Australian Government

Australian Customs and Border Protection Service

INVESTIGATION

INTO THE ALLEGED DUMPING OF CERTAIN HOLLOW STRUCTURAL SECTIONS EXPORTED FROM THE PEOPLE'S REPUBLIC OF CHINA, THE REPUBLIC OF KOREA, MALAYSIA, TAIWAN AND THE KINGDOM OF THAILAND

AND

ALLEGED SUBSIDISATION OF HSS EXPORTED FROM THE PEOPLE'S REPUBLIC OF CHINA

ASSESSMENT OF A PARTICULAR MARKET SITUATION

CHINA

13 APRIL 2012

THIS DOCUMENT AND VIEWS OR RECOMMENDATIONS CONTAINED THEREIN ARE PELIMINARY AND MAY NOT REFLECT CUSTOMS AND BORDER PROTECTION'S FINAL POSITION

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1 EXECUTIVE SUMMARY

The Australian Customs and Border Protection Service (Customs and Border Protection) is continuing its investigation into whether alleged dumping of certain hollow structural sections (HSS) exported to Australia from the People's Republic of China (China), the Republic of Korea (Korea), Malaysia, Taiwan and the Kingdom of Thailand (Thailand), and the alleged subsidisation of HSS exported to Australia from China, has caused material injury to the Australian industry producing like goods.

This investigation involves an assessment as to whether there was a situation in the Chinese domestic market for HSS during the investigation period[1] such that selling prices of HSS in that market are not suitable for the determination of normal value under s.269TAC(1) of the *Customs Act 1901*[2] (the Act) (i.e. a 'market situation' or 'particular market situation' existed).

After having regard to all relevant information, Customs and Border Protection has preliminarily formed the view that it <u>is</u> satisfied there was a situation in the Chinese HSS market during the investigation period such that sales in that market are not suitable for use in determining normal value under s.269TAC(1).

This preliminary position is due to a determination that the Government of China (GOC) has significantly influenced the Chinese iron and steel industry, and this influence is likely to have materially distorted competitive conditions and affected supply within that industry. This in turn is considered likely to have impacted domestic selling prices of HSS such that they are not substantially the same as they would have been if they had been determined in a competitive market (considered likely to be artificially low).

Due to the nature of the GOC influence and its likely impact, Customs and Border Protection considers that sales of HSS to third countries are unsuitable for determining normal value in respect of HSS exported to Australia.

Customs and Border Protection therefore considers that the normal value in respect of HSS exported to Australia from China should be constructed under s.269TAC(2)(c) of the Act.

This paper outlines Customs and Border Protection's assessment of these matters.

It is noted that the construction of normal value under s.269TAC(2)(c) will be undertaken in accordance with the conditions of Regulation 180 and 181 of the *Customs Regulations 1926* <u>(the Regulations)</u>, as required by s.269TAC(5A). The Regulations provide for an examination of the reasonableness of exporters' recorded costs.

Customs and Border Protection's assessment as to costs reasonableness, and the exact method of constructing normal value under s.269TAC(2)(c) will discussed in the investigation's Statement of Essential Facts (SEF), which is due to be placed on the public record by 23 April 2012.

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1 The investigation period in this case is 1 July 2010 to 30 June 2011.
2 All references to sections, divisions or parts of legislation contained in this document are references to the Customs Act 1901, unless otherwise specified.

2 INTRODUCTION

2.1 Background to the investigation

On 12 August 2011, OneSteel Australian Tube Mills Pty Ltd (ATM) lodged an application under s.269TB of the *Customs Act 1901* (the Act)[3] for the publication of a dumping duty notice in respect of certain hollow structural sections (HSS) exported to Australia from China, Korea, Malaysia, Taiwan and Thailand, and a countervailing duty notice in respect of HSS exported to Australia from China. Additional information was received from ATM on 26 August 2011 in support of its application.

This application alleged that HSS has been exported to Australia from China, Korea, Malaysia, Taiwan and Thailand at prices lower than its normal value, and that HSS exported to Australia from China has received countervailable subsidies, and that this dumping and subsidisation has caused material injury to the Australian industry producing HSS.

Following consideration of the application and additional information, Customs and Border Protection initiated an investigation on 19 September 2011. Public notification of this initiation was made in *The Australian* newspaper on 19 September 2011.

Australian Customs Dumping Notice (ACDN) No. 2011/43 provides further details of this investigation and is available at www.customs.gov.au.

2.2 Allegations of a market situation

In its application, ATM alleged that during the investigation period, a particular market situation existed in the Chinese HSS market that rendered sales in that market unsuitable for determining normal value under s.269TAC(1).

This claim focussed on allegations that the Government of China (GOC) has heavily influenced the domestic HSS market in China through:

- provision of steel raw materials (hot rolled coil (HRC) and/or narrow strip) at less than adequate remuneration (alleged subsidy Program 20);
- the prevalence of SOEs involved in the manufacture of HRC and narrow strip in China that receive benefits for the production of these materials resulting in artificially low raw material input prices for HSS manufacturers in China;
- reduced and/or subsidised energy (electricity) input prices in the manufacture of HRC, narrow strip and HSS itself; and
- benefits received by HSS manufacturers from the GOC including reductions in taxes, exemptions on duties and VAT, the provision of grants, and concessional interest payments (i.e. government subsidies) that impact the selling prices for HSS manufactured in China.

ATM's allegations strongly relied on the findings of the Canada Border Services Agency (CBSA) in its 2008 investigation into carbon steel welded pipe (CSWP) from China (a sub-set of HSS), during which the CBSA conducted a 'Section 20'[4] inquiry.

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[3] A reference to a section or subsection in this report is a reference to a provision of the Act, unless otherwise specified.

[4] Of the Canadian *Special Import Measures Act 1985*

This inquiry resulted in the CBSA finding that:

> *... the GOC has substantially determined the domestic prices in the welded pipe sector through a number of methods, namely:*
>
> - *by controlling the export levels of welded pipe sector through various tax mechanisms to maintain domestic prices in the welded pipe sector at a certain level;*
> - *by influencing the price of the main raw material input, hot-rolled sheet and strip that is used in welded pipe sector, and by doing so maintaining the domestic prices in the welded pipe sector at a certain level;*
> - *through various VAT tax policies that have affected the level of profits of the producers in the welded pipe sector which will affect domestic selling prices; and*
> - *through various means regulated the number of and controlled the production of producers in the welded pipe sector in order to affect the domestic prices.*[5]

Further, ATM relied upon the findings of the 2008 European Commission (EC) investigation into welded tubes and pipes of iron or non-alloy steel. During this investigation, 6 Chinese exporters of the investigated goods claimed 'market economy treatment' from the EC, however the EC did not find that these exporters qualified for this treatment, as they did not meet the following criteria:

(i) business decisions are made in response to market signals, without significant State interference, and costs reflect market values

(ii) firms have one clear set of independently audited accounting records; and

(iii) no distortions have been carried over from the non-market.

It is noted that both the EC and Canadian tests applied in the above-mentioned investigations are distinctive from that applied by Customs and Border Protection in its assessment of whether a 'market situation' exists in a particular market. However, it is considered that certain considerations of the EC and CBSA are relevant to Customs and Border Protection's assessment, and have been taken into account in this assessment where relevant.

In International Trade Remedies Branch Consideration Report No. 177 (CON177), it was accepted that ATM provided sufficient evidence in the application to support its claim that domestic sales of HSS were unsuitable for the purposes of determining a normal value in China under s.269TAC(1), given the degree of government interference and the likely impact on competitive conditions on the domestic market in China.

2.3 Australian legislation, policy and practice

2.3.1 China as a market economy

[5] CBSA, *Statement of Reasons Concerning the making of final determinations with respect to the dumping and subsidizing of Certain Carbon Steel Welded Pipe Originating in or Exported from the People's Republic of China*, August 2008 at page 64.

Australia treats China as a market economy for anti-dumping purposes and Customs and Border Protection conducts its investigation in the same manner for China as it does for other market economy members of the World Trade Organisation (WTO).

Irrespective of the country subject of the investigation, the Australian anti-dumping framework allows for rejection of domestic selling prices in market economies as the basis for normal value where there is a situation in the market making the sales unsuitable, as outlined below.

2.3.2 The Act and Regulations

Market situation

S.269TAC(1) of the Act provides that the normal value of any goods exported to Australia is the price paid or payable for like goods sold domestically in the ordinary course of trade in arm's length transactions.

However, .s.269TAC(2)(a)(ii) provides that the normal value of the goods exported to Australia cannot be determined under subsection (1) where the relevant Minister[6] is satisfied that:

> *'...because the situation in the market of the country of export is such that sales in that market are not suitable for use in determining a price under subsection (1)'.*

Where such a market situation exists, normal value cannot be established on the basis of domestic sales. Instead, the normal value may be determined on the basis of a cost construction[7] or third country sales.[8] Therefore, a determination as to whether there is a market situation has potential consequences for the assessment of normal value and dumping margins.

S.269TAC(2)(c) provides that a cost construction of normal value comprises the sum of what the Minister determines to be the cost of production or manufacture of the exported goods and (on the assumption the goods were sold domestically in the ordinary course of trade rather than being exported) the administrative, selling and general costs associated with the sale and the profit on that sale.[9]

S.269TAC(2)(d) provides that where the Minister directs that third country sales be used for normal value, it will be based upon the price paid or payable for like goods sold in the ordinary course of trade in arms length transactions for exportation from the country of export to a third country.

Determination of costs

In constructing normal value based on costs, s.269TAC(5A) provides that these costs must be worked out in accordance with the Regulations.

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6 In this case, the Minister for Home Affairs.
7 Section 269TAC(2)(c)
8 Section 269TAC(2)(d)
9 The inclusion of an amount for profit is conditioned by s. 269TAC(13), which provides that 'where, because of the operation of section 269TAAD, the normal value of goods is required to be determined under subsection (2), the Minister shall not include in his or her calculation of that normal value any profit component under subparagraph (2)(c)(ii).' Section 269TAAD applies to sales deemed not to be in the 'ordinary course of trade' due to sales being at below cost prices.

Note: in calculating the cost of like goods for the purposes of conducting ordinary course of trade tests under s.269TAAD (to establish sufficient sales in the ordinary course of trade for determining normal value under s.269TAC(1)), these costs are also to be established in accordance with the Regulations.

In terms of costs of manufacture or production, Regulation 180(2) requires that if:

1. an exporter keeps records relating to like goods that are in accordance with generally accepted accounting principles (GAAP) in the country of export; and
2. those records reasonably reflect competitive market costs associated with the production or manufacture of like goods;

the Minister must work out the cost of production or manufacture using information set out in the exporter's records.

In terms of administrative, selling and general costs, Regulation 181(2) provides that if:

1. an exporter keeps records relating to like goods that are in accordance with generally accepted accounting principles (GAAP) in the country of export; and
2. those records reasonably reflect the administrative, selling and general costs associated with the sale of like goods;

the Minister must work out the cost of selling, general and administrative expenses using information set out in the exporter's records.

Where the conditions of Regulation 180(2) and 181(2) are not met, it is Customs and Border Protection's position that the costs records kept by that exporter are not required to be used in working out their costs, and Customs and Border Protection may resort to other information to calculate these costs.[10]

Note: this paper does not specifically address Customs and Border Protection's application of the Regulations in calculating normal value in relation to HSS exported to Australia from China. This assessment will be contained within the investigation's SEF.

2.3.3 Policy and practice

Market situation

In relation to market situation, the Customs and Border Protection's Dumping and Subsidy Manual[11] states:

'Sales that would otherwise be relevant for determination of normal value may be unsuitable because the price does not reflect a fair price in normal market conditions. The legislation does not define market situations that would render domestic sales as unsuitable. The investigation and analysis of each case must

[10] For example, in the recent investigation into aluminium extrusions from China (REP 148), Customs and Border Protection found that the conditions of Regulation 180(2) were not met as, although the records of Chinese exports were kept in accordance with the GAAP, the cost of primary aluminium in these records was not reasonably reflective of competitive market costs. Customs and Border Protection instead substituted the prevailing London Metals Exchange (LME) price of primary aluminium for the costs of Chinese manufacturers.

[11] Available online at http://www.customs.gov.au/site/page5719.asp

fully set out the reasons for the unsuitability of sales before determining normal value under succeeding provisions of section 269TAC of the Act.

In considering whether sales are not suitable for use in determining a normal value under s. 269TAC(1) of the Act because of the situation in the market of the country of export, Customs and Border Protection may have regard to factors such as:

- *whether the prices are artificially low; or*
- *whether there is significant barter trade; or*
- *whether there are other conditions in the market which render sales in that market not suitable for use in determining prices under s. 269TAC(1) of the Act.*

Government influence on prices or costs could be one cause of 'artificially low pricing'. Government influence means influence from any level of government.

In investigating whether a market situation exists due to government influence, Customs and Border Protection will seek to determine whether the impact of the government's involvement in the domestic market has materially distorted competitive conditions. A finding that competitive conditions have been materially distorted may give rise to a finding that domestic prices are artificially low or not substantially the same as they would be if they were determined in a competitive market.[12]

[Emphasis added]

It is considered that the underlined quote reflects the nature of Customs and Border Protection's assessment in this report in relation to the existence of a market situation in the Chinese HSS market.[13]

It is considered that the assessment as to whether a market situation exists in a particular market constitutes a positive test. That is, before actual selling prices are rejected, Customs and Border Protection needs to identify a 'market situation', and be satisfied that the 'market situation' renders the sales in that market not suitable for normal value purposes.

Although it is for Customs and Border Protection to establish the nature and consequence of the 'market situation', including an evaluation of whether there is an impact on domestic prices, it is considered that the pricing effect does not have to be quantified.

Determination of costs

In relation to the determination of reasonableness of costs under Regulation 180(2) and Regulation 181(2), it must be assessed:

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12 Customs and Border Protection Dumping and Subsidy manual June 2009, pp 26-27

13 It noted that Customs and Border Protection considers it is possible for a degree of government influence to exist in a market without rendering the situation in the market such that sales are unsuitable for establishing normal value under s.269TAC(1). However, Customs and Border Protection considers that significant government intervention in relevant market factors could distort prices to a degree that those prices may be unsuitable for normal value.

1. whether the costs of manufacture are 'reasonably reflective of competitive market costs' associated with the manufacture of like goods; and
2. whether selling, general and administrative costs reasonably reflect costs associated with selling like goods (i.e. are these costs generally reasonable).

