

CHAPTER 1

Overview

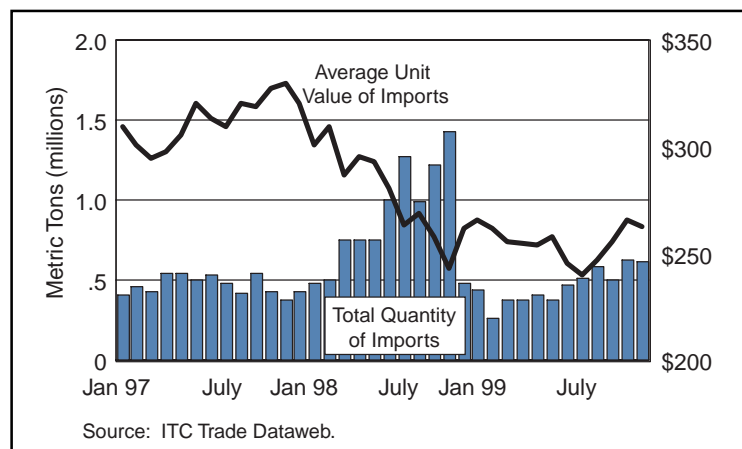
Introduction

Over a six-month period in 1998, the U.S. steel industry saw its position in a strong U.S. market severely disrupted as low-priced imports reached all-time record levels.

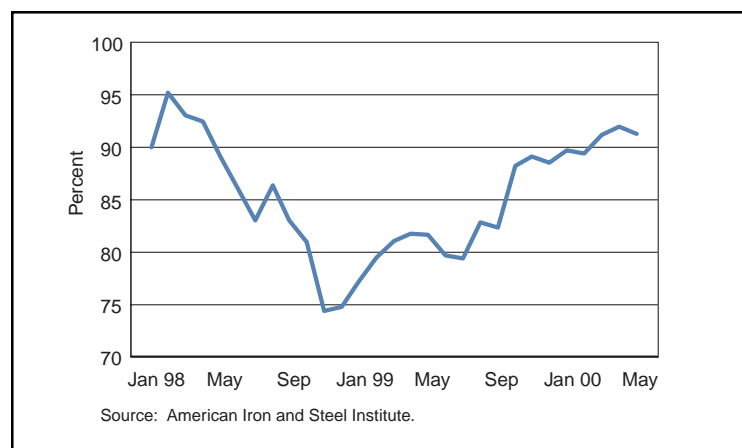
- Imports of hot-rolled steel—the focal point of the crisis—increased over 70 percent from the previous year’s record high, while the average prices of these imports fell nearly 20 percent (*Chart 1-1*)¹.
- Capacity utilization rates for U.S. producers dropped to 75 percent at year’s end from over 90 percent earlier in the year (*Chart 1-2*).
- While shipments by domestic producers were up slightly in the first half of 1998, they fell 11 percent between the first and second halves of 1998.
- Accumulating losses drove six companies into bankruptcy.
- Thousands of U.S. steel workers were laid off.

It was not until the second half of 1999 that the industry showed signs of recovery:

- Prices for a number of steel products are now up from the depressed levels seen in late 1998 and into 1999.



