the last 18 years are reflective of a high level of awareness on the part of successive Australian Governments of the emergence of a modern Chinese economy which operates under market conditions and is regulated by the rule of law.

In the case of Australia's attitude towards China, that awareness has been coupled with a high degree of honesty and respect, qualities which are lacking in the way in which some other

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<sup>1</sup> For example, why is it that reduced prices to clear excess production are not able to be considered as competitive market costs? Such a phenomenon would seem to be a clear example of the operation of a competitive market, and would need to be taken into account if the market for which the comparison was being undertaken had a similar condition.

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countries continue to discriminate unfairly against China and its exporters. The Applicant asserts that findings made by other investigating authorities in other jurisdictions should be replicated here. The GOC rejects such findings and calls upon Australian Customs to maintain the qualities of honesty and respect which have typified the trade relationship between the two countries in its evaluation of the facts of this case and the application of the law to those facts.

#### **1 Dumping – the Regulation 180(2)(b)(ii) test**

Paraphrased, this Regulation provides that Australian Customs must use the costs of HRC as recorded in the financial accounts of Chinese HSS producers for working out the normal value of the HSS produced by them if the accounts reasonably reflect competitive market costs associated with the production or manufacture of like goods.

The first observation that the GOC makes about this Regulation is that it is either an improper implementation of the Anti-Dumping Agreement (ie an “as such” non-compliance), or could lead to an improper application of the ADA Agreement in any given case (ie an “as applied” non-compliance). Article 2.2.1.1 of the ADA Agreement provides that a producer’s records must be used for normal value purposes provided they reasonably reflect the costs associated with the production and sale of the product under consideration. On one view the addition of the words “*competitive market*” in Regulation 180 – which are words which do not appear in the Article - add nothing, in that the concept of “cost” in a market system assumes formation of the cost concerned by the forces of competition.

However Regulation 180 goes further than that. It changes the words “*reasonably reflect the costs*” as appearing in the Article to the words “*reasonably reflect competitive market costs*”. In other words, in Regulation 180 it is not the costs of the producer concerned that its records must reasonably reflect. Instead, under the claimed Australian implementation it is competitive market costs that must be reflected. The focus of the Regulation is not on the cost of the input purchased by the producer. The focus of the Regulation could be said to be on other costs: namely, “*competitive market costs*”.

If the addition of the words “*competitive market*” as adjectives describing the “costs” is seen to be some justification for picking and choosing between the costs of different countries, on the basis that one or other cost is thought to be more or less competitive, or more or less reasonably competitive, than another, then that would be an improper use of the Article and

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would result in non-compliance with the ADA Agreement. The Article says nothing about reasonably competitive market costs. It says that the records of a producer must be used for normal value purposes if they reasonably reflect the costs of production of the product under investigation. The GOC submits that if a Chinese HSS producer buys HRC in the Chinese domestic market, and records that cost in its accounts, then there is no opportunity for that cost to be rejected in normal value calculation. There is no ability to reject that cost, other than where it is not a cost at all, or where it has not been properly recorded such that the records of the producer do not reasonably reflect it.

Accepting, only for the purposes of argument, that Regulation 180 does require an assessment of "competitive market costs" in the broad, the GOC submits that if it is established that the market in which the producer purchased the input concerned is a competitive one, then the accurate recording of the cost of that input in the producer's record precludes any other examination of it.

The Applicant does not advance its case that Chinese HRC costs are not competitive market costs by arguing that they are different to or less than HRC costs in other countries, or that they are differently affected by taxes than are HRC costs in other countries. It certainly does not advance its case when the assertion that Chinese HRC costs were less than HRC costs in other countries is not true. Further, the assertion that Japanese HRC costs are more competitive than Chinese HRC costs is unsupported. We will explain these things in this submission.

**2 Subsidisation – the Section 269T and Section 269TACC tests**

The second purpose for which an imputed input cost can be relevant in investigations such as this one is for the purposes of establishing whether a benefit has been conferred by a particular type of subsidy. Subparagraph (a)(viii) of the definition of subsidy under Section 269T of the *Customs Act 1901* ("the Act") provides that a subsidy can be constituted by a financial contribution by the government or a public body which involves the provision of goods to an enterprise and which confers a benefit on the enterprise. Section 269TACC(4)(d) then explains that such a benefit arises if the provision of the goods was at less than adequate remuneration. Adequacy of remuneration is judged under Section 269TACC(5) by having regard to the prevailing market conditions for like goods in the exporting country concerned.