It is noted these Regulations specifically relate to the costs of like goods, rather than the price of the goods themselves (the price of these goods is what is examined for a market situation assessment).

Customs and Border Protection considers it is possible that government influence on these costs can be such that these costs are not reasonably reflective of competitive market costs (costs of manufacture) or not generally reasonable (administrative, selling and general costs). Again, it is considered that this is a question of the degree of the influence.

2.4 Previous HSS market situation investigations

2.4.1 2006 investigation (No 116)

In 2006, Customs and Border Protection conducted an investigation into HSS from China (and other countries/regions).

That investigation also involved an assessment of whether there was a particular market situation in China that made domestic prices unsuitable for determining normal value. The final findings of that investigation (including the assessment of market situation) are contained in Trade Measures Report 116 (REP116).

In REP116, Customs and Border Protection concluded that it was not satisfied that such a market situation existed in China during that case's investigation period.

2.4.2 2008 review (No 143) and investigation (No 144)

In 2008, Customs and Border Protection conducted an investigation into HSS from China and Malaysia (certain exporters) and a review of HSS exported from China.

This investigation and review also involved allegations and a subsequent inquiry into whether there was a particular market situation in the Chinese HSS market during the investigation and review's investigation period. However, both the investigation and review were terminated on the grounds that Customs and Border Protection was not satisfied that injury had been caused by dumping, and consequently no final assessment was made as to whether a market situation existed.

2.5 Information relied upon

In addition to the information contained in ATM's application for this investigation, Customs and Border Protection has also received the following information relevant to the assessment of the existence of a particular market situation in China, and the reasonableness of Chinese exporters' costs for the purposes of the Regulations:

- various submissions from interested parties;
- responses to the Chinese Exporter Questionnaire;
- a response from the GOC to the Chinese Government Questionnaire (GQ); and

- a response from the GOC to the Supplementary Chinese Government Questionnaire (SGQ)

In addition, independent research into these matters has been conducted.

This information has been analysed, assessed, and considered in arriving at the conclusions in this paper.

2.6 Background – HSS production process and materials

2.6.1 Production process

HSS (certain electric resistance welded pipe and tube) is manufactured from coils of flat-rolled steel in varying thicknesses and coil widths.

This coiled, flat-rolled steel is first slit lengthwise from its large coils then re-rolled into smaller coils that are loaded onto pipe and tube mills, unrolled and fed into the mills via an accumulator or similar mechanism (which allows a continuous flow of slit coil into the production process). The width of the slit coil is the circumference or perimeter of the finished pipe or tube.

The slit coil is then "cold formed" through a series of rollers and continuously welded along the seam in an 'electric resistance welding' process into a hollow round tubular shape.

The round tubular shapes are further formed through rollers into round, square, rectangular and other shaped pipe or tube.

The pipe or tube is then surface-finished by applying various protective coatings such as paint, varnish, oil or galvanising (including in-line galvanising, repair galvanising of the weld where the steel coil is pre-galvanised, or hot dip galvanised).

The pipe and tube is cut to length (either before or after the finishing process depending on the finish).

2.6.2 HSS raw materials

It is Customs and Border Protection's understanding that HSS can be made from either:

- HRC;
- cold-rolled coil (CRC); or
- narrow strip.

This can either be unfinished (black) or pre-galvanised.

It is further understood that narrow strip (narrow hot-rolled flat steel produced directly from heating and rolling billet, as opposed to HRC, which is made from heating and rolling wider steel slabs) used to manufacture HSS is a raw material somewhat unique to China, and is a distinguishing feature of the Chinese HSS market from the markets of the other investigated originating countries/region.

It is understood that narrow strip has a different production process and a different cost structure from HRC (including higher scrap output and lower production efficiency).

During the current investigation, importers, exporters and the Australian industry have expressed the understanding that the use of narrow strip is decreasing in the production of HSS in China.

Customs and Border Protection is not aware of any instances in China where HSS manufacturers use CRC.

2.6.3 HRC and narrow strip raw materials

As part of its examination of the Chinese HSS market, Customs and Border Protection has also examined the Chinese markets for HRC and narrow strip, and the raw materials for these products themselves.

For the purposes of this report, it is considered useful to briefly outline the process of making these raw materials.

As discussed above, Customs and Border Protection understands that HRC is produced by the heating and rolling of wide steel slabs. This results in large, wide steel coils. Conversely, narrow strip is made from heating and rolling narrower steel billets, which results in smaller, narrower steel coils.

In terms of the production of HRC and narrow strip itself, it is understood that:

- steel billets and slabs are made from liquid steel that has been cast into the certain form;
- liquid steel is made by combining iron, varying amounts of steel scrap and fluxes in a furnace;
- iron is smelted by combining iron ore, coke and limestone in a furnace; and
- coke is produced from coking coal, which is converted to coke through a heating process ('coking').

Customs and Border Protection understands that it is common for steel billets in China to contain a higher proportion of scrap steel than steel slabs. For this reason, narrow strip (made from billets) is commonly of a lower quality than HRC (and is expected to be lower in price as a result).

It is further understood that, in relation to coke, the practice in China is generally to import coking coal and convert it to coke in country, for use in domestic iron smelting.

2.7 Report structure

In undertaking its assessment of the Chinese iron and steel industry (including the HSS market), Customs and Border Protection has identified and examined various GOC influences in the Chinese iron and steel markets, and assessed their likely impact on the price of HSS.

This report therefore takes the format of:

1) outlining the major identified GOC influences and measures in the Chinese iron and steel markets;
2) assessing whether a particular market situation was created by this influence; and
3) assessing whether the reasonableness of exporters' costs for the purposes of the Regulations were affected by this influence.

The report then concludes by outlining Customs and Border Protection's proposal for calculating normal value in China.

2.8 The 'iron and steel industry'

This report focuses on an assessment of the Chinese iron and steel industry, and uses this and related terms throughout (e.g. 'iron and steel enterprises').

The GOC's *Development Policies for the Iron and Steel Industry* (the National Steel Policy or NSP)[14] defines the 'iron and steel industry' as follows.

> *The term "the iron and steel industry" as mentioned in the present Development Policies covers:*
>
> *the selection of iron mines, manganese mines and chromium mines and working techniques and relevant supporting techniques such as agglomeration, carbonization, iron alloy, carbon products, fire-resisting materials, iron smelting, steel rolling and metal products.*

The NSP is discussed in detail in Section 3.2.1 of this report.

The NSP definition of the Chinese iron and steel industry is broad, and extends from raw material mining through to the production of steel products themselves (including HSS).

The term 'iron and steel industry' and related terms is therefore used in this report by Customs and Border Protection in the broad sense that the GOC uses it – ranging from the mining of steel raw materials, through to the manufacture of HSS and other metal products.

[14] GOC response to the GQ, Attachment A11.

3 GOC INFLUENCE ON CHINESE IRON AND STEEL INDUSTRY

3.1 Introduction

As mentioned in Section 2.7, Customs and Border Protection has identified various GOC influences that relate to the Chinese iron and steel industry. These take the form of:

1. broad, overarching GOC macroeconomic policies and plans that outline aims and objectives for the Chinese iron and steel industry; and
2. more specific 'implementing measures' that go towards actively executing the aims and objectives of these policies and plans.

These identified policies, plans and implementing measures are numerous, and it is considered that it is not practicable to undertake detailed discussion of each identified item. Instead, Customs and Border Protection has sought to outline and assess the most prominent of these in this report.

3.2 Broad macroeconomic policies

3.2.1 The National Steel Policy

On July 8 2005, the GOC's *Order No. 35 of the National Development and Reform Commission* and the National Steel Policy (or NSP) were promulgated, after the approval of the GOC's State Council.[15]

The introduction to the NSP reads as follows:

> *...In order to elevate the whole technical level of the iron and steel industry, promote the structural adjustment, improve the industrial layout, develop a recycling economy, lower the consumption of materials and energy, pay attention to the environmental Protection, enhance the comprehensive competitiveness of enterprises, realize the industrial upgrading and develop the iron and steel industry into an industry with international competitiveness that may basically satisfy the demand of the national economy and social development in terms of quantity, quality and varieties, we have formulated the development policies of the iron and steel industry according to the relevant laws and regulations and the domestic and international situations the iron and steel industry faces so as to guide the sound development of the iron and steel industry.*

The NSP goes on to outline the GOC's aims and plans for the Chinese iron and steel in Chapter I as follows:

- maintain steel production capacity of iron and steel at a 'reasonable scale' and have the 'comprehensive competitiveness' reach an 'internationally advanced level';

[15] China's Cabinet, which has the power to enact and amend administrative regulations at the national-level pursuant to national legislation, and in areas where there is no legislation enacted by the NPC, the State Council also has powers to enact or amend administrative regulations in any other aspects of economic and social affairs under the Constitution.

- by 2010, elevate the production proportion of 'good' iron and steel products and satisfy the development requirements of other national industries;
- increase the size of 'backbone' enterprises by acquisition and reorganisation, increasing industry concentration, so that by 2010 the top ten enterprises account for over 50% of national production (70% by 2020);
- change 'unreasonable layout' by 2010 through 'layout adjustment' and form a 'comparatively reasonable industrial layout' by 2020;
- elevate environmental Protection and resource utilisation, and waste management (setting targets for energy and water consumption per tonne of coal and steel by 2010 that 'shall' be met); and
- meeting standards for 'wastes as discharged' and controlling volume of this waste.

The policy continues by outlining matters that go towards meeting the aims of the NSP. These appear to be more tangible 'action-items' rather than broad policy aims. Of note are:

- cutting of production and relocation of enterprises in certain regions while encouraging establishment in other regions;
- elimination of 'backwards capacity';
- prescribing equipment levels 'technical and economic indexes' and industry access conditions;
- offering support for research and development;
- encouraging the use of domestic technologies and equipment and prohibiting the use of second-hand 'backward' production equipment that has been 'eliminated';
- encouraging mergers and reorganisation of iron and steel enterprises;
- closely scrutinising new steel projects (subject to examination, approval or verification by the NDRC);
- setting minimum levels of 'self-owned capital' in certain projects and limiting foreign investment in the iron and steel industry (foreign investors prohibited from having a controlling share); and
- restricting exports of 'preliminary processed products' such as coke, iron alloy, pig iron, waste steel and steel ingot with 'high energy-consumption and serious pollution'.

The NSP further outlines the repercussions for not adhering to its policies (for enterprises in the industry and administrative entities as well) e.g. relevant GOC departments to deny registration, not issue production permits, not process import tax refund, etc. for enterprises that do not comply with the NSP, and financial institutions are not to provide finance to these entities.

3.2.2 National and regional five-year plans/guidelines

National FYPs

At the Central Government level, the GOC develops and issues five-year plans (FYPs) for the economic and social development of the nation. The first of these national FYPs was issue in 1953, and subsequent FYPs have been issued periodically since this time.

Customs and Border Protection understands that China's National Development and Reform Commission (NDRC)[16] plays a primary role in the development of these FYPs, and they are debated and given final approval by the National People's Congress (NPC), the Chinese legislature and highest GOC body.

Further, each FYP is compiled in accordance with the 'suggestions' of the Central Committee of the Communist Party of China on the formulation of that particular FYP.

The current national FYP is the *Guidelines of the 12th Five-Year (2011-2015) Plan of the People's Republic of China for the National Economic and Social Development*[17] (the 12th National FYP), which was approved by the NPC in March 2011, a few months prior to the end of the investigation period.

The previous plan, the *Eleventh Five Year (2006 – 2010) Plan of the People's Republic of China for the National Economic and Social* Development (11th National FYP)[18] was promulgated in 2006 and relates to the years preceding, and the majority the investigation period itself. The 11th FYP is therefore considered most relevant to the investigation into HSS.

The stated purpose of the 11th National FYP plan is to:

> *'...clarify the national strategic intention, define key emphasis in the government work, and guide the behaviour of market subject'.*

The plan's introduction notes it is:

> *'...the common program of action of our people...and is the important basis for the government to fulfil the responsibility of economic adjustment market control and surveillance, social management and public service'.*[19]

The 11th National FYP (and all other FYPs) sets out the GOC's general aims, principles and objectives for development of the Chinese economy of the following five-year period, as well as specific development aims for regions, social groups (e.g. peasants) and industries/sectors in China.

In relation to the steel industry, Chapter 13, of the 11th National FYP refers to the adjustment of the raw material 'structure and distribution'. Section 1 of this Chapter outlines the GOC's aims and objectives relating to the iron and steel industry specifically:

> *'Adhere to domination of domestic demand, <u>make efforts to resolve surplus production capacity</u>, strictly control additional iron and steel production capacity, accelerate the elimination of backward technology, equipment and product and improve iron and steel product grade and quality. Push iron and steel industry to develop recycle economy and exert the product manufacture, energy conversion and waste digestion and treatment function of iron and steel*

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16 The GOC submitted in response to Part C1 of the GQ that the NDRC is 'China's high-level macroeconomic and social development strategy planning agency. It has been responsible for introducing and facilitating the implementation of China's macroeconomic and overall social development strategies.'

17 GOC response to the GQ, Attachment 143.

18 GOC response to the GQ, Attachment 22

19 11h National FYP, page 1.

> *enterprises. Encourage enterprises to carry out transregional collectivised restructuring and form several enterprises with international competitive force. In combination with the relocation of urban iron and steel enterprises such as Shougang and elimination of backward production capacity, construct Caofeidian iron and steel base. Actively utilize low grade iron ore resources.*[20]

Further, Chapter 19 of the 11th National FYP outlines specific development goals for certain regions of China, noting that the Central and Northeast regions should focus on the development of the steel industries in those regions (and iron in the Central region as well).

These statements clearly articulate the GOC's desire to re-structure, develop and in some cases 'control' aspects of the domestic iron and steel industry, and display the importance placed by the GOC on the development of its iron and steel industries.

Further, many of these aims goals, and objectives have been clearly carried into the current (12th) FYP, in fact noting the GOC has issued an industry-specific *12th Five-Year Plan of Iron and Steel Industry*[21] that operates in conjunction with the 12th National FYP, listing objectives such as 'accelerate products upgrading', 'promote energy conservation and emission reduction in depth', 'strengthen technology innovation and technology reform', 'eliminate backward production capacity', 'optimize industry layout', and 'enhance resource safeguard ability'.