1-1. U.S. Imports of Carbon Hot-Rolled Flat Products, 1997–1999

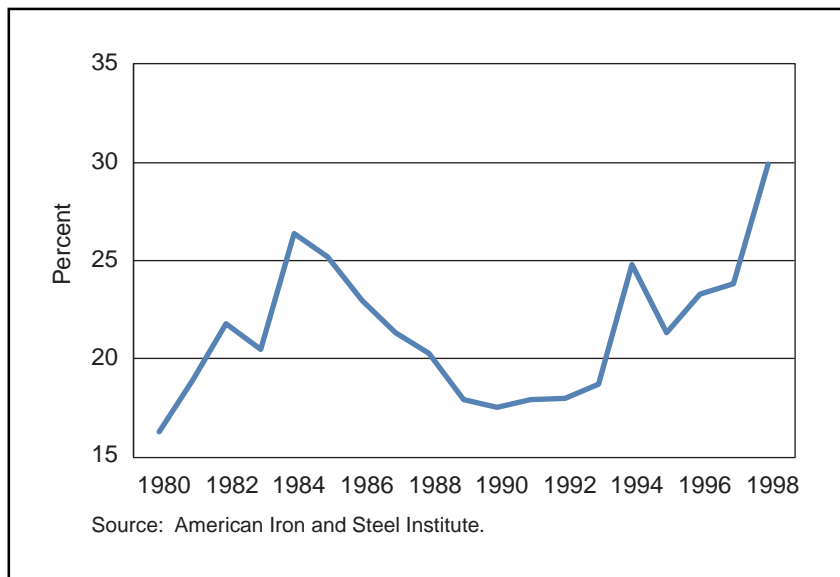


1-2. Monthly Capacity Utilization Rates

- New orders are rising and shipments are up 21 percent.
- The industry has been operating at more than 90 percent of capacity so far this year versus 80 percent during the same period last year.

The 1998 U.S. Steel Import Crisis

The bulk of the increase in steel imports in 1998 and the drop in prices were attributable to a few countries: Russia, Japan, Korea, and Brazil.² Some foreign steel producers and traders cut prices significantly. In the last six months of 1998, high-quality Japanese steel was being sold at prices approaching lower quality Russian products. This decline in prices led to a steep rise in import penetration in 1998. Import penetration exceeded the previous peak reached in 1984 that resulted in the imposition of voluntary restraint agreements (*Chart 1-3*).



1-3. Import Penetration: Steel Mill Products, 1980-1998

The Asian financial crisis and the catastrophic drop in demand in Asia compounded the problems caused by overcapacity in the global steel industry (*see box, next page*).³ The financial crisis quickly resulted in deep recessions in many Asian economies. Capital flight contributed to the significant depreciation of many Asian currencies. As investment and consumption in Asia fell, the demand for steel plummeted. When financial turmoil spread to other countries, such as Russia and Brazil, more and more steel was diverted to the remaining healthy markets, including the

United States. But long-term structural factors—government assistance, impediments to importing, noncompetitive market structures, and unsound banking practices—were also at play. These structural issues have often led to unfair trade problems over the years. Since 1980, almost 40 percent of the unfair trade cases investigated in the United States have been related to steel products. More than half of these steel cases resulted in some form of trade relief.

Short-Term Factors Behind the Crisis

A number of short-term factors emerge as explanations for how the 1998 U.S. steel crisis came about.

Lost Asian Demand. The main precipitating event was the Asian financial crisis. Beginning with Thailand in mid-1997, financial troubles quickly spread throughout Asia, bringing with them the worst economic downturn to hit the region in thirty years. As economies collapsed, demand for steel in the region quickly dried up. Asian steel producers and traditional exporters to the region, such as Japan, Russia, and Brazil, sought other markets. The situation was further exacerbated as the financial crisis spread to Russia and Brazil by mid-1998.

Currency Depreciations. The Asian crisis led to currency depreciations in many of the world's largest steel-producing countries. Weaker currencies enabled exporters in these countries to lower their dollar-denominated

steel prices and still make money (as dollars converted into greater amounts of local currency). Korean and Brazilian steel became particularly attractive to the U.S. market, due to substantial depreciations.

- **Korea.** Between 1997 and 1998, the Korean currency, the won, lost 32 percent of its value compared to the U.S. dollar. Effectively, this meant that Korean steel, which previously had sold for \$350 a metric ton (MT) could now be sold for \$238, without any change in the amount of local currency received. Of course, exchange rate changes cut both ways: won prices rose for imported inputs such as iron ore and coke, which are typically denominated in dollars.
- **Brazil.** In Brazil, the local currency gradually declined 12 percent over the course of 1998. However, because the Brazilian steel industry sources all of its raw materials domestically, there was no significant increase in input costs. This gave Brazilian producers considerable flexibility to reduce dollar-denominated prices in order to maintain their level of exports to the United States.

