



American Primary Aluminum Association

OECD Report Confirms Continuous Government Intervention and Subsidization in the Aluminum Industry Across Multiple Markets: A Comprehensive Remedy is Required to Address the Distortive Effects

**Prepared by: Counsel to the APAA
Alan H. Price, Robert E. DeFrancesco, and Beth Baltzan**

Introduction

The American Primary Aluminum Association (“APAA”) has consistently called for a comprehensive relief to address the adverse effects the global primary aluminum capacity crisis is having on the U.S. industry. While China is a significant contributor to the problem, it is not the only contributor. The U.S. International Trade Commission (the “ITC”) in a 2017 report detailed the significant subsidies provide across multiple countries and regions and the adverse effects these subsidies had on the U.S. primary aluminum industry.¹ In a new recently released report the Organization for Economic Cooperation and Development (“OECD”) confirms that government distortive subsidies are widespread across multiple regions and that these subsidies are having negative effects on market-based producers in other regions.²

The OECD report recognized that these subsidies not only “played a role in fueling” the excess capacity expansion, but also assisted in maintaining what would otherwise be uneconomic capacity in regions both inside and outside China.³ The report confirms that overcapacity is not simply a function of Chinese subsidies; instead, several countries provide significant support to local aluminum producers, including: Australia, Brazil, Canada, China, the Gulf Cooperation Council countries (including Bahrain, Oman, Saudi Arabia, Qatar, and the UAE),⁴ India, and Norway.⁵

¹ *Aluminum: Competitive Conditions Affecting the U.S. Industry*, Inv. No. 332-557, USITC Pub. 4703 (June 2017) (“Competitive Conditions”).

² OECD (2019), “Measuring distortions in international markets: the aluminium value chain”, OECD Trade Policy Papers, No. 218, OECD Publishing, Paris. <http://dx.doi.org/10.1787/c82911ab-en>. The Organisation for Economic Co-operation and Development (OECD) is a think tank established in 1961 with the goal of promoting policies to improve the economic and social well-being of people around the world. See <http://www.oecd.org/about/>.

³ Competitive Conditions at 12.

⁴ The OECD report was able to obtain and examine the subsidies provided by Bahrain, Saudi Arabia, and Qatar specifically.

⁵ Competitive Conditions at 29, 30, and Table A-2.

The OECD report measures the distortion in international markets caused by government intervention and subsidization by examining in detail the financial reporting of the major individual primary aluminum producers across the globe.⁶ Based on an evaluation of these 17 major producers, the OECD found that:

- Aluminum subsidies tend to target primary aluminum smelting;⁷ while smelters in subsidized countries expanded, in the United States they shuttered;⁸
- Numerous countries in addition to China provide these subsidies;⁹ and
- The top five primary aluminum producing companies received 85% of all support.¹⁰

In addition, the report notes that there is an increasing amount of government ownership throughout aluminum value chain. In this regard, the report particularly identifies China, Norway, and Gulf Cooperation Council countries.¹¹ While the report indicates that state-ownership and control play a significant role in the degree of subsidization a firm might receive, it is not a determinative factor. The report shows that subsidies are widespread across multiple firms both state-owned and non-state owned.

The OECD report confirms that the adverse effects of the global excess capacity crisis in primary aluminum is fed by government intervention across multiple markets by numerous players. The subsidies provided by each government creates a vicious cycle of increasing subsidization, capacity expansion and maintenance, and price declines.

The subsidies themselves distort market dynamics and create a misperception that certain regions are inherently more cost-competitive than other non-subsidized regions. For example, the report shows that the low energy costs enjoyed by producers in Canada and the GCC countries are actually due to extensive government subsidization in those regions. It is the subsidies that create the perceived cost advantage, without which producers in these regions could not maintain and expand capacity.

As the chart below shows, the overcapacity problem is not just a China problem. In the aftermath of the financial crisis, numerous countries deployed state-directed capital to expand and maintain their primary aluminum industries. Despite the fact that aluminum prices were in the midst of a significant decline, from 2013 to 2017 countries that provided significant subsidies expanded capacity, while those that did not saw significant contractions in capacity.