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The cost or price which is used for the purposes of this comparison has become known as a "benchmark".

In its application for this investigation, the Applicant alleged that State-owned enterprises (which we will refer to as State-invested enterprises, or "SIEs") are supplying HRC to HSS producers for less than adequate remuneration ("Program 20"). It would appear that this is what the applicant alludes to in its submission through the use of the expression "*artificially low HRC prices*". In its application, and in the Applicant's letter, Japanese HRC prices are advanced by the Applicant as the appropriate benchmark for the purposes of Section 269TACC(5).

The GOC absolutely and categorically denies the allegations made by the Applicant that Chinese HRC producers are public bodies that are in some way vested with and exercise governmental authority. To the contrary, they are fully profit-motivated commercial enterprises operating in a highly competitive market environment. The Applicant must overcome that hurdle before any argument about a proper "benchmark" for determining whether a benefit has been conferred becomes at all relevant. The GOC submits that comparisons with the HRC prices in any other country do not aid the Applicant's "public bodies" argument.

The GOC denies that any such program in the nature of the alleged Program 20 exists. HRC costs recorded by Chinese HSS producers in their financial accounts are derived from the interaction of the forces of supply and demand. State invested steel enterprises in China cannot be characterised as "public bodies", and even if they could be, there could be no finding that they provide HRC for less than adequate remuneration. The GOC has addressed such issues in its previous submissions, and will continue to do so.<sup>2</sup>

As noted above, the price differential alleged by the Applicant is only evidence that it is cheaper to buy HRC, produced in China, in China, than it is to buy HRC produced in Japan, in

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<sup>2</sup> As the GOC has explained in its response to the Government Questionnaire, the GOC, through its capital contributor entity SASAC, evaluates SIEs and their executives based on the market and financial performance of the enterprises. If the HRC market is not a competitive market, and if SIEs had the market power to manipulate prices in that market, the only logical consequence would be that SIEs would exercise that market power by increasing HRC price in order to generate greater profit. It is not in the interest of SIEs to engage in "uncompetitive practices" by selling products for less than adequate remuneration. The explanation for low prices of HRC in China - at those times when the price of HRC in the Chinese market is low compared to other markets - is in fact fierce competition, and not a lack of it.

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Japan. The most that can be read from this is that China had a comparative advantage over Japan in the production of HRC in the period concerned. This is not evidence of a subsidy. China could be the cheapest producer of HRC in the world and there would still be no evidence of a subsidy on the basis of that fact alone.

Also, and despite the GOC's objection to any "public bodies" finding against SIE steelmakers in China, the GOC submits that such a finding would not preclude the use of the prices of those SIEs from being the "benchmark".

Moreover, the HRC prices of a country like Japan cannot be used as a "benchmark", for reasons we will also further explain.

Article 14(d) of the Subsidies and Countervailing Measures Agreement ("the SCM Agreement") provides the standard formulation for valuing the "benefit" arising from a program such as that alleged by the Applicant:

*...the provision of goods or services... shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration... The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale).*

The GOC notes that in its report *United States - Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada* ("DS257") the Appellate Body allowed for the use of a benchmark price other than one determined in relation to market conditions in the country of provision in very limited circumstances.<sup>3</sup> The Appellate Body said:

*...an investigating authority may use a benchmark other than private prices of the goods in question in the country of provision, when it has been established that those private prices are distorted, because of the predominant role of the government in the market as a provider of the same or similar goods. When an investigating authority resorts, in such a situation, to a benchmark other than private prices in the country of provision, the benchmark chosen must, nevertheless, relate or refer to, or be connected with, the prevailing market conditions in that country, and must reflect price, quality, availability, marketability, transportation and other conditions of purchase or sale, as required by*

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<sup>2</sup> By citing DS257 in this way, the GOC is not to be taken to be in agreement with the Appellate Body's formulation of an exception to the use of prices in the country of provision as stipulated by Article 14(d).