Overcapacity in the Global Steel Industry

Overcapacity is a relative term, and there is no single agreed-upon definition. Generally, the term is used to describe the fact that global steelmaking capacity has been consistently well-above global steel production over the long term. In the case of steel, this may be attributable to the fact that less than perfect market forces dominate the industry, such that government supports and other activities have sustained uneconomic capacity and production. Although there may be different ways to measure global steelmaking capacity and production, most industry experts that have analyzed the issue find a sizable and consistent gap between capacity and production over the long term.

A 1999 Organization for Economic Cooperation and Development (OECD) report concludes that world steelmaking capacity has remained well-above production between 1985 and 1999. The report states that world steelmaking capacity increased by almost 150 million metric tons (MT) during this time and that by 2001 it will have increased by an additional 45 million MT. However, steel production has increased in “distinctly smaller proportions,” resulting in a widening gap between production and capacity. (Efforts are currently under way in the OECD Steel Committee to refine the capacity measurement pursuant to questions raised as to the accuracy of some of the underlying country capacity data.)

Most other steel analysts have also concluded that there is significant overcapacity in the global steel industry. A World Steel Dynamics study of capacity utilization rates reached conclusions very similar to those of the OECD. Moreover, the London-based Iron and Steel Statistics Bureau (ISSB) estimated world excess capacity to be 250 and 275 million MT in 1997 and 1998, respectively.

Comparable findings of overcapacity have been made for specific regions and countries. The ISSB calculated 100 million MT of overcapacity in Eastern Europe and countries of the former Soviet Union, 70 million MT in Asia, 50 million MT in the European Union (mainly in Italy and Spain), and 15 million MT in the United States. The United Nations estimated that overcapacity in Russia and Ukraine was between 20 million and 30 million MT. Analyzing the Japanese steel industry, a 1999 report by a committee sponsored by the Ministry of International Trade and Industry, which took into account domestic and global demand over the long term, estimated that 15 percent of Japanese steelmaking capacity, about 17 million MT, was “surplus.” Finally, one of the conclusions reached by a recent International Monetary Fund report was that “excess production capacity” had been created in the Korean steel industry as a result of government influenced private investment (although the report did not explain how this conclusion was reached). While estimates from various sources indicate that there is substantial unused steelmaking capacity throughout the world as a whole across many years, high fixed costs and other factors (including, for example, protected markets and subsidies) encourage steel makers to operate facilities at high levels of capacity. Such high capacity utilization, combined with substantial unused capacity overhang, tends to suppress prices worldwide (see box “*The Economics of the Steel Industry*” in Chapter 2).

The currency depreciations in Russia and Japan were less of a factor in 1998.

- **Russia.** Because the weakening of the ruble came relatively late in the crisis, it appears that few imports from Russia could have reflected the depreciation prior to the dramatic reduction in Russian imports at the end of 1998 as a result of antidumping cases.⁴
- **Japan.** In Japan, the depreciation of the yen clearly played a role in the ability of Japanese steel makers to charge lower dollar prices. However, import data indicate that cuts in Japanese prices for key products exceeded the amount of the yen's depreciation.

Strong U.S. Demand. The growing U.S. economy stood in stark contrast to the convulsions and contractions besetting many economies around the world. In the United States, demand for steel was strong and, until the middle of 1998, domestic prices generally were still high. Given the openness of the U.S. market and prevalent high demand and prices for steel, foreign produced steel naturally found its way to the United States.

