AEGIS EUROPE ON WTO REFORM

THE BUSINESS CASE

ANNEXES

Annex 1 - Business cases on global excess production capacity

Annex 2 - AEGIS Europe experiences of distorted international competition

March 2019

Annex 1 – AEGIS Europe Business Cases On Global Excess Capacity

The industry alliance AEGIS Europe promotes manufacturing, investment, employment, growth & innovation in Europe. AEGIS represents a strong industrial basis of more than 20 sectors[1] covering the total value chain.

Based on the data of sectors that were readily available, the production amounts over 316 million tonnes, with a turnover of more than 420 billion euro's, securing jobs for more than 1.9 million people.

	2007	2017	
	production		
	400 million tonne	316 million tonne	-21%
	turnover		
	490 billion euro	420 billion euro	-14%
	direct jobs		
	2140 thousand	1868 thousand	-19%
	capacity utilisation		
	90%	80%	-11%

based on aggregated data for aluminium, bikes, ceramics, paper, steel steeltubes, rail equipment, shipbuilding& maritime equipment

AEGIS stands for free and fair trade. Unfortunately, Europe's industrial base has shrunk over the last decade, mainly due to excess capacities in China and dumping practices on European markets. Since 2017, 273,000 jobs have been lost in the selected sectors, with a negative growth rate of 19%.

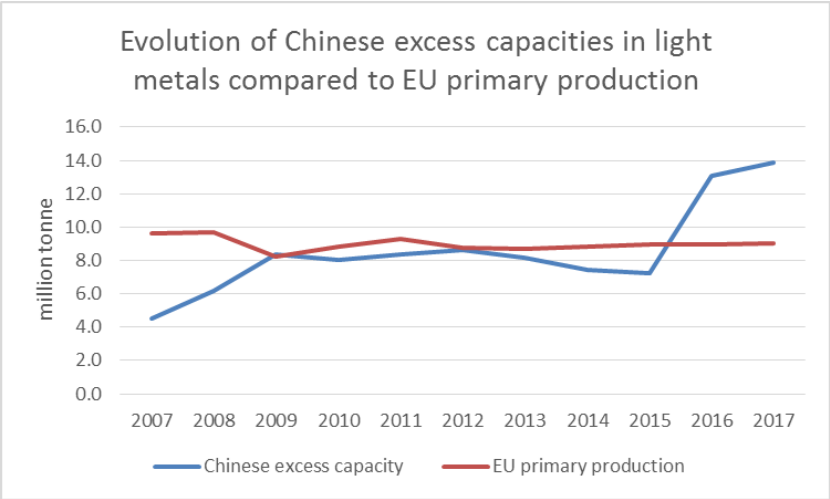
The decline in turnover is around 14%, partially rebalanced by producing higher added value products.

[1] The European sectors are: ferro-alloy producers; wheel manufacturers, aluminium, technical fabrics producers, bicycle manufacturers, ceramic industry, container glass, domestic glass, rope, twine & netting industries, steel wire rope industries, glass fibre producers, industrial fasteners, man-made fibres, non-ferrous metals, rail, steel, steel tube, fertilizers, shipbuilding and maritime equipment manufacturers, Sustainable Solar Energy Initiative.

The production rates also show a declining trend and lower capacity utilization rates, despite 2007 and 2017 being peak years in the economic cycle.

The 2009 report of the European Chamber in Beijing[2] already flagged the huge challenge of excess capacities in China and identified 6 key sectors in trouble: steel, aluminium, cement, chemicals, refining and wind power equipment. The report states in the middle of the financial crisis: "the overcapacity problem in China is by no means a new one. But its pervasive influence has become even more prominent, and its effects on both the Chinese and international economies have become even more destructive".

Since then China has become even more of an industrial powerhouse. Many more sectors have excess capacities, and are expanding further. Since the economic slowdown excess capacity in China e.g. in light metals (and others) has easily surpassed Europe's domestic production.

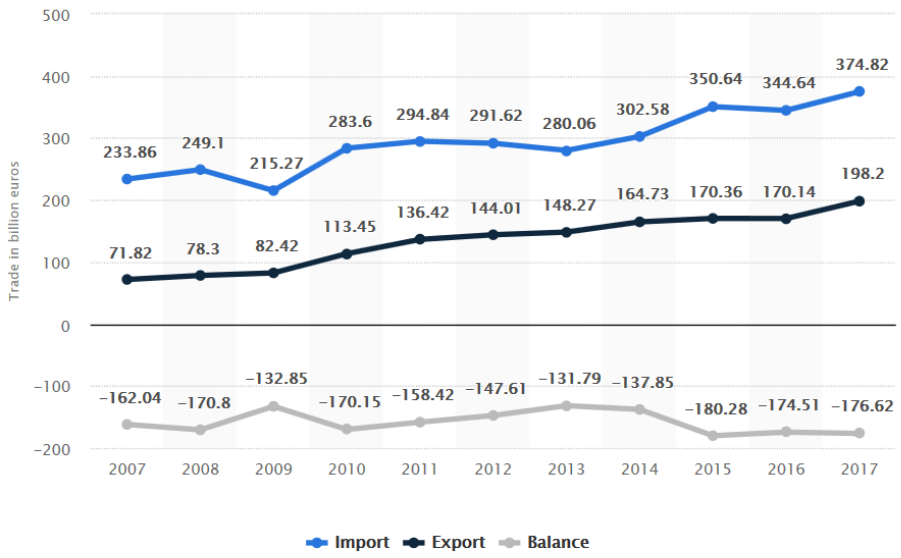


China exports its excess capacities to the rest of the world, with exports reaching a record level in 2018, despite trade frictions.

[2] European Chamber of Commerce in China: Overcapacity in China, causes, impacts and recommendations (2009)

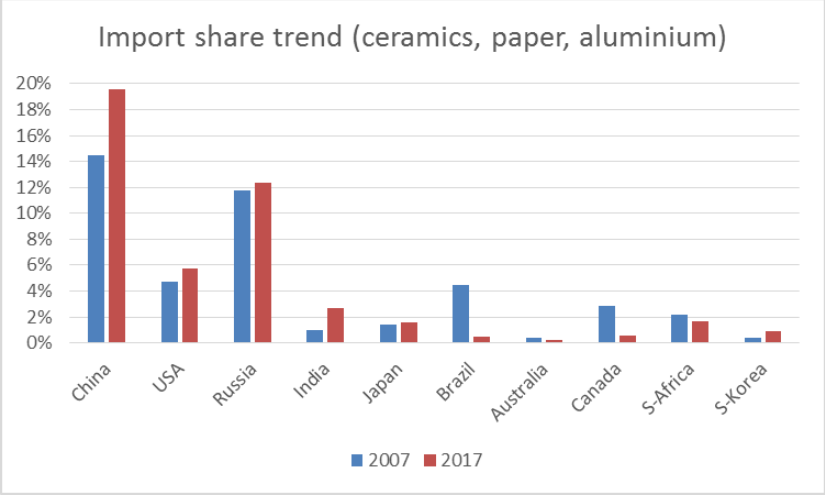
In 2015, the European Chamber in Beijing produced an updated report confirming that since 2009 overcapacity in China had only continued to worsen, affecting additional industries (shipbuilding and paper/paperboard).[3]

EU Trade balance with China (2007-2017, billion euro's)



Source: Statista 2019

The EU trade deficit with China grew to 176.6 billion euro's in 2017.



[3] European Chamber of Commerce in China: OVERCAPACITY IN CHINA/ An Impediment to the Party's Reform Agenda (2015)

China's import share for aluminium, ceramics and paper increased from around 14% in 2007 to more than 19% in 2017. In parallel, the import shares of other regions have either declined or become less substantial – despite anti-dumping measures being in place for several products.

In some other sectors like steel and bikes, China's import share did decline because of anti-dumping measures.

China certainly deserves a fair share of the global trade with the EU. However, about 80% of all anti-dumping cases worldwide are against China, indicating its frequent dumping practices.

Even more detrimentally, China's excess capacities are subduing world price levels for industrial products. Industries are consequently very hesitant to invest in greenfield operations in the EU, and furthermore their profit levels can be insufficient compared with maintenance costs.

Ten years later, the effects on Europe's industrial sectors are significant: closed capacities, lower utilization rates, subdued investment levels and huge job losses. At the same time, European industry has established world-leading environmental standards, with best-in-class technologies and much cleaner energy sources than in China and most other regions worldwide.

These trends have been calculated between two years in the economic cycle, 2007 and 2017. It is highly likely that the situation we have described will worsen in the coming years. There are significant further risks for European industry from the adverse effects of Chinese excess capacity.

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

- **European Aluminium**
- **European Bicycles**
- **European Ceramics**
- **European Ferro-Alloys and Silicon**
- **European Fertilizers**
- **European Glass Fibre**
- **European Shipbuilding and Marine Equipment**
- **European Non-ferrous Metals**
- **European Steel**
- **European Rail**

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Aluminium

European Aluminium, founded in 1981 and based in Brussels, is the voice of the aluminium industry in Europe, and actively engages with decision makers and the wider stakeholder community to promote the outstanding properties of aluminium, secure growth and optimise the contribution our metal can make to meeting Europe's sustainability challenges.

Our 80+ members include primary aluminium producers; downstream manufacturers of extruded, rolled and cast aluminium; producers of recycled aluminium and national aluminium associations are representing more than 600 plants in 30 European countries. Aluminium products are used in a wide range of markets, including automotive, transport, high-tech engineering, building, construction and packaging.

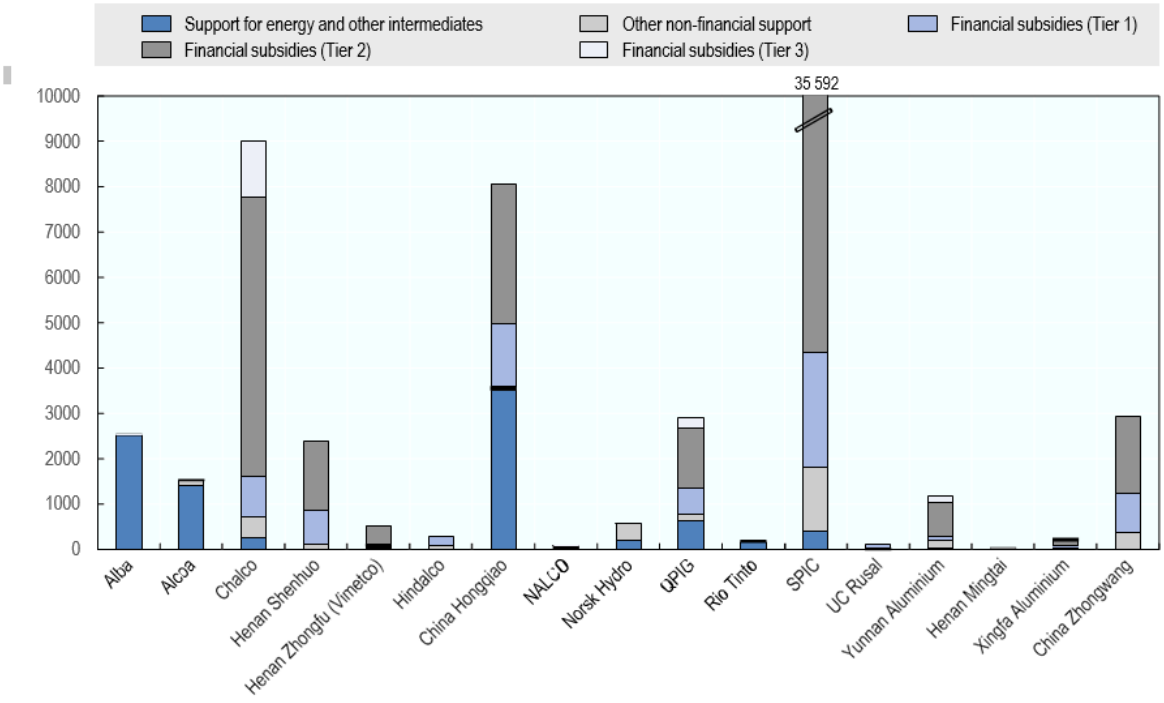
The demand for aluminium is growing on a global scale by an annual rate of around 5%. Unfortunately, the aluminium market has a huge problem because of the excess capacity in China. This excess capacity amounts to 5 times the EU production of primary aluminium. Also in semi fabrication China has built up huge excess capacities.

Both the G-7 as the G-20 have mentioned the tremendous issue of Chinese state intervention in its aluminium industry, and there are several publications on the topic. The most recent OECD study is remarkable because it is an assessment on company basis and on a global scale. So in January 2019, the OECD published a report called: "Measuring distortions in international markets: the aluminum value chain ".

A main conclusion is that, although all firms received some form of support, it is highly concentrated: **the top 5 recipients receive 85% of all support. And these are all Chinese companies.**

Government support for firms studied reached between USD 20-70 billion over the period 2013-17, depending on how financial support is estimated

Total government support by type, 2013-17 (USD millions, current)



The summary of the report states: "This report builds on the OECD's longstanding work measuring government support in order to estimate support and related market distortions in the aluminium value chain. Results show that non- market forces, and government support in particular, appear to explain some of the recent increases in aluminium-smelting capacity.

While government support is commonly found throughout the aluminium value chain, it is especially heavy in China and countries of the Gulf Cooperation Council. Looking across the whole value chain also shows subsidies upstream to confer significant support to downstream activities, such as the production of semi- fabricated products of aluminium.