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*Article 14(d)<sup>4</sup>*

According to the Appellate Body in DS257, an external benchmark can only be used in situations where “the predominant role of the government in the market [is] as a provider of the same or similar goods” and where the government distorts the prices of those goods in the market by reason of its predominance. Even then, a benchmark may only be used which relates or refers to, or is connected with the prevailing market conditions in that country, and which reflects price, quality, availability, marketability, transportation and other conditions of purchase or sale as required by Article 14(d).

The Appellate Body also commented that:

*It is clear, in the abstract, that different factors can result in one country having a comparative advantage over another with respect to the production of certain goods. In any event, any comparative advantage would be reflected in the market conditions prevailing in the country of provision and, therefore, would have to be taken into account and reflected in the adjustments made to any method used for the determination of adequacy of remuneration, if it is to relate or refer to, or be connected with, prevailing market conditions in the market of provision. This is because countervailing measures may be used only for the purpose of offsetting a subsidy bestowed upon a product, provided that it causes injury to the domestic industry producing the like product. They must not be used to offset differences in comparative advantages between countries.*

These pronouncements of the Appellate Body must be kept firmly in mind by Australian Customs should it make a finding that one or other of China’s HRC producers is a public body carrying out some sort of governmental government authority. And to remind Australian Customs, should it be necessary to do so: the GOC rejects the proposition that such a finding is open on the facts of this case

## **C HRC cost comparisons – the evidence**

Fundamentally, the GOC says that a comparison of prices in different markets cannot establish that a price in one of them is not a competitive market cost. Furthermore, a cost derived from a market other than the market in the “country of provision” of an alleged subsidy cannot be indiscriminately used as a “benchmark”.

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<sup>4</sup> Paragraph 103



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The GOC submits that the most that can be inferred from the fact that the price of an input is lower in one market when compared to another market is that that the market with a lower price has a comparative advantage.

**1 Graphical comparisons of HRC prices in different markets**

It is apparent from the comments at Part 3.2 of the Applicant's letter that the Applicant has misunderstood the basis on which the GOC submitted a graphical representation of SBB price data over the investigation period in its submission dated 19 November 2011. Footnote 12 to that letter makes it clear that the submission of that information was not intended to detract from the GOC's primary submission, which was that HRC prices in China were and are competitive because of the competitive operation of the Chinese market, and not because they are the same as costs in other competitive markets.

The SBB data was tendered to show a comparison between the price paid for HRC in the Chinese domestic market and the prices paid for HRC in other domestic markets around the world. This comparison indicated that the price of HRC purchased from the Chinese domestic market was similar to the price of HRC found in some other competitive markets during the period of investigation.

The GOC has been unable to analyse the information provided in support of point 3.2 of the Applicant's letter, due to the fact that it has been deemed to be confidential.<sup>5</sup> The GOC notes that the term "HRC" covers a multitude of standards and types of product, each with different costs. Nowhere is it made clear in the Applicant's letter that "like with like" is being compared.

Nonetheless the GOC does wish to point out that even with its comparative advantages over other country markets, and its extremely competitive market conditions, China's average domestic HRC price was still not the lowest in the world during the relevant time. For most of the investigation period, the Chinese domestic price was higher than the Turkish domestic price, and was also very close to the Korean domestic price. China's domestic price was

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<sup>5</sup> To the best of the GOC's knowledge, the Applicant does not operate in either Japan or China, so the GOC is forced to question both the efficacy of the information provided and the reason for its confidentiality.

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certainly not as low as some export prices from Russia or Ukraine.<sup>5</sup>

On the basis of the available information, Turkey's domestic prices were at similar levels to China's. The GOC also observes that Erdemir, which is Turkey's largest integrated flat steel producer, recorded a net profit rate of 12% during 2010. Given that Erdemir accounted for about 25% of Turkey's crude steel production, its ability to influence market pricing is clearly apparent. If Australian Customs was to deduct this profit margin from the reported average domestic prices during the investigation period, it will be found that the observable but approximate market costs in Turkey were actually far lower than those in China.

In making these comparisons the GOC is not proposing that Turkish or Korean HRC prices can be used as a "surrogate" for determining a reasonably competitive market cost of HRC in China, or as a "benchmark" for working out whether a benefit has been conferred. The domestic price of HRC in China is set in a competitive market and the cost of HRC is already reasonably reflected in the accounts of the HSS producers. In fact it much more than reasonably reflects that cost. It is precisely that cost.

