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The U.S. Specialty Steel Industry
Today and Tomorrow

Remarks by David A. Hartquist
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to the
American Metal Market Conference:
Stainless and Its Alloys
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Introduction

As was stated at the outset of this panel discussion, these are indeed volatile times in the stainless steel market. Raw material prices are at all-time highs; most experts are forecasting overcapacity in Asia; and imports are accelerating. Everyone involved in the stainless supply chain is faced with more challenges than ever before.

My comments this morning will focus on some of the critical factors that we believe will continue to have a major impact on stainless steel supply. But first, let me make a few key points to set the stage.

First,

1. U.S. members of SSINA continue to invest here, but we need to make sure that this commitment to a domestic manufacturing base continues;

2. Second, a healthy specialty metals industry is very important for the country for many reasons, one key reason being the national defense;

3. Third, a level playing field for trade and investment is critical for the long term investment. This is not protectionist, just fair. The objective here is to maintain ongoing investment in equipment and technology development in the U.S.

4. There are three main factors that affect domestic investment: taxes, costs, and trade.

Why is this important to the supply situation of specialty metals in the United States? Why does a healthy specialty steel industry matter?

All of you here understand how essential specialty steel is to today's industrialized economy.

The U.S. specialty steel industry is without doubt both modern and efficient, and is at the leading edge throughout the world in both new product development and the most current technology used to produce these materials. Maintaining this high-technology base has been the key to our success in a highly competitive global market. We know that process and product development cannot be separated – and as we have found to be true – "our production facilities are our laboratories."

Our concern, though, is that over an extended period of time, the US could gradually lose its domestic specialty metals manufacturing base if US manufacturers of specialty metals -- like so many others -- move production offshore in search of what they perceive to be better business opportunities and higher profits. If this were to happen, we would lose our leading edge position in specialty metals technology because, if the manufacturing base moves, research and development will certainly follow in order to take advantage of lower costs and ties to the manufacturing process. As I just said, "our factories are our laboratories." This link between manufacturing and technology development is not well understood or appreciated by many people, but it is critical to an understanding of the situation facing the industry today.

National Defense

Specialty steel is vitally important to almost every U.S. military platform, whether it is the stainless wire for bomb springs and tank fuses; the flat-rolled armor plate for plane and ship armament or ground vehicles such as Humvees; or the high-temperature alloys used in aircraft engines and rockets; and alloys for the F18, Joint Strike Fighter, Black Hawk and Apache helicopters; even materials for nuclear propulsion. American-made specialty metals are critical to our military strength.

These metals are an integral part of many different applications, but they are not commodities; they're very high tech in nature and are in a continuing state of development. They are not "off the shelf items," and many are either proprietary or "sole-sourced" to a single US company.

Fortunately, the U.S. government recognizes the importance of specialty metals to national defense. Beginning over 30 years ago, Congress has required that defense applications use domestically-sourced specialty metals if available. Most recently, the DOD published notice in the Federal Register of its intent to strictly follow the provisions of this law.

Investment

I began by saying that our member companies continue to make significant investments here in the U.S. We know that companies make investment decisions based on the expected rate of return on their investments relative to their cost of capital. This is not necessarily true abroad. Unfortunately, we do not operate on a level playing field, and each year the field seems to tilt further in favor of investment outside the US.

The problem is that incentives to invest overseas continue to increase. The list is long and includes favorable tax treatment, lower operating costs- some legitimate, but some heavily influenced by foreign government intervention- and outright subsidies including currency manipulation.

At the same time, disincentives to invest in the US continue to grow: rapidly rising costs of energy, healthcare and post-retirement benefits; exorbitant regulatory and legal costs; high taxes; and increasing concerns about the enforcement of US trade laws.

What can we do about these problems?

At first blush, it almost seems that there is no solution and that the eventual demise of the US specialty metals manufacturing base is inevitable – that it's only a matter of time. But this is not how SSINA feels. We believe meaningful things can be done to address these potential problems, and we are working hard on them.

We need to do two things: First, the US government, working with U.S. industry, needs to become more proactive. It needs to create policies that encourage investment here. Second, our industry must continue to maintain its competitive edge with investments in the U.S.