Overall, market distortions appear to be a genuine concern in the aluminium industry, and one that has implications for global competition and the design of trade rules disciplining government support[4].

The aluminium sector has seen major changes over the last 15 years, notably the rise of China as the leading producer by a wide margin in most segments of the value chain. This unprecedented increase in output has fueled concerns about excess capacity in the sector that is depressing global aluminium prices and threatening the viability of producers worldwide.

To understand whether this increase in capacity has been driven by non-market forces, this report examines 17 of the largest firms operating along the aluminium value chain, which together make up more than half of global smelting capacity. Key findings are:

- Total government support for the 17 firms reached up to USD 70 billion over the 2013-17 period, depending on how financial support (i.e. concessional loans) is estimated. Although all 17 firms received some form of support, it is highly concentrated: the top 5 recipients receive 85% of all support, most of it at the smelting stage of the value chain.

- There are also important differences in the nature and scale of support received. Chinese firms obtained all of their support from Chinese authorities, notably financial subsidies, which overwhelmingly benefitted Chinese producers. Together with energy and input subsidies, these measures accounted for the vast majority of all support in China. By contrast, most other firms in the study tend to be multinationals that obtained support in the different places in which they operate (e.g. Australia, Brazil, Canada, and countries of the Gulf Cooperation Council - GCC), predominantly in the form of non- financial support (e.g. energy subsidies) and in lesser amounts. For all firms, support for R&D and labour is relatively minor.

[4] Page 2 and further: OECD study Measuring distortions in international markets: the aluminum value chain. https://www.oecd-ilibrary.org/docserver/c82911ab-en.pdf?expires=1548756785&id=id&accname=guest&checksum=FCCEA6F077A170A4E64885062985D696

- The vast majority of financial support was provided by China's state-owned banks to Chinese aluminium SOEs; however, two large private firms also benefitted from support from state-owned banks: China Hongqiao, the world's largest producer of primary aluminium, and China Zhongwang, China's largest producer of extrusion products.

- Looking at the value chain reveals that subsidies upstream confer significant support to downstream activities. Direct support at the smelting stage is important, but trade measures also matter. China's export taxes on primary aluminium, as well as its incomplete VAT rebates on exports of certain aluminium products, have served to discourage exports of primary aluminium and encourage production (and export) of semis and fabricated articles of aluminium. Access to cheap inputs has enabled Chinese producers of semis to expand production and compete in global markets at lower cost.

- While governments participate in the aluminium value chain via SOEs, state influence is at least as important as ownership, including because SOEs are both recipients and providers of support – especially in China, where SOEs provide SOEs and private producers alike with below-market-cost inputs and loans. This fluid relationship between the government and companies generates opacity around the form and scale of government support.

- In sum, non-market forces, and government support in particular, appear to explain some of the increases in capacity in the aluminium sector in recent years. While government support is common all along the value chain, it is especially large in China and the GCC countries, even under the conservative assumptions used in this report. Excess capacity thus appears to be a genuine concern in aluminium, and one with implications for global competition and the design of trade rules disciplining government support.

- Two implications for the design of trade rules emerge from the analysis: (i) **government support needs to be understood in the context of value chains,** as upstream support has the effect of supporting downstream production; (ii) **subsidy rules need to better account for the influence of the state, both as regards the dual role of SOEs as recipients and providers of**

support, and what this means for the transparency of support policies, including at the WTO.

- Finally, this study raises the question of whether similar patterns of government support can be seen in other value chains. Sector characteristics and data permitting, the approach pioneered in this study could help to build a broader understanding of government support in all its forms. The aim is to improve transparency of government support policies and thereby underpin international efforts to mitigate trade conflicts that otherwise will arise."

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Bicycles

Distortions in China and challenges for the EU bicycle, e-bike and components industry

Distortions in China

In terms of distortions in the bicycle, e-bike and components (BEC) industry in China, there are all types of support from the Government of China (GOC) (at all levels), and they promote increased capacities, cheap inputs and exported outputs as in other sectors. Indeed the BEC industry is considered strategic by the GOC for several reasons, primarily because of its role in both promoting electric transport and the development and use of new materials. In addition, the BEC industry employs many workers in China and trains them in precision mechanics.

Challenges for the BEC producers in the EU

The many forms of support from the GOC, including the supply of major inputs (e.g. electric motors and batteries in the case of e-bike producers), have led to major production overcapacities in China and this situation poses major challenges for the BEC producers in the EU:

1) Production overcapacities in China have been aggravated by a drop in bicycle and moped consumption in China:

- Moped consumption dropped with bans enacted in major Chinese cities to cut down on pollution and congestion.

- Bicycle consumption has dropped recently because of the failed Chinese experiment with unbridled bike-sharing. Steps have been taken to correct the resulting problems but PRC bicycle consumption is still down.

2) Chinese BEC producers have already taken over other major markets (the US and Japan) and the EU has been their main focus ever since the 1990's. In addition to an anti-dumping investigation (and subsequent expiry reviews over a 25-year period), the EU industry has needed to request anti-circumvention investigations of EU imports from seven other countries in order to address the unfairly traded Chinese exports.

3) In the EU, e-bike demand has been growing strongly but from a small base while standard bicycle consumption has dropped slightly. As the average price and profitability of e-bikes is higher than for standard bicycles, it has made that part of the BEC industry a particularly important focus for EU producers. As until now, there were no EU trade defence measures in place for that product, the EU producers requested and the Commission has been carrying out both anti-dumping and anti-subsidy investigations of e-bike imports from China. While the Commission is proposing definitive measures as a result of those investigations, there are already market indications that the Chinese producers are seeking to circumvent those measures as they have tried with the EU measures on imports of standard bicycles.

4) Unilateral EU regulations and policies also pose a major challenge for EU BEC producers. Two particular examples are

- While EU producers are careful to comply with EU chemicals (REACH) regulations concerning the paints, e.g., used on bicycles, imports from China often do not and EU enforcement has not addressed this situation.

- While EU producers mainly transport their product by road in the EU, imports from Asia are mainly transported by ship to the EU. Because emissions requirements in the EU are so much stricter for road transport than for shipping transport, the EU rules effectively subsidise imports.

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Ceramics

About the European ceramic industry

Cerame-Unie is the umbrella association representing 9 ceramic sectors, from consumers and construction goods to industrial applications and numerous high-tech applications. The European ceramic industry is made for 80% by SMEs, accounting for 200,000 direct jobs and a turnover of 31bn EUR.

European ceramic industry is a trade champion exporting 9.2bn EUR in 2017, with a positive trade balance amounting to 4.6bn EUR. Nonetheless, the industry is facing increasing challenges in the markets at home and abroad. European exporters are increasingly encountering trade barriers and non-tariff measures in several countries primarily, but not exclusively, in North Africa, the Gulf region and South-East Asia.

More importantly, the industry faces unfair competition and distorting practices from China. Internally, it creates an injury to the domestic industry as repeatedly proved by trade defence investigations. In third countries, it damages European exports often unfairly affected by *erga omnes* measures due to the lack of political will or power to address the main source of the injury (China).

European Commission Report

Systemic market distortions

In 2017 the European Commission published a report on significant distortions in the Chinese economy for the purposes of trade defence investigations. Under the new methodology the Commission shall produce, make public and update a report describing market circumstances where there are well-founded indications of the existence of significant distortions.

The report analyses a number of issues in relation with the socialist market economy or state capitalism. In particular the report found significant distortion in relation with:

- The system of Five-Year plans;
- Stat-Owned Enterprises;
- Financial system;
- Public procurement;
- Investment restrictions;
- Means of production - land, energy, capital, labour and raw materials.

Chinese ceramic industry overcapacities

According to the report of the Commission:

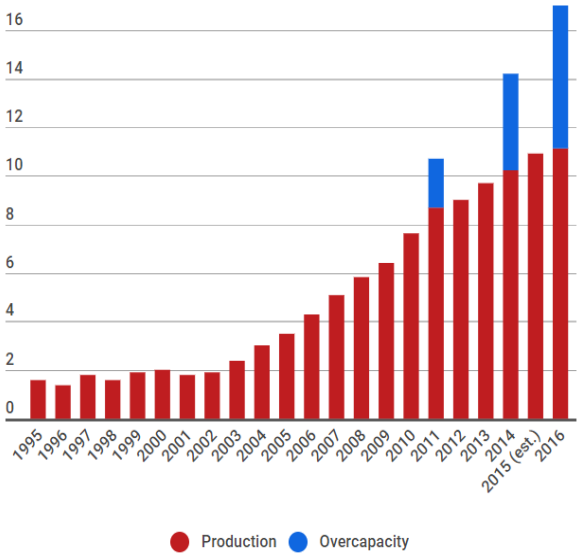
"The Chinese construction ceramic industry increased its ceramic tiles production capacity by nearly 30% between 2011 and 2014 (from 10,8 billion m^2/year to respectively 13,9 billion m^2/year), and thereafter by 22% between 2014 and 2016 (to 17 billion m^2). Unutilized production capacity expanded from 20% in 2011 to 26% in 2014 and to 35% at the end of 2016, reaching almost 6 billion m^2, with a spare capacity increase of 3.8 billion m2 over the said five years. **Chinese overcapacity numbers exceeded therefore several times the total European Union annual consumption**, which stood at around 0.9 billion m^2 in mid2016".[5]

The fact that in China market share is often seen as more important than profitability – and overcapacity is viewed as an opportunity to gain market share – results in the problem of structural long-term overcapacity. As a result, many ceramic tile companies cut down products prices leading to price wars where products are sold nearly without any profit.

[5] European Commission, *Commission Staff Working Document On Significant Distortions In The Economy Of The People's Republic Of China For The Purposes Of Trade Defence Investigations*, Pag. 439

Table 1. Chinese ceramic tiles production 1995-2016 (billion, sq.m)

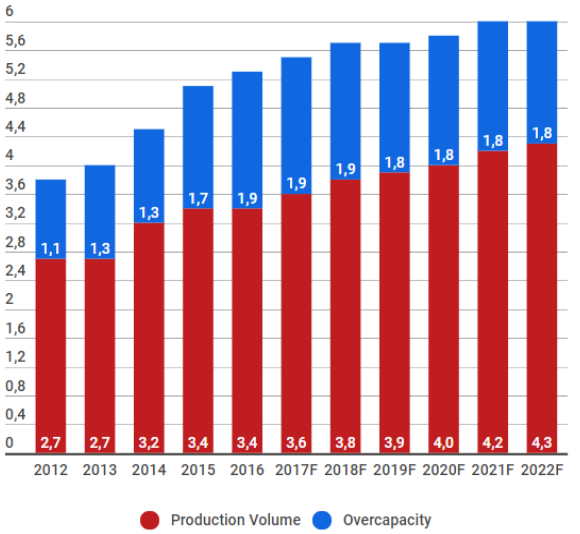
***6bn sq.m.overcapacity**= 6x EU consumption (2016)*



Source: China Building Ceramics Association;
European Commission

Table 2. Chinese ceramic kitchenware & tableware production 2012-2020F (mln, sq.m)

***2mln tons overcapacity**= 7x EU consumption (2016)*



Source: China Research and Intelligence

Government intervention in the ceramic industry

As a traditional sector of Chinese industry, the ceramic sector receives particular attention and management from government across all levels. Its labour-intensive nature and historic roots ensures that the **state is committed to managing the development of the industry**.

The Chinese government **aims to consolidate the industry into large conglomerates** and steer production towards a **more value-added production base**. The basis for such state intervention emanates from the Construction Materials Industry Development Plan 2016-2020, which is based on the 13th FYP and compliments the Made in China 2025 strategy.

Despite the intention to reduce overcapacities, the Plan encourages increasing capacities to ensure security of supply. Furthermore, the State Council in May 2016 issued Guiding Opinions on the construction industry employ various financial and other incentives to achieve the policy goals.

The **state provides subsidies** for commercialisation, R&D, patents, and more, whilst also providing financial relief to enterprises affected by foreign trade defence measures. Subsidy schemes are also available for process upgrades and technology and innovation.

All the processes described above are openly supported by the State, in the form of innovation funds, preferential loans, export incentives, financial transfers, tax relieves, land use cost relief and employment-stabilisation schemes, etc. These policies, and the support related to them have direct and indirect consequences on the cost structures of companies and product prices, **leading to significant market distortions in the sector**.

Example of government support: Chaouzhou

Based on materials made available to the Commission, a certain number of ceramic producers have benefitted from support enshrined in the planning measures of the City of Chaozhou. One of the beneficiaries of numerous subsidies is allegedly a (listed) company active in that city. The company benefitted in the period of 2013-2017 from allocations of at least RMB 1 million (€129,000) from each of the following schemes:

- An allocation from the first batch of the 2015 Enterprise R&D Support Fund of the Guangdong Province.
- An allocation from the second batch of the 2015 Technology Renovation Fund.
- Rewards for completed technology renovation projects at industrial enterprises of Chaozhou City in 2015.
- Support for the development and commercialization of high performance optical fibre high-speed connector materials.