Further, the GOC observes that China's domestic HRC price was higher than the US mid-west domestic price during the first half of the investigation period. The US price then experienced a sharp increase in the second half of the investigation period before easing to a level similar to the Chinese price at the end of the POI.

## **2 Adjusting for taxes in price comparisons**

The Applicant's letter takes issue with the submission of the SBB data solely, it would seem, on the basis that GOC prices include a 17% VAT. The Applicant claims that this should be removed in order arrive at any proper comparison.

Any successful consideration of the whether the cost of an input reasonably reflects competitive market costs can only be of value if the actual costs faced by users of the input in that market are analysed. Logically, the actual prices paid will include all cost factors without exception. Relevant taxes, to the extent that they must be incurred by the producer, are such a

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<sup>5</sup> *Steel Business Intelligence, HRC price* <http://www.steelbb.com/steelprices/ital/>

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cost factor

The GOC does not believe that simply removing 17% from the price of HRC purchased within China would accurately reflect the price for HRC without VAT. It cannot be assumed that Chinese HRC producers would charge 17% less for HRC if the tax were to be removed. No doubt there would be cascading effects all throughout an economy if such a tax were to be removed, with comprehensive adjustments to costs, profits, demand and supply taking place both upstream and downstream of HRC.

Removal of 17% from the price of HRC paid by Chinese consumer does not represent anything of relevance to the argument that the Applicant seeks to make out. The HRC price less 17% does not reflect the competitive price paid by domestic Chinese consumers for HRC, nor does it assist in any comparison of Chinese HRC costs to HRC costs in other countries. It is a mathematical device without meaning or relevance.

Nonetheless, if the Applicant wishes to present such an argument, it should not do so only in relation to Chinese prices as shown in the graph. Product and consumption tax systems are very common. While the GOC does not intend to analyse the scope and effects of such schemes, nor their commonality, the GOC notes that such schemes are evident in the countries which were included in the graphed SBB data as follows:

Country	Consumption/product tax
Brazil	State and Federal taxes of up to 18% <sup>7</sup>
India	4% to 5%
Japan	5%
Korea	10%
Thailand	10%

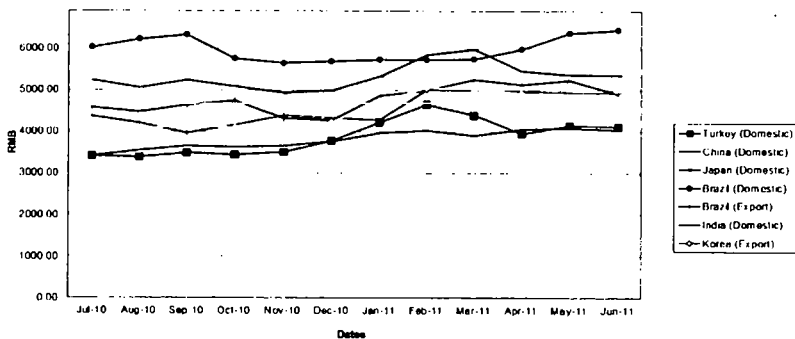
<sup>7</sup> Federal tax on steel of up to 15%, with IIRC taxed at 5%. State tax varies between 17% and 18%, and is applied to the price plus the Federal tax. Example: If the all up price of steel with the 5% Federal tax ("IPI") included is say 200, then the theoretical price without the impact of the taxes would be 161.42 calculated as follows:  
Step 1 - remove IPI: 200 divide by 105 multiply by 100 = 190.48  
Step 2 - remove State tax (assume 18%): 190.48 divide by 118 multiply by 100 = 161.42

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Turkey	18%
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One can see that there would be a large impact on many of the prices in the graph if, using the Applicant's logic, taxes were to be removed.<sup>9</sup> Here is the same graph with taxes of the order shown in the above table removed.

**SBB Coil Price Comparisons Excluding VAT**



In submitting this information, the GOC reiterates that it does not agree that competitive conditions in one country can be judged by the prices paid in another country. However, the SBB data shows that actual prices paid for HRC in China were not greatly different to actual prices paid for HRC in other competitive markets during the investigation period, whether with or without the Applicant's "tax removal" idea.