Regional FYPs

At the provincial (and in some cases municipal) level, the GOC develops and disseminates subordinate FYPs, which reflect the GOC's objectives of the national FYP as they apply specifically to that province/region.

As with the 11th National FYP, Customs and Border Protection has observed multiple references to developing and advancing the Chinese iron and steel industry in the 11th FYPs of various provinces, as outlined below.

<u>Outline of the Eleventh Five-Year Plan for the Economic and Social Development of Hebei Province</u>[22]:

> *According to high-end, high-quality goods, specialization, deep processing direction, catching a variety, grasping quality, to grasp integration, supporting excellent and eliminating inferior, optimize enterprise organization structure, product structure, technical equipment structure and industrial layout, improve industrial concentration and the level of technology. Build Tang gang and Han Gang two enterprise group with millions tons level, and Caofeidian high-quality plate, Chengde vanadium and titanium products two big base, strengthen six products series of board strips, wire rods, pipe, section bar, special steel and steel processing. Speed up project construction of overall plan of optimizing industrial update and Caofeidian steel, Han Gang structure, and realizes big province of steel to strong province of steel.*

20 11th National FYP, page 16.

21 GOC response to the SGQ, Attachment 144.

22 GOC response to the SGQ, Attachment 147

Outline of the Eleventh Five-Year Plan for the Economic and Social Development of Shandong Province:[23]

Strictly execute the state iron and steel industrial policies, encourage combination and restructuring, enhance industrial concentration, develop high-efficiency steel products, consolidate large-scale iron and steel bases, strengthen market competitiveness, and by 2010, the sales revenue of the material industry will reach RMB 760 billion.

This FYP includes a specific reference to the central iron and steel industry industrial policies, i.e. the NSP.

Outline of the Eleventh Five-Year Plan for the Economic and Social Development of Jilin Province (2006-2010):[24]

Transform and update metallurgy industry cluster. Use high and new technology actively; strive to develop high quality and high value-added metallurgy products, form relative thorough metallurgy industry system, and construct important high-quality fine steel production base in the northeast. Focus on supporting three series products: stainless steel and products, and actively promote reorganization of ferroalloy group and carbon group, on the basis of strengthening reconstruction and enlarging capacity of ferroalloy and carbon products, and promote the construction of million tons high-quality goods steel project, extend to develop stainless steel series products; Special steel, rely on Jianlong firm accelerate the implementation of million tons of steel project, and plan and construct Panshi metal products industrial park...

Outline of the Eleventh Five-Year Plan for the Economic and Social Development of Tianjin City:[25]

Strengthen competitive industry

Metallurgical industry - According to principles of controlling total amount, expanding high-quality goods, reducing energy consumption, speeding up restructure of the, promote adjustment of metallurgical industry structure actively. Adopting advanced technology and equipment, accelerate transform and update of steel pipe capacity, "TianSteel" move to east, build plate base and high-grade metal products and other important projects, form commanding heights of industry. Build tubular product base with seamless steel as leasing, high quality steel production base with cold rolled sheet, galvanized sheet, color-coated plate, cut deal and stainless steel plate as leading, and high quality steel products processing base with special wire rope, and tyre cord, prestressed steel strand of low relaxation as leading, and build petroleum steel pipes and fine steel deep processing base in the downstream of Haihe river. By 2010, obtain capacity of 2.6 million tons of seamless steel tube, 10 million tons of plates, 1 million tons of high-grade sheet metal products.

HSS enterprises that manufactured and exported HSS to Australia during the investigation period were located in all of these provinces/regions.

23 GOC response to the SGQ, Attachment 146

24 GOC response to the SGQ, Attachment 148

25 GOC response to the SGQ, Attachment 145

The statements made in these provincial and municipal FYPs closely align with objectives outlined in the 11th National FYP in relation to the iron and steel industry.

3.2.3 Blueprint for Steel Industry Adjustment and Revitalization

In March 2009, the Chinese State Council released the *Blueprint for Steel Industry Adjustment and Revitalization* (the Revitalization Plan).[26]

The Revitalization Plan, which identifies the importance of the steel industry to the Chinese national economy, states its purpose and objectives follows:

> *To cope with the impact of international financial crisis on the national economy, materialize the general principle by the State Council of stabilizing growth, enhancing domestic demands and adjusting the structure, ensure stable operation of steel industry, accelerate structural adjustment, and facilitate industrial upgrading, this blueprint is hereby formulated as an comprehensive action plan of measures for the steel industry to deal with the current situation, which is valid from 2009 to 2011.*

The Revitalization Plan goes on to highlight the challenges faced by the Chinese steel industry at the time of formulating the plan, including production capacity exceeding demand, weak innovation (with high-end products being imported rather than domestically made), poor geographical location of certain enterprises (restricted as to resource access), low concentration in the industry with major producers accounting for less than 30% of total production), and 'weak' domestic resources (in particular, limited domestic sources of iron ore).

The Revitalization Plan is aimed at addressing these matters, and sets out principles and targets of the plan.

The Revitalisation Plan outlines 8 broad 'achievements' (which have also been referred to as 'tasks') designed to carry out the plan. These are:

1. stabilising the domestic market and improving climate for export;
2. speeding up the dismantling of 'backward capacity' while 'strictly keeping the total standstill' (controlling production levels);
3. increasing industry concentration and 'enhance' reorganisation (through promoting mergers and acquisitions including promoting specifically-named mergers);
4. encouraging technical innovation and progress;
5. rationalising the location of capacity (including building a 'coastal steel base' and ensuring the Shougang and Caofeidian Steel projects are finalised);
6. raising product quality and changing product types produced (e.g. developing 'key' steel products (high-speed railway, high-strength automotive, etc) and raising the 'certificate standard' to promote steel quality to 'reach advanced international level');
7. stabilizing the import of iron ore (including 'normalize' the market order – including building an 'import pricing mechanism'[27] – some sources have said this is aimed to go as far as reducing the price of iron ore);[28] and

[26] GOC response to the GQ, Attachment A12.

8. develop resources domestically and internationally (increasing the level of iron ore exploitation, encourage ore exploitation abroad, etc.).

The plan further outlines 'policy options' for the Revitalisation Plan:

- rescheduling import and export tariff rates – continuing the policy orientation of controlling the export of 'two high, one resource'[29] and low value-added goods;
- raising VAT refund rates for 'steel products featured with high technical content and high value-added';
- 'severely' enforcing environmental and resource management policies;
- improve the 'Steel Industry Policy' (the NSP) including updating the 'Catalogue of Structural Adjustment of Industries' (thought to be the 'Directory Catalogue on Readjustment of Industrial Structure' – see Section 3.3.1);
- establishing an information-sharing system for GOC departments to provide information for future decision-making;
- providing grants to iron and steel enterprises for various reasons (research and development, cash flow management); and
- 'discriminate financially' enterprises that build in violation with laws or regulations, or who have 'backwards capacity'.

Many of these aims and objectives closely align with those of the NSP and the 11th National FYP. Specifically, the aims to direct the structural adjustment of the domestic steel industry through the merger and consolidation of steel enterprises, the elimination of backwards capacity, the setting of standards for the industry and establishing technological development standards.

In many ways, the Revitalization Plan appears to be a continuation and a reiteration of many of the aims and objectives of the NSP and the 11th National FYP, in response to the challenges highlighted during the global financial crisis (GFC).

3.2.4 Alignment and importance of GOC policies

The 11th National FYP was issued for the period 2006 – 2010, shortly after the promulgation of the NSP in 2005, while the Revitalisation Plan was promulgated in 2009 for the period 2009 – 2011. Each policy/plan is complimentary, and consistent in their aims and objectives for the Chinese iron and steel industry, with many common aims and objectives between the three documents observed, such as to:

- eliminate backwards capacity;
- control production levels;
- encourage mergers, restructuring and relocation;
- promote technological and product quality improvement; and
- implement and encourage environmental measures.

It is considered that the 11th National FYP, the NSP and the Revitalization Plan comprehensively and collectively outline the GOC's macroeconomic policy for the

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27 In is response to the SGQ, the GOC submitted that there has been 'no detailed progress' on implementing this mechanism (Question 33(c)(ii)).

28 *CISA Unveils revitalisation plan for Chinese steel industry*, http://www.mineprocessing.com/News/detail-a738-b0-c0-d0-e0-f.html

29 The GOC has advised this refers to High emission, high energy consumption, resource commodities (response to SGQ, Question 33(d)).

Chinese iron and steel industry from 2005-2011, and that these policy aims and objectives have been continued past 2011 in the 12th National FYP and the 12th Five-Year Plan of Iron and Steel Industry.

It is further observed that multiple GOC policies, plans and measures issued prior to the NSP in 2005 have similar goals and objectives to the NSP, 11th National FYP and Revitalization Plan. These include the:

- *Tenth Five-Year Plan for the National Economic and Social Development of the People's Republic of China* (2001 – 2005);[30]
- the *Directory Catalogue on Readjustment of Industrial Structure* (discussed in Section 3.2.4 of this report); and
- the State Economic and Trade Commission's (SETC)[31] *Development Plan for the Metallurgical Industry* (2001 - 2005).[32]

Customs and Border Protection observes that the Chinese iron and steel industry has been a focus of the GOC for over a decade.

In addition to outlining the GOC aims and objectives in relation to the Chinese iron and steel industry, these macroeconomic plans highlight the overall importance of the industry to the Chinese economy. For example, the NSP identifies the iron and steel industry as 'an important basic industry of the national economy', the Revitalization Plan identifies the industry as a 'pillar industry' and states:-

> *Steel industry is an important mainstay industry for national economy, which is widely influenced to the whole society, highly interrelated between industries, and significantly stimulated the consumption, and plays a crucial role in the economy, social development, finance and taxation, national defense construction and employment stability.*

Customs and Border Protection observes that the importance of the iron and steel industry to the entire Chinese economy and development is consistently acknowledged by the GOC.

3.2.5 Implementation of GOC macroeconomic policies

GOC position

In its response to the GQ and SGQ, the GOC has indicated that the importance of its broad macroeconomic policies is limited, suggesting that they are somewhat intangible and set out the GOC's aspirations for the steel industry, rather than act as enforceable plans that the GOC sets out to achieve.

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30 GOC response to the GQ, Attachment 23.

31 This entity no longer exists. The functions of SETC were absorbed by the NDRC in 2003.

32 Although Customs and Border Protection has been able to access the text of this plan, Asia Times Online reported in its article *Execution plan for China's industrial revolution* of July 20, 2001 (http://www.atimes.com/china/CG20Ad04.html) that it was *'based on China's 10th Five-Year Plan ...(and) is aimed at promoting the restructuring and upgrading of the industrial sector.* The article further reported the objectives of the plan include advancing the product quality of certain enterprises (Baosteel, Anshan Steel, Wuhan Steel and Shougang) up to the 'world's advanced level' and enable them to clinch a certain share of the international market, and to *'improve the quality of steel products and further explore H-shape steel market, to strictly control the construction of new welded tube units and speed up the pace of eliminating backward high-frequency welded tube units.'*

In relation to its FYPs, the GOC has submitted that:

> *An FYP is an aspirational guidance document, and does not set mandatory targets for the steel industry. Moreover, industrial policy aspirations of an FYP are relatively macroeconomic and vague, rather than being specific and quantifiable aims.*[33]

Similarly, the GOC has submitted In its response to Question C2.9(a) of the GQ:

> *The National Steel Policy is an aspirational document, not a legal document. It sets out the means by which the steel industry can modernize its operation and remain competitive and efficient in the future. As such, the objectives of the National Steel Policy are to elevate the levels of technology used in the iron and steel industry; to promote structural adjustment; to improve the industry layout; to promote recycling and to minimize the industry's environmental impact; and generally to guide the sound development of the iron and steel industry.*

This is despite the fact that the NSP itself is written in such a way that indicates its importance and binding nature. Indeed, the 'Other Matters' included in Chapter IX state (among other things):

- persons or entities that violate the policy shall be 'given punishments' by relevant GOC departments (Article 36); and
- the policy 'shall be observed by all the administrative departments of the people's governments' (Article 39).

The GOC's response to the GQ further submits that:

- the NSP is an isolated document, is not specifically monitored by the GOC;[34]
- there are no additional laws, decrees, rules, promulgations, edicts, opinions, measures, regulations or directives developed or implemented as part of the NSP;[35] and
- there are no monitoring mechanisms in place which specifically relate to the realisation of the objectives outlined in Chapter 1 of the National Steel Policy.[36]

Customs and Border Protection's assessment

Customs and Border Protection consider that the 'aspirational' nature of these policies/plans does not necessarily mean that the aims and objectives they establish are not attempted to be realised by the GOC, or their progress monitored.

Significant evidence has been observed to suggest that the aims, objectives and action items/measures in these policies are actively implemented and monitored by the GOC, and adhered to by Chinese steel enterprises.

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33 GOC response to the SGQ, Question 10(a).

34 GOC response to the GQ, Question C2.9(b)

35 Ibid

36 GOC response to the GQ, Question C2.9(f)

For example, during its recent investigation into aluminium extrusions from China (REP144), Customs and Border Protection undertook verification meetings with the GOC. During this verification, the GOC's NDRC was queried about FYPs in China generally.

This discussion was summarised in Customs and Border Protection's *Government of the People's Republic of China Visit Report, February 2010*, which observes:

> *The NDRC stated that GOC's FYPs*[37] *is (the) most important plan of China, like a blueprint for the next five years of development of the country. The NDRC noted that the national FYPs are the leading document in planning the economy and social development of China.*
>
> *However, the NDRC stressed that FYPs are only guidance documents rather than an operable documents, and there are no details for operation and implementation in the FYPs.*
>
> ...
>
> *The NDRC noted that implementation of the objectives of the FYPs is at the GOC-agency level, whereby each area will release specific policies and regulations (i.e. each responsible area develops and implements its own policies to implement the FYPs).*[38]

Additionally, during that same verification visit, the China State Reserve Bureau noted the 11th National FYP was a legally binding document.[39]

While the NDRC confirmed the guidance or 'aspirational' nature of these FYPs, the above statement is clear evidence that the GOC makes efforts to achieve the outcomes of the plans through various sub-policies and measures in the sphere of responsibility of each level of GOC and its relevant departments.