⁶ *Id.*

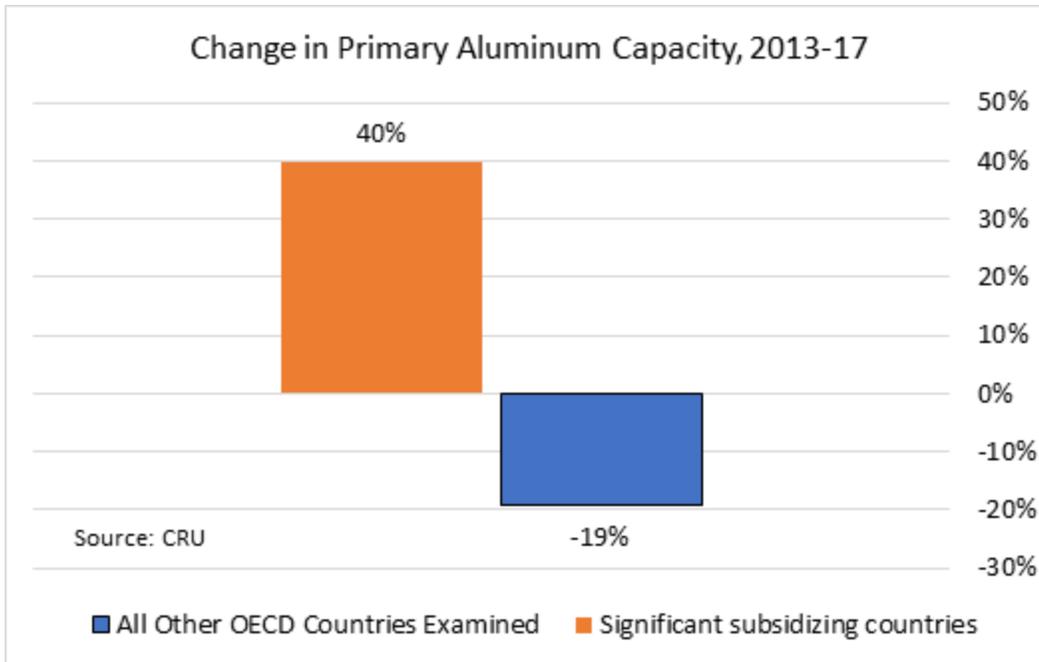
⁷ Competitive Conditions at 30-31.

⁸ *Id.* at 11-12.

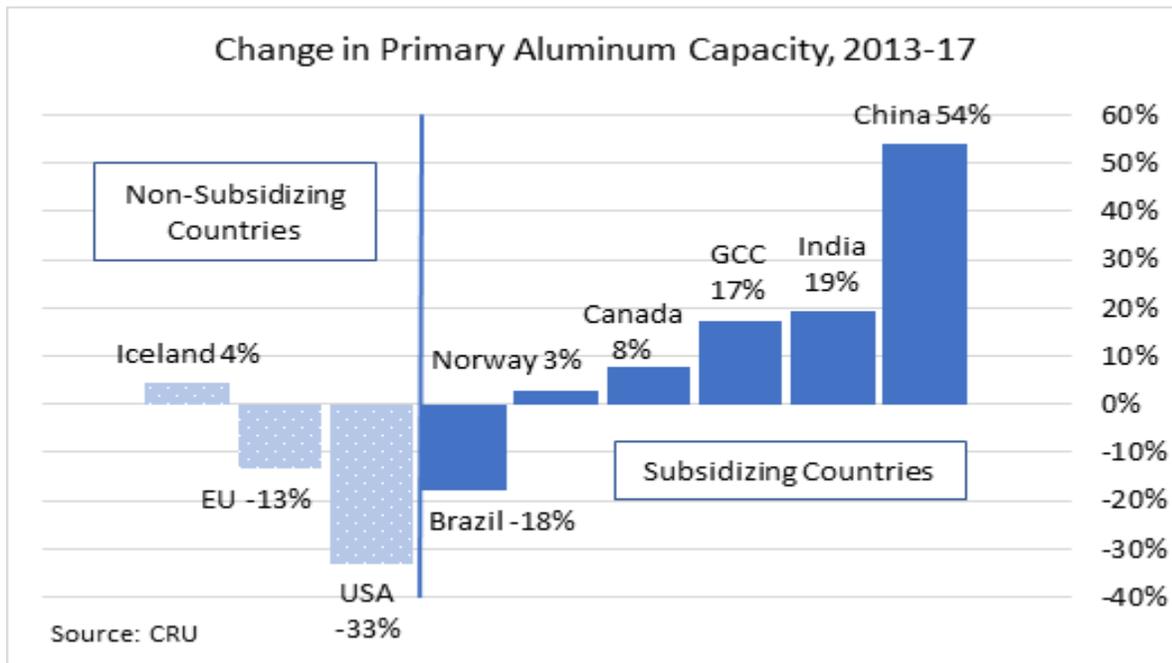
⁹ *Id.* at 15.