The above countries were selected for comparison because of their substantial steel producing status. However the volume of each of them pales in comparison with Chinese steel production. Indeed Australian Customs may decide that if volume of production, market size

<sup>9</sup> The source of this data is the same as that used in the original graph, ie SBB. However certain inaccuracies were detected in the Brazil domestic information. They have been corrected in this version.

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and market conditions are taken into account, these countries have little correlation to the steel market in China and that the prices of any of them would have to be severely adjusted to meet the requirements expounded by the Appellate Body in DS257. Brazil, for example, has one of the highest tax burdens in the world. It has been reported that the Brazilian market suffers from substantial logistic bottlenecks and rapidly increasing costs, and that its steelmakers are struggling to stay competitive with lower cost steel imports. Its steel production in 2010 was less than 30 million tonnes.

And as we will now demonstrate, the prospect that Chinese steel prices might be within the lower range of HRC prices in the world is not surprising, given the size and competitive nature of the Chinese market.

### 3 Comparing markets

Due to its confidentiality, the GOC is not in a position to provide comment on the specific evidence of price differentials between Chinese and Japanese HRC submitted by the Applicant. However, the GOC would again note that the "fact" that the domestic price of like goods<sup>9</sup> in two separate and geographically isolated markets are different does not prove or assist in proving that the market which has lower prices is not competitive.

Comparing Chinese HRC costs with Japanese costs and noting that they are different only proves that the domestic market for HRC in China has different competitive conditions to the domestic market for HRC in Japan and that the two economies have different economic settings.

The GOC considers that any finding that domestic prices of Chinese HRC do not reflect competitive market costs, based on a comparison with other countries' domestic HRC costs, would be both reckless and illogical. Any substitution of the price of HRC from Japan for the price of HRC paid by Chinese HSS producers on this basis would be to deem the Chinese market as being uncompetitive – and the Japanese HRC market as being the competitive market "preference" - without actually considering the particulars of the Chinese market, or

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<sup>9</sup> Again, the GOC is not aware of the "likeness" of the goods in the comparison which has been made by the Applicant.

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indeed of the Japanese market itself.

Each market has its own characteristics in terms of supply, demand, substitutability, elasticity, regulation, the market power of producers and consumers and other pricing factors. A lower price in one market simply shows that it has a comparative advantage over the other market. No negative inference can be drawn from the existence of a comparative advantage. It is the concept which drives trade.

The GOC has made its position in relation to Regulation 180(2) clear in this and in previous investigations carried out by Australian Customs. Any consideration of whether the costs of HRC in the Chinese domestic market reasonably reflect competitive market costs can only be made based upon the evidence of competition within that market. Are there many sellers? Are there many buyers? Is the price derived through the interplay of supply and demand, rather than as a result of any monopoly power?<sup>10</sup>

From its consideration of the GOC's response to the Government Questionnaire, and from the numerous Exporter Questionnaires lodged, and from the verifications of Chinese HSS producers presently being carried out, Australian Customs will learn that the Chinese market for HRC is in fact highly competitive. Prices are derived through the interaction of the forces of supply and demand.

In the Applicant's recent submission to Customs regarding verification visits to China,<sup>11</sup> it attempted to support its argument that HRC prices in Japan are an appropriate "surrogate" or "benchmark" as follows:

*ATM has compared Chinese coil prices with Japan domestic FOT prices. Japan is the largest regional producer of HRC in Asia (excluding China) by a factor of 2 (the next largest is Korea). Japan is the net exporter of HRC by a factor of 3.5 over next largest supplier (i.e. Taiwan). These factors highlight Japan as a competitive supplier of HRC and an important benchmark.*

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<sup>10</sup> In relation to this consideration, the GOC would remind Australian Customs of its submission dated 19 November 2011. The GOC considers that even if Australian Customs were to find that State invested enterprises were public bodies (which they are not) Australian Customs would still have no evidence to show that the price of HRC produced by these enterprises is artificially low (because they are not). SIEs do not detract from the level of competitiveness of the Chinese market for HRC.