Specifically, it is noted that GOC has issued numerous sub-policies, directives, notices, etc. and imposed multiple measures since the promulgation of the NSP, the 11th National FYP and the Revitalization Plan that appear to go towards achieving at least some of the goals and aims outlined in these documents.[40]

These include:

- measures to eliminate backwards production capacity and encourage technical and environmental improvement;
- market entry criteria and industry operating conditions;
- measures to curb 'production capacity redundancy';
- guiding industry mergers and restructuring;
- import and export measures on coke; and
- subsidies in the iron and steel industry.

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37 In reference to the national-level FYP.

38 Page 39.

39 Customs and Border Protection's *Government of the People's Republic of China Visit Report, February 2010*, page 49.

40 In some cases, theses macroeconomic policies are stated specifically in implementing documents.

These measures are discussed separately in more detail in Section 3.3 of this report.

3.3 Implementing measures

During its investigation, Customs and Border Protection has identified numerous GOC measures that it considers go towards meeting at least some of the objectives of the above-mentioned GOC macroeconomic policies in relation to the domestic iron and steel industry.

The most prominent of these are discussed below.

3.3.1 Measures to eliminate backwards production capacity and to encourage technical and environmental improvement

The elimination of 'backwards production' or 'backward technology' is a common theme observed in the GOC's macroeconomic policies relating to the iron and steel industry.

Conversely, the encouragement of certain more advanced technology or 'hi-tech' products, and environmental improvements are also common objectives of the GOC's macroeconomic policies and plans.

Specific measures that are considered to be aimed at implementing these policy objectives are discussed in this section.

The Directory Catalogue on Readjustment of Industrial Structure and the Interim Provisions on Promotion Industrial Structure Adjustment

The GOC has promulgated the *Directory Catalogue on Readjustment of Industrial Structure* (the Directory Catalogue), which is issued and updated by the NDRC.

The GOC provided the revised Directory Catalogue (issued in 2011) as Attachment 173 of the SGQ,[41] and the 2005 (original) version at Attachment A6-1 of the GQ.

In the Directory Catalogue, certain industry activities, products and equipment are listed into three categories:

- 'Encouraged Investment Industries';
- 'Restricted Investment Industries'; and
- 'Eliminated Investment Industries'.

Customs and Border Protection has observed the following items of note in the Directory Catalogue (original and updated version) in relation to the iron and steel industry (among other items).

[41] Customs and Border Protection notes this 2011 revision is consistent with an aim of Section IV(6) of the Revitalization Plan to 'Update the Catalog of Structural Adjustment of Industries'.

	Encouraged Investment Industries	Restricted Investment Industries	Eliminated Investment Industries
2005 Directory Catalogue	• Construction of new-generation coking ovens. • Development and application of modern hot-rolled broad-band steel rolling mill and key part manufacturing. • Production of oil well pipe...high-pressure boiler pipe....and steel pipe used in the long-distance transport of oil and gas.	• Hot-rolled steel sheet projects of below 800mm. • Hot-dip galvanising sheet project of below 250,000 T/per annum.	• Hot-rolled narrow strip steel mills.
2011 Directory Catalogue	• Special steel bars and wires and high quality steel forged materials used for technology of high-performance, high quality and upgrade and update steel product development and application • Non coking iron making processing and coke oven gas. • High-performance oil and gas transmission pipeline steel. • On-line quality testing technology application in productive process	• Melted iron for steel-making. • Hot rolled strip project less than 1450mm. • Hot galvanized steel sheet rolls project less than 300,000 ton /year.	• Hot rolled narrow strip steel mills.

The original and updated Directory Catalogue also categorises certain items of coal, power, and petroleum and natural gas as encouraged, restricted or eliminated.

From the above, it appears as though there is a desire to discourage and/or eliminate the manufacture of narrow strip in China (a possible raw material for HSS), as well as restrict the investment in smaller-scale galvanised hot rolled steel (another possible raw material for HSS).

The original (2005) Directory Catalogue was issued alongside the *Decision of the State Council on Promulgating the "Interim Provisions on Promoting Industrial Structure Adjustment" for Implementation* (the Interim Provisions),[42] which provides context to the Directory Catalogue.

The Interim Provisions note:

> *The formulation and implementation of the "Interim Provisions" is an important measure to implement the spirit of the fifth plenary session of the 16th CPC Central Committee, to achieve the objective of the "Eleventh Five-year" planning, and is of great significance to ensure the all-round implementation of the scientific view of development, to strengthen and improve macro-control, to*

[42] GOC response to the GQ, Attachment A19. Customs and Border Protection notes that the GOC has submitted that the Interim Provisions are 'abolished', however the date of abolition is not clear. In any event, Customs and Border Protection merely relies on the Interim provisions in this case to demonstrate the importance of the Directory Catalogue to the GOC and the reasons for its imposition, noting the original Directory Catalogue has bec in force from 2005, being updated in 2011 (i.e. in force in the years prior to and during the investigation period).

further transform the ways of economic growth, to propel industrial structure adjustment, optimization and upgrading, and to keep the stable and fast development of the national economy.

The people's governments…shall take the promotion of industrial structure adjustment as an important reform and development task at present and within a period in the future, establish the liability system, lay emphasis on implementation, and shall, in accordance with the "Interim Provisions" and in light of the local situation on industrial development, formulate specific measures, rationally guide the investment directions, encourage and support the development of advanced production capacities, restrict and eliminate outdated production capacities, prevent blind investments and low-level redundant construction, and effectively propel industrial structure optimization and upgrading.

The Interim Provisions go on to outline specific objectives, principles and 'key points' for adjustment of the Chinese 'industrial structure'. This includes several iron and steel industry-related aims and objectives, including:

We shall support the development of cold rolled stainless steel sheets, cold rolled silicon steel… We shall urge the industries of oil refining, ethylene, steel, cement and paper making to develop towards those of large bases and of large scale. We shall strengthen the geological survey of important resources such as iron … increase the geological reserve of resources, and practice rational exploitation and comprehensive utilization.[43]

The Interim Provisions make direct reference to the Directory Catalogue, observing:

- *The "Catalogue for the Guidance of Industrial Structure Adjustment"* (the Directory Catalogue) *is the important basis for guiding investment directions, and for the governments to administer investment projects, to formulate and enforce policies on public finance, taxation, credit, land, import and export, etc.*[44]
- *The restricted category…need to be transformed or prohibited from being newly built.*[45]
- *The eliminated category mainly include the outdated techniques, equipment and products which do not conform to the relevant laws and regulations, seriously waste resources, pollute environment, do not meet the work safety conditions, and need to be eliminated.*[46]

The Interim Provisions go on to state:

- financial institutions shall provide credit support to encouraged investment industries; and
- investments are prohibited towards projects in the restricted and eliminated categories.

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[43] Chapter II, Article 6
[44] Chapter III, Article 12
[45] Chapter III, Article 15
[46] Chapter III, Article 16

In its response to the SGQ, the GOC confirmed that:

> *Investments are prohibited for projects under the "restricted" or "eliminated" categories. Relevant departments shall supervise projects of the eliminated category to exit the industry within the prescribed time limit in accordance with law.*[47]

The GOC also noted:

> *The encouraged category enjoys some corresponding preferential treatment with regard to imported equipment.*[48]

It is observed that the Interim Provisions make direct reference to the 11th National FYP and its role in implementing the objectives of that plan. Further, Article 19 states:

> *If any enterprise of the eliminated category refuses to eliminate the production technique, equipment or products, the local people's government at each level and the relevant administrative department shall, in accordance with the relevant laws and regulations of the state, order it to stop production or close it, and shall take appropriate measures to resettle the employees of the enterprise, and guarantee the safety of financial institutions' credit assets, etc. If its products are subject to the administration by permit for production, the relevant administrative department shall lawfully revoke its permit for production; the administrative department for industry and commerce shall urge it to lawfully go through modification registration or nullification registration; the administrative department of environmental Protection shall revoke its permit for pollution discharge; and the electric power supply enterprise shall lawfully stop supplying electricity to it. If any enterprise violates the provisions, its persons directly held liable and the relevant leaders shall be subject to liabilities in accordance with the law.*

The Interim Provisions therefore give wide-ranging powers to GOC agencies to impose the requirements of the Directory Catalogue to eliminate certain production processes, equipment and products, and encourage others.

Notice of the State Council on Further Strengthening the Elimination of Backward Production Capacities

Further to the Directory Catalogue, the GOC's State Council issued its *Notice of the State Council on Further Strengthening the Elimination of Backward Production Capacities*[49] (the Backward Capacities Notice) in 2010.

In its response to Question 35 of the SGQ, the GOC has explained that:

> *"Backward production capacity" means the out-dated techniques, equipment and products which do not conform to the relevant laws and regulations; which seriously waste resources; which pollute the environment; or which do not meet work safety conditions (same as those in the "eliminated category").*

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47 In response to Question 32(b)(ii)

48 In response to Question 32(b)(ii)

49 GOC response to the SGQ, Attachment 176.

Customs and Border Protection notes from the above that the concept of backwards production capacity' is linked directly to the category of eliminated items on the Directory Catalogue.

The Backward Capacities Notice focuses on the elimination of backward production capacities 'on schedule' by:

> ...*focusing on such industries as electricity, coal, iron and steel, cement, nonferrous metal, coke...in accordance with the scopes of and requirements for elimination of backward production capacities as prescribed in such documents as the Decision of the State Council on Promulgating and Implementing the Interim Provisions on Promoting the Industrial Restructuring (No. 40 [2005] of the State Council)* [the Interim Provisions]...*Catalogue for Guiding Industrial Restructuring* [the Directory Catalogue] *and the plans for restructuring and revitalizing industries including iron and steel, nonferrous metal, light industry, textile, etc.*

It is considered these 'plans' for restructuring and revitalising the iron and steel industry include the NSP, the 11[th] National FYP and the Revitalization Plan.

The Backward Capacities Notice states there has been 'remarkable progress' been in China in terms of the elimination of backwards production capacities, but notes the targets for eliminating this capacity have not yet been met.

The Backwards Capacities Notice outlines how this goal is to be achieved, through measures such as:

- strengthening the 'Policy Constraint Mechanism' – controlling market access, strengthening the 'economic and legal means', 'intensifying' law enforcement and punishment (including revising the Directory Catalogue);
- improving policy incentives – strengthening fiscal support of backwards capacity elimination, resettling employees, supporting the transformation of enterprises (science and technology upgrading);
- improving the 'supervision and inspection mechanism' – including each region and the central Ministry of Industry and Information Technology (MIIT) producing an annual list of enterprises with *'backward production capacities to be eliminated, the backward technologies and equipment, the deadlines for elimination and the overall progress'* and the monitoring and reporting on the progress of the elimination of backward production capacities;
- strengthening GOC organisation and leadership of the elimination of backward production capacities;
- supporting competitive enterprises in elimination of backward production capacities through merger, acquisition or restructuring of enterprises with a backward production capacity;
- relevant GOC agencies and government levels shall *'earnestly work out implementation plans, divide the objectives and tasks among cities and counties, assign them to specific enterprises, and timely submit lists of to-be-eliminated enterprises with a backward production capacity to the Ministry of Industry and Information Technology and the National Energy Administration'*;
- improving the regulation and control of land use plans, and prohibiting land supply for construction projects of backward production capacities and in industries with severe overcapacity;
- giving *'full play to the role of pricing mechanisms, such as differential prices for electricity and reform of prices for resource products, in eliminating backward*

production capacities... and raise the costs for energy, resources, environment and land used by enterprises and projects with a backward production capacity.

The Backwards Capacities Notice further outlines that, if an enterprise fails to eliminate its backward production capacities before the prescribed time limit:

- its pollutant discharge permit shall be revoked,
- no banking financial institution shall provide any form of new credit support to it,
- the investment management department shall not examine and approve new investment projects of the enterprise,
- the land and resources management department shall not approve new land for use by the enterprise, and
- the relevant management department shall not issue any production license for it or shall withdraw any production license or production safety permit previously issued.

The Backwards Capacities Notice further provides for enterprises that do not eliminate backward production capacities according to the relevant provisions to be closed down.

Customs and Border Protection's assessment

The Directory Catalogue, Interim Provisions and Backward Capacities Notice are examples of sub-policies and measures for GOC macroeconomic policies that are designed to implement the 'aspirational' aims of those policies.

Further, evidence exists to demonstrate that the GOC actively monitors the elimination of backwards production, and measures the success this objective. For example, General Steel Holdings Inc (General Steel) in its Form 10-K (annual report) filing with the United States Securities and Exchange Commission (SEC) for the period ended 31 December 2007 observed:

In November 2007, the National Development and Reform Commission (NDRC), the nation's top economic planner, reported that to date 29.4 million tons of outdated iron smelting capacity and 15.21 million tons of outdated steel smelting capacity had been eliminated.

General Steel is a United States-incorporated company that, through a 100% owned-subsidiary, operates a portfolio of four Chinese steel companies with various focuses.[50] One General Steel subsidiary, the Baotou Steel Pipe Joint Venture, produces spiral steel welded pipe, but not HSS itself.

General Steel went on to state:

...(the NDRC) also later announced obligation contracts with 18 provinces, autonomous regions and municipalities to eliminate 49.31 million tons of outdated iron smelting capacity and 36.1 million tons of outdated steel smelting capacity. The obligation letters involved 573 enterprises.

[50] Daqiuzhuang Metal, Baotou Steel – General Steel Special Steel Pipe Joint Venture Co., Ltd., ("Baotou Steel Pipe Joint Venture"), Shaanxi Longmen Iron and Steel Co., Ltd. ("Longmen Joint Venture"), and Maoming Hengda Steel Group Co., Ltd..

This again demonstrates the GOC's measures (which appear from General Steel's statement to be binding in nature) and commitment to ensure the implementation of this particular aspect of its macroeconomic policies and plans.

Further, in response to the GQ, the GOC provided listings of companies that have been affected by the elimination of backwards capacity since 2005, specifically:

- Attachment 27 - *List of Closed and Disused Iron & Steel Production Capability of Enterprise*; and
- Attachment 28 – *2010 Enterprises list of Elimination Steel-making Production Capacities*.

In these attachments, the GOC has provided details of 'closed and disused equipments' including details of types of furnaces and their capacities. This listing included enterprises that, from their name, appeared to be involved in various iron and steel products, including:

- manufacture of steel pipes;
- manufacture of 'special steel' products;
- steel rolling;
- iron casting and smelting;
- steelmaking and casting; and
- coking.

It is observed that these closures have therefore involved a variety of iron and steel enterprises, including those involved in making pipe and tubes (potentially including HSS) and rolled steel (such as HRC and narrow strip).