¹⁰ *Id.* at 6.

¹¹ *Id.* at 28.



Further, when examining the data by country, it is clear that the subsidized expansion is not limited to China.



Other than Brazil, each of the countries that provide significant subsidies to their aluminum industry saw capacity expansions from 2013 to 2017. The countries that do not provide significant subsidies to their aluminum industries generally saw significant declines in capacity. Despite providing significant subsidies, Brazil’s capacity declined due to extended power production issues in the country. Nevertheless, the lesson is clear, subsidies have led to

continued capacity expansions and a race to the bottom at the expense of producers in countries that do not provide subsidies.

The U.S. Aluminum Association has defined overcapacity as existing when a country's capacity "has expanded far beyond its domestic needs."¹² This definition applies to all of the countries identified in the above chart that the OECD found to provide extensive government support, including Canada, the GCC countries, India, and Norway. None of these countries can consume anywhere close to all the aluminum that they produce. They are principally export platforms. While each of these countries was able to expand or maintain capacity, the U.S. industry which does not benefit from significant state support was forced to contract.

The President's Section 232 relief is intended to and has begun to reverse these effects.¹³ However, if countries are granted wholesale exemptions from the program, that relief will be undone quickly, and the restarts will be terminated as quickly as they started. The U.S. industry is already experiencing a surge of primary aluminum imports from Australia because they were completely excluded from the relief. Primary aluminum is a globally traded commodity. The excess capacity crisis that has plagued the global aluminum industry therefore artificially depresses the global aluminum price. Because that price is set through the global exchange, imports from any country transmit those adverse price effects to the U.S. market, regardless of source. The only way to ensure that the price within the United States rises to address those effects is to impose tariffs on a sufficient volume of imports. Consequently, all countries must be subject to either tariffs or quotas to ensure the U.S. industry's recovery continues and the program is not undermined.

The ITC 332 report and now the OECD report confirmed that financial and input subsidies provided by governments around the world have tilted the scales in favor of producers in those regions at the expense of market-based players in the United States and elsewhere. But for these subsidies, global capacity and production would be lower and prices higher allowing market-based players to compete on a more level playing field. These findings support the continued application of the Section 232 relief broadly across all import sources.

¹² Letter from Heidi Brock to Sec'y Commerce, re: *Section 232 National Security Investigation of Imports of Aluminum* (June 20, 2018), <https://www.bis.doc.gov/index.php/forms-documents/section-232-investigations/2039-18-aluminum-association-heidi-brock-pdf/file>. The APAA does not agree that this is the way to define overcapacity. The Aluminum Association's definition actually buys into the Chinese argument that a country is entitled to supply its entire domestic consumption of a particular product. That argument is autarkic in nature and therefore at odds with the very premise of the global trading system. Capacity should be decided by supply and demand. Overcapacity arises when governments, including those identified above, subsidize their industries and otherwise create incentives that lead to more supply than demand will bear.

¹³ Robert E. Scott, "Aluminum tariffs have led to a strong recovery in employment, production, and investment in primary aluminum and downstream industries," Economic Policy Institute (Dec. 11, 2018).

