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REPORT FROM THE COMMISSION TO THE COUNCIL

on Steel re-balancing action

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1. INTRODUCTION

Following the presentation of the report from the Commission of 17 July, the Council adopted conclusions on 19 July whereby:

“the Council invites the Commission to submit an additional report as well as a proposal regarding the definitive content and application of Annex I to Regulation 1031/2002, and will decide on this proposal taking account of the decisions on product exclusions and compensation to be made by the US. The Council intends to revert to this issue by the end of September.”

Accordingly, this additional report provides an update of recent developments concerning the impact of the US steel safeguards on US and world markets (2), dispute settlement (3), product exclusions (4) and compensation (5).

2. THE IMPACT OF US STEEL SAFEGUARDS ON US AND WORLD MARKETS

2.1. The impact of the US steel safeguard on the US market

The 17 July report explained that the US safeguards had produced very large artificial price increases, thereby encouraging the maintenance of uneconomic capacity and that their withdrawal next year will cause further market disruption. More recent data has confirmed this analysis, with continued upward pressure on prices and the cost of steel in the US remaining well above world levels.

In addition, it is striking that, in recent months, a number of US steel firms have reported “improved results” in the form of smaller financial losses than in the corresponding quarter of the previous year. There must be a real question mark about firms that are still unable to break even at a time when the US market is protected by the safeguard in addition to numerous anti-dumping and anti-subsidy measures and when prices have climbed so sharply. Such firms will face acute difficulties when the price bubble breaks and when the safeguard is withdrawn following its condemnation by the WTO.

As a result, some time in the second half of next year we are likely to see yet another repetition of the “steel industry crisis” that has occurred every three to five years. No doubt, as in the past, such a crisis will lead to calls for yet more protectionism, including WTO illegal use of antidumping and countervailing duty measures. However, the cycle will only be broken if the US authorities and industry are willing to address the underlying issues, notably the problem of uneconomic capacity and market distortions.

2.2. Proliferation of safeguard measures in other markets

The taking of protectionist safeguard measures on a large spectrum of steel products by the US has triggered chain reactions around the world, where the relevant authorities and steel industries fear to see the already severe impact of those measures on their business increased by trade diversion to their own market.

Canada, China, Chile, the Czech Republic, Hungary, Poland, have initiated or are in the process of initiating safeguard investigations and other countries (Bulgaria, Romania) have been indicated to be considering similar initiative. In most if not all cases, this is likely to result into the adoption of protective measures. In fact, measures are already in force in China, Hungary, Poland, Chile and Mexico.

Although in theory there is a tendency in all these countries to follow the EC model (safeguards as a safety net against trade diversion), in practice most of them have not been able to resist domestic protectionist lobbies. Hence, the measures they introduced are more restrictive, sometimes considerably, than the EC safeguard measures. All this can only increase the pressure on other countries to follow the example. In the medium term, free trade in the steel sector could be seriously compromised, and it is again important to recall that all this is, at least ostensibly, linked to the imposition of measures in the US.

3. STATE OF PLAY ON WTO DISPUTE SETTLEMENT

In response to the US steel safeguards, a large coalition involving the EC, Japan, Korea, China, Switzerland, Norway, New-Zealand and Brazil, has engaged WTO dispute settlement procedures against the US.

The thorough co-operation achieved in the consultations phase continued in the Panel stage, with the establishment of a single Panel, composed of the same panellists, to consider the requests of all the complainants. Following the composition of the Panel on 25 July, a close co-ordination ensured the presentation of highly convergent arguments in the submissions to the Panel.

The Panel report is expected for March 2003. The Commission is confident that this report will conclude that the US measures are inconsistent with WTO requirements on safeguards, since the steel measures literally repeat the flaws already found in previous US safeguards condemned in WTO. If the US appeals, the Appellate Body is expected to circulate its report in September 2003.

In light of the fact that the Panel report is likely to be based on the confirmation of prior rulings of the Appellate Body, an appeal would only represent a delaying tactics. The Commission therefore considers that the US should be encouraged to withdraw its illegal safeguard measures upon the issuance of the Panel report.