General Motors Strike. An unexpected strike of General Motors workers during the summer of 1998 had the effect of adding a degree of uncertainty. When the strike began, it was unclear how long it would last and what effect it would have on an already jittery steel market. The financial crisis abroad was softening world steel demand, and U.S. imports were beginning to increase. However, in the end, the strike was relatively short-lived (fifty-four days) and its direct impact was minimal and focused on a few products, particularly cold-rolled steel.

Long-Term Factors Behind the 1998 Crisis: Market-Distorting Trade Practices

Beyond the immediate causes of the 1998 steel crisis, the underlying structural issues that have historically plagued the global steel industry are crucial to understanding the events that took place in 1998.

Unique Characteristics of Steel Trade

The world steel industry is characterized by a variety of noncompetitive practices. The effect of such practices is that investment decisions as well as pricing and sales almost certainly are different from what would occur in a purely competitive market. In a competitive industry, production and ultimately capacity should respond to market signals. The steel industry is not the only sector where demand fell as a result of the Asian crisis. It is, however, one of the few where there was a very large increase in U.S. imports relative to domestic demand. There was no dramatic increase in U.S. imports of autos despite falling sales in Asia. There was no rise in imports of chemicals or electronic products on the order of steel imports. The reason for this is that steel tends to be unique in both its industry characteristics and in the degree to which noncompetitive market conditions exist as a result of government actions and inactions.

Because of the importance of the steel industry in many national economies, the marked tendency among all countries during an economic downturn or crisis is to preserve productive capacity in the hopes of saving jobs and maintaining economic stability (*see box*).⁵ One way or another, steel companies around the world benefit from government practices and policies that forestall adjustments mandated by the market. As a result, market forces are not able to bring world capacity and supply in line with demand. Because capacity and production cuts are resisted, excess capacity tends to be maintained and more steel tends to be produced. This greater supply of steel worldwide has a dampening effect on prices in good times and bad.

The thirty-year history of repeated unfair trade actions is symptomatic of underlying market-distorting practices in the global steel market (*see box*).⁶ Market-distorting practices can spill over into the global marketplace during cyclical downturns by helping steel companies maintain or increase market share and

productive capacity via the exporting of low-priced steel. Such practices enabled the steel companies in the countries most involved in the 1998 crisis to set low prices for exports and forestall downsizing adjustments mandated by the market.

History of Steel Trade Friction

The first steel dispute occurred in the United States in 1968. The filing of countervailing duty cases against subsidized European steel makers led to voluntary restraint agreements. These agreements ended in 1974 when the global steel market recovered. Another crisis and subsequent filing of dumping cases—primarily targeting Japanese exports—led to an attempt in 1977 to set minimum “fair value” prices for imports through the “trigger price mechanism.”

This policy proved ineffective against European exports which were above the minimum prices but below the European cost of production. To address this problem, antidumping cases were then filed against three-fourths of European steel exports to the United States and a new trigger price mechanism was put into place. This policy also eventually proved ineffective, which led to the filing of antidumping and countervailing duty cases in 1982. The rates of subsidization in these cases reached over 20 percent for some countries, while dumping rates topped 40 percent. Eventually, new voluntary restraint agreements were reached, which lasted until 1992.

After concluding the voluntary restraint agreement with most of Europe, however, imports surged from developing countries and other developed countries. The U.S. steel industry reacted by filing a large number of trade cases. Extremely high dumping and subsidization rates were established in many of these cases. The number of different products found to have been dumped or subsidized was also noteworthy. Between 1982 and 1986, for example, eleven steel products from Brazil alone were found to have been dumped or subsidized. The early 1980s also saw the first antidumping and countervailing duty cases filed against Korean steel.

In 1989, the United States launched an effort to negotiate a global Multilateral Steel Agreement to abolish subsidies in exchange for the end to quantitative restraints. When the voluntary restraints expired in 1992, another set of trade cases were filed. These cases included Japan, Brazil, Korea, and numerous European countries, and a number of resulting orders remain in place today. Efforts to negotiate a multilateral agreement continued until 1997, without success.