- Support for the commercialization of ceramic package substrate for application in new-type electronic components.
- Support for R&D on and the commercialization of porcelain cement for application in large capacity BME-MLCC.
- Support for technology commercialization in the field of ceramic package substrate for LED application.
- Support for the commercialization of aluminium nitride plates for application in electric and electronic components.
- Allocation from the 2013 and 2016 Central Government Fund for the Promotion of Foreign Trade for the Cultivation of Corporate Brands.
- Allocations from the Government-Bank-Enterprise-Cooperation Fund for supporting Strategic Emerging Industries and loan interest subsidies.
- A reward for going public (IPO).
- Allocations from Industry development funds.

Think!DESK report (Dr Markus Taube)

In 2017 CU commissioned a study to Think!DESK regarding market distortions and subsidisation in the Chinese kitchenware & tableware as well as wall & floor tiles industries.

The study conducted by Prof. Dr. Taube reports on the 10 largest Chinese Kitchen & tableware producers and floor and wall tiles manufacturers. 80% of domestic production and 90% of exports originate from two production hubs in Chaozhou, Guangdong and Quanzhou, Fujian. Since production is overwhelmingly concentrated in two locations, the two ceramic sectors are vital to the development of these cities and regions and are thus afforded a privileged status in the development strategies of these locales.

As a result, local authorities heavily subsidise K&T. **The study found that between 2011 and 2017 the 10 large Chinese kitchenware and tableware received total subsidies amounting to RMB 592m (EUR 76m).**

Chaozhou Three-Circle Group	**RMB 171m** (€22m)
Dehua Hengyi Ceramic Art	**RMB 7m** (€800k)
Glarun Technology	**RMB 67M** (€8.6m)
Guanfu Holding	**RMB 182m** (€23m)
Guangdong Great Wall of Culture Group	**RMB 54m** (€7m)
Guangdong Mingyu Technology	**RMB 0.6m** (€80k)
Guangdong Sitong Group	**RMB 48m** (€6m)
Guangdong Songfa Ceramics	**RMB 27m** (€3m)
Haoye (Guangdong) Porcelain	**RMB 2m** (€0.3m)
Profit Cultural & Creative Group	**RMB 34m** (€4m)

The ultimate aim of the subsidy schemes is to catch-up with international competitors. Evidence showed that all enterprises reviewed for the report received subsidies, mostly at the municipal and provincial level. Moreover, the majority of board members in the companies reviewed for the study hold senior positions in government and the Communist Party of China. Think!DESK report presents a list of subsidies directed to the ceramic industry:

a) Subsidies for innovation, commercialisation, and upgrading
b) Subsidies for exports
c) Subsidies for land, capital, and labour
d) Subsidies for sectorial structural adjustments
e) Subsidies for environmental protections
f) Subsidies for regional development

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Ferro-Alloys and Silicon

Introduction to the Ferroalloy and Silicon industry

Ferroalloys are alloys of iron and other elements that function as essential materials in the steel and foundry industries. This group can be divided into two main usage categories: as reduction agents, ferroalloys serve to remove excess oxygen from molten steel, and as alloying agents, ferroalloys adjust the composition of steel to change the physical and chemical properties of steel products.

In terms of ferroalloy production capacity and output, China ranks first in the world. The country accounts for about 40% of world production. The industry is highly fragmented, covering more than 2.000 individual enterprises. Except for the low degree of concentration, the Chinese ferroalloy sector shares some important characteristics with the wider iron and steel industry, such as severe overcapacity, backward technology, serious pollution and fierce competition. The financial development and performance of ferroalloy enterprises are deeply affected by the steel industry.

Driven by demand from steelmaking, the Chinese ferroalloy experienced a similar degree of explosive growth between 2000 and 2014. Overall output surged nearly tenfold from 4 million tons to 38 million. From its 2014 peak, ferroalloy output declined slowly to 32.9 million tons in 2017. Owing to aggressive investment in new plants since the early 2000s, the growth of capacities far eclipsed production increases.

Regarding the Silicon Industry, industrial silicon production is highly concentrated with only a few dozen players together accounting for about 90%. By the end of 2017, the country-controlled production capacities were of about 4,8 million tons compared to the 1,4 million tons distributed across the rest of the world. Actual output in China grew by approximately 5% to 2,2 million tons, representing roughly two thirds of the global output of 3,28 million tons.

Summary of market distortions in the Chinese Ferroalloys and Silicon industry[6]

The main distortions of the Chinese Ferroalloys and Silicon Industry, which create different economic challenges for the European industry, are summarized in the following points:

1. Policy objectives and executive involvement in State/Party functions

China is characterized by a strong industrial policy state guidance for industry consolidation, and the exit of small inefficient and backward plants. Production technology is the central target for industrial policy. In terms of technology and innovation the National Development and Reform Commission (NDCR) has released the Three-year Action plan to Enhance the Core Competence of Manufacturing Industry (2018-2020).

1.1. Industrial police guidance in five-year plans: the Ferroalloy sector is subsumed under the steel industry. The national five-year plan for the steel sector does not have much to say about ferroalloy production. However, on the regional level the departments have drafted more comprehensive documents with strong relevance for local ferroalloy producers, like for example The 13th Five-year Programme for the development of the Metallurgical Industry of Hunan Province. These type of local programmes summarize the main issues of industrial policy on the local level and

[6] THINK!DESK China Research & Consulting, Prof Markus Taube, Analysis of State-induced Market-Distortions in the Chinese Ferroalloys and Silicon Industries – Ferroalloy Focus, September 2018

showcases the willingness to support local enterprises. The same type of regional Work reports are present for the Silicon industry.

1.2. Supply-side structural reforms: The Supply-side structural reforms (SSSR) is the country's principal economic policy next to the long-term Made in China 2025. The SSSR is composed by 5 elements: reducing excess production capacities, reducing overhang in unsold urban housing, reducing corporate leverage, reducing corporate operating costs and strengthening weak links. The ferroalloy sector is specially impacted by the reduction of corporate operating costs. The SSSR reflects that distortions of market rules and individuals' incentives cause excessive investments and the formation of overcapacities which depressed markets for years.

Another distorting factor worth mentioning is that top decision makers are not only party members but also hold senior positions in the government and in the Communist Party of China (CPC) hierarchy.

2. Government subsidies

Chinese ferroalloy and silicon producers benefit from financial and non-monetary support from Chinese Government. Fiscal subsidies take various forms, e.g. direct cash grants, equity infusions and loan interest subsidies. The Report: Analysis of State-induced Market-Distortions in the Chinese Ferroalloys and Silicon Industries identifies more than 2.200 individual subsidy transfers to 34 major Chinese ferroalloy producers and 750 individual subsidy transfers to 8 major Chinese industrial silicon producers between 2012 and 2017. These have boosted profits during the period under review by over RMB 11 billion on the ferroalloy industry and over RMB 2,6 million on the silicon industry.

2.1. Support for Technology Development, Industrialization and Renovation: this type of support covers topics such as innovation capacity, R&D, industrialization of R&D outcomes, new product development, production technology development an upgrading, patent registration and special subsidies for certified High and New Technology Enterprises (HNTE). Between 2012 and 2017, 10 ferroalloy producers have received a grand total of RMB 1.034,6 million in profit and loss relevant subsidies.

In the same period, 8 industrial silicon producers have received a grand total of RMB 247 million in profit and loss relevant subsidies.

2.2. Support for R&D and Innovation Industrialization: 22 ferroalloy companies have obtained at least RMB 611,3 million and 8 industrial silicon producers have obtained at least RMB 168 million during the period 2012-2017 . The Ministry of Finance of China offers partial refunds for expenditures linked to the trial manufacture of new products, related experimentation and to key scientific research projects. Supported companies can seek refunds for a wide range of project-related expenses, including those for human resources, equipment, energy and general administration.

2.3. Support for Research Projects covered by Technology development plans: Chinese industrial policy with regard to technology innovation is guided by the National Medium-and Long-Term Science and Technology Development Plan (2006-2020). There is strong support from the Governments side for the adjustment of the industrial structure and improvement of industrial competitiveness.

2.4. Support for Intellectual Property and Patents: 17 ferroalloy enterprises have been supported by- mostly local- government authorities in order to protect own intellectual property and registering patterns. They have received at least RMB 10.8 million, the real amount is probably higher because not all companies have provided a breakdown of its subsidy income.

2.5. Support for Plant Renovation and Equipment Upgrading: under the impression of the global financial crisis, the National Development and Reform Commission (NDRC) introduced industrial policy guidance documents for the key industries, including steel and non-ferrous metals. At least 23 producers of ferroalloys and 6 producers of industrial silicon have taken advantage of subsidies for plant renovation and equipment upgrades.

2.6. Support for Brands and Trademarks: The Government of China encourages the formation of strong brands and trademarks. Financial incentives haven been instituted by sub-national governments. Several ferroalloy and silicon producers have obtained subsidies in conjunction with their brand or trademark registration.

2.7. Support for High and New Technology Enterprises (HNTE): Enterprises that are recognized as High and New Technology Enterprise (HNTE), thanks to their special status, have obtained significant subsidies from (mostly local) government authorities.

2.8. Support for enhanced Product Quality and Quality Management Systems: at least 11 ferroalloys enterprises have benefited of grants related to the quality of their products, as well as rewards for successful certification, prizes, or simply grants aimed at improving their competitiveness in terms of single product.

2.9. Support for Environmental Protection and Resource Conservation: As a raw material based and energy intensive industry, the ferroalloy and silicon sector are strongly affected by the Government of China's green development initiatives. From 2012 to 2017 subsidies for environmental protection have amounted to at least RMB 1.1 billion.

2.10. Support for Energy Conservation: the Chinese Government (GOC), as part of the overall strategy to protect resources and limit waste, has guided local authorities in supervising the energy intensive industries, like metallurgy, to upgrade plant equipment for improved energy efficiency standards. To this end, China support enterprises to establish energy management centers, through funds provided from the central government budget. Energy management centres (EMC) are established as demonstration projects in heavy energy consuming sectors, such as the steel, non-ferrous metals, chemical and construction industries (at 3).

2.11. Support for Synergistic Resource Utilization: Between 2012 and 2017 ferroalloy producers have received a combined subsidy income for synergistic resource utilization of RMB 428.2 million. These subsidies are separate from and additional to the financial benefits obtained from VAT and EIT privileges supporting the same comprehensive resource use activities.

2.12. Support for Plant Relocation: China has influenced the industry layout moving heavy industries from urban areas and resettling them in dedicated areas. Many industry parks have been planned with this idea, in order to offer infrastructures and specialized equipment alongside with: advanced

logistics and transportation facilities as well as ready and cheap access to energy, water, raw materials and other vital inputs. These park administrations are subunits of local government authorities. In order to fill their parks, local governments have been found to provide generous investment incentives and tax breaks. Additional government subsidies are provided to compensate at least partly for the costs incurred in relocating production plant. As this is not always technically feasible or economically advisable, industrial enterprises often use such a move as an opportunity to upgrade and or expand their equipment.

2.13. Support for SME Development: Many, not to say most, of the enterprises that have been flushed out of the market in overcapacity-stricken industries from ferroalloy to solar cells have been SMEs. Support for the group of technologically advanced and competitive enterprises of this group has been important to the growth of many specialized producers. A remarkable aspect of SME promotion policies is that they do not appear to take account of the size of parent companies. The China National Machinery Industry Corporation or Hebei Iron and Steel Co., Ltd. are, in fact, very large companies that ultimately come to benefit from SME development subsidies.

2.14. Support for Key Industry Revitalization and Transformation: Special funds for key industry revitalization and technology renovation projects were allocated from the central government's budget to support projects in key industries by means of loan interest subsidies and support grants (NDRC 2009 at 2).

3. Tax preferences

3.1. Privileges for High and New Technology Enterprises: Various ferroalloy producers as well as silicon producers have been recognized by local government organizations as "high and new technology enterprises" and thus have benefited from a reduced enterprise income tax rate of 15%.

3.2. Privileges under the Great Western Development Programme: the "Great Western Development Programme" has been established to stimulate the economy in China's less developed central and western regions. Enterprises that engage in encouraged activities can also benefit

from the exemption of VAT and import tariffs for equipment for own use. Several ferroalloy and silicon producers have profited substantially from this program, predominantly by means of reduced tax payments.

3.3. VAT Preferences for Products Generated from Synergistic Resource Utilization: In 2008, the Ministry of Finance and the State Administration of Taxation jointly released a VAT policy that promises immediate refunds of a certain fraction of initial payments depending on the nature of the waste or product. 50% of the VAT would be refunded on by-products generated from the desulfurization of fumes and high-sulphur natural gas generated from coal-fired power plants and other industrial plants. Several major ferroalloy producers have taken advantage of this tax preference scheme, as well as an unnamed subsidiary of Hoshine Silicon Industry Co., Ltd.

3.4. EIT privileges for enterprises with foreign investment:

3.5. Reduction of Land and Real Estate Related Taxes and Fees: it includes reduction of land fees for enterprises in financial distress and for reclaimed and rehabilitated land.

3.6. Other Tax Privilege Programmes: in the ferro-alloy sector it includes VAT exemption for selected products, tax incentives and privileges for enterprises and small and low-profit enterprises, VAT and EIT privileges for Software and IC Enterprises. In the silicon industry it includes Tax Incentives for Enterprises in Industry Parks, Reduction of Land Use Fees, Tax Privileges for Small and Low-profit Enterprises, VAT Privileges for Software and IC Enterprises, EIT Privileges for Software and IC Enterprises and Miscellaneous.

4. <u>Support in land, labour and capital</u>

4.1. Liquidity support: given by the Government of China to companies of the ferro-alloys and silicon sector, through injections of liquidity.