1. Within the aluminum industry, the bulk of the subsidies are provided to primary aluminum producers in the form of financial and input subsidies

The OECD report examined three types of support: non-financial (*i.e.*, input subsidies); financial; and trade measures.¹⁴ The report found that support is “relatively large in aluminum smelting and primarily takes the form of energy subsidies and concessional finance”.¹⁵ The discussion below focuses on the input and financial subsidies and how they distort the competitive balance in the industry to favor the subsidized producers at the expense of market-based players.

a. Energy and other non-financial subsidies distort market dynamics and create a competitive balance based on subsidies not on actual inherent comparative advantages

Energy and other non-financial subsidies inherently distort any perceived comparative advantage. An enormous amount of electricity is consumed in primary aluminum production. In the smelting process electricity is a direct input used to break chemical bonds and comprises approximately 40 percent of the total cost of production.¹⁶ As such, subsidized energy rates are a direct benefit to producers comparative cost advantages.

The OECD examined the relative energy and other non-financial subsidies provided to the largest primary aluminum producers for which information was available. The OECD quantified the value of the subsidy by using “price gaps . . . to estimate the benefits that below-market prices for electricity and fossil fuels confer to aluminium producers.”¹⁷ The OECD found that the support totaled \$12.7 billion over 2013-2017, with an annual average of \$2.5 billion.¹⁸ For the companies examined, the report found that this support was concentrated in five recipients:

- China Hongqiao
- Aluminum Bahrain
- State Power Investment Corporation
- Alcoa
- Qinghai Provincial Investment Group¹⁹

The OECD found that the principal subsidizing countries were: China, Canada, and the GCC countries.²⁰

¹⁴ Competitive Conditions at 13.

¹⁵ *Id.* at 12.

¹⁶ *Id.* at 17.

¹⁷ *Id.*

¹⁸ *Id.* at 13.

¹⁹ *Id.*

²⁰ *Id.* at 14, 81.

Because the Chinese are the highest cost producers, the fact that they provide energy subsidies to compensate for this deficit is not surprising. The energy subsidies provided by Canada and the GCC -- countries that are believed to be low-cost energy producers and therefore low-cost aluminum producers -- undermines any notion that producers in these countries enjoy an inherent comparative advantage. Based on the evidence in the report, it appears that any “comparative advantage” is the result of the energy subsidies themselves. The OECD report states that “overall, the results . . . clearly show input subsidies, and energy subsidies in particular, to constitute the bulk of all support benefitting aluminium producers worldwide.”²¹

This is true even of countries that are considered energy-rich. Thus:

Government ownership and intervention in energy markets is especially important in GCC countries, with the Middle East accounting for 30% of all price-driven subsidies for fossil fuels Because the region is energy-rich, most of its subsidies take the form of opportunity costs That said, several GCC countries producing aluminium have become lately (or are about to become) importers of natural gas, including Bahrain, Oman, and the UAE. The energy subsidies measured for GCC in this study are very large²²

With respect to Canada, the report specifies that Quebec allows aluminum smelters to purchase electricity at \$0.01-0.02 per kWh below those paid by other large industrial users, resulting in a significant subsidy.²³

In addition to energy inputs, the report notes the value of tax concessions as a subsidy. In particular, the OECD comments that these subsidies can provide support for physical capital, which in turn is important because of its effects on investment, “favouring the renewal of a company’s capital stock.”²⁴ The report goes on to note that

A consequence for competition may thus be that countries that have subsidized capital the most end up having the most competitive firms, e.g., the most energy-efficient smelters. In turn, those firms that have acquired newer equipment may subsequently be able to compete effectively without subsidies.²⁵

These input subsidies allow smelters to lower their cost of production and cost of capital, effectively shielding producers in these regions from some of the worst effects of the excess capacity crisis. The subsidies give the appearance that these producers are more

²¹ *Id.* 87.

²² *Id.* at 88.

²³ *Id.* at 17, 88.

²⁴ *Id.* at 90.

²⁵ *Id.*

profitable than they otherwise would be resulting in increased investment to maintain and increase capacity.

b. Financial Subsidies Contribute to the Buildout of the Excess Capacity and Have Been Provided Across All Markets

Financial subsidies, primarily in the form of concessional lending, are one of the principle drivers of the capacity buildout. Aluminum producers throughout the world have used concessional financing to “upgrade” and expand capacity. According to the OECD, while financial subsidies are more “heavily concentrated in Chinese firms.”²⁶ Western firms have also obtained “30-year loans at zero interest rate from Investissement Quebec, a state-owned investment company”²⁷ Australia provided \$173 million in funding to prevent the closure of a smelter.²⁸ Further, Indian producers have also received concessional financing to expand production. From 2013 to 2017, primary aluminum capacity in India increased by 19 percent increasing by 668,000 metric tons.²⁹ This is simply not possible without significant amounts of concessional financing consistent with its aluminum industrial plans.