In addition to the dumping and subsidy cases filed over the years, four “Section 201” cases (which address import surge situations) have been pursued on various steel products.

Russia

Perhaps the most significant long-term factor leading up to the 1998 steel crisis has been the emergence of Russia as one of the world’s top steel exporters. In the period before the crisis, the Russian steel industry was caught between two systems. A large steelmaking capacity built in Soviet times to meet domestic needs faced a domestic market in which demand had collapsed. Privatized companies continued to do business by bartering their products, often not paying their workers, suppliers or taxes, knowing that bankruptcy procedures rarely resulted in the closure of a company. In addition, state-controlled input suppliers continued the old command economy tradition of providing low-priced inputs and transport to the steel industry. In this environment, there was a tendency for more steel to be produced than demand would otherwise dictate and for steel to be sold at prices not necessarily related to the cost of production. As a result, Russia experienced trade frictions with a number of countries, of which the United States is only the latest example.

Japan

Lax enforcement of antitrust laws is the primary market-distorting trade practice in Japan affecting steel. The U.S. government has longstanding concerns regarding the lack of effective enforcement of competition rules in Japan in general,⁷ and coordination within Japan’s steel sector warrants greater scrutiny. Many steel industry experts note that a “cooperative system” exists among the major steel producers in Japan. Apparent

coordination on production and other matters help allow Japanese steel companies to charge high prices for their products in Japan. Because domestic supply needs to be controlled for such a system to work, import barriers of one sort or another are kept in place to keep import volumes to a minimum. A protected domestic market confers a competitive advantage on Japanese firms. Revenues from high-priced home market sales can be used to increase competitiveness through, for instance, spending on research and development. Domestic revenues can also be used to sustain low-priced exports, which can give rise to concerns of unfair trade.

Korea

The financial difficulties of the Korean steel industry as a whole in the 1990s can be linked to excessive borrowing to fund over-investment in under-performing capacity. Massive new investments in steel during the 1990s were encouraged by unsound, often government-influenced, bank lending practices. A number of nonviable companies, which accounted for almost a quarter of domestic capacity, were kept in operation before and during the crisis, and continued to produce for domestic and export markets.

The government has also supported the development of Korea's largest steel producer—POSCO—to the point that POSCO has achieved a monopolistic position in the Korean steel market. As a government-owned company, POSCO was used by policymakers to further the government's industrial development objectives, which included providing low-cost steel to downstream producers. The Commerce Department found that to be an export subsidy. Additionally, POSCO's dominant position raises fundamental concerns about competition within the Korean steel market and possible trade effects that POSCO's continued dominance may have in the future. Korea's antitrust authorities, the Korean Fair Trade Commission (KFTC), looking at the Korean market in mid-1998, found that POSCO's dominance had anticompetitive effects and recommended splitting up the company. Yet the Korean government has not implemented these recommendations and, as also noted by the KFTC, POSCO's market power remains a significant concern for the future of the Korean industry and steel trade.

Brazil

As in Japan, Brazilian producers enjoy the advantages of a domestic market insulated from real market competition. Although the industry is now mostly privatized and has made progress toward full market reliance, Brazilian antitrust authorities have already found evidence of cooperative pricing practices among Brazilian steel producers once. Another investigation is currently under way. These practices, in combination with various import barriers, reduce domestic competition and create conditions for producers to charge higher prices at home. Brazilian producers are able to leverage the advantage of an insulated home market to sell cheaply abroad.

The depreciation of the Brazilian currency in 1998 gave Brazilian producers the flexibility to cut prices even more in order to retain U.S. export levels in the face of stiff competition, particularly from Russia and Japan. The difference between Brazilian domestic prices and Brazilian export prices to the United States, even after accounting for the depreciation, was the principal reason for the U.S. industry's dumping concerns with Brazil in 1998.