Federal government policymaking is not a popular subject because it is often associated with protectionism or with the government picking winners and losers. We believe, however, that effective policies consistent with the principles of free enterprise can be created, and should be based on the following simple assumptions:

1. US multinational companies will continue to invest here if the investment playing field is relatively level, because investing in the US will be a viable, reasonably low-cost option with considerably less business risk.

2. It is not necessary or even desirable to stop investment overseas by multinational companies. It is only necessary to create an environment that encourages significant, ongoing investment here; and

3. If investment continues to occur in the US at a reasonable rate, the US will never lose its manufacturing base or the competitive advantage it currently enjoys in specialty metals.

None of these concepts is protectionist or isolationist in nature. We don't want to build a wall around the US; many of our own member companies are multinational companies. We're not suggesting that this needs to change. But there are certain issues central to leveling the "investment" playing field in this country, and I would like to discuss a few.

First, taxes. Simply stated, the US tax system discourages investment in this country. Corporate income taxes, for example, are higher in the US than in other countries. This affects investment decisions. Corporate taxes should be border-adjustable and consumption-based. In addition, many other economies utilize VAT systems to encourage exports - something the US does not do, but should consider. U.S. tax policies should encourage innovation. Similarly engineering education and research should be supported.

Another key issue is costs of manufacturing. As documented by NAM, costs of manufacturing in the U.S. are rising in comparison to other countries. NAM estimates that external, non-production costs related to taxes, health care, litigation, regulation and energy are at least 22% higher in the U.S. than the average of its nine most important trade competitors. The fact that the U.S. has been unable to develop an effective national energy plan is a good example of the differences in approach between global trading partners and its potential impact on future investments by U.S. manufacturers.

Many cost elements, *apart from labor*, are much higher in the US than in other locations around the world. This does not need to be the case. For example, cost factors related to energy, environmental regulations, and post-retirement benefits are disproportionately high for manufacturers of specialty metals in the US. Effective US policies could level the "cost" playing field in areas other than just labor. For example, it might include initiatives to lower energy costs; demands that environmental control systems in foreign countries increase to levels comparable to those required of US manufacturers; and decrease the burden of post-retirement benefit costs to US manufacturers.

Another example would be health care costs – which as you all know have exploded in recent years and now have a substantial impact on our ability to compete. This is particularly true with respect to other countries that have national health systems. We need a solution that maintains health care benefits without adversely affecting the competitiveness of US manufacturers.

Level the Playing Field

So what does a level investment playing field look like? Not like this!

As a result of these imbalances, we are facing powerful new entrants in the specialty steel marketplace, particularly in stainless and electrical steels. Globally, even though capacity exceeds demand, we still see new facilities being added around the world. We're seeing competitors springing up in China, India and Russia - despite attempts by the Bush Administration to discourage foreign government subsidies.

Much of the new capacity is being funded through massive government subsidization, particularly in China. The Administration actively supports negotiations through the OECD to restrict such subsidization, but the negotiations have essentially fallen apart. China participated in the negotiations, but was not forthcoming with respect to restrictions on subsidization.

The U.S. stainless steel industry is modern, efficient and competitive. The market during the last few years has been strong and most companies have had good financial performances. SSINA members recognize, however, the importance of being able to address Chinese subsidies in the future should the need arise. We are pleased that the Department of Commerce has announced its willingness to pursue countervailing duty cases against non-market economies like China. This is consistent with U.S. law and WTO rules.

The Import Situation

What do the U.S. import numbers look like? It's a mixed bag – but this much is clear – much international pressure is being exerted on all our main product lines. To be sure, times are good today, but let's look down the road a bit.

Imports of total stainless steel in 2006 were just over 800,000 tons, representing a 23% increase compared to 2005; U.S. consumption was about 2.6 million tons, up by about 15%, causing import penetration to rise to 32%. The largest product category, stainless steel sheet/strip, also had the highest increase of imports last year – to over ½ million tons. Even though U.S. consumption of sheet and strip increased by 13% last year, imports increased three times faster, causing import penetration rates to reach almost 30%. So as you can see, the pressure is mounting. In addition, imports of plate increased by 35%, and stainless steel wire imports by 11%. The supply environment is very rapidly becoming more competitive, and it is becoming more difficult for us to keep the playing field level. Let me give you a concrete example of what I mean by this.