The OECD report confirms that Chinese firms typically receive significant debt financing and carry excessive debt loads at interest rates that companies with that level of debt would not normally be able to receive.³⁰ However, despite these high debt loads, the interest rates are low, and the investments continue.³¹ The OECD report quotes an expert that:

China’s banking system was designed not to serve the interests of the private sector but to provide credit – cheaply and in large amounts – to state-owned companies.³²

The report makes clear that the Chinese capacity increase was financed through government directed debt. The Chinese aluminum industry is an example of the overall industrial debt bubble building within the Chinese economy. Across multiple industries, the Chinese used government directed financing to rapidly expand capacity and production contributing to the overall excess capacity crisis weighing down global pricing across numerous industries.

China, however, is not the only country that has used excessive debt financing to maintain and expand capacity. As discussed above, the report shows concessional financing from Canada and Australia. The report also shows that other countries like India are now following the Chinese lead and providing larger amounts of state-directed financing to increase its aluminum capacity

²⁶ *Id.* at 13.

²⁷ *Id.* at 102.

²⁸ *Id.* at 19, 90.

²⁹ CRU International Ltd., CRU April 2018 Market Outlook Report (Apr. 2018) at Table S.7.

³⁰ Competitive Conditions at 19, 20.

³¹ *Id.* at 20-22.

³² *Id.* at 23, 103.

and production. Over the last three years, no other country expanded aluminum production and capacity as rapidly as in India. Since 2008, India's rate of aluminum capacity expansion is second only to China's.³³ Yet, like the Chinese, India producers are high-cost coal-based energy aluminum producers. But for the government-directed financing, such rapid expansion both inside and outside of China would not have been possible.

2. This is not just a “China” problem: Significant subsidies are being provided in numerous markets

As capacity expanded over this period and prices collapsed, governments across the globe provided significant subsidies to local producers in those countries. These subsidies are widespread across several regions and are not specific to China. While the OECD report confirms that China is responsible for a significant portion of the overall subsidies and excess capacity, China is by no means alone. Other countries also heavily subsidize aluminum smelting. These subsidies are not being provided in a random fashion; rather, the principal providers of these subsidies have industrial policies that establish the process to be used to secure and expand aluminum smelting.

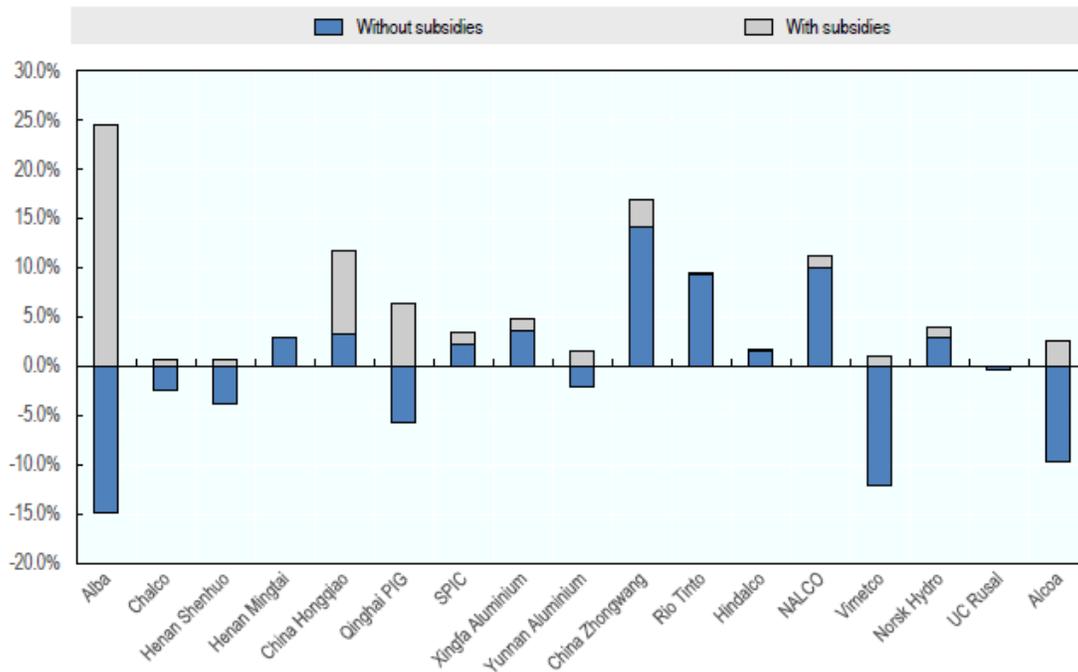
The report links these subsidies to the profitability of the companies receiving the subsidies. This profitability is otherwise difficult to explain in the context of plummeting aluminum prices.³⁴ These subsidies distort market dynamics and adversely affect market-based players in the United States and elsewhere.