4.2. Policy Bank Finance: to bolster liquidity and increase of course the productivity.

4.3. Loans Interest Subsidies: Ferroalloy producers have received loan interest subsidies RMB 258.8 million. Industrial silicon producers have received loan interest subsidies for the import of manufacturing equipment.

4.4. Reduction of land use cost: the ferroalloy producers between 2012 and 2017 have received a total of RMB 98.7 million in subsidies related to land use. In the case of the Industrial silicon, between 2012 and 2017, producers have received a total of RMB 30.5 million in subsidies related to land use

4.5. Among other forms of support: the reduction of labour and social security cost, electricity and heating subsidies, reduction of transportation costs.

5. Foreign Trade Guidance

Supervision and regulation of foreign trade and overseas business have been a hallmark of Chinese industrial policy since the times of central planning. After the onset of reforms in the early 1980s, controls have been relaxed and reduced in number. China's accession to the WTO in 2001 mandated the end of some policy interference.

However, 40 years into the reform era and 17 years after joining the WTO, the Government of China maintains a variety of instruments to direct trade flows in line with the national industrial policy agenda.

The most important programmes and policy tools in use today are:

- Import/export administration: Several ferroalloys and silicon producers have received loan interest subsidies for the import of manufacturing equipment and other products. In the case of export restrictions, the Government of China reserves itself the right to control which companies are allowed to export certain ferroalloys.
- Export promotion: subsidies for export credit insurance, incentives and rewards, foreign trade development subsidies.

Conclusions

This report documents in considerable detail that the Chinese ferroalloy and silicon industry is subject to heavy handed governmental guidance and discretionary interference.

Given this constellation, ferroalloy and silicon producers in the rest of the world are right to be concerned about Chinese industry structures and the

potential damage these can wreak on global ex-change patterns and price structures. European firms are directly threatened by this constellation.

Silicon: another example of overcapacities

The EU Silicon Industry has been supported by an Antidumping duty for more than 25 years due to recurrent dumping from the People's Republic of China (PRC)?

Silicon is also a staggering example of huge overcapacities, permanently threatening the worldwide market balance.

EUROALLIAGES has reported to the Commission in the last expiry review (2014 which was concluded with the renewal of the measures for 5 years in May 2016) of the Anti-dumping measures a total silicon capacity in the PRC in the range of 5.3 million tons, to be compared with an EU silicon consumption of around 500 000-550 000 tons.

Even if this figure was challenged by the China Chamber of International Commerce (CCIC) and the Silicon Branch of the China Nonferrous Metal Industry Association (CNMIA) which alleged a much lower capacity, the Commission concluded that the evidence submitted by these Chinese interested parties was not convincing at all and that in any event, there was enough spare capacity in the PRC to serve several times the volume of the Union consumption.

These overcapacities are directly linked with all types of government subsidies granted by the PRC government to the Chinese Silicon Industry, as reported in the 'Analysis of State-induced Market Distortions in the Chinese Ferro-Alloy and Silicon Industries' Report by THINK!DESK China Research & Consulting referred to above.

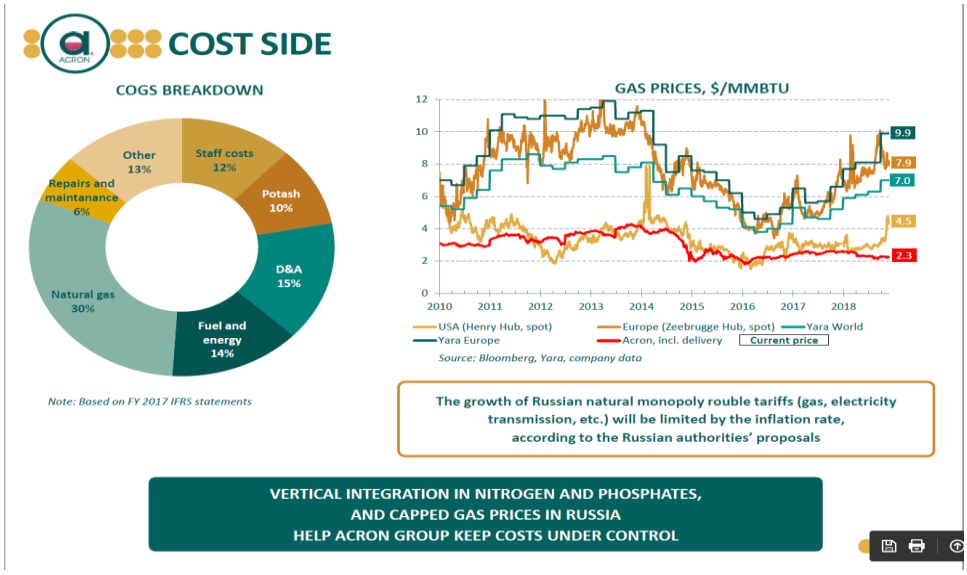
Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Fertilizers

Russia Gas Market distortions arising from state interventions

Russian state fixing of gas tariffs: JSC ACRON – a major Russian fertilizer manufacturer, in its quarterly report Dec 2018 confirms and applauds "capped gas prices" as Russia state intervention.

While Russian domestic gas prices are state fixed, Russian export monopolistic gas prices are sold in the EU at premium prices often 3 to 5 times higher than the Russian domestic prices. This dual pricing system thus creates a double injury, first, Russian injurious dumping of finished products like fertilizers and, second, distorted high gas prices to overall EU manufacturing.



Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Glass Fibre

Distortions in China and challenges for the EU glass fibre reinforcement (GFR) industry

Distortions in China

In terms of distortions in the glass fibre reinforcements (GFR) industry in China, there are all types of support from the Government of China (GOC) (at all levels), and they promote increased capacities, cheap inputs and exported outputs as in other sectors. The GFR industry, as a new materials sector, is considered an industry to be promoted by the GOC for the development of new capacities. Accordingly, in a Chinese industry dominated by large State-owned enterprises, the GOC supports Chinese GFR producers in the building and expansion of facilities, both in China and abroad. The result is that major overcapacities of Chinese producers in both China and abroad have led to substantial dumping of subsidised exports in the EU.

Challenges for the GFR producers in the EU

The many forms of support from the GOC have led to major production overcapacities in China and this situation has posed major challenges for GFR producers in the EU:

1) Production overcapacities in China have not diminished inter alia because GFR demand growth has levelled off in China and Asia more generally.

2) GFR was one of the first products for which the EU imposed anti-subsidy measures on imports from China (in addition to anti-dumping measures). The Commission investigation, which was concluded in 2014, confirmed that the Chinese producers were substantially subsidised.

3) At the same time, the largest Chinese GFR producers have – with the help of subsidies granted by both the GOC and the local government – set up production in third countries (for example, Egypt) with the express aim of circumventing EU trade defence measures.

4) Unilateral EU regulations and policies also pose a major challenge for EU CFP producers. Two particular examples are

- The EU ETS system covers EU glass (fibre) production but not the imports of glass (fibres). To date, this point has been addressed through the grant of free allowances but carbon leakage remains an issue that needs to be addressed as free allowances are eliminated.

- While EU producers mainly transport their product by road in the EU, imports from Asia are mainly transported by ship to the EU. Because emissions requirements in the EU are so much stricter for road transport than for shipping transport, the EU rules effectively subsidise imports.

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Shipbuilding and Maritime Equipment

i. Introduction: Europe's global maritime technology leadership at stake

Commercial shipbuilding and the maritime equipment industry operate in a truly global market. Over the last decades, European companies in the shipbuilding industry have seen a dramatic change of their business with almost all orders for cargo ships (tankers, containers or bulkers) going to East Asia. This occurred to a large extent as a result of sector specific industrial and export-led policy strategies in third countries (South Korea and recently China) involving massive state aid, creating trade distortions and lack of global level playing field for the European shipbuilding and maritime equipment Industry.

Today the maritime technology industry in Europe, i.e. encompassing both shipbuilding and maritime equipment, consists of more than 22,000 companies. Together they employ more than 900,000 skilled people and generate an annual production value of € 112.5 billion. European shipyards, maritime equipment manufacturers and maritime service suppliers are today global leaders in the production and development of complex high-tech ship types, advanced and technology intensive maritime equipment, and sophisticated marine engineering solutions. However, the sector's global leadership position is at stake since third countries like China are clearly targeting the European success markets through aggressive State-led industrial policies and strategies as well as unfair (trade) practices.

ii. The problem of government interventions in world shipbuilding

The world shipbuilding industry has always been characterized by cyclicality, strong government intervention (particularly in Asia) and overcapacity [7]. Considering the strategic role of this industry, the creation of new or additional shipbuilding capacity in third countries is often supported by political decision makers as it symbolizes economic development, future prosperity and – in some cases – geo-political power. Removal or deletion of shipbuilding capacity on the other hand is painful for the company as well as its consistency.

Over the last decades, massive state aid in South Korea and China to expand shipbuilding activities and/or to prevent ailing shipyards to exit the market have contributed to global overcapacity (Figure 1). **This in turn induced shipbuilding companies to engage in injurious pricing practices which resulted in tremendous distortions of competition, with European companies being the main victims**. Indeed, when unsustainable capacity is kept in existence, shipyards accept loss-making orders to fill production facilities. The resulting losses lead to new government interventions to save shipyards from bankruptcy. This in turn creates a **continuous "vicious circle" with dramatic consequences** for the global shipbuilding and shipping communities as it can be seen in the chart below (Figure 2).

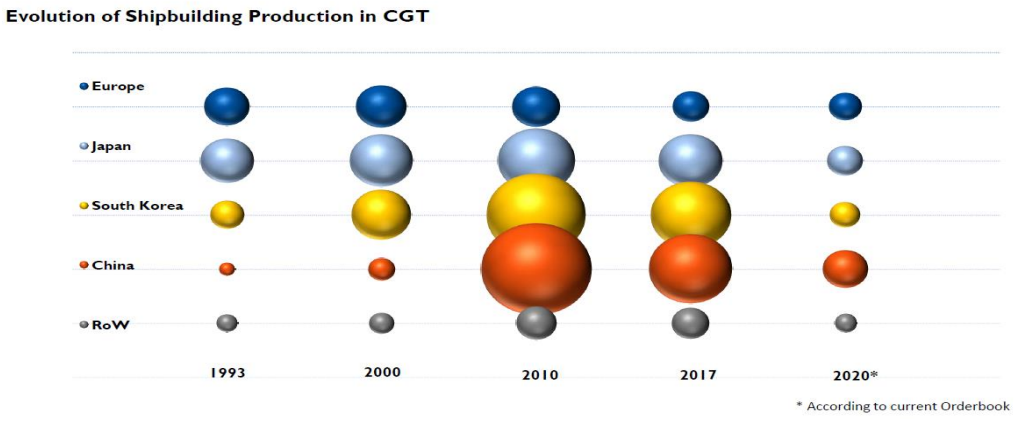


Figure 1 (Source: Clarksons)

[7] See also OECD WP6 -IMBALANCES IN THE SHIPBUILDING INDUSTRY AND ASSESSMENT OF POLICY RESPONSES (2017). Also, OECD WP6 Workshop on factors impacting costs and distorting the shipbuilding market (2018)

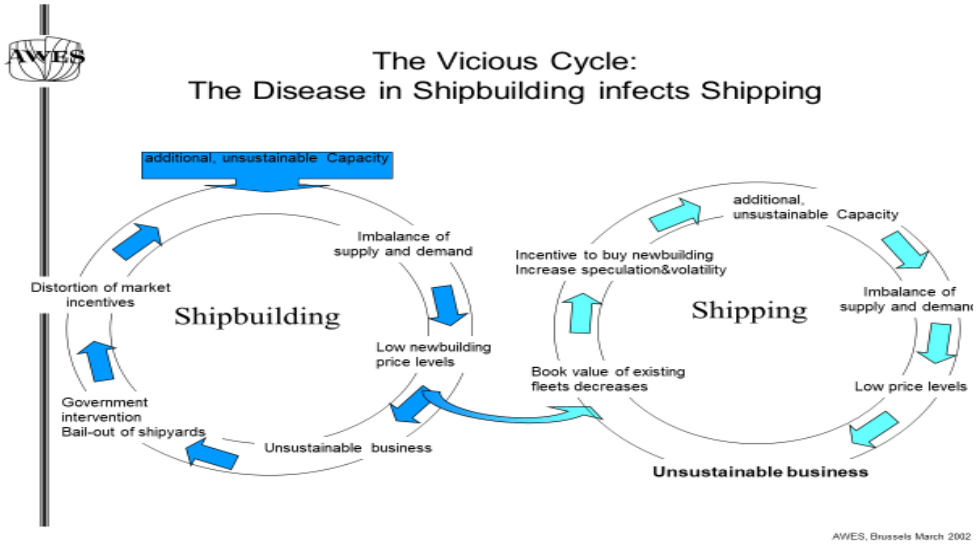


Figure 2 (Source: AWES/SEA Europe)

Due to the specific nature of shipbuilding, notably a global and cyclical industry with long production cycles and capital-intensive investments, the negative effects of certain market distortions can be and have been long lasting as well as damaging for the whole international shipbuilding community.

iii. Absence of effective trade disciplines for shipbuilding

The WTO Agreement on Subsidies and Countervailing Measures (The ASCM) has not been able to tackle or remove trade distortive subsidies introduced in shipbuilding or other market-distorting support measures by governments or government related entities. This was *inter alia* demonstrated in the EU complaint against South Korea in WTO concerning unfair trade practices in shipbuilding and the subsequent panel findings from March 2005. **In the case of shipbuilding and maritime equipment it has often been difficult to classify subsidies as either prohibited or actionable with trade distortive effects since such subsidies most often are granted irrespective of either export performance or import substitution**. And it is furthermore often difficult to demonstrate any adverse trade effect. Preferential financing arrangements, equity infusions and conversions (e.g. equity swaps), tax exemptions or reductions, supply of goods and services by governments to e.g. a shipyard below market price and distortive discretionary policies such as local content

requirements are among those type of subsidies which obviously could have a harmful effect in the shipbuilding and maritime supply industry not least due to the high export intensity existing in the maritime technology industry.