Recently, the EU challenged Commerce's "zeroing" practice in calculating antidumping duty margins in AD investigations. Up until this WTO challenge, Commerce did not average the positive dumping margins on dumped sales with the negative dumping margins on nondumped sales when calculating the margin, but instead would set nondumped sales to "zero" when calculating the overall dumping margin. Just this past year, the WTO ruled that Commerce had to average nondumped and dumped sales when calculating dumping margins in investigations. To implement this decision, Commerce conducted so-called "Section 129" investigations where it recalculated the margins that were the subject of the EU's original challenge, and released its preliminary results in February 2007. Commerce investigated 9 cases in the stainless steel industry: 4 stainless steel bar, 3 wire rod, 1 plate in coil, and 1 sheet and strip case.

The preliminary results of these cases have particularly significant results for several of the stainless steel products. In particular, if the final results are unchanged from the preliminary results, six stainless steel foreign producers will be excluded from existing antidumping duty orders, and the antidumping duty order on stainless steel wire rod from Sweden will be revoked in its entirety. The original EU challenge only involves recalculation of the margins in original investigations of these cases, not administrative reviews, but that could change. So while we are not preaching doom and gloom on the trade front, you can see that there are serious issues we are grappling with in this regard.

China

You've heard me mention China numerous times in the past few minutes. Why? One reason is that it has a built-in competitive advantage based on the manipulation of its currency that gives China about a 40 percent advantage on that basis alone. SSINA has joined with other manufacturing industries in challenging China's currency practices to try to bring its currency more in line with its real value.

While revaluation of the Chinese renminbi has captured most of the attention in the press, similar concerns apply to the other major Asian producers, such as Japan, Taiwan and Korea.

Apart from trade-related issues, China's growth, per se, clearly has fueled the unparalleled run-up in prices of all raw materials, resulting in significant increases in the price of many specialty metals that contain these raw materials. Plus, in a period of less than three years, China has become a major exporter of stainless steel flat-rolled products – a core commodity product of US producers. China is now the number two offshore source of stainless flat-rolled products in the US market, having increased its exports to the US by over 500% in the past year alone. In stainless long products (bar, rod, and wire), which are critical to numerous aerospace and defense programs, Chinese imports have increased by almost 100%.

What about Chinese pricing practices? I recently read a chilling quote about selling prices of the Chinese "Chery" cars. It went like this: "Price point? When asked that question, the reply from the Chinese manufacturer was, 'at what price do you want us to sell it?'". Tells you a lot, doesn't it?

What else can we do about this? Recently, H.R. 1229, the "Non-Market Economy Trade Remedy Act of 2007," was introduced by Congressman Arthur Davis and Phil English. The legislation will ensure that U.S. countervailing duty (CVD) law applies to imports from non-market economies (NMEs), including China.

Over the past six years, our nation has seen record trade deficits – including an estimated $232 billion trade deficit with China in 2006 – and the movement of manufacturing facilities overseas, particularly to China. The effects on our manufacturing base, its workers and our economy as a whole have been substantial and are continuing.

The purpose of CVD law is to offset any unfair competitive advantage that foreign manufacturers or exporters have as a result of government subsidies. Whether it is through government intervention in currency markets, government intervention in raw material markets, preferential access to loans from state-directed banks or by other means, manufacturing in China and other NMEs remains heavily subsidized. In fact, governmental command and control is a hallmark of a non-market economy. There is a test case involving the paper industry before Commerce right now. On March 30, Commerce made a preliminary decision to change its policy, and allow CVD cases against China and other non-market economies. We hope the final decision in that case will be affirmative, and that Congress will also pass legislation making this policy a matter of law.

SSINA is publishing today a new study of Chinese government subsidies to its specialty steel producers. We have made copies available to you. It is very interesting reading, to be sure.

Thank you for your attention.