

# China's Export Duties: Trouble For The Aluminum Industry?

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In an April 14, 2015, notice, China's Ministry of Finance moved to comply with the World Trade Organization's ruling in a dispute with the United States and other countries by eliminating export tariffs on rare earths, tungsten and molybdenum products. While the elimination of tariffs on the raw materials subject to the WTO dispute garnered immediate attention, the same notice included an additional change to China's system of export restraints that has potentially far-reaching implications for global manufacturers: the elimination of the export tariff on certain aluminum products. In a move completely unrelated to implementation of the WTO's findings in the rare earths dispute, the measure reduced to 0 percent a 15 percent export tariff on certain unwrought aluminum alloy products (i.e., billets and slabs), as well as on alloyed and unalloyed aluminum bars and strips.

The move is symptomatic of the state-led approach that has generated enormous overcapacity and excess supply in numerous Chinese industries, including aluminum. As China's economic growth has begun to sputter, an already severe imbalance between supply and demand has become untenable, even for China's highly subsidized aluminum producers. The reduction of the export tariff thus appears to indicate China's desire to use foreign market demand to alleviate oversupply pressures that have built up at home, likely at the expense of foreign firms.

The immediate – and obvious – effect of this revision to China's export tariffs is simple. China is going to export more aluminum, perhaps a lot more, and prices are going to fall, probably by

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substantial margins. Export and pricing numbers for May 2015 show that the barrage has already begun. According to a recent report in the Financial Times, China exported around 410,000 metric tons of aluminum products in May, a 21 percent year-on-year increase. Aluminum prices on the London Metal Exchange have gone in the opposite direction. In the past month, the LME price for aluminum has plummeted from around \$1,800 per metric tons to under \$1,680 per metric ton on excess supply. With the U.S. Midwest aluminum premium falling as low as 8 cents per pound at the end of May, prices have already hit a level that barely covers the global average cost of producing primary aluminum.

The Chinese MOF's decision is a symptom rather than the cause of the global aluminum industry's real problem. Generally, removing export restraints tends to eliminate trade distorting effects. Yet, by selectively removing only some restraints, China continues to manipulate the market by targeting some products and not others. Reducing export tariffs to 0 percent on a few tariff line items opens the floodgates a little bit farther, but the biggest concern is the floodwater that has been building up for the last 15 years.

Since 2000, when China produced only 12.5 percent of global primary aluminum output, the country's annual production has grown approximately eight-fold on the back of state subsidies like free land and cheap electricity. This accounts for nearly the entire increase in global supply since then and has thrown the market into chronic surplus. Particularly in the wake of the global financial crisis, Chinese capacity and production have soared as producers elsewhere have been forced to rationalize capacity to deal with collapsing prices.

In conjunction with this enormous build-up of primary aluminum capacity, China has encouraged production of downstream products by restricting exports of upstream primary and semi-processed products. Export restraints on primary aluminum have exacerbated the already depressed Chinese primary aluminum prices, bestowing a substantial cost advantage on domestic manufacturers of downstream aluminum products.

Over time, however, China's economic growth has continued to slow, creating a looming crisis in the property market and weakening demand for cars and other consumer goods. Unsurprisingly, aluminum prices on the Shanghai Futures Exchange have trended sharply downwards over the last year, indicating that China's downstream manufacturers simply cannot absorb the millions of tons of excess aluminum in the market. The domestic oversupply crisis has become so acute that the government has been forced to take action. At the same time, prices outside of China have strengthened on capacity rationalizations and post-crisis economic recoveries. Rather than taking steps to eliminate excess capacity, in line with producers in the rest of the world, China has decided to try exporting its way out of trouble.

China's aluminum export tariffs are already set up in a manner that encourages exports of certain products and discourages exports of other products. This system has distorted trade flows and has left the government highly susceptible to fraud. A 13 percent value-added tax rebate on exports of extruded aluminum profiles, for example, has led to surging exports of extrusions, first to North America and now, in the wake of anti-dumping and countervailing duties in the United States, to other markets in Asia, where they either displace overseas producers or are transshipped to circumvent the U.S. trade remedies. It can be difficult to judge the true extent

of the problem, however, as many producers over-report their export shipments to claim additional VAT rebates.

It also has been widely reported that many Chinese primary producers over the last year have simply run their billets and ingots through nominal processing operations to avoid export tariffs on primary aluminum and to take advantage of the 13 percent VAT rebate on semi-finished downstream products. Much Chinese aluminum that is exported as "extrusions" is thus never intended for sale as such. Rather, it is simply melted down and recast as billets, ingots or slabs in overseas facilities for sale in foreign markets. According to some reports, one Mexican producer of billet and slab has stockpiled as many as 850,000 tons of Chinese extrusions for use as raw material in its billet and slab operations.

Notably, the Chinese government has not decided to simply call a duck a duck and remove export tariffs on all aluminum products. Instead, tariffs have been reduced selectively on two tariff lines for bars and strips that do not include the 13 percent VAT rebate. Export tariffs as high as 30 percent on most primary and semi products remain in place. The MOF's announcement, while continuing to encourage certain categories of exports, simply makes it a little bit easier for producers to avoid the export tariffs that remain unchanged and a little bit less expensive for the government when they continue to do so. Furthermore, the export tariffs have merely been "adjusted" on a temporary basis. They have not been "canceled" as were the tariffs on rare earths, tungsten and molybdenum. They can be reinstated at the whim of the government.

In this sense, the long-term effects of the export duty adjustment itself are unclear. Today, it means that excess Chinese primary aluminum capacity in the form of billets and slabs may compete more directly with global primary producers that have invested millions of dollars to rationalize capacity and restructure operations in pursuit of stronger demand for advanced downstream products. Regardless, because aluminum is a globally traded commodity, the mere existence of massive excess supply in China depresses global prices, whether or not Chinese primary aluminum products compete directly for sales in foreign markets. At the same time, surging volumes of downstream aluminum exports are unlikely to be affected. Downstream manufacturers will continue to benefit from artificially low input prices for the base ingots and from the VAT rebate on extruded profiles.

The issue that must be addressed, then, is not whether China increases or reduces aluminum export tariffs. Rather, the issue going forward must be how to address the relentless, subsidized expansion of China's aluminum industry regardless of market dynamics. Whether through direct competition with exports of primary aluminum products or downstream products from China, or through depressed prices on global exchanges, this expansion hurts the global aluminum industry and will continue to do so until the problem is resolved, either through multilateral negotiations or dispute settlement.

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