The existing subsidy provisions in the WTO ASCM are considered largely ineffective, owing amongst others to the lack of transparency and comprehensive information on trade-distorting subsidies and state support measures provided by some shipbuilding countries. In the meantime, new forms of support measures, which appear more difficult to effectively capture or regulate, have surfaced. Although direct contract related subsidies have practically ceased around the world, state aid to compensate injurious practices ex-post such as restructuring aid to make up for lasting predatory pricing in the past has become more important. Moreover, it should be noted that financial contributions are not only provided to shipyards directly, but also to shipowners. Such subsidies, aimed at boosting demand, are considered to have an impact on shipbuilding industry's activities if they are provided subject to building new vessels in domestic yards or the requirement to source equipment from local suppliers. Besides hampering market access for European companies and level playing field, these measures worsen the severity of overcapacity hindering the exit of outdated production capacity.

Besides, the specific nature of the "ship" product and its market have been preventing an effective application of anti-dumping disciplines. The existing WTO anti-dumping rules do not effectively address distorting pricing practices in the shipbuilding sector, amongst others because ships are rarely imported in the common customs sense known for most other products (permanent entry into commerce in the affected economy). **Hence, shipbuilding operates *de facto* under a unique absence of effective international trade rules**.

Since shipbuilding is a global market, to respond to these problems, the major shipbuilding countries have been seeking for global solutions. **Long running efforts to establish a legally binding global regime under the OECD have so far not succeeded.** Nor can tangible results be expected in this domain in the foreseeable future despite the best efforts of the EU.

iv. Risks for the European maritime technology industry

Due to the current collapse of most market segments in standard ship types, shipbuilding nations, particularly in Asia, continue their policies of state support measures, through a wide range of tools to support their local shipyards and/or their local maritime equipment manufacturers. Furthermore, some third country governments, in particular China, are seeking ways to push into specialized market segments where European companies are being successful. With a dedicated government policy, the current world leader position of Europe in terms of complex ship types, including cruise shipbuilding, and advanced systems, technologies and equipment is targeted.

Regrettably, in the past decades, Europe has not been vigilant enough and has therefore already lost almost its entire market for the building of tankers, bulkers and containerships. A loss not caused by industry or business transformation under normal market conditions but by strategic industry policies and government intervention introduced first in Japan, subsequently in Korea and now in China. These ship types are nowadays almost all built in Asia as a result of Asian Government's massive state aid support distorting the market and inducing companies to engage in injurious pricing practices.

What happened in the past with traditional merchant ship building (tankers, bulkers, container ships), can easily happen again with the sophisticated and high added value niche shipbuilding segments in which European shipbuilders are world market leaders today. The most prominent example today is the China 2025 industry strategy.

NON-EXHAUSTIVE LIST OF CONCRETE EXAMPLES AND CASES

a) SOUTH KOREA

For years South Korean shipyards have been able to benefit from state-linked finance enabling them to build vessels at low prices and to compete for business, despite a lack of newbuilding demands or an over-capacity on the global market.

In 2015 the three biggest Korean shipyards suffered a deficit of more than USD 7.2 bn. Since South Korean shipbuilding is one of the country's most important industries, the Government-owned banks and financial institutes have come forward with rescue measures, including financial schemes and other support policies[8]. State-owned Korea Development Bank (KDB) and KEXIM (Export-Import Bank of Korea) lending to the shipbuilding and shipping industries amounted to KRW 58 Trillion as of March 2016 (IMF 2016).

In 2018, the Korean government implemented a **plan to order 200 large cargo vessels**[9] in the next three years to help the ailing shipping and shipbuilding industry in the current difficult global market environment. South Korea's Financial Services Commission announced moreover that financial relief will be offered to (local) equipment suppliers of local shipbuilders to produce eco-friendly products[10]. In November 2018, the government also unveiled a new package of financial measures potentially worth as much as $1.5bn to support the country's ailing smaller yards, including by backing newbuilding orders of 140 liquefied natural gas-powered vessels by 2025[11].

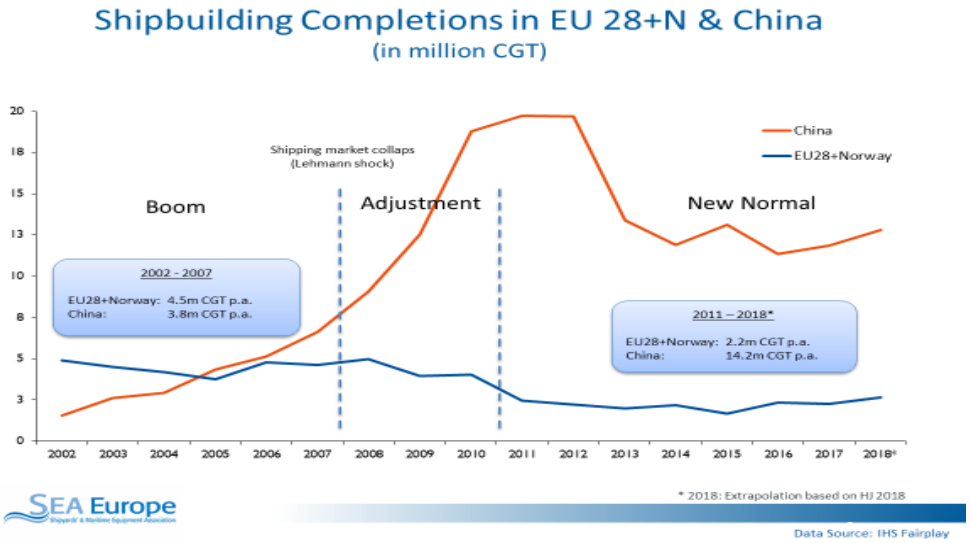
Being one of the world's largest shipbuilding economy, the massive state support measures provided by the South Korean Government create distortion of competition and further aggravate the overcapacity problem in

[8] By way of example, since 2015 South Korea provided a total of $11 billion in financial assistance to Daewoo Shipbuilding & Marine Engineering Co. through government-affiliated financial institutions.
[9] https://www.ship-technology.com/news/south-korea-order-200-ships-three-years/
[10] https://fairplay.ihs.com/commerce/article/4303271/seoul-offers-financial-aid-for-marine-equipment-makers?utm_source=Eloqua&utm_medium=email&utm_campaign=CL_FDN%20200618_PC9157_e-production_E-11060_FP_0620_0420
[11] https://worldmaritimenews.com/archives/265325/south-korea-unveils-financial-boost-for-smaller-shipbuilders/?uid=91013

the global shipbuilding and shipping market, to the detriment of the European maritime technology industry.

b) CHINA

In 2006, the Chinese government identified shipbuilding as a strategic industry, and introduced a plan for its development. In a short time, its market share doubled from 25% to 50%, at the expense of Japan, South Korea, and the countries of Europe.



The figure shows in a relatively short timeframe China has grown to now reach 7 times the "output" (production) level of Europe (EU 28 +Norway), as measured in newbuilding completions in Compensated Gross Tonnage (CGT).

According to some studies [12], China's rapid rise was driven by hidden government subsidies that reduced shipyard production costs, not least because the industry benefited from new shipyards that were constructed as a consequence of this government plan.

In 2009, the Chinese Ministry of Industry and Information (MIIT) issued the **Chinese Shipbuilding Scrapping & Newbuilding Subsidy Programme**. The scheme, originally running until 2013, was later extended until 2015 and subsequently to 2017. The aim of this policy is to promote the scrapping of old

[12] Kalouptsidi, Myrto (2017), 'Detection and Impact of Industrial Subsidies, the Case of Chinese Shipbuilding'. CEPR Discussion Paper No. 12080

and polluting vessels which have not yet reached their service life, stimulating demand for newbuilds at Chinese yards. Under the scheme, the old polluting vessels must be registered in China and the newbuilding had to take place on a Chinese shipyard.

The share of Chinese owners placing orders at Chinese shipyards increased from 28% in 2013 to 51% in 2015. Chinese state-owned shipyards have attracted 94% of the orders placed by Chinese ship-owners[13]. In September 2017 Cosco Shipping Holdings reported that it received CNY 510 million (USD 78.3 million) of the subsidy (Seatrade Maritime News, 2017). This comes after Cosco Shipping Energy Transportation, another subsidiary of China Cosco Shipping Corporation Ltd., also announced a few days earlier that it had benefited from CNY 355 million (USD 53.7 million) scrap and build subsidy. In both cases it was reported that the subsidy would be recognized in the 2017 financial year as non-operating income (Lloyd's List, 2017). In its annual report 2017 Cosco Shipping Energy Transportation declared a total of CNY 365 464 657.73 shipbreaking assistance" (拆船补助), with CNY 212 582 700.00 reported for 2016 (SSE, 2018).

Foreign equipment manufacturers were apparently allowed to participate subject to complying with certain conditions, i.e. a) the percentage of "local" marine equipment must be at least 70%; b) "local" supply referred only to manufacturing companies. Sales offices of a foreign marine equipment supplier or subsidiaries despite having operated in China for several years did not qualify as local suppliers. As a result, European engine manufacturers were not able to sell engines to these subsidized ships, regardless of whether they had factories in China or not.

In 2014, the Chinese government published a **'white list'** of shipyards who are benefitting from prioritized policy support and access to domestic bank loans. In the years after the initial list, several yards were added and also removed from the white list. The latest alterations were made in 2018 and the white list now contains approximately 70 shipyards of which several yards are focused on shipbuilding for the (international) offshore oil & gas industry.

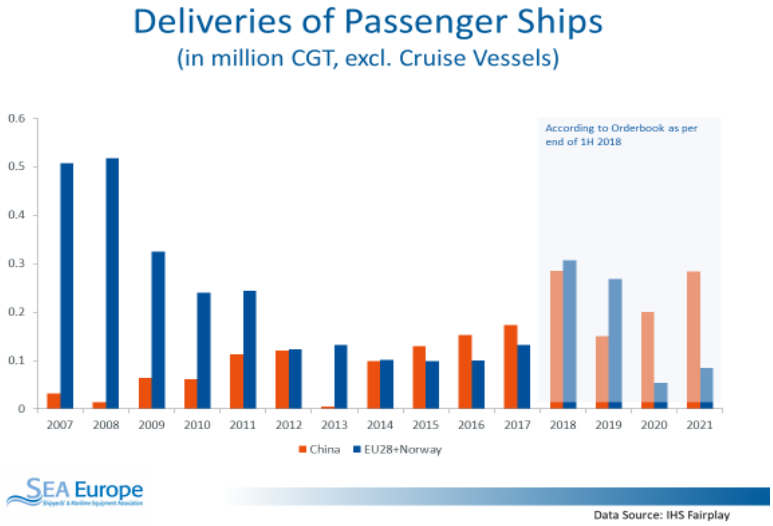
[13] DANISH SHIP FINANCE (2015)

Shipyards on the white list have a prominent position in the Chinese shipbuilding industry. Approximately 90% of all vessels build in China were built at a shipyard on the white list.

In **"Made in China 2025",** China declared its ambition to take over Europe's global leadership position in complex shipbuilding and in advanced maritime technologies by 2025 latest[14]. Consistent with such objective, at the beginning of 2017 the Chinese Ministry of Industry and Information Technology (MIIT) updated the five-year Shipbuilding Action Plan (2016-2020) through several "safeguard measures" targeting the higher-value ship segment as well as increased domestic content for marine equipment. These include increasing financial support and encouraging and guiding financial institutes to implement differentiated credit policies for the shipbuilding industry. To complement the Shipbuilding Action Plan (2016-2020), at the end of 2016 MIIT launched a five-year action plan specially dedicated at "**Boosting Capabilities of Marine Equipment**" whereby "*Different financial support measures as import taxes, newbuilding credit, development finance and insurance shall be mobilized for the development of marine equipment*". [15]

In this regard it is worth noting that through aggressive low pricing strategies in 2017-18 China has been already successful in winning several European ferry newbuilding orders (a niche segment in which European shipyards were until recently global leaders). Some publicly reported ship prices provided seem to indicate **offer price well below cost of production**.

