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ON

TRADE DISPUTES WITH A FOCUS ON LUMBER AND STEEL

I. INTRODUCTION

Mr. Chairman, on behalf of the U.S. steel industry, I thank you for the opportunity to present testimony before your Committee today. You and your colleagues have a daunting task before you. The domestic steel industry is at a crossroads. Both the President and this Committee initiated an investigation under Section 201 of the trade laws last year and the International Trade Commission ("ITC") voted unanimously that the domestic steel industry has been seriously injured by foreign imports. The President must now make his final decision by March 6 on the remedy that is to be provided.

A tariff of at or near 40% must be imposed for four years in order to allow the industry to recover from the serious injury caused by imports and to make the necessary adjustments to better withstand future low-priced import surges. So-called "tariff rate quotas," will provide no benefits and might well be worse than nothing at all as they often have the perverse effect of encouraging imports as foreign producers rush for the border to beat the cap, knowing that their effective duty rate will be lowered by any duty-free imports they can get in under the cap.

Contrary to the assertion of our opponents, this tariff remedy would not result in significant increases in the prices of everyday products that use steel. Foreign producers and importers have indicated that duties of up to 20-25 percent will simply be absorbed without affecting imports. Indeed, actual written offers have been received memorializing the intent of foreign producers to absorb Section 201 duties. Furthermore, increases in steel prices have minimal effect on the price of end-products since steel represents only a small share of the total cost of most products that contain steel.
And lastly, since 1995 the price of finished goods has risen 10 percent while the cost of hot-rolled steel, for example, has *declined* 27 percent. Our proposed tariff rate increase will only result in modest and reasonable price increases.

I cannot overemphasize the importance of this moment -- the health of the American steel industry and the jobs of thousands of steelworkers are at stake.

II. ORIGIN AND CAUSE OF THE STEEL CRISIS

This steel crisis began in 1998 with a sustained surge of foreign steel into the U.S. market. Imports remained at extraordinarily high levels in 1999 and 2000, depressing prices and preventing the domestic industry's recovery. These imports have continued to seriously injure the domestic steel industry and to severely diminish profitability. Current market prices are at a twenty-year low (see Chart 1). Since the import deluge began in 1998, 43,600 steelworkers have lost their jobs and 31 firms have been forced into bankruptcy. These 31 firms include the nation's second and third largest integrated steel producers -- Bethlehem Steel and LTV Steel Company. (See Chart 2.) While Bethlehem is still operating, LTV is in the process of auctioning off its assets.

These problems have occurred despite the fact that our industry has taken dramatic steps to reduce our own capacity and to modernize operations. Since 1980, domestic steel producers have invested over $60 billion in steel plant modernization, closed numerous inefficient mills, reduced capacity by over 23 million tons and eliminated hundreds of thousands of jobs. As a result, the American industry is efficient, clean and world class competitive. It now takes fewer than four man-hours per ton steel produced (see Chart 3).

Our industry is facing these injurious imports for one reason: foreign steelmaking overcapacity. Foreign steel manufacturers are producing steel in such quantities that it is impossible for them to sell all of the steel they produce unless they export their products to the United States at artificially deflated prices. To illustrate, in 1999, foreign excess steelmaking capacity was more than two times as great as the total of annual U.S. consumption (see Chart 4).

Subsidies

Overcapacity has several root causes. One of these is the massive government subsidies provided to foreign steel manufacturers. These subsidies have taken the form of debt assumption, tax breaks and equity infusions and have been provided by governments in many countries, including Germany, Spain, Italy, Ireland, China, India and Russia. The Department of Commerce has found that more than one-third of the steel production of the largest 76 foreign steel companies has benefited from government subsidies (see Chart 5). In Europe, European Union ("EU") member country governments provide subsidies to steelmakers in significant amounts. For example, during the period 1995-2001, the EU Commission approved more than $2 billion in government aid to Spanish steel producers. In Asia, Korea continues to provide large subsidies to its steel industry, even after an attempt to create a steel company with $6 billion in government loans failed miserably. (See Chart 6 for a partial inventory of foreign steel subsidies.)

Market access barriers

In addition, many foreign countries protect their domestic steel industries through formal and informal market access barriers, including in-country distribution barriers to foreign steel and international market-sharing agreements by foreign steel companies. For example, the EU imposes quotas and pricing guidelines on steel imports from selected countries, and in Japan a variety of import barriers are in place to prevent foreign steel from penetrating the market. In Brazil, import tariffs, licensing schemes and "captive distribution channels" protect Brazilian steelmakers from foreign competition. These barriers allow foreign steel producers a protected home market in which they can sell at high prices while dumping their excess production in the open U.S. market.