<sup>11</sup> File 2012/001523-03 folios 26 to 31

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The GOC agrees that Japan is a substantial producer and exporter of HRC in Asia. However, a closer look at the statistics shows that Japan's HRC production in 2010 was only about 14% of China's HRC production in the same period:<sup>12</sup>

HOT ROLLED COIL ('000tonnes)	ACTUAL				
Production (as finished product)	Q2/2010	Q3/2010	Q4/2010	Q1/2011	2010
EU - 27	18138	14903	15548	18246	65480
JAPAN	4500	4164	3975	4256	17048
SOUTH KOREA	2393	2148	2900	2919	9760
TAIWAN	1019	1090	1454	1326	4635
BRAZIL	1883	1841	1479	1607	6939
<u>CHINA</u>	31305	30486	29300	28821	118097

This fact alone indicates that the status of Japan as the next largest HRC producer can afford little support, if any, to the Applicant's argument that Japanese HRC prices can be simply "plucked out" of some information service and then "plugged in" as an appropriate "benchmark" either for a competitive market cost in China or for working out whether a benefit has been conferred in subsidy terms.

As stated in B2 above, an appropriate benchmark must – according to the Appellate Body - relate or refer to, or be connected with, the prevailing market conditions in the country of provision. An appropriate benchmark must reflect price, quality, availability, marketability, transportation and other conditions of purchase or sale in the country of provision. These essential conditions require adjustments to be made before any base "benchmark" can become a "benchmark" that can actually be used for the purposes of Article 14(d) of the SCM Agreement.

**4 Strong cost connections between Chinese prices and international costs**

The GOC also wishes to point out that the Chinese steel industry is not only a valid market in and of itself, but that it is also very closely connected to international markets in the use of raw material inputs.

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<sup>12</sup> MEPS *China Steel Insight*, July 2011 at page 9

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Iron ore is the key raw material for making HRC. China is the world's largest iron ore importer, with import volumes of 627 million MT during 2009 and 614 million MT during 2010.<sup>13</sup> This represented more than 65% and 57% of the world's total iron ore trade respectively.<sup>14</sup> China's domestic production of useable iron ore (on a converted iron ore content basis) was 234 million MT during 2009, indicating a strong reliance on imported iron ore. According to the Ministry of Industry and Information Technology of China ("MIIT"), 69% of iron ore consumption during 2009 was imported iron ore.

Amongst the major Chinese steelmakers, it is reported that Baosteel imports 100% of its iron ore requirement. Anshan Steel's iron ore imports account for about 45% of its iron ore requirements. At the same time, China's domestic iron ore miners are finding it increasingly difficult to compete with imports, and many have suspended production.<sup>15</sup>

The GOC is advised that two metric tonnes of iron ore are typically required to produce one metric tonne of HRC. According to an Ernest & Young report on the global steel market, the average world HRC price in 2010 was USD614 per tonne and the average iron ore price was USD153 per tonne. Accordingly HRC prices and profitability are highly sensitive to the global iron ore price.

Chinese steel manufacturers fully participate in this international market. The claims that the Chinese HRC market is not a competitive market, or that prices in that market do not reflect competitive market costs, cannot be sustained. These claims ignore the fact that the Chinese market is significantly cost-connected with the international market.

##### **5 Japanese HRC prices are not indicators of competitive market costs for China**

Does the Japanese market possess the necessary characteristics to provide an appropriate competitive market cost for HRC in China, or a benchmark for "benefit" purposes?

The first thing we would note is that different economies have different economic settings.

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<sup>13</sup> China Customs

<sup>14</sup> International Steel Statistics Bureau <http://www.isib.co.uk/global.html>

<sup>15</sup> *Throng of Chinese iron ore miners suspend production* see <http://www.interfax.com/newsInt.asp?v=2010&m=3&d=7&id=291106/>



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Japan is one of the most developed countries in the world with a per capita GDP in 2010 of approximately USD34,000. China, on the other hand, is still a developing country, with a per capita GDP in 2010 of only USD7,600. The economic settings of these two countries are clearly different. It follows that the costs incurred for manufacture of like goods in the two countries are also likely to be very different. The discrepancy is magnified when average wages are compared. According to a US Bureau of Labor Statistics report, in 2008 the average hourly rates for manufacturing industry employees in China was USD1.36. This was far less than its north east Asian neighbours such as Japan, Korea and Taiwan, where the rates were estimated at USD27.80, USD16.50 and USD8.68 respectively. Australia's average hourly rate in the same period was USD36.94.<sup>16</sup>

According to MEPS,<sup>17</sup> Japan's apparent consumption of HRC in 2010 was 6.8 million tonnes, representing 39.83% of its own production in that year. On the other hand, there were 111.1 million tonnes of apparent HRC consumption in China, meaning that Chinese consumption was over 16 times that of Japan. On top of that, China consumed an amount equal to 94.07% of its own HRC production.

