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The U.S. And China Are Both Wrong On Steel

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The United States and China have begun a “bilateral steel dialogue” to discuss curbing surplus global supplies. China is the world’s largest steel producer and exporter. The United States is the fourth largest producer and a leading importer, so a useful exchange of ideas ought to be possible. But don’t hold your breath.

This exercise is likely to amount to a dialogue of the deaf for the simple reason that neither side gives any indication of actually understanding the economics of the situation. Both sides should seek to resolve the dispute by reorienting their policies to align with their underlying economic interests.

Clumsy central planning has led to the greatest oversupply of steel-making capacity the world has ever seen. Chinese policymakers set their steel sector on a path of continual expansion, which led to an eight-fold increase in that country’s steel output over the past 15 years. However, Chinese leaders forgot to build an “off” switch into their steel-making leviathan, which now produces fully half the world’s output.

China should shut down a portion of its steel industry

Countries with market-oriented economies would have stopped building mills long before the expected return on investment became negative. China has not been constrained by such financial discipline. For China, bringing new mills on line actually subtracts value from the economy rather than adding it. New mills devalue all the mills built previously, so asset values of the country’s steel makers have plunged. Then, when China exports steel at bargain prices, it effectively transfers some of that lost wealth to other countries.

It would serve China’s economic interests to shut down a large portion of its steel industry. The country is believed to have in excess of 1,200 million metric tons (MMT) of steel capacity, and actually produced more than 800 million metric tons (MMT) in 2015. For starters, at least 200 MMT of useable capacity should be shuttered permanently. China should do this not because other countries want it to cut back, but because reducing capacity would strengthen the remaining portion of China’s own steel industry. Although more closures likely would be needed, this first step would help to staunch the bleeding and may allow much of the industry–in China and other countries–to return to profitability.

Since steel is a globally-traded commodity, China's excesses are bedeviling steel producers around the world. The United States is no exception. In the face of rising imports, American production declined 11% over the past four years, dropping from 89 MMT in 2012 to 79 MMT in 2015. Some firms are losing money. U.S. steel producers are justifiably unhappy with the circumstances.

Protectionist measure by the U.S.

Unfortunately, U.S. policymakers seem determined to follow a protectionist path that won't provide much (if any) help to the U.S. steel industry, but definitely will hurt the broader U.S. economy. Steel producers hope that imposing a few more anti-dumping or countervailing duty (AD/CVD) restrictions might help to raise prices by further limiting imports of steel. However, the 149 AD/CVD measures currently in place obviously haven't returned the steel industry to health, so it's folly to think that a handful more would make any difference.

The real cost of import restrictions is the harm they do to manufacturers of value-added products that use steel as an input. Those downstream manufacturers are a much larger factor in the U.S. economy than are steel producers. Department of Commerce statistics indicate that "primary metal manufacturing," which includes steel, copper, aluminum, magnesium, etc., added about $60 billion of value to the economy in 2014. Downstream manufacturers that utilize steel as an input generate value added of $990 billion, more than 16 times larger. Employment by primary metal manufacturers was 400,000, while downstream manufacturers employed 6.5 million, also 16 times greater.

Steel import restrictions have made the United States a high-priced island in an ocean of low-priced steel. U.S. prices have not been high enough to return the steel industry to profitability, but they are high enough to give imported goods an advantage when competing in the U.S. market against domestic manufacturing firms. Carrier has been criticized by politicians for its decision to move 2,100 air conditioner jobs from Indiana to Mexico. It seems likely that the many AD/CVD duties against steel–not to mention restrictions on imports of copper tubing and aluminum extrusions–played a role in that decision. Carrier can escape those policy-imposed costs simply by moving production across the border.

A clear message to China

The United States should deliver this message to the Chinese: Thank you for transferring so much wealth from China to the United States by selling low-priced steel. It's helping to keep our large manufacturing sector globally competitive.

This approach has a decent prospect for getting the attention of Chinese leaders and encouraging them to downsize and restructure their steel industry.

And, after tweaking the Chinese, U.S. officials should follow up by reforming AD/CVD laws so that import restrictions could be imposed only when economic analysis shows that benefits would outweigh the costs. It makes no sense to respond to economic harm caused by low-steel prices by imposing policies that do even more damage to the U.S. economy.

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