Response to the Crisis in the United States

The U.S. steel industry had been through import crises before, and had undergone a painful restructuring process in the 1980s and early 1990s.

- During that time, the U.S. industry closed dozens of inefficient mills, cut capacity, invested billions of dollars in new technology, raised productivity by more than 300 percent, and eliminated 330,000 jobs.
- At the same time, the U.S. industry invested more than \$7 billion in environmental controls, cutting polluting emissions by 90 percent.

- Led by “mini-mill” companies such as Nucor, the U.S. industry became a world leader in low-cost production.

As a result, the U.S. industry believed that it would be difficult for foreign producers to deliver steel to the U.S. market at a lower cost than U.S. mills.

The 1998 crisis was especially damaging to the U.S. steel industry because the U.S. economy as a whole was doing well. The steel market is highly cyclical, rising and falling with the ups and downs of the economy. When the economy is growing, the industry counts on being profitable to tide it over when times are bad. In the first half of 1998, both prices and demand for steel were up.

By the second half of 1998, steel prices had plummeted even though demand for steel in the U.S. market remained strong. U.S. steel companies and several communities suffered from a wave of low-priced imports (*see box*).

The magnitude of new imports and their detrimental effect upon the U.S. steel industry led to calls from the industry and steel workers for relief. Even Nucor, a highly efficient U.S. mill which had previously refused to join in administrative proceedings against unfair trade practices, felt compelled to support such measures. U.S. steel workers believed they were facing unfair competition. Evaluating the steel crisis and formulating an appropriate response became one of the President’s top economic and trade priorities.

Adopting a multi-pronged approach, the Administration provided strong enforcement of the trade laws in a manner consistent with World Trade Organization (WTO) requirements, while undertaking bilateral efforts and other measures to address the market-distorting practices that contributed to the crisis. Due in part to

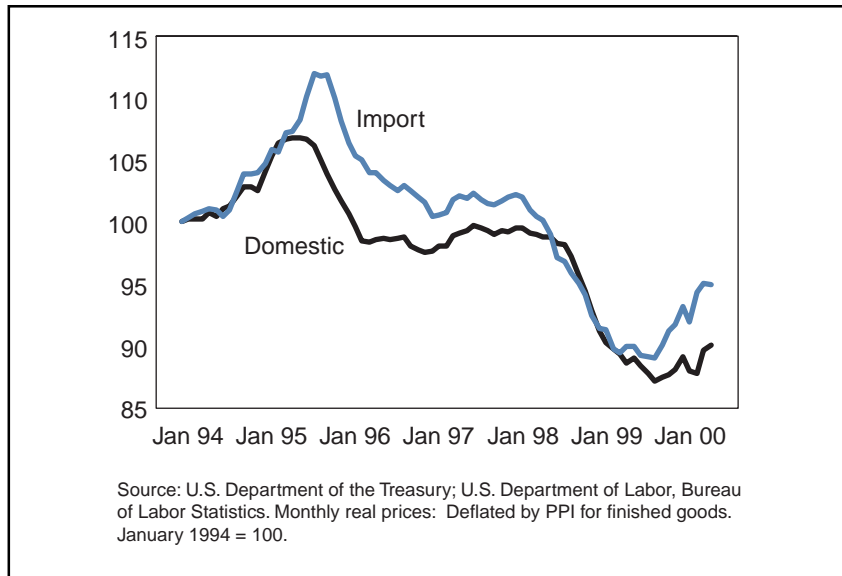
A Company in Bankruptcy, A Community in Crisis

Riverdale, Illinois, home of Acme Steel, is a bedroom community located in Cook County on the southern border of Chicago. Established in the 1950s, Riverdale’s fortunes rose and fell with the area’s steel-based manufacturing.