Thus, we can see that HRC production in Japan is low volume and export driven, compared with the situation in China where production is of a much higher volume and is domestic demand driven. The Chinese market is of a very large scale, with huge domestic demand and the ability to absorb the majority of its own production. It is no surprise to find that producers compete with each other by selling their products at lower prices. The Chinese steel price was also affected by over-supply and over-capacity in the global steel sector during FY 2011.<sup>18</sup> Chinese steelmakers did not have the upper hand in lifting prices or in passing on increasing

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<sup>16</sup> See <http://www.bls.gov/ils/>

<sup>17</sup> "MEPS (International) Ltd is a consultancy company operating in the steel sector worldwide, providing independent steel industry analysts, consultants, steel prices, forecasts, news and reports" [www.meps.co.uk](http://www.meps.co.uk)

<sup>18</sup> *Ernest & Young Global Steel- 2011 trends/2012 outlook*, <http://www.ey.com/Global/Industries/Mining--Metals/Global-steel---2011-trends-2012-outlook---Caution-ahead---how-can-steelmakers-cope-for-growth>

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raw material costs to end consumers due to the fragmented nature of the market.<sup>19</sup> Equally or more competitive export prices were present on the global market – also taking into account freight costs – from regions such as Chinese Taipei, Russia, Ukraine and Turkey. Chinese steelmakers also faced competition from imported products. Korea, for example, exported around 25% of its steel production to China during 2010.<sup>20</sup>

In view of all these factors the GOC submits that it is no surprise to find that Chinese producers continued to find it to be necessary to compete by selling their products at low prices. This, we would have thought, is fairly basic economics.

We can also quite easily see – from other conditions of competition in the Japanese market – that Japan does not possess the necessary similarities of economic and commercial conditions that the Appellate Body would require in any use of a benchmark other than one in the country of provision of any alleged subsidy application under Article 14(d).

We have already seen that there is a huge volume of steel production and consumption in China. Notwithstanding that, amongst the top five steelmakers in the world there are two Japanese companies, one Korean company, and only one Chinese company.<sup>21</sup> When the respective domestic market size of these three countries is taken into account, it is clear that the Japanese and Korean steelmakers will be likely to have significantly greater market power in their respective domestic markets than any single Chinese steel company has in China.

We also note that the investigation period also included the time of the devastating earthquake and tsunami that struck Japan in March 2011. The Japanese economy, and steel companies in particular, were all badly affected by this terrible event. The Annual Reports of three of Japan's largest steelmakers – Sumitomo, JFE and Nippon Steel – all mention the impacts of this natural catastrophe. Production was cut due to damage and electricity disruptions caused by the earthquake and its accompanying tsunami. With such an extraordinary scenario having

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<sup>19</sup> "China steel sector" *Macquarie Research*, 6 July 2011

<sup>20</sup> *Ernest & Young Global steel- 2010 trends, 2011 outlook*, <http://www.ey.com/SG/en/Industries/Mining--Metals/Global-Steel--2010-trends--2011-outlook--Challenges-and-issues>

<sup>21</sup> Source: World Steel Association, ranked on the basis of crude steel output in 2010

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occurred in that country during the relevant period, it is clearly inappropriate to advance Japanese HRC prices as any reasonable competitive price or benchmark.