It should be recalled that the adoption of either the Panel report (if there is no appeal) or the Appellate Body report by the WTO Dispute Settlement Body automatically triggers the application of additional tariffs on the long list of products comprised in the EC re-balancing Regulation.

4. STATE OF PLAY ON PRODUCT EXCLUSIONS

The Commission's report on steel re-balancing action published on 17 July explained the process by which firms could request that particular products should not be subject to the additional tariffs imposed by the safeguard measure. It noted that, to that date, the US authorities had published four lists, made up of a total of 247 product exclusions. About 150 of these exemptions were granted either directly to European companies, or to US steel consumers purchasing their needs to European companies. The previous report estimated that, up until 11 July, the exemption process has reduced the impact of the initial safeguard measures on European steel producers by some \$230 million.

The US Administration published a further list, excluding 14 products, on 18 July immediately before the Commission recommended the postponement of the decision on whether to take early countermeasures. Two further lists, totalling 215 product exclusions, were announced in press releases issued on 12 and 22 August and formalised by means of publication in the Federal Register on 30 August¹.

Our assessment, based on detailed information provided by European firms and industry associations, is that the additional exclusions announced since the 17 July report could enable EC steel firms to export 650 000 tonnes to the United States without paying additional tariffs and reduce the impact of the original safeguard measures by a further \$420 million. Thus, in total, the seven lists that have been published may affect EU produced steel worth some \$650 million. This figure represents nearly 30% of the \$2.3 billion of EC exports estimated to be affected by the original US announcement. Alternatively, it can be seen that, if total EC steel exports to the US were to remain at their 2001 level of \$4 billion, approaching 60 per cent of these exports would avoid additional tariffs.

Whilst the substantial additional exclusions granted in August were certainly welcome, and will benefit both European exporters and the many US firms that need high quality steel from Europe, the refusal to grant many well founded requests remains surprising and unsatisfactory.

Although the USTR press release issued on 22 August said "This concludes the review of all pending exclusion requests that were filed on or before May 20, 2002", we understand that firms have been invited to identify technical problems with the descriptions of the products, as published in the Federal Register, and that this might lead to the publication of further notice designed to remedy such problems.

In any case, the process will restart in November 2002 with the possibility to apply for exclusions that would take effect from March 2003. Of course, companies whose requests are successful will still have had to pay additional tariffs (or been shut out of the US market) for a year. In addition, the value of such "second year" exclusions will be limited by the fact that, in the same month, the WTO Panel is expected to rule against the US safeguard measures.

¹ vol 67, No 169 pages 56182 ff

5. STATE OF PLAY ON COMPENSATION

The Safeguard Agreement establishes a balance between the right for a WTO Member to take safeguard action – provided that WTO requirements are complied with – and the obligation to maintain a substantially equivalent level of concessions with WTO Members affected by safeguard measures.

In the steel case, the US has questioned the obligation under Article 8 SA to provide compensation for the adverse trade effect of the steel safeguards in the form of tariff reductions on products other than steel.

Anyhow, the Commission considers that a proper interpretation and application of Article 8 SA is of major systemic importance in order to avoid the proliferation of abusive safeguard actions.

6. CONCLUSIONS

As a conclusion of this report, the Commission wishes to highlight the following:

- the product exclusions decided by the US in August contribute to mitigate the negative trade effect of the US steel safeguards;
- however, the product exclusions represents less than 30% of the total impact of the US safeguards on EC export and more than 40% of EC total steel exports to the US are still subject the US protectionist measures;
- the EC should therefore vigorously pursue its WTO challenge against these measures, which is expected to result in the condemnation of the US illegal safeguard action by the Panel in March 2003;
- the US should be encouraged to withdraw its safeguard measures immediately after the Panel report;
- a broad international initiative should be envisaged to tackle the difficulties to be faced by the steel industry;
- the issue of compensation remains of great systemic importance to avoid abuse of safeguard action;
- adequate pressure should be kept on the US to reduce further the negative trade impact of its safeguard action by way of additional product exclusions;

In light of the elements above, the Commission does not propose, at this stage, the application of Annex I of Regulation 1031/2002.