III. THE UNITED STATES NEEDS A DOMESTIC STEEL INDUSTRY

The U.S. steel industry is a key element of our nation and our economy. The domestic steel industry supplies many essential industries with the basic materials to manufacture their products. The close collaborative Research & Development and near-at-hand supply that domestic steel manufacturers can provide is essential to downstream producers -- not only of autos, but consumer durables and food containers.

The domestic industry is also a cornerstone of America's national defense and infrastructure. On August 26, 2001 President Bush spoke to the important role the domestic steel industry plays in our national security. Steel is an indispensable component of many types of weapons systems and the vehicles that carry those weapons, including ships, tanks, and a variety of other vehicles. Further, our nation's transportation system is dependent on steel. Oil and gas pipelines, electric power generation and transmission systems, waterway locks and dams, factory buildings and other steel and steel reinforced structures that make up our economic and industrial infrastructure all need steel.

Finally, it is important to note that the domestic steel industry is a customer to many other industries for goods and services, including the trucking, rail, shipping and electronics industries. The steel industry's use of goods and services in its production process generates considerable economic activity at the intermediate levels. This is the so-called multiplier effect. The U.S. manufacturing sector, including the steel industry, has one of the highest multiplier effects: for every $1 of a manufactured product sold to an end-user, an additional $1.19 of intermediate activity is generated; the multiplier effect for the service sector is a mere 77 cents for every $1 sale. The steel-generated demand for key raw materials such as coal, iron ore and limestone, provides jobs in many regions of this country where jobs might otherwise be very scarce. Many businesses in communities across the nation rely on the spending generated by the steelworkers' paychecks and the steel industry is a major contributor to the U.S. tax base, including the tax base of state and local governments.

All of this is important background information, but is not the reason that I am before you today. I am here to ask for your help. I believe that the Administration and Congress have a unique opportunity to help our industry survive the import crisis and make it stronger through consolidation. Sadly, if government assistance is not forthcoming, our industry's troubles will continue and only get worse.

IV. SECTION 201 INVESTIGATION AND RECOMMENDATIONS

The Administration has recognized the severe economic crisis facing the industry. On June 5, 2001, President Bush announced an initiative to address the endemic problems plaguing the global steel market and the U.S. industry. This program contains three key elements: (1) initiate a Section 201 investigation, (2) begin negotiations with trading partners in order to eliminate inefficient excess steelmaking capacity; and (3) enter into negotiations on the rules governing steel trade, and eliminate those underlying market distorting subsidies that have led to the current situation. The Finance Committee also initiated a Section 201 investigation that was merged by the ITC with the investigation brought by the Administration. The U.S. industry strongly supports these efforts to address the steel import crisis.

On October 22, 2001 the ITC determined that the domestic steel industry was being injured by imports of foreign produced steel. On December 7, 2001, the ITC outlined remedy recommendations that included import duties ranging from 20% to 40% and quotas. A majority of the Commissioners recommended a strong tariff-based remedy for most steel products, with two of the Commissioners recommending a 40% tariff rate.

The purpose of my testimony is to outline the industry's proposal for ending this crisis. Specifically we are asking that the President fulfill his pledge by imposing effective Section 201 remedies and by providing appropriate assistance in addressing legacy costs. We believe that an adequate remedy must include these two elements.

First, a strong tariff-based remedy, as provided for in the recommendations of the ITC, is essential in order to return steel prices to their normal pre-crisis levels and to allow American steel companies to make the necessary investments to remain viable and competitive in the future.

Second, our government must provide assistance to the industry that would facilitate the consolidation process. This assistance is most needed in the area of legacy costs that our companies must face.

V. <u>THE DOMESTIC INDUSTRY SUPPORTS A STRONG TARIFF-BASED REMEDY</u>

<u>Tariff relief</u>

A strong Section 201 tariff-based remedy of at least 40% is necessary in order to return steel prices to normal and sustainable levels and to provide our steel companies the time to make necessary adjustments to enhance long-term competitiveness. This tariff relief must be substantial enough in order to ensure that prices return to market-based levels.