In the case of Sumitomo, its report states:

*Great East Japan Earthquake damaged Kashima Steel Works, which forced us to record an extraordinary losses of 162 billion and a net losses of 17 billion. After the earthquake, the Group promptly launched a disaster management task force and made groupwide efforts to restore operations.*

JFE's report states:

*JFE Holdings has decided not to issue fiscal 2011 earnings forecasts at this time due to ongoing negotiations concerning the prices of both raw materials and steel products, as well as continued uncertainties surrounding the outlooks of various customer industries after the earthquake, making it impossible to compile rational forecasts.*

*The outlook for overall business in Japan is unclear following the Great East Japan Earthquake, which damaged a portion of production facilities and also has led to restrictions in electricity supply, clouding the outlook for certain areas of domestic production.*

Comments in Nippon Steel's refer to unusual conditions in the Japanese market both before the earthquake and as a result of it:

*In Japan, construction and public works investment remained stagnant, [to the contrary, 45% of China's GDP was contributed by investment in fixed assets, which provided better demand for steel products] but some movement toward economic recovery appeared in the first half of the fiscal year supported mainly by improving economic conditions overseas and government business stimulus policies. The recovery stalled briefly in the second half of the year as the effectiveness of the economic policies faded and the yen's strength persisted, but the gradual recovery trend had remained essentially intact until the March 11 Great East Japan Earthquake.*

*The Great East Japan Earthquake on March 11 caused extensive damage to the operations of the Nippon Steel Group, particularly to the Kamaishi Steelworks and the Sendai Factory of Nippon Steel & Sumikin Metal Products Co., Ltd. Nippon Steel has reported a ¥23.7 billion special loss in its consolidated accounts for fiscal 2010 to cover the cost to mainly restore the production facilities and equipment that were damaged or lost in the Great East Japan Earthquake. (comments added)*

China's HRC market price was less volatile than the domestic price of some other countries during the investigation period. Many factors might affect prices in one market as compared to another. The Chinese HRC market was and is the largest in the world by far. It was a competitive market in the investigation period, and remains as such today. Commentators believe that there was consistent demand and supply in China during the investigation period.

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with some level of oversupply.<sup>22</sup> The competitiveness of the market meant that no HRC producers had the market power to force any significant price increase, nor indeed to manipulate the market in any direction. China's HRC prices have also been generally in line with global market trends, but with less volatility and in the lower price range.

If one is to examine market conditions based on production and consumption alone, then the HRC markets of Korea and Chinese Taiwan would be much better comparators to use compared to Japan. This is because both the Korean and Taiwanese markets have had higher consumption to production ratios than Japan, at respectively 122% and 76.2%. That being said, such an indicator can only be one of many factors that would need to be taken into account in determining whether the market conditions of one country are so similar to another country that the price in that country could actually be used as a benchmark for a competitive market cost in the other country. Indeed if such an exercise is properly conducted, Australian Customs will identify that the conditions which do exist in China prove its competitive nature and cannot be replicated in any other place. There is, we submit, more than enough evidence to rebut the Applicant's contention that the Chinese market price is not a competitive one. A cost or benchmark borrowed from some other market is neither necessary nor useful.

Once again, the GOC notes that any successful consideration of whether the cost of an input reasonably reflects competitive market costs can only be of value if the actual costs faced by users of the input in that market are analysed. Therefore, the exercise should be looking at the true costs in that country in question. Looking at the selling price of other foreign markets provides no relevant consideration.

## D Conclusion

The Applicant has claimed that perceived price differences between HRC purchased domestically in China and HRC purchased domestically in Japan is evidence that Chinese HSS manufacturers are benefiting from "*artificially low HRC prices*".

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<sup>22</sup> <http://www.c-bm.com/news/2012/1-11/B92956287.shtml>; <http://www.business-standard.com/india/news/no-crd-in-sight-to-steel-oversupply-price-slump/45413/>

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However, as we have explained:

- price differentials between goods in two separate geographic and political areas are evidence of nothing other than the comparative advantage of one market over another; and
- on a comparative basis, and given the market conditions in place at the time, it cannot be said that Chinese HRC prices were “artificially low” in the investigation period.

The Applicant also claims that there is a program in place in China whereby “public bodies” exercising “governmental authority” provide HRC to HSS producers at less than adequate remuneration. The GOC rejects the notion that enterprises selling HRC In China have the status of public bodies and denies that such a “program” can be said to exist.

Furthermore, as we have also explained in this letter:

- there are a number of conditions which need to be satisfied before the question of a benchmark price for working out whether a benefit has been conferred becomes relevant, and
- a price from some other market cannot simply be used as a benchmark without first attempting to determine its basic suitability for the task, in a comparative sense, and then adjusting it to accord with the prevailing conditions in China.

Lodged for and on behalf of the  
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