The GOC has submitted, in relation to these listings, that:

> *Closure of these companies can be due to any one of a number of factors, or to a combination of factors. These factors would include bankruptcy, increasing competition, old equipment, inability to invest, local protectionism, increasing overheads, enforcement of environmental regulations. Their closure was not forced on them by any decision made by the GOC outside China's legal framework of laws and regulations.*

It is noted that this statement by the GOC does not indicate that it has not been involved in the closure of these enterprises, merely that these closures have not been forced on enterprises outside China's legal framework of laws and regulations.

It is further noted that the GOC has included 'old equipment' as one such factor, which is considered is likely to relate to the elimination of 'backwards' equipment.

In response to SGQ, the GOC emphasised that the Directory Catalogue is essentially an environmental measure:

> *The GOC defends its right to legislate for the Protection of its environment and the health of its people. The Directory Catalogue is not an instrument of industry intervention with the commercial intention of making Chinese industries the most competitive in the world or of forcing the industry to conduct its business as dictated by the GOC. It is a regulatory document which articulates how environmental laws are to be applied.*

Customs and Border Protection agrees that certain measures of the Interim Provisions and Directory Catalogue would reasonably be considered to be environmentally-focussed, particularly those that relate to the elimination of older, environmentally harmful technologies and techniques.

However, it is considered that all of these measures cannot be considered to be purely environmental, particularly when the nature of some 'encouraged' items on the Directory Catalogue are observed.

In particular, the Directory Catalogue can reasonably be considered to go towards meeting the GOC's policy aims of encouraging technical innovation, raising product quality, and changing the product mix, as well as encouraging environmental improvements.

3.3.2 Market entry criteria and industry operating conditions

Standard Conditions of Production and Operation of the Iron and Steel Industry

The Standard Conditions of Production and Operation of the Iron and Steel Industry (the Steel Standard Conditions), dated 21 June 2010, were provided by the GOC as Attachment 160 to its response to the SGQ.

The Steel Standard Conditions state their purpose is:

> *To further strengthen management of iron and steel industry, provide norms to production and operation of the steel industry, to practice standard norms of production and operation for existing enterprises in iron and steel industry and to be used as the basis for relevant departments and agencies in project approval or filing, resource allocation, approving and issuing Production License of Construction Steel, providing norms for iron ore business and advancing elimination of backward capacity etc.. Conditions of production and operation of the iron and steel industry shall be combined with mergers and reorganization, elimination of backward capacity and etc., in order to reduce the quantity of steel enterprises step by step, lower the proportion of backward capacity, improve and consummate industry management.*

The Steel Standard Conditions go on to state they are:

> *…the basic condition for production and operation of existing iron and steel industry, and it is the transitional norms which is in line with current development level of our iron and steel industry and will be constantly improved with the improvement of the overall level of our iron and steel industry. The higher Admittance conditions required for the construction and reconstructions projects of iron and steel industry shall be implemented in accordance with the requirements concerned in "Development Policies for the Iron and Steel Industry"* [the NSP].

The conditions then outline a multitude of requirements for enterprises in the Chinese steel industry. These specifically relate to:

- product quality standards;
- environmental protection;
- energy consumption and comprehensive utilization of resources;
- workmanship and equipment;

- production scale; and
- safety, sanitation and social responsibility.

Of these, some notable conditions include the below.

- *Iron and steel enterprises 'shall posses sound environmental Protection management system, be equipped with complete monitoring and management facilities for pollutant emission, install automatic monitoring system networked with the local environmental Protection department.*[51]

- The volume of blast furnaces shall be more than 400m3. the normal capacity of converters shall be more than 30 T, the normal capacity of electric furnaces shall be more than 30 T, the area for Sintering machine shall be more than 90 m2, the height of Coke oven chambers shall be more than 4.3m, and all of these shall comply with the Directory Catalogue.[52]

- Iron and steel enterprises shall eliminate backward production facilities in accordance with the NSP, the Revitalisation Plan and the revised Directory Catalogue.[53]

- 'Crude steel production of common steel enterprises' shall be 1,000,000 ton or more, of special steel enterprises shall be 300,000 ton or more, and the 'proportion of alloy steel' is to be more than 60% ('specialization' enterprises such as HSS manufacturers that use '100% percent alloy steel' are excluded from this provision).[54]

The Steel Standard Conditions further note that:

> *Enterprises does not meet the Standard Conditions shall be reformed in accordance with the Standard Conditions. Where the enterprises still fails to meet the Standard Conditions, (it) shall exit steel production gradually.*
>
> *For enterprise that does not meet the Standard Conditions, <u>relevant departments shall not approve or file its new projects, shall not be equipped with the new mining resources and land, shall not issue new production license for products and shall not provide credit and finance support</u>.*

[Emphasis added]

It is noted that the Steel Standard Conditions align with the NSP in many ways (in fact mentioning it explicitly in Article II(D)(2)).

Admittance Conditions for Coking Industry

The GOC has provided the *Admittance Conditions for the Coking Industry* (the Coking Admittance Conditions) as Attachment 160 of the SGQ.

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51 Article II(B)(2)
52 Article II(D)(1)
53 Article II(D)(2)
54 Article E

The GOC has not provided a full translation of this document as requested. From the document as provided, it is understood the Coking Admittance Conditions were promulgated in 2004.

These conditions set conditions for entry to the coking industry, including:

- industry layout;
- techniques and equipment used, including production scale and environmental measures;
- product quality standards; and
- resource and by-product utilisation standards.

The conditions also include provisions for 'Supervision and management' of coking enterprises. The translation provided by the GOC, though incomplete, indicates that adherence to the Coking Admittance Conditions is monitored, and enterprises that do not meet the conditions shall have action taken against them by the GOC.

It is noted that the Coking Admittance Conditions are directly referred to in the Ministry of Commerce's 2008 *Notice Regarding Declaration Conditions and Procedure of 2009 Trade Coke Export Quota,*[55] discussed further in Section 3.3.5. These conditions provide that only enterprises that meet the Coking Admittance Conditions could apply for an export quota for coke (i.e. enterprises that do not meet the conditions could not export coke).

Customs and Border Protection's assessment

Customs and Border Protection considers that the GOC's measures for market entry and industry operation for the iron and steel industry and coking industry can reasonably be considered to go towards the GOC's aims of making environmental improvements, and to encourage technological and product quality advancement and structural adjustment in the Chinese iron and steel industry.

The linkages between the Steel Standard Conditions, the Coking Admittance Conditions, and the GOC's measures to eliminate backwards production capacity and to encourage technical and environmental advancement are observed.

Customs and Border Protection notes the potential impact these market entry and industry operation criteria may have on enterprises operating in the iron and steel industries. For example, iron and steel enterprises that do not meet the Steel Standard Conditions may have to upgrade their facilities to remain in operation, or face potential closure by the GOC.

3.3.3 Measures to curb production capacity redundancy

Circular of the State Council on Accelerating the Restructuring of the Sectors with Production Capacity Redundancy

In 2006, the State Council promulgated its *Circular of the State Council on Accelerating the Restructuring of the Sectors with Production Capacity Redundancy* (the Redundancy Circular).[56]

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[55] GOC response to the GQ, Attachment 44.

[56] GOC response to the GQ, Attachment A20.

The Redundancy Circular notes the

> *...major and difficult task' of the 11th National FYP to 'promote the strategic restructuring of the economy as well as to elevate the international competitiveness of all sectors.*

The document goes on to note that some sectors

> *...make such blind investment and inefficient expansion that they have incurred production capacity redundancy, which has turned into a predominant problem in the economy.*

The Redundancy Circular singles out the iron and steel industry as one that is particularly affected by this problem. The Redundancy Circular further outlines the observed downfalls or 'aftermaths' of production capacity redundancy, and observes

> *If such situation is let go at random, the conflict rooting in the binding force of resource scarcity will pop up further, the issue of structural imbalance will be worsen off, there will witness an obvious increase in enterprise bankruptcy as well as in unemployment. So we should resolutely make efforts to solve all the problems.*

The Redundancy Circular continues by outlining the 'requirements and principles' and 'key measures' to accelerate the restructuring of sectors with production capacity redundancy.

The Redundancy Circular notes:

> *The key to promote the restructuring...is to give full play to the fundamental role of the market in allocating resources and fully exert the market strength to promote the survival of the fittest...*

but goes on to state

> *...we should, by means of restructuring, reform and elimination through selection, accelerate the restructuring process in the sectors with production capacity redundancy.*

In relation to the iron and steel industry, the Redundancy Circular states the GOC's key measures to do so will include:

- strictly control newly-initiated projects, including generally not granting approval for the establishment of any new steel plant;
- eliminate outdated production capacity including in iron smelting and coking industries;
- 'promote the joint restructuring between a predominant large-sized iron & steel enterprise and other iron & steel enterprises in the same region so as to form several iron & steel enterprise conglomerates with an annual production capacity of more than 30 million tons';
- 'earnestly' implement the Directory Catalogue; and
- make efforts to implement iron and steel industry policies and strengthen their 'examination'.

Customs and Border Protection considers that these measures are inconsistent with the notion of giving 'full play' to the fundamental role of the market in allocating resources.

Circular on Controlling Total (Capacity), Eliminating the Obsolete (Capacity) and Accelerating Structure Adjustment of Iron and Steel Industry

The iron and steel industry-specific *Circular on Controlling Total (Capacity), Eliminating the Obsolete (Capacity) and Accelerating Structure Adjustment of Iron and Steel Industry* (the Steel Industry Capacity Circular) was issued by the GOC in 2006.

The GOC has been requested to supply a copy of this document, but has declined to do so, observing the document has been superseded in 2009 by the *Notice of the State Council on Ratifying and Forwarding the Several Opinions of the National Development and Reform Commission and Other Departments on Curbing Overcapacity and Redundant Construction in Some Industries and Guiding the Sound Development of Industries*[57] (the 2009 Overcapacity Notice).

Despite not having access to a copy of the Steel Industry Capacity Circular, Customs and Border Protection understands from the CBSA's analysis of this document within its 2008 CSWP *Statement of Reasons* report that this GOC document outlined improvements observed in the iron and steel industry due to GOC macroeconomic controls (e.g. reduced investment, reduced consumption, improving product mix to high value goods, increase mergers and eliminate backwards production).

It is further understood that the Steel Industry Capacity Circular further noted that 'powerful measures' should be implemented to backward capacity,[58] which the circular notes are important aims of the 11th National FYP.

2009 Overcapacity Notice

The 2009 Overcapacity Notice, which the GOC has provided as the replacement notice for the Steel Industry Capacity Circular, notes that, at the time of its publication, issues of overcapacity continued to cause problems in the Chinese economy. This includes "serious problems including vicious market competition, low economic benefits, business failure or underproduction, unemployment and increasing bad debts of the bank".

The notice goes on to outline 'guiding opinions' designed to

> *...fulfil the Party Central Committee and the State Council's package plan coping with international financial crisis, consolidate and develop good economic situation, promote structure adjustment, curb overcapacity and redundant construction in some industries and guiding the sound development of industries and guide new industry in orderly development.*

The GOC has declined to provide a full translation of this document as requested. However, the translation provided shows these 'guiding opinions' relate to 'taking

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57 GOC response to the SGQ, Attachment 150.

58 As quoted in CBSA, *Statement of Reasons Concerning the making of final determinations with respect to the dumping and subsidizing of Certain Carbon Steel Welded Pipe Originating in or Exported from the People's Republic of China*, August 2008 at page 59.

seriously' the issue of curbing overcapacity, and implementing certain 'measures' to curb this overcapacity.

3.3.4 Guiding industry mergers and restructuring

Evidence of restructuring

The GOC has not provided any specific circular, notice or other GOC document subordinate to the above-identified macroeconomic policies that directly relates to the implementation of mergers in the iron and steel industry. However, it is noted that the macroeconomic policies themselves are comprehensive in terms of these aims, outlining specific mergers that should occur, geographic areas that are to be built up, and GOC measures that should be implemented to facilitate these mergers.

For example, section IV(5) of the Revitalization Plan states the GOC should:

> *Formulate measure to facilitate merger, acquisition and/or reorganization of steel mills, i.e. to make things more viable for enterprises in planning M&A and reorganization, such as relocate or resettle extra workers in other jobs, transfer or refer assets to some other entities out of original management scope, evaluate and settle the debts, and resolve issue of the fiscal interests therein. Prioritize in sequencing decision making on renewing or upgrading project by those enterprises out of interregional reorganization. To better implement the favorable taxation policy for reorganization among steel mills.*

In light of these policies, evidence has been observed that demonstrates that the GOC aims of industry restructuring, relocation and creation of large iron and steel enterprises has occurred.

In response to the GQ, the GOC provided a requested (non-exhaustive) listing of steel companies that have merged (or been acquired by other enterprises) since 2005 (Attachment 29). This list displayed multiple mergers of iron and steel enterprises since 2005 (the year of promulgation of the NSP), including mergers involving large SIEs.

Further, in Attachment 26 to the GQ, the GOC provided a report by KPMG entitled *China's Iron and Steel Industry Amid the Financial Crisis*, which included a (non-exhaustive) listing of iron and steel industry mergers and acquisitions for the period 2004 - 2009 (at page 24).

This table is reproduced below.

