A Summary of Money for Metal

A detailed examination of Chinese Subsidies to its Steel Industry

Prepared for:
- AISI
- SMA
- SSINA
- CPTI

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Contents

Introduction

- China steel capacity is 500 MT and will be 600 by year end 2007.
- In 2001 was 100 MT.
- Expansion is the result of Chinese <u>government control</u> and <u>subsidies</u>.
- 8 of the 10 largest Chinese steel producers are 100 % owned / controlled.
- 19 of the 20 are majority owned / controlled.
- 91 % is state owned / controlled.
- This report identifies Chinese steel producers have received at least $ 52 bill dlls in subsidies.

Introduction

- This report do not estimate fiscal, financial and other type of subsidies
- These subsidies have fueled China steel exports.
- China moved from a net importer to a net exporter in 2006.
- At the same time China became the largest single steel exporter by volume.
- China finished steel exports surged to 33.8 MT in first half 2007.
- Up 100 % compared with same period in 2006.
- The result has been artificial growth of steel capacity and WTO violation.

1. Ownership & Control

Chinese Government Ownership & Control of Steel Industry

PRODUCER	PRODUCTION (2006)	GOV OWNERSHIP %
Anshan	22.6	100.0
Baosteel	22.5	100.0
Tangshan	19.1	100.0
Shagang	14.6	55.0
Wuhan	13.8	100.0
Jinan	11.2	100.0
Magang	10.9	100.0
Laigang	10.8	91.0
Shougang	10.6	100.0
Valin	9.9	100.0
Handan	7.9	100,0
Baotou	7.5	64.4
Anyang	7.0	100.0
Panzhihua	6.8	100.0
Jiuquan	6.6	100.0
Taiyuan	6.3	100.0
Tangshan	6.0	0
Liuzhou	5.4	100.0

Chinese Government Ownership & Control of Steel Industry

- Of the top 20 Chinese steel producers:
    - 7 are partly or wholly owned by the central government
    - 13 are partly or wholly owned by a provincial or regional government
    - 1 is partly owned by a local government.
- This ownership leads to competing interests among governments.
- This explains difficulties to elimination of obsolete capacity.

Government Direction & Management

Central Government Policies: Steel is Strategic

- Five years plan: Central Committee of Communist Party & NDRC
- List of industries to be encouraged (eligible for tax exemptions)
- Foreign investment catalogue (to be encouraged & prohibited)

Provincial & Local Government Policies & control

- Steel targets, Raw materials, infrastructure.

Other forms of control

- By installing Party members as directors & supervisors

2. Subsidies

Chinese Documented Steel Subsidies

TYPE OF SUBSIDY	VALUE (Bill RMB)	VALUE (Bill $ usd)
Loans	130 991	17 317
Equity Conversion	141 008	18 641
Land Use	38 900	5 142
Grants	1 956	258
Mandated Mergers	9 470	1 251
Currency undervaluation	70 862	9 368
Tax benefits	Unknown	Unknown
VAT Rebates	Unknown	Unknown
Domestic Preference	Unknown	Unknown
Raw Materials	Unknown	Unknown
Electricity	Unknown	Unknown
Environmental	Unknown	Unknown
TOTAL	393 189	51 980

Cash Grants and Capital Infusions

- This is the most important type of subsidy used in the steel industry.
- These are documented in the financial statements.
- Though cash grants would become less frequent.
- China has adimitted to the WTO that still continues to offer grants that are operating at a loss.
- China has promised to eliminate them.
- The Canadian government found benefits to steel industry in the form of direct grants to satisfying export criteria

Equity Infusions and Conversions

- There are two forms: (1) Straight injection and (2) debt – to – equity.
- This capitalization technique relieves cash starved companies of their obligation to repay their debts.
- Another option are. Debt – to – equity swaps. In the year 2000, China reported 37 steel companies benefited with $ 7.5 billions dollars.

Land Use

- China steel industry receives subsidies lease agreements for land.
- This is documented in financial statements.
- Private land ownership is prohibited in China. Instead the Chinese Government offers lease agreements.
- A differential price could be obtained through negotiations.
- Steel mills enjoy the use of land at prices substantially below any market

Mandated Mergers

- One of the newer tools used by the Chinese Government consists of government mandated mergers and transfers of ownership.
- These mergers were defined by China´s 11 th Five Year Plan.
- Objective: Growth of unprofitable capacity trough grants.
- This is supporting the creation of world class entities and supporting the consolidation process.

Preferential Loans and Credit

- The government also direct credit to Chinese steel producers to obtain some specific goals.
- This is done by Central, provincial and local governments through the state banks.
- These are preferential loans: below market rates and debt fogiven.
- In the CVD case on Coated Paper, DOC found such loans.

Tax Benefits to the Steel Industry

- The Central, provincial and local governments provide a variety of tax exemptions, reductions and credits.
- Many of these tax incentive were part of the WTO subsidies notification and complaint made by US and Mexico. Were identified more than 45 different tax incentives programs. (most benefit steel)
- Basic programs:
  - Enterprises that are Foreign Invested Entities (FIE´s): Export oriented
  - Enterprises that purchase domestic over imported goods.

Tax Incentives for FIE´s: Export Oriented

- Tax benefits for Export – Oriented – Producers & FIE´s
  - Two free and Three Half program, but not less than 10 years on income tax
  - FIE may continue to pay half if exports constitute 70 % of sales.
  - Tax reduction on location
  - Technology and knowledge intensive
  - Reinvest profit
  - High tech.
- Domestic Preference
  - VAT refund for foreign investment and domestic equipment.
  - 40 % refund: Chinese equipment vs imports.
  - Tax policy for Chinese made technological up grades
  - Chinese companies with foreign investment: Income tax from 33 % to 15 %

Value Added Tax Policies

- There are at least three types of VAT rebate <u>to encourage production</u> of selected steel products.
  - On imported equipment not for resale to encourage foreign investment and up grade technology.
  - Specific locations
  - VAT subsidy (tax rebate) program: Direct payments upon exports
    - Debated: If does not exceed the indirect taxes levied on domestic market)

Other Subsidies

- Benefits for purchasing domestically produced inputs & equipment
- Raw Materials (Coke, Ferroalloys, Non ferrous metals, Iron Ore)
  - Exports Restrictions
- Energy / Electricity: Discounted rates.
- Environmental subsidies: Falling to enforce basic environment standards
- Currency undervaluation: Almost 40 %.