³³ CRU International Ltd., CRU April 2018 Market Outlook Report (Apr. 2018) at Table S.7.

³⁴ Competitive Conditions at 83.

Figure 5.5. Government support has helped companies increase their profitability

Average profit margins over the 2013-17 period, with and without non-financial government support (%)



Note: Data for QPIG and SPIC are for the years 2012-16, and 2013-16 for Vimetto.
Source: OECD research.

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Notably, while China tends to subsidize Chinese companies, the same is not necessarily true of other countries. Instead, these other governments focus on attracting smelters, without regard to the nationality of the company owning or operating the smelters. The OECD’s analysis shows that even some of the largest Western aluminum producers would not be profitable without the subsidies provided by the local governments where they operate.³⁶ Clearly these subsidies help to maintain and expand capacity that would otherwise be uneconomic to operate.

3. The subsidies force American facilities to bear the brunt of the market distortions and resulting capacity crisis.

The significant subsidies provided both inside and outside of China, targeted at the smelting stage, enhancing or even creating profits that otherwise would not exist, explains why it is that U.S. smelters have been forced out of business while their foreign counterparts prosper and

³⁵ *Id.* at 85.

³⁶ The report also shows a comparatively small amount of subsidies provided by the United States, which tends to provide subsidies for research, development, and workforce training. Competitive Conditions at 19. These types of subsidies are indirect and thus have less impact on the market than, for example, direct energy subsidies. (Indeed, certain R&D subsidies are permitted under WTO rules.) See Agreement on Subsidies and Countervailing Measures, Article 8.2.

expand. The report makes clear that but for the subsidies, these foreign competitors would not enjoy a comparative advantage over the U.S. industry.

The OECD report specifically notes that U.S. and EU smelters bore the brunt of the harm caused by the aluminum price freefall, shuttering their smelters even as companies in China and the GCC had “sustained solid profit margins.”³⁷ The report finds that production is declining there, and in Australia, as “OECD-based aluminium companies have invested in the Middle East to benefit from the region’s comparatively low energy prices”³⁸ – which, as noted above, the report also finds to be subsidized.³⁹

The OECD report shows that while “China was increasing its smelting output by a factor of twenty, capacity declined in a number of OECD countries, a trend that has accelerated markedly in recent years.”⁴⁰ This rapid expansion caused other countries to rapidly expand their own subsidies resulting in a vicious cycle of subsidies, production capacity expansion, and declining prices. OECD-based companies shift production from non-subsidizing countries to subsidizing countries.

Market-based players in the United States would be competitive but for the subsidies provided around the world in these other locations. The subsidies have created profits where none otherwise existed, giving companies with smelters in China, Bahrain, Canada the false appearance that they are more efficient lower-cost producers than their American counterparts.⁴¹

These manufactured profits have multiplier effects in terms of the harm they cause to producers that do not enjoy these subsidies and try to compete based on market forces. The “profitable” companies are able to invest those (unearned) profits in technology and updated equipment. Thus, they are able to give the appearance that their success is due to their modern facilities, when in fact even their ability to invest in those facilities depends on the subsidies.