Chart 7. M&As for China's iron and steel sector between 2004 and 2009

Mergers and acquisitions in China's iron and steel sector between 2004 and 2009

Group name	M&A	Year	Crude steel output 2008 (in 10,000 tonnes)
Northeast Special Steel Group	Founding of the group	2004	140.28
Wugang Group	1. Restructuring of Ergang	1. 2005	2,733.39
	2. Restructuring of Kungang	2. 2007	
	3. Restructuring of Liugang to form Guangxi Iron and Steel Group	3. 2008	
	4. Fangcheng Port Project	4. 2008 (approved)	
Baosteel Group	1. Acquisition of Xinjiang Bayi Iron and Steel	1. 2007	3,544.3
	2. Hangang New Zone	2. 2007	
	3. Guangdong Iron and Steel Group	3. 2008	
	4. Zhanjiang Base	4. 2008 (approved)	
	5. Restructuring of Ningbo Iron and Steel	5. 2009	
Anben Group	1. Joint venture with Linggang to form a new base	2. 2007	2,343.93
	2. Bayuquan Base	1. 2008 (in operation)	
	3. Equity participation in Fanhe Group	3. 2008	
Huafeng Iron & Steel	Control over Jiangsu Xigang Group	2007	1,125.69
Taigang Group	Joint venture between Taiyuan Iron and Steel (Group) Co., Ltd. and Tianjin Steel Tube (Group) Co., Ltd. to form Tianjin Taigang Tianguan Stainless Steel Co., Ltd	2007	920.17
Magang Group	Merging with Anhui Hefei Iron and Steel Group and 71% interested in Magang (Hefei) Iron and Steel Co., Ltd	2007	1,503.9
Pangang Group	Restructuring of Xichang New Steel (Group) Co., Ltd	2007	751.01
Shagang Group	Merging with Jiangsu Huaigang, Yonggang, Henan Yongxin Steel Plant	2007	2,330.46
Jiantong Group	Equity participation in Tonggang Group	2007	654.25
Hebei Iron and Steel Group	Founded by a joint venture between Tanggang Group and Hangang Group	2008	3,328.39
Shandong Iron and Steel Group	Founded by a joint venture among Jinan Iron and Steel Group, Laiwu Iron and Steel Group, and Shandong Provincial Metallurgy Co	2008	2,184.08
Shougang Corporation	Caofeidian iron and steel base project	Commissioned in April 2009	1,219.28

Source: *China Metallurgical News*

Additionally, the following mergers of Chinese iron and steel enterprises that occurred in the year prior to 30 June 2009, have been reported by General Steel Holdings in its Form 10-K (annual report) filing with the SEC for the period ended 30 June 2009:

- Wuhan Iron & Steel Group (WISCO) (referred to in the above table as 'Wugang Group') acquired Liuzhou Iron & Steel Group and established Guangxi Iron & Steel Group for the purpose of building a new mill in Fangchenggang city, Guangxi province;
- Baoshan Iron & Steel Co., Ltd (Baosteel), a state-invested enterprise (SIE) and China's largest steelmaker, acquired and recapitalised Guangzhou Iron & Steel Enterprises Group and Shaoguan Steel Co. Ltd. with the goal of building a new facility in Guangdong province; and
- Tangshan Changcheng Steel Group and Tangshan Bohai Steel Group incorporated in late December 2008 (though further evidence suggests that Tanshan Bohai Steel Group was not physically formed until early 2012).

Customs and Border Protection also notes evidence exists to display the following additional recent mergers.

- The creation of Tianjin Bohai Iron & Steel Group Corp in 2010 through the merger of Tianjin Pipe (Group) Corp (TPCO), Tianjin Iron & Steel Group, Tianjin Tiantie Metallurgy Group and Tianjin Metallurgy Group Co.[59]
- The formation of Angang New Co. in July 2010 after Anshan Iron & Steel Group won government approval to take over Pangang Group Co.[60]

The *China Steel Yearbook 2011* (the Steel Yearbook, published annually by the China Steel Development Research Institute) includes reports of the 'improved concentration ratio' of the Chinese iron and steel industry. Reporting that the 'concentration' of the Chinese steel industry (by production output) in the 'top 10' Chinese producers has increased from 35.4% in 2005 to 48.6% in 2010.[61]

Types of merged enterprises

It is noted that these mergers have involved a variety of enterprises in the iron and steel industry, producing varying types of steel, steel products and steel raw materials. Customs and Border Protection's research indicates that products and activities of merged steel enterprises include:

- steel plate;
- HRC;
- narrow strip;
- pipe and tube;
- steel bars and rods;
- steel wire;
- CRC;
- steelmaking and casting;
- mining, smelting and processing of iron; and
- coking.

Specifically in relation to pipe and tube (the sector that HSS falls within), Tianjin Pipe (Group) Corp (TPCO) is a large producer of pipe and tubing in China that focuses largely on larger-sized oil pipe (non-HSS). However, the company's website indicates that it is also a producer of structural tube in the parameters of HSS.[62]

In addition, Customs and Border Protection notes that Baosteel, which has been shown to be a leader in the structural adjustment of the Chinese iron and steel industry via mergers and acquisitions (see below and extracts from Baosteel's annual report at Section 3.4.1), is itself a manufacturer of HSS.[63]

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59 Chinamining.org in *4 Steel Companies in Tianjin starts merger to form 20 million tonne giant*, http://www.chinamining.org/News/2010-01-07/1262844995d33153.html (accessed 2/4/12)

60 Bloomberg, China's Top 10 Steelmakers in 2010 Ranked by Production, *http://www.bloomberg.com/news/2011-01-26/china-s-top-10-steelmakers-in-2010-ranked-by-production-table-.html* (accessed 2/4/12)

61 China Steel Development Research Institute, *China Steel Yearbook 2011*, Beijing Metallurgical Industry Press, 2011 at page 19.

62 http://www.tianjinpipe.com/about-test.htm

63 As displayed in Baosteel's Electric Resistance Welded Pipe product catalogue, available at http://tv.baosteel.com/web/plc/p-pdf/1103C0104.pdf (accessed 6/4/12).

GOC position

At Question 2.9(r)(i) of the GQ, the GOC was asked to describe how it had (if at all) encouraged or requested mergers to take place amongst iron and steel enterprises in China.

The GOC submitted:

> *The National Steel Policy sets out the vision for the future landscape of the steel industry, consistent with the macro-economic goals of sustainability, resource efficiency and land use. The GOC does not request mergers or consolidations at the commercial level. In fact, the GOC has an interest in the maintenance of commercially desirable conditions in the industry, from the point of view of sustainability, social objectives, infrastructure costs, and welfare costs to the community. The government itself does not determine the situations of market for the purchase and sales of steel or HSS. The GOC does not play a "commanding" role. Instead, the GOC's role is at the coordination level. Any mergers or consolidations would take place at the corporate level, because the enterprises involved consider for themselves that the policy environment that the government seeks is conducive to their development in that way.*

Customs and Border Protection's assessment

Despite the above submission of the GOC, evidence exists to indicate the GOC has played a guiding role in the restructuring of the iron and steel industry through enterprise mergers, and has closely monitored the progress of this structural adjustment.

Firstly, it is anecdotally evident from the number, type and entities involved in these mergers that this consolidation is in fact the realisation of certain aims and objectives of the macroeconomic policies of the GOC (e.g. construction of the Caofeidian iron and steel base,[64] the reorganisation of TPCO,[65] and the concentration of production capacity in the 'top' enterprises[66]). That is, several GOC policies have specifically stated that certain enterprises will merge, and these mergers have in fact occurred.

Secondly, available evidence suggests that this structural adjustment has in many cases been progressed, and in some cases led by GOC-owned and invested large iron and steel enterprises. Many of the larger-scale mergers that have occurred have been through the consolidation of SIEs and acquisitions by these enterprises (e.g. Baosteel/WISCO, Anshan Iron and Steel (referred to in the above table as 'Anben Group'; Hebei Iron and Steel Group and Shougang Corporation).

Indeed, Baosteel notes its role as a leader of industry restructuring in its 2010 Annual Report:

> *As one of the <u>engines of domestic iron and steel industry</u>, Baosteel has been taking an <u>active part in the reorganization of the industry in accordance with the national policies on iron and steel industry</u>. By way of various capital operation*

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64 An aim pf the 11th National FYP, the Revitalization Plan and the *Outline of the Eleventh Five-Year Plan for the Economic and Social Development of Hebei Province*.

65 An aim of the Revitalisation Plan.

66 Aim of the NSP.

including acquisition, merging, and transfer for free. Baosteel has quickly enlarged its production scale, and strengthened its comprehensive power, enhancing its core competitive power.

[Emphasis added]

Note: in its assessment of Chinese HRC and narrow strip producers for the purposes of its countervailing investigation into HSS from China, Customs and Border Protection has closely examined Chinese iron and steel industry SIEs and determined they are in fact 'public bodies' of the GOC, as evidence exists to demonstrate the GOC exercises meaningful control over these entities.

Additionally, following observations made by General Steel in relation to iron and steel industry mergers, noting the GOC's goals in relation to industry consolidation, and its actions to achieve this are noted:

- *It is the goal of the central government to consolidate 50% of domestic production among the top ten steel companies by 2010 and 70% by 2020. Throughout 2008, it steadily heightened its consolidation effort.*[67]
- *The central government has had a long-stated goal to consolidate 50% of domestic steel production among the top ten producers by 2010 and 70% by 2020. In September 2009, the central government published an industry target to eliminate 80 million metric tons of inefficient capacity from the steel industry by the end of 2011.*[68]
- *In 2007, the government held firm on its resolve to consolidate the highly fragmented domestic steel industry through coerced mergers and heightened operating requirements.*[69]

[Emphasis added]

Further, General Steel's Form 10-K SEC filing for the period to 30 June 2009 observes that 'major mergers and acquisitions have been government-directed'.

Additionally, evidence exists to demonstrate that the GOC actively monitors and evaluates the progress of this industry consolidation, and feed this into further policies, plans and measures (including outlining measures to be taken by the GOC to further support this restructuring).

For example, the Revitalisation Plan, at Section II C.3 observes the 'Significant progress concerning reorganization and integration', noting:

Some super large enterprises emerged which are stronger in self-innovation of technologies and in competitive edge in the international market, the capacity of top 5 steel producers occupy 45% of national total, and the capacity located along the rivers or in the coastal areas account for 40% or more of the national total, industrial location remarkably optimized and pollution by steel makers in key centre cities substantially decreased.

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67 General Steel Form 10-K SEC filing for the period to 30 June 2009

68 General Steel Form 10-K SEC filing for the period ended 31 December 2010

69 General Steel From 10-K (annual report) SEC filing for the period ended 31 December 2007

It is therefore considered that there is evidence to determine that significant restructuring of the Chinese iron and steel industry has been (and is still) occurring, and that this is led by, monitored and encouraged by the GOC (and certain evidence exists to display that this restructuring is in fact GOC-mandated and directed). It is considered that this restructuring has occurred as a result of factors other than basic market forces (i.e. government influence).

Customs and Border Protection further notes the linkage between this industry restructuring and the elimination of 'backwards capacity', as mergers appear to also contribute to the elimination of backwards capacity (e.g. Tangshan Bohai Steel was formed (after MIIT approval) by amalgamating 12 private steelmakers, and will undergo 'restructuring work' and the elimination of 'inefficient' facilities by the end of 2012 'in accordance with the 2011-2015 steel industry development plan released by the ministry' (MIIT).[70]

3.3.5 Export measures on coke

The GOC has provided requested schedules of its import and export tariffs, and VAT rebate rates for coal (including coking coal)[71] and coke from 1 July 2006 to 30 June 2011 (among other items). The GOC also provided data on the total import and export volume of these products for that period (though the GOC did not provide import data on HSS itself), as well as information on export quotas, export licensing, and restrictions in processing trade.

From this data, it is evident that, in the years preceding the investigation period, the GOC imposed a suite of export measures on coke, a key raw material in the production of iron (which is a major input into liquid steel, that is itself cast and used to make HRC and/or narrow strip).

These measures included:

- export tariffs; and
- export quotas and an accompanying export licensing system (2009 – 2011).[72]

Throughout this period, the GOC offered no VAT rebate on exports of coke from China.

Export tariff

The level of export tariff over time is summarised in the below table.[73]

	2006	2007	2008	2009	2010	2011 (January - June)
Export tariff (%)	0	5	25	40	40	40

70 Platts, *China approves consolidation no 2 units into Tangshan Bohai Steel Group*, 9 February 2012, available at www.platss.com (accessed 7 April 2012).

71 HS code tariff classification 27011210

72 GOC response to the GQ, Question C3.5 and GOC response to the SGQ, Attachment 155.

73 GOC response to the GQ, Attachment 42.

Further, the GOC had low levels of import duty (5%) on coke from 2006 to 2008. This was eliminated in 2009 and remained at 0% for the rest of the examined period.

The GOC has explained the rationale behind the changes in export tariffs outlined in the above table as being:

> *...to remove excessive incentive to produce and export "two high" (high energy consumption and high pollution) products, in order to meet the ultimate purpose of environment Protection.*

Export quota and license

In relation to the export quota and license, as mentioned in Section 3.3.2, MOFCOM issued the *Notice Regarding Declaration Conditions and Procedure of 2009 Trade Coke Export Quota* in 2008. This document established an export quota for coke from 2009 onwards (correlating with a large increase in export tariff from 25% to 40%).

These conditions provide that only enterprises that meet the Coking Admittance Conditions can apply for an export quota for coke. The conditions also place further restrictions on which enterprises can apply for a coke export quota (meet certain product quality standards, be of a certain production size, have environmental Protection measures, and position of certain levels and types of insurance). The conditions also set out application and approval procedures for the coke export quotas.

In relation to the rationale behind the export quota on coke, the GOC has submitted that similar reasons to those behind the export tariff on coke were also behind this measure, and noted:

> *Enterprises failing to conform to environment Protection standards, or to honour common practices in promoting social responsibilities, may be denied export quotas.*
>
> *Over the years, the above management approach has obtained achievements: the growth of coke industry investment and production has slowed down, and the industry has reduced its backward capacity and achieved upgrading of its investment and industrial structure.*
>
> *In terms of environmental improvement, the effects have been obvious. In Shanxi province, the dominant province of coke export and production, air quality has improved greatly.*[74]

Export measures on coking coal

Customs and Border Protection notes that, during the period of 2006 – 2011, the GOC also changed rates of import and export tax on coking coal as identified in the below table.

[74] GOC response to the SGQ, Question 25(a).

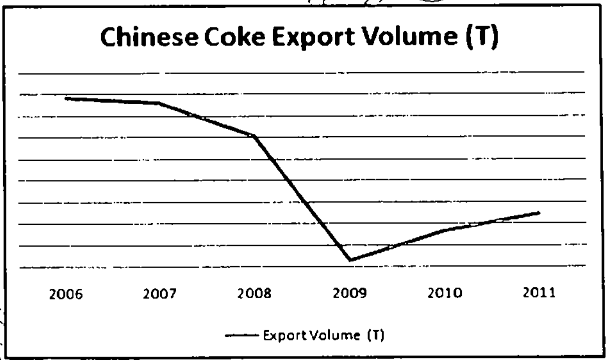
	2006	2007	2008	2009	2010	2011 (January - June)
Export tariff (%)[75]	0	5	5	10	10	10
Import tariff %[76]	3	3	3	0	0	0

As observed in Section 2.6.3, it is Customs and Border Protection understanding that the practice in China is to import coking coal (which is seen to be imported in substantial volumes in the GOC's provided import and export data), and convert this to coke in China for use in domestic iron production.

