Opinions

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Overproduction and Trade Frictions in China

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China's economic policy as of recent can be defined by two goals: a sustenance of 7-8% economic growth, and restructuring. It will not be easy, of course, to successfully achieve both policy goals. 'Restructuring' in China can mean many things. The concept can refer to the upgrading of an industrial structure centered on low value added processing and assembly to a focus on higher value added, or the expulsion of contaminating industries as environmental pollution becomes more serious day by day.

Since the global financial crisis, China has been steering its policies toward securing economic growth, giving rise to another problem where restructuring may prove to be a solution: overproduction caused by excessive investment. As this re-emerges as yet another serious issue, restructuring now also refers to the suppression of overproduction.

Excessive investment and production is not, in fact, such a recent or novel issue in China. While it already has a history of burdening the Chinese economy, it has yet again risen to the surface in force amid efforts to overcome the global financial crisis. The Chinese economy is fraught with several imbalance issues, and overproduction among them is a serious issue that is often witnessed in developing countries with a repressed financial sector. Overproduction in China can also be attributed to the distinct nature of relationship between the central and local governments, as well as to the lax management of state-owned enterprises, another typical feature in China.

It is widely accepted that overproduction not only exacerbates inefficiencies in the economy, but is also unsustainable from a long-term perspective. Recognizing this, Chinese policy authorities are seeking new mode for economic growth.

While imbalance behind the border of a national economy is a serious issue, in a global economy where countries interact constantly, however, this is a much bigger issue to resolve, because the overproduced output inevitably finds its way to overseas markets. An excessive supply of a certain product puts downward pressure on costs in the domestic market, which in turn translates into less profit. Thus, China as the world's top exporter is aware of the scenario in which such products must seek better treatment overseas.

As announced by the Chinese government, overproducing industries include steel, cement, sheet glass, and aluminum, and recently solar panels and wind power turbines have joined the ranks.

Taking the steel industry as an example, as the world's largest steel powerhouse, China, owns six of the world's top ten steel companies. Crude steel output in China reaches approximately 50% of global production. In other words, about half of the world's steel comes from China, and it is no exaggeration to say that this is a problem for the global steel industry, not just for China.

Around half of China's steel is said to be consumed by the real estate market. Protracted adjustments to correct the real estate bubble are now starting to take place, dampening demand for steel products. Nonetheless, China's steel output continues to grow. In the first half of 2014, daily steel output continued to rewrite its production record, which means that restructuring in China's domestic steel industry will not be an easy task.

This inevitably leads to trade frictions between China and other countries that are forced to swallow the excess supply. Recently the United States, Canada, EU, Australia and ASEAN countries have been investigating dumping cases on China's steel exports, and the United States already set on a preliminary antidumping judgment in March. Although transferring a production base takes place easily in these global times, the same cannot be said for the steel industry since size and several other factors make it hard to transfer plants to another country. Thus, trade frictions are not going to be resolved in the near future.

Korea has also requested the Chinese steel industry to aggressively cut back on its exports, through discussions and consultations with Chinese steel companies and the government in the last couple of years. Korean steel companies are faced with problems due to the abuse of the Chinese government's tax rebate on steel products. To control steel exports, China has withdrawn the tax rebate on low value-added steel products, but it is still applied to alloy steel.

Tax rebates on alloy steel is similar to receiving subsidies, and thus is why China's steel industry is largely expanding exports of boron-added steel to the Korean market. Boron-added steel, which is eligible for the tax rebate, however, is merely steel with a trace of boron, and can hardly be considered high value-added alloy steel. In May 2014, several Korean steel companies ended up alleging Chinese steel exporters for dumping.

Based on the above cases, a few projections can be made for the future. First of all, it is highly unlikely that the overproduction issue in China will find a solution in the short term. This means that trade frictions between China and key trade partners will persist for a while. Secondly, excess output from China finding its way to overseas markets will not be the case only in the manufacturing sector. Recently China's real estate development businesses have been venturing into the global market, and real estate purchases by the Chinese have been rising sharply. There may be several reasons behind this phenomenon, but one important factor is that the serious oversupply of China's real estate market has been largely undermining profit rates. Thus, China's overproduction will affect other countries not only in manufacturing sector, but also in real estate, infrastructure construction sector and so forth. KIEP