A 40% tariff remedy is necessary because it is the minimum tariff rate that would be sufficient to allow the American steel industry to return to reasonable and fair profitability and importantly, ensure that low priced imports do not continue to harm the domestic industry. In fact, the imposition of a 40% tariff would still leave prices below their average levels over the past 20 years (see Chart 7). A lesser tariff would not be effective as foreign producers and importers of foreign steel expect that duties of up to 20% would simply be absorbed by foreign producers, and would have little or no effect on imports. In order for this tariff to have any impact, it must be substantial.

<u>Relief based on quantitative restrictions would not be effective</u>

A number of foreign producers and importing interests have aggressively advocated the use of tariff rate quotas ("TRQs") as a remedy in the Section 201 investigation. Quantitative restrictions like TRQs – which apply an additional duty only after a certain volume of imports has come in at low or zero duty rates – are known to be far less efficient and far more trade distortive than simple tariff-based measures. The domestic industry does not support remedy proposals that include quotas or tariff-rate quotas as they would offer no real relief to the domestic industry – and could very well do more harm than good.

TRQs will provide inadequate price relief as importers can average prices of steel entered with and without duty. By contrast to a tariff, which raises prices for all steel imports, a tariff-rate quota would allow a significant amount of steel to enter duty-free. There would be no price relief for these in-quota imports, which would continue to depress domestic steel prices.

TRQs would precipitate a race to the U.S. market, as each importer seeks to bring in as much material as possible before the tariff-rate quota ceiling is reached. This is exactly what happened in another Section 201 cases involving steel wire rod products, causing substantial additional injury to the domestic producers (see Chart 8).

TRQs that permit a large volume of imports to enter duty-free deny the U.S. Treasury revenue for adjustment programs. A substantial tariff would produce significant revenue for the U.S. Treasury that could be allocated to assist with the adjustment and restructuring of the domestic industry, including providing for legacy cost assistance to displaced workers and retirees. A TRQ, by contrast, would permit all or at least the vast majority of imports to enter the U.S. market duty-free. Thus, there would be little or no tariff revenue to assist in adjustment and restructuring.

Finally, TRQs will promote customs fraud and require bureaucracy to administer country- and product-specific allocations. A complex TRQ remedy would be subject to greater customs fraud than would a simple tariff system, as importers would seek to misclassify steel to categories where there is still duty-free quota available. This is not a problem with a simple, across-the-board tariff. A TRQ remedy also would be extremely difficult to administer. To reduce the likelihood that very low-priced imports from a few countries would flood in and fill the quota, separate TRQs would have to be established on a country- and a detailed product-specific basis. To administer these many separate TRQs, and to address the repeated classification issues that would arise, a substantial administrative bureaucracy would have to be established to administer the TRQ remedy.

Four-year implementation period

The proposed 40% tariff remedy must be imposed for four years. This time period would allow the domestic steel industry the time to make the necessary adjustments to import competition, and would allow the President to achieve his objective of addressing and repairing the global steel trading system.

This remedy would give the President more leverage in his talks with foreign countries. The imposition of tariffs for a four-year period would demonstrate to foreign producers and governments that the United States is serious about addressing the problem of foreign excess steelmaking capacity. If further abuse of the U.S. market is disallowed, foreign steel producers will be forced to make the difficult decisions to take the steps already taken by the American industry – the modernizing of facilities, the elimination of inefficient capacity, the scaling back of production – to bring about the return of stability and balance to the global steel market.

Comprehensive relief is needed

Relief on slab is critical. Preferential treatment for slab imports would force domestic steel producers to close their hot-ends, creating an industry of steel processors, and an abandonment of steelmaking in the United States. Slab would be the only remaining outlet for the enormous world excess supply of low-priced steel. Given that slab comprises the majority of the value of the finished product, is the locus of much of the innovation, and is really what it means to make steel, it would be a catastrophe to leave slab effectively uncovered. The only fair remedy is to put everyone on an even footing – including slab re-rollers, hot band re-rollers, integrated mills, etc. – and insure that any imported feedstock is subject to a consistent remedy.

Current antidumping and countervailing duty orders must remain in effect

Those who oppose these remedies assert that if any Section 201 relief is granted, current antidumping and countervailing duty orders must be eliminated. The Section 201 relief that we are proposing is by law temporary relief that is not designed to address the systemic problems that have precipitated this crisis. In that regard, these existing antidumping and countervailing duty orders remain necessary in order to offset the effects of systemic dumping and foreign government subsidies. Setting aside these orders would perversely reward foreign producers that engage in unfair trade in steel products.