These import and export tariff rates on coking coal, though much lower than those noted for coke itself, appear to correlate with the GOC's shift to high export tariffs on coke, whereby imports tariff rates on coking coal decreased as export tariffs on coke increased.

Traded volumes of coke and coking coal

The export volume data for coke provided by the GOC in its SGQ response has been charted below.[77]

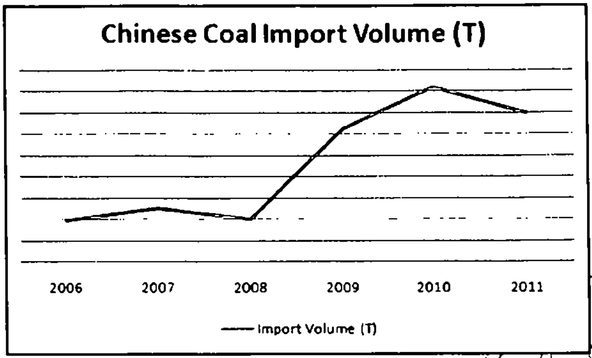


Chinese imports of coal over the same period (noting this data was provided for coal collectively and not split into coking and other coal, though it is considered the general trend of coal imports into China is relevant nonetheless):

[75] GOC response to the GQ, Attachment 42.

[76] GOC response to the GQ, Attachment 43.

[77] This data was pro-rated for 2006 and 2011, as the GOC was only asked to provide data from July 2006 – June 2011.



It is noted that China's export volume of coking coal and the import volume of coke are consistently much lower than the import volume of coking coal and export volume of coke, which suggests the understanding that coking coal is imported and converted to coke in country (rather than importing already 'coked' coal) is reasonable.

World Trade Organisation (WTO) Dispute DS394, 395 and 398

China's export tariffs,[78] and export quotas and licensing of coke (and other raw materials) has recently been subject to a WTO dispute before a WTO Panel and then the Appellate Body, the findings of which were handed down in July 2011 and January 2012 respectively.

This dispute also involved objections to the setting of minimum export prices (MEPs) for these raw materials.

Both the Panel and Appellate Body (appeal on certain matters) found that these Chinese measures were WTO-inconsistent, with the Appellate Body finding in conclusion:

> *The Appellate Body recommends that the DSB request China to bring its measures, found in this Report and in the Mexico Panel Report, as modified by this Report, to be inconsistent with China's Accession Protocol and the GATT 1994, into conformity with China's obligations thereunder, such that the "series of measures" do not operate to bring about a WTO-inconsistent result.*[79]

Of particular note is the fact that the Panel found that China had not demonstrated that the application of export restrictions on coke are justified pursuant to Article XX(b) of the GATT 1994 (i.e. the general exception to allow parties to adopt or enforce measures that are necessary to protect human, animal or plant life or health' by any contracting party of measures) – noting that the Panel found that the export duties on coke were inconsistent with China's WTO Accession Protocol in any case and the exception under XX(b) was not available in any case, hence the findings in relation to

[78] Particularly that from 2009 onwards.

[79] Reports of the Appellate Body, China – Measures Related to the Exportation of Certain Raw Materials (AB201-5) at 363.

export tariffs on this matter were made *arguendo*. This point was not appealed by China to the WTO Appellate Body.

Customs and Border Protection's Assessment

Customs and Border Protection observes these measures on coke appear to be consistent with the aims of the NSP to restrict exports of coke (see Section 3.2.1) and the aim of the 2009 Revitalization Plan to *Continue on policy orientation of controlling export of "two high, one resource" and low value-added goods* (see Section 3.2.3).

It is considered that the GOC's export measures on coke (particularly from 2009 onwards) can reasonably be considered to have had a significant impact on the domestic iron and steel industry – discussed further in Section 4.4.3.

3.3.6 Subsidies in the iron and steel industry

Subsidies to HSS producers

During its investigation, Customs and Border Protection has preliminarily found that HSS producers in China have benefited from 18 identified countervailable subsidy programs, while multiple other programs are still being assessed.[80]

The amount of benefit received under these programs is being assessed. However, it is anticipated that the largest of these programs (i.e. the program that is anticipated would have provided the greatest benefit to HSS producers) is Program 20, which concerns the provision of steel raw materials (HRC and narrow strip) to HSS producers by state-invested enterprises (also referred to previously as state-owned enterprises) at a price that is considered to be less than adequate remuneration.

Other subsidies that have been preliminarily identified as being countervailable include grants for research and development, brand excellence, hi-tech industry investment, and holding specific patents, as well as tax reductions based on location and enterprise type.

It is reasonable to consider that at least some of these subsidies will assist with the implementation of the GOC's macro-economic plans for the steel industry (e.g. encouraging hi-tech steel enterprises and steel product research and development).

'Upstream' subsidies

In addition to these investigated subsidies, Customs and Border Protection notes that the identified GOC macroeconomic policies and implementing measures it has examined have made multiple references to the provision of grants, financial support and other subsidies to enterprises in the iron and steel industry generally (i.e. including 'upstream' enterprises to HSS manufacturers) to assist with the implementation of GOC policies and plans.

For example the Backwards Capacities Notice outlines that the GOC will strengthen 'fiscal support of backwards capacity elimination' and support the transformation of enterprises (science and technology upgrading). Further, the Revitalization Plan

[80] These are the subject of a separate preliminary Customs and Border Protection report *Preliminary Assessment of Countervailable Subsidies*, available on the public record.

mandates the provision of grants to iron and steel enterprises for research and development, cash flow management, and other reasons.

Although Customs and Border Protection notes evidence of these upstream subsidies in the context of this assessment of market situation in China, it is not considered that sufficient evidence has been found that suggests that there are reasonable grounds for the publication of a countervailing duty notice in relation to these programs, as required by s.269TC when initiating investigations into alleged programs.

Specifically, sufficient evidence has not been found that suggests:

- that these subsidies could reasonably be considered to be countervailable; or
- that benefit received under thee subsidies by upstream producers as passed through to HSS manufacturers.

For this reason, these subsidies have not been further investigated by Customs and Border Protection for the purposes of the concurrent countervailing investigation.

3.4 Further evidence of implementation and impact of GOC policies

Further to the above-outlined measures, Customs and Border Protection has encountered more general evidence that highlights the importance, widespread implementation, and mandatory nature of these GOC policies. This is outlined below.

3.4.1 Implementation by SIEs

Customs and Border Protection observes Article 36 of the *Law of the People's Republic of China on the State-Owned Assets of Enterprise*,[81] which requires;

> *A state-invested enterprise making investment shall comply with the national industrial policies, and conduct feasibility studies according to the state provisions; and shall conduct a transaction on a fair and paid basis, and obtain a reasonable consideration.*
>
> [Emphasis added]

Publicly available evidence displays that large Chinese SIEs in the iron and steel sector have complied with this Article, and play a leading role in implementing and achieving the aims of the NSP, the Revitalization Plan, and other GOC policies. In particular, Customs and Border Protection has observed the following remarks in various annual reports of Baosteel.

2006 Annual Report:

> *...in order to achieve the restrictive target of energy saving, consumption lowering and pollution reducing, the Chinese government has promulgated a series of policies and regulations, explicitly pointing out the direction and timetable for the structural adjustment and elimination of the outdated capacity or the steel industry, and it is becoming common understanding to realise the adjustment of industrial layout by replacing the outdated capacity with the advanced capacity.*

---

[81] GOC response to the GQ, Attachment B27.

...

Baosteel firmly set up the scientific outlook on development, solidly implemented the state's policies for the development of steel industry, adhered to the sustainable development, strictly controlled the investment scale, rationally arranged the construction projects and optimized the investment structure...

2008 Annual Report:

In 2008, guided by Policies for Development of Iron & Steel Industry and Circular Economy Promotion Law of the People's Republic of China, a series of progress in the steel industry have been made: regional and cross-regional consolidation in China's domestic steel industry has been accelerated; the strategic coastal deployment of major steel enterprises has basically formed, optimizing the industrial layout; the technical equipment of these enterprises has been rapidly boosted, improving the mix of products; new development in obsolete capacity shutdown, energy conservation and emission reduction has been achieved.

2010 Annual Report:

As one of the engines of domestic iron and steel industry, Baosteel has been taking an active part in the reorganization of the industry in accordance with the national policies on iron and steel industry. By way of various capital operation including acquisition, merging, and transfer for free, Baosteel has quickly enlarged its production scale, and strengthened its comprehensive power, enhancing its core competitive power.

[Emphasis added]

The extract from Baosteel's 2008 Annual Report, reproduced in Section 3.3.4, is also noted.

These statements confirm that Baosteel, a leading enterprise in the Chinese steel industry, a known manufacturer of HRC used by HSS exporters in manufacturing HSS, and a manufacturer of structural pipe and tubes itself (see Section 3.3.4), is aware of, and actively implements, aspects of the GOC macroeconomic iron and steel policies (including participation industry restructuring through mergers, eliminating outdated capacity (backwards), and implementing environmental measures).

Further, Baosteel notes the restrictive nature of the GOC's policies, and the progress that has been made 'guided' by these policies.

3.4.2 General influence on enterprises

Customs and Border Protection has also observed evidence (in addition to the above Baosteel comments) that demonstrates the impact or potential impact the GOC macroeconomic policies, plans and implementing measures can have on iron and steel enterprises operating in China. It is noted that these are both potentially positive and negative.

General impact

The general impact of these GOC policies, plans and measures have on iron and steel enterprises operating in China is observed by General Steel in its Form 10K Annual Report filing with the SEC for the period ended 31 December 2010:

> ***We face the risk that changes in the policies of the Chinese government could have significant impact upon the business we may be able to conduct in China and the profitability of such business.***
>
> *The economy of China is transitioning from a planned economy to a market oriented economy, subject to five-year and annual plans adopted by the government that set down national economic development goals. Policies of the Chinese government can have significant effects on the economic conditions of China. The Chinese government has confirmed that economic development will follow a model of a market economy under socialism. Under this direction, we believe that China will continue to strengthen its economic and trading relationships with foreign countries and business development in China will follow market forces. While we believe that this trend will continue, there can be no assurance that such will be the case. A change in policies by the Chinese government could adversely affect our interests through, among other factors: changes in laws; regulations or the interpretation thereof; confiscatory taxation; restrictions on currency conversion; imports or sources of supplies; or the expropriation or nationalization of private enterprises. Although the Chinese government has been pursuing economic reform policies for approximately two decades, the Chinese government may significantly alter such policies, especially in the event of a change in leadership, social or political disruption, or other circumstances affecting China's political, economic and social climate*

[Emphasis added]

This statement (which is mirrored thorough General Steel's annual reports from as far back as 2006) indicates the potential impact of GOC policies on Chinese iron and steel enterprises generally.

Impact of environmental constraints

General Steel has also made the following observations in relation to the specific impact of environmental measures on its Chinese operations in its Form 10-K Form for the period ended 31 December 2010.

> ***We are subject to environmental and safety regulations, which may increase our compliance costs and reduce our overall profitability.***
>
> We are subject to the requirements of environmental and occupational safety and health laws and regulations in China. We may incur substantial costs or liabilities in connection with these requirements. Additionally, these regulations may become stricter, which will increase our costs of compliance in a manner that could reduce our overall profitability. The capital requirements and other expenditures that may be necessary to comply with environmental requirements could increase and become a significant expense linked to the conduct of our business.

[Emphasis added]

Impact of industry operating conditions, elimination of backwards capacity, and consolidation

In its Form 10-K Form for the period ended 31 December 2010, General Steel made the following observations.

> *On July 12, 2010, the Ministry of Industry & Information Technology Commission issued the Steel Industry Admittance and Operation Qualifications. The new standard specified requirement for all aspects of steel production, which include: size of blast furnace, size of converters, emission of waster water, dust per ton of steel producing, quantity of coal used for each process of steel making and output capacity commencing in 2009.*
>
> ...
>
> *While the operational conditions become more stringent, more small and medium size companies will likely to (be) aggressively look for valued partners which could lead to opportunities for high quality acquisitions for our Company. We believe the directives have indirectly strengthened our position as an industry consolidator by creating quantitative measures we can use to better qualify potential acquisition targets.*

In its Form 10-K filing for the year ended 31 December 2007, General Steel also noted:

> *We believe the government will continue, and likely strengthen, its industry consolidation effort. As capacity from weaker market players is removed, capacity allotments are shifted to existing companies, such as our Longmen Joint Venture.*[82]
>
> ...
>
> *We believe that the government will continue to strengthen its industry consolidation effort. As excess capacity from weaker market players is removed, the eliminated capacity will be reassigned to steel companies which have gained government approval for expansion.*[83]

[Emphasis added]

3.5 Conclusion

After reviewing the identified GOC macroeconomic policies in relation to the iron and steel industry, and related implementing measures, Customs and Border Protection considers there is extensive evidence on the record to show that the GOC plays a significant role in the iron and steel industry in China, through its various policies, plans and implementing measures (including through the implementation of these policies by iron and steel industry SIEs as public bodies).

[82] General Steel Form 10-K filing for the period ended 31 December 2007.

[83] General Steel Form 10-KQ filing for the period ended 31 March 2008.

For ease of analysis, it is considered that these GOC influences can be broadly categorised as follows:

1. measures to drive structural adjustment;
2. technological, efficiency and environmental development measures;
3. export restrictions on coke; and
4. subsidisation of encouraged practices and products.

In categorising the above, it is noted that there is some degree of overlap between these categories (e.g. subsidisation is considered to be used to encourage technological and efficiency development).

The likely impact of these measures, and whether they have created a 'market situation' is examined in the following chapter.

4 ASSESSMENT OF MARKET SITUATION

After identifying numerous GOC influences on the iron and steel industry, Customs and Border Protection has undertaken an assessment as to whether it is reasonable to consider that a market situation existed in the Chinese HSS market during the investigation period, such that sales in that market are unsuitable for determining normal value under s.269TAC(1).

4.1 Approach to assessment

In assessing whether a market situation has been created by government influence on an industry, it is considered that several approaches may be open to Customs and Border Protection.

In examining whether a market situation existed in the Chinese HSS market, Customs and Border Protection has focussed particularly on an economic assessment of the likely impact of these GOC influences on the determinants of supply of HSS, and the resulting likely impact on the price of HSS in China.

