

## STRATEGIES FOR RESOLVING SECTORAL INDUSTRY PROBLEMS: STEEL AND SHIPBUILDING

There is general agreement among governments and industry that international markets for certain industrial products, including steel and ships, have been distorted significantly by government interference. This interference has prevented those markets from operating normally, especially by preventing the closure of inefficient production facilities, and this has resulted in those industries being seriously affected by surplus capacity. With trade tensions rising at the international level, pressures have increased to deal with these issues, both politically and in substance.

The OECD has assumed a leading role in efforts to restore normal competitive market conditions in these two sectors, which, if successful, would strengthen the multilateral trading system. The OECD has succeeded in bringing major players from member and non-member economies together in a multilateral forum, and is providing economic analysis in support of international negotiations on legally binding instruments which will strengthen World Trade Organization (WTO) disciplines.

### Steel

#### *Strengthening disciplines on government support*

Steel markets have long been distorted by government subsidies and related support measures designed to enhance the competitiveness of existing firms and/or boost capacity. The situation has resulted in overcapacity, which has contributed significantly to the chronic problems that have affected steel trade over the past several decades. In December 2002, negotiations were launched under the auspices of the OECD to address the situation, by negotiating an agreement that would go considerably beyond WTO rules in banning subsidies. All major steel-producing economies are participating in the talks, which are set to conclude during 2004.

If an agreement is to be reached, difficult issues concerning the scope of any exceptions to a blanket prohibition of subsidies and the scope and character of preferential treatment for developing economies will have to be resolved, as will the design of effective enforcement instruments. Considerable progress has been made in other areas, and work on an advanced negotiating text is nearing completion.

### **Market turnaround**

The weak market conditions that served as a catalyst for the steel negotiations have recently taken a remarkable turn for the better. Supported by strong growth in steel consumption in China, the world's largest steel market, global steel demand rose sharply in 2002 and 2003, reaching record levels in each year. This growth has resulted in growing tightness in key materials markets, leading this year to sharp increases in prices and physical shortages in those materials. Some steel producers have had to limit production as a result of the shortages.

International trade in steel products has remained robust, representing 26% of world consumption in 2003. Moreover, with the elimination of safeguard measures by key players, trade tensions have eased.

The outlook for 2004 is promising, as the steel market should continue to grow, with production expected to pass the one billion tonne level for the first time. High prices and low availability of raw materials for steelmaking, however, remain a concern, as does a growing number of bottlenecks in ocean freight.

### **Eliminating inefficient excess capacity**

In addition to the negotiations on a steel subsidies agreement, governments are paying considerable attention to issues related to steel industry restructuring. Peer reviews of crude steel capacity developments have taken place alongside the negotiations, and this is helping to increase transparency and identify ways that could facilitate adjustment. The reviews showed that between 1998 and 2002, some 104.6 million tonnes of capacity were permanently closed, with further closures of up to 35.6 million tonnes of inefficient excess capacity expected for the period 2003-2005. Such closures represent more than 12% of total crude steelmaking capacity, but they are being surpassed by expansion, with global capacity expected to continue to grow for the next several years. Whether world consumption will be able to sustain the growing capacity throughout the business cycle is of concern, especially given the difficulties that the industry has experienced in adjusting to market downturns in the past.

## **Shipbuilding**

### **World shipbuilding faces looming crisis**

For decades the world shipbuilding industry has frequently experienced cyclical rises and falls in demand. This fluctuation, combined with the existence of excess capacity and the availability of government support, has pushed ship prices to below economic levels, as shipyards have attempted to keep their workforces employed.

At the moment the strong demand for shipping is being fuelled by sustained global economic growth, especially in China, as well as by environmental rules that require many single-hull tankers to be scrapped by 2005. This has generated strong demand for new ships, and most yards are working at close to capacity.

However, there is an element in this of natural future demand being brought artificially forward, and at the same time capacity has been expanding continuously. Potentially, overcapacity in the industry could be as high as 30% in 2007, according to recent OECD estimates. Without action to counter the distortions in the market created by this imbalance between capacity and demand, the world shipbuilding industry may head into a new crisis if, as is expected, demand for new ships falls sharply once present demands are met.

### **OECD leads initiative to find solutions**

Faced with this potential crisis, governments and industry in both OECD and non-OECD economies have agreed that there is a need to establish normal competitive conditions in the world's shipbuilding industry. This is to be achieved by a legally binding international agreement to be concluded by end-2005 in a Special Negotiating Group on a new Shipbuilding Agreement that first met in December 2002. In addition to OECD members, Brazil, China, Croatia, the Philippines, Romania, the Russian Federation, Singapore, Chinese Taipei and Ukraine have participated in the negotiations.

It is generally agreed that existing general trade rules, as embodied in the WTO Agreement on Subsidies and Countervailing Measures (ASCM) and Anti-Dumping code, are not ideally suited for shipbuilding, since its special characteristics hinder the effective application of these rules.

Therefore, the efforts to establish "normal competitive conditions" in the shipbuilding industry have focused on:

- a support measures discipline, which would effectively prevent direct and indirect subsidies as well as other official regulations and practices in favour of the shipbuilding industry; and
- a discipline to deal with any other market distorting practices that may be identified.

In support of these instruments, binding dispute settlement before an international panel is envisaged to deal with violations of the support measures discipline and/or other practices. This would be backed up by appropriate "remedies" and "sanctions".

### **The Special Negotiating Group**

Six regular meetings of the Special Negotiating Group and two special sessions (industry consultation and expert meeting) have been held so far. There is widespread agreement that a discipline for support measures is absolutely crucial to the Agreement, but there are still some divergent views about the details of such a discipline.

With respect to the second key issue, that of market-distorting practices and in particular distorting pricing practices, there are still widely diverging views on whether any practices exist that warrant intervention through this agreement. Every effort is being made to search for common ground on this important issue.

### **High chance of success**

Never before have governments and industry been so united in their wish and determination to strengthen fully-binding and enforceable disciplines for these two industrial sectors. If this political will continues to prevail these discussions within the OECD can be successful.