Price increases for steel users would be reasonable and modest

It is important to dispel a myth that has been perpetuated by foreign producers. They claim that any tariff increase would harm consumers of steel-related products. Steel, however, constitutes only a small share of the total cost of most products that contain steel. For a typical family car, the increase caused by the imposition of a 40 percent tariff would be about $60. For a refrigerator, the increase would be about $3. In fact, as measured by the Department of Commerce, steel's share of total costs is minimal for many industries – it is a mere 0.8% for construction; 3.4% for motor vehicles and parts; 5.4% for other transport equipment; 6.8% for household appliances; 4.6% for electrical industrial apparatus; and for the highest of Commerce's categories, fabricated metal products, steel's share of total costs is only 15.9% (see Chart 9).

Those who oppose this remedy assert that relief under Section 201 will not return the domestic industry to a state of profitability and that relief would only raise consumer prices to prohibitive levels. This argument is clearly wrong, and misstates the available facts. Steel's share of total costs for most products is relatively small, and so any tariff increase will have a minimal, if any, effect on consumers.

An effective remedy is responsible economic policy

The remedy that we are proposing makes sense from an economic standpoint. The U.S. steel industry is a catalyst for economic activity throughout the economy and provides goods and services that are needed in a host of other industries. By preserving the domestic steel industry, we ensure that industries that use steel have a predictable source of supply of quality products, and are not held captive to the whims of foreign steel producers. Importantly, our proposal ensures the return of real competition in the market for steel products restoring market forces worldwide to normal and sustainable levels. Foreign steel industries and manufacturers would be forced to make the changes necessary to bring their production in line with market realities.

VI. OBSTACLES TO CONSOLIDATION MUST BE ADDRESSED

The Administration has asked the domestic industry to look for means to restructure and rationalize domestic production. The industry, however, will not be able to take the necessary steps to achieve these goals without government assistance in solving the legacy problem -- the extraordinary liabilities for health care and pension costs.

These liabilities are in part the result of U.S. government policies that go back 50 years and included government intervention in health and pension matters. This intervention was unique among domestic industries and resulted in legacy costs such as the requirement that domestic steel companies finance 100% of employee health plans and provide for substantial financial benefits in employee pension plans. While we are not here today to denigrate past U.S. government policies, we do believe that the government has a role in addressing these problems.

It is instructive to note that our competitors in other countries generally do not face the same level and types of employee and retiree health-care costs. In Canada, Japan, the UK, France, Germany, Russia and China, health care is government funded to varying degrees. For instance, in Canada the national health insurance system provides universal access, comprehensive coverage and public funding for hospital and physician services. In Japan, the government subsidizes company-sponsored health plans with significant contributions.

It is important to recognize that while these legacy costs are not unique to U.S. domestic steel producers, our foreign competitors have benefited from generous government assistance that effectively has rendered these liabilities insignificant. In Argentina, France, Germany, Britain, Belgium, Spain, Italy, Mexico, Brazil, South Korea, India and Thailand, the government has provided significant financial assistance to cover legacy costs to these industries. For example, in Argentina, Belgium, Italy and Spain, retiree and worker-benefit costs have historically been underwritten by the government.

I also want to respond to the allegation that U.S. government assistance with legacy costs would set a bad precedent and would encourage other domestic industries to ask for federal assistance. This is a false assumption. The problems facing the domestic steel industry, and the reason for the need for government assistance, are totally unique. Our industry's current problems result from an unparalleled history of unfair trade, massive foreign subsidization and excess capacity, and government intervention, particularly in regards to labor relations, as I have previously explained. Our industry currently faces an estimated 250 million metric tons of excess steelmaking capacity around the world. It is difficult to imagine any other industry facing similar circumstances.

We are anxious to work with Congress and the Administration to develop a plan to address this obstacle to necessary industry restructuring.

VII. CONCLUSION

The very future of our domestic steel industry is at stake. Strong relief under Section 201 coupled with assistance in solving the legacy cost problem is essential if the industry is to recover. Strong relief is equally critical to create incentives for international capacity reduction, restoring balance to the global steel market.

Our government has a unique opportunity to ensure the continued viability of a domestic industry critical to national security and represents a basic element of U.S. manufacturing. I hope that we do not miss this opportunity.