[14] See J. Holslag, "The Silk Road Trap" (2018).
[15] "Study on New Trends in Globalisation in Shipbuilding and Marine Supplies – Consequences for European Industrial and Trade Policy", BALance Management Consulting



Examples of state support measures adopted in 2017 and reported in the press include[16]:

- **CSIC Ltd. share issuance:** The listed firm and State-Owned Enterprise (SOE) China Shipbuilding Industry Corporation Limited (CSIC Ltd) has issued shares worth RMB 3.9 billion (USD 566 million), as reported in May 2017. The shares were acquired to 81% by CSIC, 12% by Dalian Shipbuilding Investment and 7% by Wuhan Wuchuan Shipbuilding Investment, the latter two being subsidiaries of CSIC. The operation was reportedly undertaken in an effort to improve the company's cash flow situation and increase its ability to construct military vessels (Lloyd's List, 2017).
- **CSIC Ltd. debt-to-equity swap and ensuing share issuance.** In August 2017, it was announced that two of the subsidiaries fully owned by CSIC Ltd., Dalian Shipbuilding Industry Co Ltd (DSIC) and Wuchang Shipbuilding Industry Group Co Ltd (WSIG), would benefit from a total of CNY 22 billion (approximatively USD 3.3 billion) of debt-to-equity swap. This move comes after CSIC Ltd's debt-to-equity ratio reportedly reached 2.3 in March 2017 (Lloyd's List, 2017) and the shares of the Shanghai-listed company stopped trading in May 2017. Of the eight investing companies, China Cinda Asset Management Co Ltd and China Orient Asset Management Co Ltd, both controlled by the Chinese

[16] Source: OECD WP6 (2018). See also https://fairplay.ihs.com/commerce/article/4303986/china-wavers-over-shipyard-state-aid-talks

Ministry of Finance, swapped debt for equity for a total of CNY 7 billion. The other six companies, including State-owned enterprises, provided cash for equity, thus enabling the two shipbuilders DSIC and WSIG to service their debts (Lloyd's List, 2017; China Daily, 2017). In an effort to regain full ownership of its subsidiaries DSIC and WSIG, CSIC Ltd. announced in October 2017 that it would issue new shares worth CNY 22 billion to the eight investors in exchange for their shares of the subsidiaries. This would dilute the stake of the state-owned CSIC in CSIC Ltd. by approximatively 9% to 45.43% (Lloyd's List, 2017).

- **CSSC capital injection.** Two listed units of the China State Shipbuilding Corp. (CSSC) announced early 2018 that their subsidiaries would issue new shares in an effort to gain capital and reduce their leverage ratio. The move aims to raise a total of CNY 10.2 billion (USD 1.6 billion). Two subsidiaries of the CSSC unit China CSSC Holdings, Shanghai Waigaoqiao Shipbuilding and Chengxi Shipyard, want to issue shares worth CNY 5.4 billion, while the two subsidiaries of CSSC Offshore & Marine Engineering, Guangzhou Shipyard international and Huangpu Wenchong, aim to issue shares for CNY 4.8 bn (Lloyd's List, 2018). All investors have a state background, either being directly state owned or benefiting from government funding (Lloyd's List, 2018).
- **Government support for CSIC and CSSC**. China Shipbuilding Industry Corporation (中国船舶重工集团公司, CSIC) reported an amount of CNY 611 371 866 government subsidies as non-operating income in its third quarter statement of 2017. In the year 2016, CSIC reported a total of CNY 1 526 582 463 as government subsides under non-operating income (CSIC, 2017). China State Shipbuilding Corporation (中国船舶工业集团公司, CSSC) declared CNY 1925501.38 subsidies in the first nine months of 2017 and CNY 1 311 653 520 as government subsidies in its 2016 annual statement (CSSC, 2017).

- **CExim to take major role in financing CMA CGM's boxship orders**. In September 2017, the French shipping line CMA CGM was reported to have confirmed putting down orders for six 22 000 TEU boxships plus options for three more. The ships are estimated to cost USD 140 million or less each. The contracts have been secured by two CSSC-owned yards (Lloyd's List, 2017). The Export Import Bank of China (CExim) is said to take the lead in financing the deal, which is worth up to USD 1.2 billion. Thanks to its liquidity, CExim would be "able to offer loans at attractive prices", according to banking sources (Lloyd's List, 2017).

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Non-ferrous Metals

About the European non-ferrous metals industry

The non-ferrous metals industry is divided into three categories:

1. Base metals: aluminium, copper, lead, nickel, zinc, tin.
2. Precious metals: gold, silver, platinum, palladium and etc.
3. Technology metals: silicon, cobalt, titanium, magnesium and etc.

General Priorities and Challenges of European non-ferrous metals industry

1. *Access to secure and sustainable supply of raw materials.*

The EU NFM industry is highly dependent on imported raw materials (especially primary) due to the lack of appropriate ores in the EU. EU access is further restricted by tariffs and taxes in place in important raw material producing countries like China and Russia, which creates an unequal international playing field. The EU is also highly dependent on the accessibility of EU 'urban mines' (recyclable materials) where it is currently facing fierce competition from abroad (China, India).

2. *Increasing import penetration from regions with lower costs of production inputs.*

An illustration of this trend is the case of China, where export of value added products is indirectly encouraged through industrial policy aimed at keeping input prices low by providing direct or indirect subsidies.

3. *Rising importance of recycling.*

This is a response to the need to reduce CO2 emissions but also to higher prices, less secure access to primary raw materials, and environmental policies and regulations.

4. *Investments in new raw material sources development.*

Despite the increased recovery rates for most NFM sectors, imports of primary raw materials will remain an essential and major source of supply to the European markets for technical and structural reasons (e.g. long-term stock and rising demand). Mining operations and the raw materials projects are being developed even within the EU in response to restricted access to raw materials from countries such as China.

5. *Increased prices and export of scrap in the EU.*

The constraints of raw materials imposed by supplying countries has increased pressure on available sources of scrap and demand for these inputs from the EU has risen sharply. In addition, the ineffective enforcement of trade related aspects of environmental regulations related to waste shipment resulted in growing losses of valuable raw material inputs.

6. *Multiple environmental policies have an impact on the EU NFM industry*.

Environmental standards, Waste regulation, REACH. Generally speaking, the mean impacts lie in the administrative burden, compliance costs and correct implementation and enforcement, while insufficient harmonisation of environmental policies and policy interpretations at Member State level creates inefficiencies. Internationally the EU environmental regulations are the most far reaching and ambitious compared to other developed and developing economies. There are no comparable environmental regulations in place in developing countries. These are generally still setting up their environmental framework (e.g. China).

7. Electricity prices in the EU are among the highest in the world.

Aluminium smelters based in the EU (excluding Norway and Iceland) pay often more than twice the price for their power compared to their international competitors. In this respect, the EU Emissions Trading Scheme (EU ETS) is an important factor for energy intensive NFM sub-sectors and segments in the EU, which is affecting the sector indirectly

through increased electricity prices. Non-ferrous metals are price takers: they can't pass on their (increased) energy costs to downstream users due to global trading via the London Market Exchange.

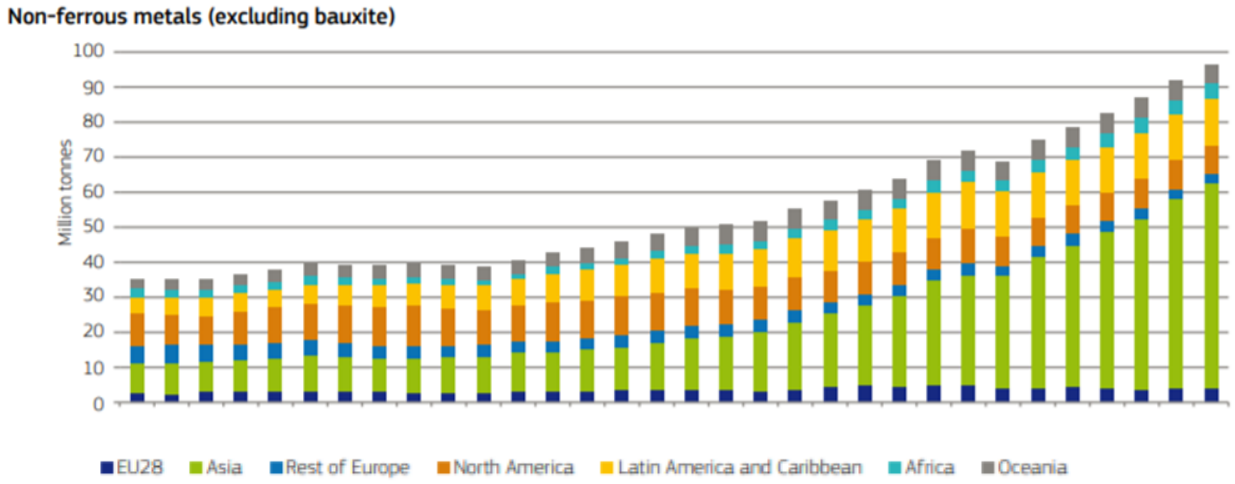
Access to Raw Materials

The global need for raw materials is increasing rapidly. In such a context, the EU is highly dependent on the foreign supply of raw materials.

As it can be seen in the graph[17] below, mining production in Asia showed considerable increases for the non-ferrous metals group.

Moreover, it should be noted that:

- The production of aluminium (45%), zinc (36%), nickel (31%) and lead (50%) is highly concentrated in China.
- Copper is mainly extracted in Latin America, where the principal producer is Chile (32%).
- Production of chromium is mainly divided between China (33%) and South Africa (31%).



Graph 1: World regions share of global production (for different material categories, 1984-2015). Source: European Commission, The Raw Materials Scoreboard, 2018.

[17] European Commission, The Raw Materials Scoreboard, 2018. The percentages refer to a five-year average global production (2010 - 2014).

Excessively high import reliance can become a security of supply issue, as economies are more vulnerable to e.g. export restrictions applied by producing countries. **Import dependency reaches 100 % for several metals** and, not surprisingly, most of the critical raw materials. For the non-ferrous metals the import dependency is the following: antimony (100%), bauxite (85%), cobalt (32%), copper (82%); manganese (89%) molybdenum (100%), niobium (100%), platinum (98%), tantalum (100%), titanium (100%), vanadium (84%), zinc (61%).

The global production of critical and some non-critical raw materials continues to be highly concentrated in a few non-EU countries that often have low levels of governance, which brings with it a high risk of supply disruptions[18]. China is the major supplier of critical raw materials, accounting for 70% of their global supply and 62% of their supply to the EU (e.g. rare earth elements, magnesium, antimony, natural graphite, etc.), Brazil (niobium), USA (beryllium and helium), Russia (palladium) and South Africa (iridium, platinum, rhodium and ruthenium) are also important producers of critical raw materials[19].

Europe's low-carbon transition needs more metals, which we want to make cleanly and in Europe

The global demand of metals is steeply increasing and will continue to grow in the upcoming years. This is mainly driven by the push towards a low carbon economy: indeed, every conceivable low-carbon product contains metals in some shape or form and Europe's low-carbon transition will require even more. Some examples:

- According to the World Bank[20]: +200% more metals will be needed by 2050 for the world's wind turbines and solar panels;

[18] European Commission, Raw Materials Scoreboard, 2018.
[19] European Commission, DG GROW, Critical Raw Materials, 2017 http://ec.europa.eu/growth/sectors/raw-materials/specific-interest/critical_en
[20] World Bank Group, The Growing Role of Minerals and Metals for a Low Carbon Future, 2017.

- The European Commission's Joint Research Centre (JRC)[21] states that +20% of today's EU metals demand will be needed by 2030 for new low-carbon technologies;
- The German Mineral Resources Agency (DERA)[22] forecasts that +95% more strategic metals will be needed by 2035 for the world's emerging technologies.

Europe's non-ferrous metals industry operates at the highest standards in terms of responsible sourcing, CO2 emissions' reduction, recycling rates and chemicals' management. Just to give an example, our production is amongst the most efficient in the world:

- Aluminium: 53% reduction in CO2 emissions since 1990 (3x lower CO2 emissions than Chinese aluminium production);
- Copper: 60% reduction in energy intensity since 1990;
- Nickel: 48% reduction in energy intensity since 1990 (7x lower CO2 emissions than Chinese nickel production);
- Zinc: 35% reduction in energy intensity since 1990.

This has a cost which affects our competitiveness, for this reason we need a global playing field for our industry.

The need of a level playing field: industrial subsidies and overcapacities

China's non-ferrous metals industry constitutes a core element of government planning in the context of the Strategic Emerging Industry Initiative (launched 2009), the Made in China 2025 Plan (launched in 2015) as well as other high-level programmes.

To make China's mining/metals industry competitive, China's government directly intervenes in the pricing of capital, labour, land, raw materials and

[21] Joint Research Centre, European Commission, Critical Metals in the Path towards the Decarbonisation of the EU Energy Sector, 2013.
[22] German Mineral Resources Agency (DERA) at the Federal Institute for Geosciences and Natural Resources (BGR). Raw materials for emerging technologies 2016.

basic inputs to the production process. These distortions create wrong price signals that affect the full value chain.

Examples of market distortions, which were identified in Prof Dr Taube' study *Analysis of Market-Distortions in the Chinese Non-Ferrous Metals Industry (2017)*[23], are the following:

- Subsidies: The 65 analysed companies received subsidies accounted as non-operating income amounting to more EUR 5.2 billion (from 2011 to 2016). These grants make up 44% of these companies' aggregate after tax properties. In addition, the companies received another EUR 2.1 billion in deferred income subsidies.
- Debt-equity swaps: Additionally, the examined companies exhibit a very high debt ratio of up to 98%. Debts are regularly transformed through debt-equity swaps, where the State takes over the shares. This instrument is used to keep under-performing but strategically important companies alive.
- Energy and export subsidies: The 65 examined companies have received over 4,000 individual subsidy transactions since 2011. Energy subsidies stand out due to their sheer magnitude (EUR 300 million between 2011 and 2015). Combined export subsidies totaled EUR 16.9 million.