In doing so, the likely impact of these GOC influences on the determinants of supply of HSS has been outlined below in relation to each identified category of influence.

4.2 Economics of supply

It is generally accepted that demand and supply side factors of a market for a product influence prevailing prices for that product.

It is accepted economic analysis that if a factor that influences supply (other than the price of a product) changes, this will cause a change in supply. A change in supply, or a shift in the supply curve, can have the effect of:

- increasing supply, which causes producers to supply more products at any given price; or
- decreasing supply, which causes producers to supply less products at any given price.

In each of these cases, the equilibrium price (the price at which the quantity demanded equals the quantity supplied) will be different to the price before the shift in supply.

It is in this context that we explain whether the GOC policies and measures have led to HSS prices that are considered likely to be significantly different to what they would have been without GOC influence in the iron and steel sector.

4.3 Determinants of supply

The supply of any given goods can be shifted by changes in the determinants of supply. These determinants include:

- the costs of the factors of production;
- technology;
- the price of related goods;
- the number of suppliers in the market; and
- expected future prices.

It is considered that, of these determinants of supply in relation to HSS:

- the costs of the factors of production;
- technology; and
- the number of suppliers in the market

have likely been impacted by the GOC influences outlined in this paper.

4.3.1 Cost of the factors of production

The term 'factors of production' relates to the inputs of production of a good, including land, labour and capital goods.

It is generally accepted that if the price of a factor of production decreases, supply of the product increases, while if the price of a factor of production increases, supply of the product decreases.

It is considered likely that the impact of GOC influences have overall increased supply in the iron and steel industry – as discussed in Section 4.4.

4.3.2 Technology

It is accepted that changes in technology are a determinant of supply.

Generally, it is accepted that adoption of newer technologies enable producers to use fewer factors of production to produce goods, which lowers the cost of production and increases supply.

It is considered likely that the impact of GOC influences have increased the use of more advanced technology, equipment and production practices in the iron and steel industry and this has increased supply – as discussed in Section 4.4.

4.3.3 Number of suppliers in the market

It is accepted that, all other things being equal, the greater the number of firms in the market producing a good, the larger the supply of that good.

It is considered likely that the impact of GOC influences have decreased the number of market participants throughout the iron and steel industry (though this has not had the effect of reducing production overall, see further discussion at Section4.5.1).

4.4 Impacts of GOC influences

4.4.1 Structural adjustment

As noted in Section 3.3.4, significant evidence of the implementation of the GOC policy of restructuring, re-locating and consolidation of the Chinese iron and steel industry into larger, more favourably located enterprises has been observed. Further, evidence that the GOC has implemented measures to eliminate redundant capacity in the iron and steel industry has been observed.

Consequently, structural adjustment has been seen both in 'upstream' producers of HSS raw materials (and the upstream inputs of these raw materials as well), but also in the Chinese pipe and tube sector and amongst enterprises that themselves produce HSS and other pipe and tube products.

Furthermore, it is considered that the merging and consolidation of the iron and steel industry is likely to be more widespread than those mergers listed in Section 3.3.4, which are non-exhaustive listings. It is therefore considered likely that numerous other iron and steel enterprises (including HSS manufacturers and other pipe and tube producers) have undergone mergers and restructuring in line with these GOC policies.

It is considered that the effects of this structural adjustment for enterprises are likely to include:

- greater cost efficiency through the creation of economies of scale;
- tax benefits;
- shifts in market share;
- improved profitability;
- improved research and development through consolidated efforts (and a resulting improvement in production processes and efficiency, as well as product quality and output levels);
- increased administrative efficiency;
- improved ease of access to funds; and
- reduced number of competitors.

Many of these effects are considered to be beneficial for enterprises involved, and the industry overall. These benefits appear to be in line with the GOC aims and objectives to:

> *....realize the industrial upgrading and develop the iron and steel industry into an industry with international competitiveness that may basically satisfy the demand of the national economy and social development in terms of quantity, quality and varieties*

as stated in the NSP.

Indeed, Customs and Border Protection notes General Steel's comments in its 10-K filing for the period ended 31 December 2007, and Form 10-KQ filing for the period ended 31 March 2008 (reproduced in Section 3.4.2), that identify this restructuring and shifting in capacity from 'weaker market players' to larger enterprises as an opportunity for General Steel.

4.4.2 Technological, operating efficiency and environmental development measures

As outlined throughout this report, many of the GOC's macroeconomic policies and implementing measures for the iron and steel industry focus on achieving goals of technological advancement, increased industry efficiency (noting the overlap of this with the above-mentioned mergers and restructuring) and environmental protection. In many ways, these measures appear to overlap (e.g. technologically advanced machinery is also more environmentally friendly), so have been considered collectively.

The impact of these measures on the iron and steel industry and the enterprises operating within it are considered to be manifold, and are considered may have a variety of impacts. Some likely impacts are outlined below:

- increased efficiency through the use of more modern equipment and manufacturing processes (resulting in lower costs and increasing industry competitiveness globally);
- decreased supply of certain materials and the need to use alternatives (e.g. the elimination of narrow strip mills in line with the Directory Catalogue will likely decrease the supply of narrow strip and force HSS and other metal product producers to use HRC or other alternatives – which may itself require technological upgrades, etc);
- increased capital expenditure (e.g. having to invest in new environmentally-sound equipment or newer production technology);
- further consolidation of the industry as enterprises that do not meet environmental, production capacity, or use of non-backwards production are forced to close/merge with compliant enterprises;
- improved product quality; and
- effects on decision-making of enterprises to comply with environmental requirements.

While Customs and Border Protection considers that it is common for governments to impose measures on their industries designed to protect the domestic and international environment, it nevertheless considers that such measures likely directly impact the operations and business decisions of enterprises, the costs incurred by these businesses, and subsequently their profits and/or selling prices.

Indeed, Customs and Border Protection notes General Steel's comments in its Form 10-K Form for the period ended 31 December 2010, which notes the ability of GOC-enforced environmental measures to significantly impact the business' costs.

4.4.3 Export restrictions on coke

Customs and Border Protection considers export restrictions on coke[84] are likely to have acted as a strong barrier to exports of coke from China, as the competitiveness of Chinese exports of coke would have been seriously eroded by the export taxes and lack of VAT export rebate, and the ability of enterprises to be involved in the export of coke was restrained.

These barriers to export would reasonably be considered to have an impact on the volume of coke exported, which has been observed in a correlating significant decline in exports of coke from China, resulting in an increased supply of coke in China (see Section 3.3.5).

In turn, this increased volume of coke retained in China could reasonably be considered to have resulted in decreased prices.

Note: publicly available cost models (available at www.steelonthnet.com) demonstrate that:

- *the cost of coke represents a significant proportion (over 20%) of the cost of cast steel (being first used to smelt iron, and this iron then used to produce steel);*

[84] Particularly from 2009 onwards when export licensing, quotas and a significant increase in export tariffs were imposed by the GOC (discussed in Section 3.3.5

- *steel represents the majority of the cost of HRC (the proportion of cost for narrow strip will depend on the amounts of scrap used to produce the billets that this strip is rolled from, though it is considered that a significant proportion of this steel scrap will also be attributable to coke); and*
- *verified information of Chinese exporters shows that HRC and/or narrow strip represents in excess of 90% of the total cost to make HSS.*

It is therefore considered that the cost of coke represents a significant proportion of the cost of HRC, narrow strip, and HSS itself.

4.4.4 Subsidisation

It is noted that Customs and Border Protection has found that Chinese exporters of HSS have been in receipt of numerous countervailable subsidies from the GOC, and that evidence exists to suggest that upstream suppliers of steel and steel raw materials have also potentially been in receipt of subsidies.

The likely impact of these subsidies on the iron and steel industry are considered to be diverse.

For example:

- direct injections of funds into enterprises may result in lower factors of production being passed on to their customers by reduced selling prices;
- grants for research and development may result in greater operating efficiency through technological innovation, and increased product quality;
- GOC funds to assist with the consolidation and merger of enterprises (such as those outlined in the Backwards Capacities Notice) may assist with the adjustment of the industry and the potential impacts of this outlined in Section 4.4.1).

4.5 Impact on supply and price of HSS

In examining the above, it is considered that a combination of the likely impacts of GOC influences on the Chinese iron and steel market are likely to have affected the determinants of supply of HSS in China.

4.5.1 Likely impact on each determinant

Structural adjustment is likely to have impacted on the supply of HSS and hence the price of HSS in the following ways.

- Reducing prices of the factors of production of HSS including the price of HSS raw material inputs due to increases in supply brought about in the HRC and narrow strip market (as well as changes in supply of upstream steel, iron and other raw material manufacturers).
- Improving the technology used by consolidated enterprises (including as a result of consolidated research and development) and hence reducing the cost of production and increasing supply.
- Increasing operating costs through the costs of compliance with environmental standards and industry operating conditions which would likely decrease supply (this influence would likely also have the effect of decreasing supply in

upstream industries due to their own compliance costs, decreasing the supply of HSS inputs and increasing the cost of these inputs)..

- Eliminating redundant capacity and consolidating production into larger, merged steel enterprises. It is noted that, while this may, in terms of economic analysis, be expected to decrease supply, this is not likely given the circumstances – that is, the structural adjustment is aimed at eliminating redundant and backward capacity and, while the shift of demand to larger more efficient producers may have reduced the number of producers and some overall capacity, it is unlikely to have resulted in significantly less production and a decrease in supply.[85] This is confirmed by statistics published in the Steel Yearbook that demonstrate that both crude steel out put and steel product output grew each year from 2006 to 2010 (approximately 50% and 70% in the period respectively).[86]

Technological, and operating efficiency measures are likely to have increased the supply of HSS (and hence the price of HSS) through the elimination of backwards capacity and adoption of more technologically-advanced production techniques, reducing the cost of production (both of HSS manufacturers, as well as for HRC and narrow strip manufacturers and in upstream industries, affecting supply in those industries as well).

Export restrictions on coke are likely to have impacted the supply of HSS and the price of HSS through the reduction of input prices through the impact of the reduced price of coke on the supply of iron, and then the flow-through effects of supply in steelmaking and casting, HRC and narrow-strip production, then HSS itself.

Subsidisation is likely to have impacted the prices of factors of production of HSS and hence the price of HSS through:

- improving the technology used by HSS manufacturers, decreasing the cost of production, as well as affecting the supply and hence price of HRC and narrow strip enterprises (and upstream industries that are also likely to have received subsidies);
- decreasing the cost of inputs of HRC and HSS through the encouraged structural adjustment of HRC, narrow strip, and upstream industry entities (see above); and
- directly reducing input prices of products at each stage of production if the subsidies are passed on by the recipient enterprises.

Customs and Border Protection therefore preliminarily determines that the price of HSS in China is likely to have been influenced by changes in the determinants of supply, leading to increased supply and consequently lower prices in both the HSS and upstream industries.

4.5.2 Overall impact

It is noted that some of these influences could reasonably be considered to have increased the price of factors of production and (in isolation) create a shift in the supply curve to the left, which would likely have the impact of raising HSS prices. However, it

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85 Refer to the comments within general Steel's Form 10-K filing for the year ended 31 December 2007 (reproduced at Section 3.4.2) that discusses the shifting of capacity amongst industry members.

86 *Supra*, note 61 at p11.

is considered that the majority of these GOC influences on the prices of factors of production, and improvements in technology, would have resulted in an overall shift in the supply curve to the right, resulting in a lowering of the price of HSS.

In noting the above, Customs and Border Protection has undertaken comparative analysis of the domestic Chinese selling prices of HSS by exporters that have co-operated with this investigation, and the selling prices of the co-operating exporters from other investigated countries (taking into account product mix). In doing so, it has been observed that the Chinese domestic HSS prices were consistently below those of all other countries (with the exception of one pipe type from one Chinese exporter, though this was not significantly greater than the price of similar pipe from exporters from other countries).

While it is noted that this disparity may be due to several reasons, it is considered that this analysis correlates Customs and Border Protection's assessment that HSS prices in China are likely to have been suppressed overall, as outlined above.

Customs and Border Protection observes that the changes in supply in HSS and resultant impact on HSS prices have been brought about in a significant part by the GOC influence within the iron and steel industry.

4.6 Conclusion – market situation

Customs and Border Protection considers that the GOC has exerted numerous influences on the Chinese iron and steel industry, which are likely to have materially distorted competitive conditions within that industry and affected the supply of HSS, HRC, narrow strip, and upstream products and materials.

The impact of these GOC influences on supply are extensive, complex and manifold, and their resulting impact on the price of HSS is not able to be easily quantified. However, as discussed in Section 2.3.3 it is not considered that the quantification of price effects is necessary in assessing the suitability of prices for normal value under s.269TAC(1).

Customs and Border Protection's analysis of the information available indicates that prices of HSS in the Chinese market market are not substantially the same (likely to be artificially low), as they would have been without the GOC influence. Customs and Border Protection considers that GOC influences in the Chinese iron and steel industry have created a 'market situation' in the domestic HSS market. such that sales of HSS in that market are not suitable for determining normal value under s.269TAC(1).

5 PROPOSED METHOD OF CALCULATING NORMAL VALUE

After finding that there was a market situation in the Chinese HSS market that renders domestic selling prices of HSS unsuitable for normal values under s.269TAC(1), Customs and Border Protection must consider alternative methods for calculating normal value.

As stated in Section 2.3, where normal values cannot be established under s.269TAC(1) due to the existence of a market situation, normal value may be determined on the basis of a cost construction[87] or third country sales.[88]

Customs and Border Protection preliminarily considers that the GOC influences outlined above, their likely affect on supply, and the likely resultant impact on prices, would similarly affect the selling prices of HSS by Chinese exporters to third countries. It is therefore considered that third country sales are not suitable for determining normal value.

Consequently, Customs and Border Protection considers that normal value should be calculated on the basis of a cost construction under s.269TAC(2)(c).

As noted in Section 2.3.2, this cost construction must be undertaken in accordance with the Regulations, which provide for an examination of the reasonableness of exporters' recorded costs. It is considered that, due to the nature of the identified GOC influences on the Chinese iron and steel industry, particular consideration will need to be had to the reasonableness of costs of Chinese HSS exporters.

Customs and Border Protection's assessment as to costs reasonableness, and the exact method of constructing normal value under s.269TAC(2)(c) will be discussed in the investigation's Statement of Essential Facts (SEF).

87 Section 269TAC(2)(c)
88 Section 269TAC(2)(d)