In 1993, Acme Steel and the United Steelworkers made a concerted effort to preserve the company. According to company officials, between 1994 and 1996 Acme Steel invested more than \$400 million to modernize its facilities with a state-of-the-art thin slab caster and strip mill. At the same time, Acme’s employees made significant concessions, including layoffs, to ensure that the new facility would be successful. When the crisis hit, start-up was 90 percent complete. However, the sharp drop in prices and the collapse of the company’s orders caused severe liquidity problems, which quickly pushed the company into bankruptcy. As Jim Howell, Acme’s President and CEO said, “The new facility was to be the engine of growth for Acme, but imports put everything on hold.”

Town officials stated that Acme Steel is the economic foundation of Riverdale. Virtually all of Riverdale’s tax revenues come from Acme. There is hardly any sales tax base—almost all retail facilities within the community have closed. Acme provides slightly over \$1 million in direct tax revenues and 70 percent of the utility taxes. Roughly 90 percent of the school budget and 60 percent of the park and recreation budget comes from Acme.

Acme’s misfortunes have meant cutbacks for Riverdale. While the town has been able to maintain police and fire services, almost half of the park staff has been let go and the youth and senior programs have been canceled. The town library has let go one-fifth of its employees and is unable to afford an Internet hook-up for use by the town’s residents, most of whom do not have access to a computer. The school district, which has a dropout rate of over 50 percent and a 48 percent new student turnover rate, has also had to cut back on programs, extracurricular activities, and its computer budget for classroom training.



1-4. Steel Price Index (Jan 1994–May 2000)

these efforts, as well as the efficiency, productivity, and competitiveness of U.S. steel workers and producers, the industry is well on the road to recovery—by early 2000 capacity utilization rates were again above 90 percent (*see Chart 1-2*) and have remained at that level through May. Domestic shipments in the first quarter of 2000 reached record levels, and first quarter 2000 earnings were up for most major steel companies. However, employment has only recently begun to recover and, while prices have improved, they are still below 1997 levels (*Chart 1-4*).⁸

Reform and Restructuring in Russia, Japan, Korea, and Brazil

As the United States reacted to the impact of the 1998 steel crisis, initial steps were taken in Russia, Japan, Korea, and Brazil to address the significant structural problems that underlay their struggling economies. These restructuring efforts have had mixed success in dealing with market distortions affecting steel trade.

- **Russia's** economy has rebounded since 1998, though it is only just beginning to make up ground lost since the beginning of the transition, and the government has a long way to go in implementing reforms that will sustain growth and investment. Domestic steel consumption is increasing, and is expected to grow if the economy continues its expansion. Barter and the nonpayment of wages and taxes by steel producers have declined sharply since 1998 and some input prices have been raised. While the Russian government's 1999 development strategy for the steel industry does not directly address many of the steel industry's structural problems, Russia's new leadership has made a public commitment to reform, and is actively encouraging cash payment of wages, taxes, and suppliers and discouraging the use of distortive barter transactions.
- In **Japan**, over the past year, the steel industry has experienced several events that ultimately could stimulate competition among major steel producers. These include (1) pressure from major automotive customers for more competitive domestic market pricing, due, in part, to the significant foreign ownership of major automotive producers; and (2) a reported increase in competition from industry leader Nippon Steel vis-à-vis the other integrated steel firms. In addition, the banking sector is undergoing significant reform. It is too early to judge whether these efforts will increase competition within the Japanese steel industry.
- **Korea** has made substantial efforts to reform its financial and industrial sectors. These efforts extend to virtually every facet of Korea's economy, including the steel industry; however, it would be premature to gauge their effectiveness. Furthermore, the Korean government's delays in implementing its stated objective of fully privatizing POSCO continue to raise concerns.
- **Brazil** has also taken positive steps toward structural reform, such as active enforcement of its antitrust laws. However, the Brazilian government's recent investigation into allegations of cartel-like behavior among certain steel producers raises a concern that industry collusion continues.

New Players in the Global Steel Market

Given the problems with integrating Russia into the global steel market in recent years, attention has been focused on other possible new players. In particular, the steel industries of China, Ukraine, and India have been cited as raising the potential for market distortion given their size and the aid they continue to receive from their respective governments.

- Although **China** is the world's largest crude steel producer, its export potential may not be as great as its overall production might suggest. Most Chinese steel producers are not competitive internationally. However, the government has set out to create a few industry leaders which could become significant exporters if the Chinese market continues to slow or if they choose to pursue exporting for other reasons. Importantly, if China joins the WTO, the United States will have new mechanisms to address trade concerns with China, including a special safeguard mechanism for import surges and increased disciplines for subsidies.
- **Ukraine's** near-term potential as a major steel exporter is significant. While Ukraine was not a major exporter to the United States during the 1998 steel crisis, large volumes of steel were exported to the United States prior to and since 1998. The government's continued involvement in most of Ukraine's steel companies raises a significant concern about the potential for unfairly traded steel in international markets.
- **India's** near-term export potential is substantial. India's steel production capacity expanded rapidly over the past few years. The decline in domestic demand and active encouragement by the government has prompted Indian steel producers to turn increasingly to exports. Here too, there is concern about the possibility for unfairly traded exports because of continued government assistance.

Avoiding Future Crises

The economic revival of many Asian economies and the continued strength of the U.S. market have led to a rebounding of global steel demand. This is a key component to relieving excessive import pressures in the U.S. steel market. However, this short-term trend does not reduce the need to address the long-term market distortions of the global steel industry. If long-term factors are not addressed, then unfair trade practices and the bilateral trade frictions they elicit are likely to occur again.

The Commerce Department and the U.S. Trade Representative (USTR), in consultation with other agencies, have developed a strategy that builds on the President's Steel Action Program to make the trade remedy process more timely and effective, and to address market-distorting practices that contribute to overcapacity and instability in the global steel industry. Major elements of the strategy include the following:

- **Early warning of import surges and of changes in industry conditions.** Commerce will continue the early release of steel trade statistics, track and publish key industry statistics, such as steel shipments and capacity utilization, and monitor global steel production and consumption. To ensure that the domestic steel industry and workers are aware of any changing conditions, Commerce will make the early warning information publicly available on the Internet and will send it electronically to representatives of producers and their workers.
- **Faster relief for industries, workers, and communities when import surges occur.** Commerce will ensure fair trade laws are responsive to crisis situations by expediting antidumping investigations and making early critical circumstances determinations. The Administration will establish an interagency rapid response team to help communities and workers hit by unfair trade and ensure that communities are aware of all federal resources that are available to them.
- **Steps to address instability in global steel markets.** Commerce and USTR will intensify their efforts to determine whether foreign practices affecting international trade in steel are inconsistent with WTO agreements and, where appropriate, will consider pursuing WTO dispute settlement. In addition, the U.S. government will address structural problems through continued, focused bilateral engagement with Russia, Japan, Korea, and Brazil and through multilateral forums, such as the Organization for

Economic Cooperation and Development Steel Committee. Where our concerns are not resolved through bilateral and multilateral discussions, the United States government will determine whether additional action is warranted. Commerce's Subsidies Enforcement Office will enhance its efforts to determine whether any foreign activities constitute actionable subsidies under the WTO Subsidies Agreement. This initiative will also include new players like China, Ukraine, and India.

- **Reinvigorating the international steel policy agenda.** The Administration will take steps to make the OECD Steel Committee a better forum for real progress, including increasing the level of participation in OECD Steel Committee meetings and reinvigorating its agenda. The Administration will seek a moratorium on multilateral development bank lending that substantially increases steel production.

By taking meaningful steps to deal with structural problems now, the United States and its trading partners can help to avoid the cycle of import surges and trade actions that have characterized steel trade for the past thirty years. These efforts will also benefit the global steel market and the economies of the countries involved by ensuring open and fair markets that will lead to increased competitiveness and productivity.