  In this respect, it is important to underline that multiple environmental policies have an impact on the EU NFM industry, such as environmental standards, waste regulation; REACH and the EU Emissions Trading System (ETS). Internationally the EU environmental regulations are the most far reaching and ambitious compared to other developed and developing economies. There are no comparable environmental regulations in place in developing countries. These are generally still setting up their environmental framework (e.g. SEPA in China) and their environmental policies tend to focus on other environmental topics (e.g. water and air pollution in India). Therefore, European companies

[23] Prof. Taube, Analysis of Market-Distortions in the Chinese Non-Ferrous Metals Industry, 2017.

have to comply with additional standards (and higher costs) than many of its global competitors.[24]

In addition, the production of non-ferrous metals is very electro-intensive (electricity costs amount for around 40% of the cost of production for aluminium, zinc and silicon), and high energy prices in the EU discourage investment in primary production. The cyclical nature of commodity prices, determined by global demand and supply, also affects the non-ferrous metals sector. Most non-ferrous metals are globally traded, and their prices are set by the London Metal Exchange (LME). This price mechanism limits the capacity of non-ferrous metals producers and processors to pass on costs to customers.

Energy subsidies are therefore an additional element creating imbalances and harming the competitiveness of our sector.

- Overcapacities**:** The Prof Dr Taube' study also sheds light on massive overcapacities in several sectors, which is influencing global prices:
  - Overcapacities have been identified in the aluminium, tungsten, magnesium and led sectors.
  - In 2016, the utilisation rate of China's aluminium primary production was only 77%.
  - Tungsten had a utilisation rate of nearly 50%,
  - Support for China's copper industry has led to import substitution at the expense of foreign suppliers.

China's exports to the EU have also increased for several semi-fabricated products. For example, as it can be seen from the graph below, since 2007, a 107% increase for aluminium and 606% for lead semi-fabricated products has been registered.

[24] Ecorys, Competitiveness of the EU Non-Ferrous Metals Industries, 2011.

	Aluminium Semis (CN Codes: 7604+7605+7606+7607+7608)	Lead Semis (CN Codes: 780411+780419)
	EU 28 IMPORT from China	**EU 28 IMPORT from China**
2007	187,312	28.2
2008	207,833	72.2
2009	120,943	83.3
2010	183,923	65.9
2011	365,005	95.4
2012	284,363	100.2
2013	282,424	91.5
2014	347,411	103.9
2015	433,082	123.4
2016	390,229	99.6
2017	388,433	199.1
% Increase	107	606
Source: Eurostat, tonnes		

Graph 2: EU28 Import from China in 2007-2017. Source: European Commission, Eurostat.

As for copper, the exports of some semi-fabricated products (from China to the EU 28) have increased:

- Foil of refined copper, backed, t < 0.15 mm: 5.4 k t in 2016, +390% since 2000 (1.1 kt).
- Wire, copper-zinc base alloy: 3.6k t in 2016, +17900% since 2000 (20 t)
- Pipes or tubes, copper-zinc base alloy: 2k t in 2016, +6566,7% since 2000 (30 t)[25].

Overcapacities can be found not only in the aluminium, lead, tungsten and magnesium sectors, but in other sectors as well. In fact, for example, China has planned a further increase of its copper smelting capacity by 2020. Moreover, it should be noted that the share of global smelting, since 2008, has increased in 35% for copper and in 30% for nickel.

Conclusions

These reports on NFM industry show that in order to be competitive at global level and keep complying with the highest standards, NFMs need a stable framework of rules at international level granting a level playing field. We hence look at the WTO, which we believe should act as the guardian of trade

[25] UN Comtrade.

rules, standing at the **centre of a multilateral system that aims to promote an open, rules-based and fair-trade environment against policies that lead to discrimination and protectionism.** In this regard, the WTO is indispensable to help businesses source, produce and sell products and services across the globe equitably and competitively. In particular, the European non-ferrous metals industry needs an effective WTO able to face global challenges such as overcapacities, state subsidies and unfair protectionism.

Sources:

- Analysis of Market-Distortions in the Chinese Non-Ferrous Metals Industry, THINK!DESK China Research & Consulting, Prof. Dr. Markus Taube, pp. 124-129; 130-133; 145-151.
- Ecorys, Competitiveness of the EU Non-Ferrous Metals Industries, 2011.
- German Mineral Resources Agency (DERA) at the Federal Institute for Geosciences and Natural Resources (BGR). Raw materials for emerging technologies 2016.
- International Lead and Zinc Study Group, n. d. Available from: http://www.ilzsg.org (accessed: 25.03.2017).
- International Magnesium Association. Available from: http://www.intlmag.org (accessed: 16.03.2017).
- Joint Research Centre, European Commission, Critical Metals in the Path towards the Decarbonisation of the EU Energy Sector, 2013.
- U.S. Geological Survey, 2017, Mineral Commodity Summary – Tungsten. Available from: https://minerals.usgs.gov/minerals/pubs/commodity/tungsten/mcs-2017-tungs.pdf (accessed: 13.02.2017).
- Wirtschaftsvereinigung Metalle, 2017a, Die Statistik der Nichteisen-Metallindustrie 15.16. Available from: http://www.wvmetalle.de/fileadmin/uploads/public/Metallstatistik/Metallstatistik_ 2015.pdf (accessed: 20.12.2016).
- World Bank Group, The Growing Role of Minerals and Metals for a Low Carbon Future, 2017.

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Steel

Objectives, guiding principles and policy recommendations of the Global Forum on Steel Excess Capacity

GLOBAL FORUM ON STEEL EXCESS CAPACITY

MINISTERIAL REPORT 20 SEPTEMBER 2018

1. INTRODUCTION

1. A driver of industrialization, the steel sector plays an important role in connecting economies through its central position in global value chains. Steel is an essential material used in virtually all manufacturing sectors and construction applications. With more than 90 countries producing a combined 1.6 billion tonnes of crude steel annually, few challenges have more global impact than those facing the steel sector.

2. Excess steelmaking capacity – a global challenge that continues to plague the sector – creates significant difficulties for steel producers in advanced, emerging and developing economies alike. While steel market conditions have shown some cyclical recovery in 2017, the underlying trend in global steel demand remains weak and excess capacity remains significant.

The situation became particularly acute in 2015. It depresses prices, undermines profitability, generates damaging trade distortions, jeopardizes the very existence of companies and branches across the world, creates regional imbalances, undermines the fight against environmental challenges and dangerously destabilizes world trading relations. It especially undermines income opportunities of employees.

3. Addressing excess capacity is a necessary condition for more stable, profitable and sustainable business and employment conditions, which allows the industry to face a number of long-term challenges more effectively and to continue investing towards value creation by adjusting to fundamental changes in economic activity brought on by the "next production revolution". If the steel industry is to continue to invest towards value creation, it will require significant reductions in excess capacity and a return to sustained profitability.

4. The dimension and depth of excess capacity implies it is no longer simply a cyclical issue to be tackled as "business as usual". Curbing excess capacity and building a well-functioning, open, competitive, efficient, stable and transparent environment is a core challenge of our time - for the steel sector and beyond, as expressed in the Hangzhou and Hamburg Summits. This report focuses on the steel sector.

5. **Recognising the serious problem of excess capacity in the global steel industry, G20 Leaders called for the formation of a Global Forum on Steel Excess Capacity (GFSEC) at their Summit on 4 and 5 September 2016, in Hangzhou, to increase information sharing and cooperation. The Global Forum on Steel Excess Capacity was formally established on 16 December 2016 in Berlin. The Global Forum brings together 33 member economies (all G20 members and interested OECD members), representing around 90% of global steel production and capacity.**

6. In line with G20 Leaders' call for increased information sharing, **the Global Forum established an information-sharing mechanism in early 2017, to exchange information on crude steel capacity developments and government policies affecting excess capacity, including market-distorting**

subsidies and other government support measures. Following the commitments by G20 Leaders at the July 2017 Hamburg summit, the GFSEC then moved to the urgent task of developing concrete policy solutions to alleviate excess capacity in the steel sector. At their 30 November 2017 ministerial meeting in Berlin, GFSEC member economies approved a substantive report (hereafter the Berlin Ministerial report) with concrete guiding principles and specific policy recommendations for governments (see hereunder). These are the basis for the tangible and swift policy action to address excess capacity in the steel sector that G20 Leaders specifically called for in Hamburg. Implementing the agreed principles and recommendations is a key priority for the Forum's work in 2018, and reflects the collective resolve of GFSEC members not simply to mitigate in the short term, but to structurally eliminate the scourge of excess capacity.

7. In the spirit and letter of the Berlin Ministerial report and, in particular, of Principle VI, the Argentinean Chair held a new round of information sharing, assessment and review which took place between February and May 2018, focusing on the **identification of market distorting subsidies and support measures that contribute to excess capacity** and the remaining policy recommendations included in the Berlin Ministerial report. While much work remains and important information is still to be provided by some members, the assessment and review process has helped identify whether practices fall under the purview of paragraph 57 of the Berlin Ministerial report and should therefore be earmarked for time-bound elimination. This has been the core objective of the GFSEC in the first half of 2018. The meetings to date have also highlighted limitations in the information sharing, which have to be addressed in order for the GFSEC to fully meet its objectives.

8. The improvement in steel market conditions now taking place provides a unique window of opportunity to address excess capacity, and market distortions that result in excess capacity and contribute to trade frictions. Indeed, the modest upturn in global demand together with a slowdown in capacity growth in recent years has helped to reduce the gap between world steel demand and capacity recently. However, with forecasts for long-term

global steel demand growth in the 1% per annum range the adjustment process will be very lengthy in the absence of more concerted efforts to reduce capacity.

9. Without delay, governments should fully seize the opportunity of the temporary relief in the steel market conditions to address excess capacity and the underlying causes of excess capacity in the steel industry and prevent its re-emergence in the future. Swift and tangible actions that encourage industry restructuring, remove market-distorting subsidies and other governmental support measures that contribute to excess capacity, enhance the role of market forces in determining the competitive outcomes in the steel industry and fostering a level-playing field in the steel sector are essential to resolve excess capacity in a structural manner – in accordance with Principle II, III and IV of the Berlin Ministerial Report. Neither the steel sector, nor the world economy, can to repeat the costly mistakes of the past - the political impetus to genuinely tackle excess capacity as soon as cyclical upturns kick in. This can only spell intense disruptions at the next downturn with significant social, economic, and trade and political consequences at the local, regional, and global level. It is our common responsibility to avoid them.

Six principles that guided the development of policy solutions to reduce excess capacity

1. **Steel excess capacity is a global issue** which requires attention in a global format with broad participation of economies and effective policy solutions to enhance the market function and reduce steel excess capacity. To support these, Forum members may set and publish goals, if appropriate.

2. In order to ensure that the steel market operates under market principles, **governments and government-related entities should refrain from providing market-distorting subsidies and other types of support measures to steel producers.** These include subsidies and other government support measures that sustain uneconomic steel plants, encourage investment in new steelmaking capacity which otherwise would not be built, facilitate exports of steel products, or otherwise distort competition by contributing to excess capacity.

3. Irrespective of ownership **all enterprises acting in the steel market (whether privately-owned or directly or indirectly owned, fully or in part, by their governments or by government-related entities) should not receive directly or indirectly subsidies or other type of support that distort competition by contributing to excess capacity, and should follow the same regulations with economic implications and rules, including bankruptcy procedures.** A level-playing field should be ensured among steel enterprises of all types of ownership. Global Forum members should also continue to fight protectionism including all unfair trade practices while recognising the role of legitimate trade defence instruments in this regard.

4. **Open and competitive markets and a market-driven approach to resource allocation based on the competitive positions of steel enterprises should be the driving forces of the steel sector.** New investment, production and trade flows should reflect market-based supply and demand conditions.

5. Wherever excess capacity exists, **governments have a role in advancing policies that facilitate the restructuring of the steel industry while minimizing the social costs to workers and communities.** Governments should ensure conditions exist for market-based adjustment, by facilitating the exit of consistently loss-making firms, "zombie" firms, obsolete capacity facilities and firms not meeting environmental, quality and safety standards. This would lead to a net reduction of capacity.

6. Recognizing that collective policy solutions and transparency are vital for market-based responses by the industry to changing conditions in the steel market, **governments should on a reciprocal basis increase transparency through regular information sharing, analysis, review, assessment and discussion as well as regular exchanges about data and concrete policy solutions, among the members of the Global Forum.** Governments should ensure that any relevant information on steelmaking capacity developments; supply and demand conditions as well as policy responses including support measures by governments and government-related entities is available on an on-going basis. Members should exchange information on the nature and extent of export credit agency support for new steel projects. The Global Forum will report to the G20 and to interested OECD countries being member of the Global Forum on progress.

Policy recommendations

a) Framework conditions

1. Members should consider the extent to which their framework conditions and institutional settings ensure proper market functioning and policy objectives consistent with the need for reducing global excess capacity.