It is evident that there is a zero-sum game when it comes to aluminum smelting. Subsidies provided by one country to lure a company to build or expand a smelter results in lost capacity in the non-subsidizing country.

4. Downstream producers have not been spared of the effects of the subsidies to primary aluminum producers

As the foregoing demonstrates, the subsidies are principally targeted at the smelting stage. Not only has this caused a diversion of smelters from countries such as the United States to those

³⁷ Competitive Conditions at 11.

³⁸ *Id.* at 41.

³⁹ *Id.* at 41, 88.

⁴⁰ *Id.* at 41.

⁴¹ See, e.g., David Fickling, *China Isn't the Reason U.S. Aluminum Is Suffering*, Bloomberg (Oct. 10, 2016), <https://www.bloomberg.com/opinion/articles/2016-10-10/china-isn-t-the-reason-u-s-aluminum-is-suffering>.

providing the subsidies, but the downstream producers have become dependent on the artificially depressed global aluminum price generated through this government intervention.

While downstream producers may generally benefit from the artificially depressed global aluminum price, many of the same governments subsidizing their primary aluminum producers also provide similar subsidies to their downstream semifinished industry. In addition, the OECD report indicates that these governments also impose other trade measures to further benefit downstream producers in their country. These same subsidies often cause similar shifts in downstream production capacity to subsidizing countries.

The report makes clear that while governments are currently focused on attracting and expanding their smelting production, the Chinese are

moving up the value chain, or climbing the product-sophistication ladder, on the underlying assumption that they would be better off processing products further downstream.⁴²

The OECD report also discusses what it terms “subsidy hotspots”.⁴³ These are special economic areas that some countries create to promote investment, sometimes across a range of industries. The report discusses several different countries that create these areas such as in China and India but notes in particular that Russia seeks to develop an “Aluminum Valley.” There, the emphasis will be on producing semis – the next step in the value chain after smelting. These “hot-spots” or industrial development zones, provide the same types of subsidies and incentives to both upstream and downstream aluminum producers located inside that zone.

Because primary aluminum comprises the overwhelming portion of downstream production costs, the distortions provided to primary producers also flow through to the downstream producers in that country as well. The combined effects of additional downstream subsidies and the distortions reflected in the primary input, put market based downstream producers at a significant disadvantage.

This government intervention has begun to have negative effects on U.S. downstream producers. There are currently antidumping and countervailing duties on imports of Chinese aluminum extrusions, foil, and common alloy sheet. Often domestic producers in these industries have been forced out of certain industry segments altogether. Indeed, this kind of downstream offshoring has become the basis for requests for exclusions from the Section 232 tariffs:

⁴² Competitive Conditions at 60; *see also id.* at 71.

⁴³ *Id.* at 17, 86.

Significant U.S. capacity, such as the capacity represented by {the} facility in Tennessee . . . has been either permanently closed or converted from cansheet production to automotive sheet production.⁴⁴

The fact is, this is yet another example of the distortive effects government subsidization and intervention has up and down the aluminum value chain. The cansheet production in the Tennessee facility that was closed was replaced by expanding sheet production in Saudi Arabia and other subsidizing countries. This same Saudi Arabian also produces primary aluminum and is identified as having received subsidized electricity.⁴⁵ The requestor was asking for an exemption to import from this Saudi Arabian facility without paying the Section 232 duties.

While downstream producers in the United States in some ways benefit from the distorted global primary aluminum input costs, they are also victims of the effects of additional government intervention further downstream. The extensive amount of state intervention in the global aluminum market detailed in the OECD report demonstrates why no market-based player is free from the distortive effects of these subsidies. The subsidies have significantly altered channels of distribution and production flows in favor of the subsidizing government. The widespread government intervention throughout the globe detailed in the OECD report requires the type of comprehensive relief across all import sources provided in the Section 232 tariffs.

⁴⁴ EXCLUSION GRANTED - Ball Metal Beverage Container Corp - Cansheet Bodystock - HTS 7606123045, Regulations.gov (Apr. 26, 2018), <https://www.regulations.gov/document?D=BIS-2018-0002-0039>.

⁴⁵ Competitive Conditions at 17.