2. Particular attention should be given to ensure that: i) competition law, trade and investment policies, and other policies foster a level playing field for competition among companies irrespective of ownership, both domestically and internationally; ii) bankruptcy legislation is effective and procedures are expedited efficiently; iii) the internal financial market is able to price risk and deal with non-performing loans; iv) labour markets and social security systems adequately support adjustment, v) different levels of government do not have conflicting policy objectives and, vi) Procurement policies should not contribute to excess capacity.

b) Market distorting subsidies and other support measures by government or government-related entities

1. Members should remove and refrain from adopting market-distorting subsidies and other support measures provided by governments and government-related entities that encourage companies to undertake capacity expansion projects, maintain consistently loss-making or uneconomic steel plants in the market, or which otherwise distort the market.

2. All Members should expeditiously share data on market-distorting subsidies and other support measures by government or other government related entities. The proper implementation of subsidies and other support measures that facilitate permanent closures of steel facilities should be carefully analysed and follow strict guidelines.

3. Governments should remove and refrain from market-distorting subsidies and other support measures by government or government-related entities that contribute to excess capacity.

4. Governments may encourage innovations in the steel sector and implementation of best available technologies among steel producers irrespective of ownership insofar as this does not distort competition and contribute to excess capacity.

c) Fostering a level-playing field in the steel sector

1. Irrespective of ownership, all enterprises acting in the steel market (whether privately-owned or directly or indirectly owned, fully or in part, by their governments or by government- related entities) should not receive subsidies or any other types of support that distort competition by contributing to excess capacity.

2. All enterprises acting in a country's steel market should follow the same rules and regulations with economic implications, including bankruptcy procedures.

3. A level playing field should be ensured among steel enterprises of all types of ownership.

d) Fostering industry restructuring by assisting displaced workers

1. Governments should favour active labour market policies which maintain and increase the employability of workers who are dismissed as a result of the restructuring.

2. Employment adjustment measures are an important instrument for addressing the social cost of restructuring. This should be provided as support to workers and should not constitute subsidization to companies, which could maintain existing capacities in place.

3. The specific needs of older workers and other disadvantaged groups affected by restructuring should be taken into account to facilitate their transitioning into alternative occupations.

4. The effectiveness and efficiency of the measures should be evaluated.

e) Government targets

1. Steel excess capacity is a global issue which requires attention in a global format with broad participation of economies. To support these, Global Forum members may set and publish goals, as appropriate, to reduce excess capacity through legal and market methods. Capacity reduction targets should be accompanied by actions to eliminate policies that contribute to excess capacity, such as market-distorting subsidies and other types of support by government or government-related entities

2. The criteria for capacity reductions should, irrespective of ownership, simulate the process of market selection with consistently loss making or non-environmentally compliant firms being forced to exit the market. Ex post assessments of whether this is the case should be undertaken.

3. Government objectives to increase capacity should not be accompanied by market-distorting subsidies or other types of support by government or government-related entities that contribute to excess capacity, including input support to steel production.

4. Government targets should take into consideration demand conditions.

f) Issues related to mergers and acquisitions

1. Mergers and acquisition should not contribute to excess capacity.

2. Any measures taken to encourage mergers and acquisitions need to be taken in accordance with effective competition law and market principles.

g) Ensuring export credits do not contribute to excess capacity

1. Members should refrain from issuing officially supported export credits for steel plants and equipment which contribute to the expansion of global steel capacity that would not otherwise take place but for such subsidisation or not be in line with global steel demand.

2. When such support is provided, the terms and conditions of officially supported export credits for steel plant and equipment should be transparent, reflect market pricing and practices, and take note of guidelines agreed among some members and on-going international negotiations. This will minimise the subsidisation associated with export credits, and thus avoid supporting the creation of additional steelmaking capacity.

Annex 2 – AEGIS Europe Sector's Assessments Of Strategic Objectives And Challenges

European Rail Supply Industry

STRATEGIC OBJECTIVES

1. To enable sustained growth of exports for European rail suppliers in a fair, rules-based environment
2. To maintain a solid industry base and supply chain, as well as jobs, for rail supply in Europe

The supply chain in the rail sector is complex and comprises several tiers (from component manufacturer to system integrator).

MAJOR ECONOMIC CHALLENGES AND RELATED DISTORTING POLICIES

With over 400.000 jobs in Europe, the European rail supply industry is a strategic sector for the EU competitiveness. While the European rail supply industry is a top exporter on world markets, suppliers are increasingly concerned by the increasing lack of level playing field between EU and non-EU competitors.

Major economic challenges	Distorting policies
EU and international public procurement	- At international level: No level-playing field due to the discrepancy between the openness of the EU market and the restrictions applied by other third countries - At EU level: • Risk of non-compliance with EU public procurement rules

	• Insufficient protection regarding abnormally low tenders in the EU • Insufficient application of best value procurement (MEAT principle) • Insufficient awareness and incentives to encourage EU-based manufacturing in procurement
Domestic market protection and overcapacities in third countries	- Preferential policies (tax, land acquisition etc.) - Local content requirements - Investment restrictions - Standardisation of products
Subsidisation of domestic industries vs. strict EU rules	- Subsidies covering exports, inputs, capital, equipment, technology, R&D, loans, guarantees, grants…
Project financing and "packages"	- Collusion between project financing and promotion of domestic industries (tied financing) - Promotion of multisectoral deals with attractive short-term conditions - Non-commitment of key players to the OECD Export Credit Rail Sector Understanding (cf. International Working Group) - As a consequence, increase in Official Development Assistance (ODA) to circumvent stricter RSU conditions

CASE STUDY: COMPETITION WITH CHINA

Overcapacities and closing down of the domestic market

After more than 20 years of sustained investment in rail infrastructure, the pace of growth in China is showing signs of reduction. Although one cannot speak of a declining home market, the 2018 World Rail Market Study foresees a growth of 1.7% (rolling stock), 2.5% (infrastructure), 3,8% (rail control) and 5% (services) for the years 2021-2023 compared to 2015-2017. The growth required

to have a convincing equity story for the capital markets also forces State-owned enterprises like CRRC to expand abroad.

According to 2016 SCI manufacturer analysis, CRRC had a capacity of 3.400 locomotives p.a., 9.000 multiple unit cars p.a. and 65.000 cars freight wagons p.a. – with a utilisation rate ranging from 50 to 80% depending on the product segments. Consequently, the maximum capacity at full utilisation would be significantly higher. In practice, this means that there is **huge excess capacity beyond the domestic demand.**

This has resulted in a consolidation strategy, as shown by the **merger between the two biggest Chinese state-owned train manufacturers** – CNR Corporation and CSR Corporation – into China Rail Rolling Stock (CRRC) in 2015, the largest train manufacturer by far (EUR 31Bn turnover in 2016). Another consequence is the **progressive closure of China's domestic market to European players**. **The accessibility of the Chinese rail market to foreign players has significantly and constantly decreased** to reach only 18% of the total market in 2017. Long-awaited reforms have not materialised. Some of the barriers to entry include:

- **Exclusion from tenders if the on-shore legal entity is not Chinese-owned or controlled** (according to NDRC rules, tier 1 equipment receives negative tender evaluation scoring if the JVco is less than 51% Chinese owned);
- Requirement that **bidders have full ownership of the IPR required for project execution** (which, combined with the previous requirement, implies transfers of technology to a non-controlled legal entity);
- Mandatory and increasing **localization requirements**, reaching e.g. 75% for metro rolling stock (70% in 2013), 50% for metro traction (40% in 2013), 60-70% for metro signaling (55% in 2013) and 75% for tramways;
- The need to obtain a **license to bid**, without any published criteria, and the impossibility to obtain a license to supply complete rolling stock vehicles (only components);
- The **lack of evaluation criteria in the tender** documents. In the evaluation criteria of bids for propulsion systems for example, a local company with independent Intellectual Property Rights (IPRs) can get 100% score of the IPR part, but a company with full transferred technologies can only get 50% of the score (total 4 points in 100).

Expansion abroad

China has laid out a clear strategy to dominate the world market for rail equipment and services. Rail is one of the ten markets listed in the **'Made in China 2025' strategy** with an objective of 25% of the turnover of the Chinese suppliers to be generated by export contracts by 2020, and 40% by 2025.

In line with this strategy, rolling stock manufacturer CRRC has been aggressively and successfully expanding internationally: first in south-east Asia, Africa, then Latin America and finally North America and Australia. Europe is one of the ultimate targets due to the significant size of its market. CRRC has already won a number of smaller tenders in Europe (e.g. in Germany and Czech Republic) and has been heavily pursuing strategic partnerships, e.g. with TÜV SÜD.

It is particularly telling that in the United States metro market, CRRC moved from absence to market dominance in 18 months, winning in succession the Boston, Chicago and Los Angeles tenders with prices significantly below the competition (the price gap ranges from 25 to 45%), while (and this is not included in the price comparison) promising, in each case but one, the opening of a new assembly site.

Extensive government support

The expansion of Chinese rail supply SOEs is strongly supported by the Chinese government through: (i) diplomatic support in the context of the Belt and Road (BRI) initiative; and (ii) financial support by way of R&D subsidies and tax credits.

a. <u>Profitability level on the Chinese market</u>

In the case of CRRC, it can be observed that the SOE achieves a Gross Margin above 20%, which by industry standard is exceptionally high. At EBIT level CRRC outperforms the European suppliers due to the variety of activities from rolling stock to new industry business and modern services segments. The fact that it benefits from a monopolistic position on its home market supports such a performance.

b. Government grants

The level of grants provided to SOEs by the Chinese government – in combination with other sources of financing – creates significant distortions on the rail supply industry market.

c. R&D support

R&D support to Chinese rail SOEs is also significant, although there are rarely details on how research projects or facilities are funded, whether and how these projects are accounted for in the "Government Grants" lines to be found in Annual Reports of companies. In 2018, CRRC for example won 2 R&D projects for the Ministry of Science and Technology's "National Advanced Rail Transportation" with 85'3 RMB state central funding (autonomous-rail rapid transit and bogie-related).

d. Export Finance

China provides by far the largest amount of Export-Credit Arrangements[26]:

ECAs

Rank	Company	Total $m	Deal count
1	China Exim Bank	25,644	58
2	JBIC	9,738	30
3	Export Development Canada	7,533	67
4	Export-Import Bank of India	6,144	28
5	Korea Eximbank	5,335	19
6	KfW	2,576	32
7	Afreximbank	833	6
8	Eksportkreditt Norge	694	6
9	EKF	507	5
10	US Ex-Im	505	3

While China officially identifies only two official export credit agencies (Sinosure and the Export-Import Bank of China (C-EXIM)), the China Development Bank also provides financing support that is similar to export credit, even though there is no clear evidence whether its activities should be

[26] Source: Trade Finance League Tables analysis, Full Year 2016, by IJGlobal

classified as officially supported export credits.[27] The three institutions work closely with the government and SOE to obtain financial deals at subsidized rates.

In the railway sector, most of the contracts won by Chinese suppliers include significant state-supported investment programs and financial guarantees that enable them to foster further investment decisions on rail markets while mitigating risks. The extensive use of export credits in order to boost national champions' exports is challenging the OECD Sector Understanding on Export Credits for Rail Infrastructure (RSU) in force since 2014 – and of which China is not part. As a reaction to this, we witness a substantial increase in non-Arrangement official finance, especially from Japan and South Korea.

In theory, offering financing does not necessarily imply that products and services should come from the same country as the source of financing. **With China, financing packages are offered with the clear pre-condition that products and services should be obtained from China (average 70% of the contract value for Belt and Road Initiative-related projects), making it extremely difficult for European suppliers to participate.**

It must be mentioned that the Chinese ECA agencies do not follow strict guidelines on sustainability matters nor on compliance ones when evaluating projects which is already a significant difference. Secondly, there are major gaps between the OECD 2014 Sector Understanding on Export Credit for Rail Infrastructure and the financing conditions proposed by Chinese export credit support:

[27] OECD Working Party on Export Credits and Credit Guarantees, "*Chinese Export Credit Policies and Programmes*," 16 March 2015, pp.2-3
http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/ECG%282015%293&doclanguage=en

	Maximum loan repayment duration	Loan vs. total investment size
OECD[28]	12 to 14 years	Specific provisions for Category 1 countries: ECA supported loan <50% of project and Premium rates for any official support that do not undercut available private market financing and that are commensurate with the corresponding rates being charged by other private financial institutions that are participating in the syndication
China support to Djakarta – Bandung project[29]	40 years, with 10 years grace period	ECA credit provided by the China Development Bank supports 70% of the total investment
China support to Hungarian portion of Budapest-Belgrade[30]	20 years	ECA credit supports 85% of the total investment
China support to Transnet[31]	15 years, with a four and a half years grace period	Loan from the China Development Bank covering 55% of Transnet's investment plan in locomotives.

[28]http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=tad/pg(2013)14/Final&doclanguage=en

[29] http://www.railway-technology.com/projects/jakarta-to-bandung-high-speed-rail/

[30] http://www.railjournal.com/index.php/europe/china-to-finance-budapest-belgrade-upgrading.html?device=auto

[31] http://www.railway-technology.com/news/newschina-development-bank-to-grant-24bn-locomotive-loan-to-transnet-4594514

State support, and in particular export financing, extends to all SOE in the sector (e.g. CRSC for signaling, CRCC/CREC for infrastructure…). In September 2017, China Exim Bank signed an agreement with CRCC (to provide about USD 30 billion for aggressive promotion of its products and technologies on world markets. The bank will offer CRCC a wide range of financial services, including credit support and information counseling[32].

[32] https://economictimes.indiatimes.com/news/international/business/chinas-high-speed-train-maker-to-get-30-billion-for-export-push/articleshow/60924380.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst