Why there will be no simple wins in the solar panel trade wars

9 November 2012

Summary

- The long year dispute between the EU, the US and China over solar panel exports escalated again this week with a Chinese WTO challenge to the EU's energy subsidy regime, and the launch of an EU investigation into Chinese state subsidies for solar panel manufacturers. This followed EU's own investigation into price distortions in the manufacture and export to Europe of Chinese solar panel modules and their components and a retaliatory Chinese anti-dumping case on polysilicons.

- Like most anti-dumping disputes, the case pits not just the US and the EU against China, but also EU domestic constituencies against each other. It also sets politically sensitive domestic policy outcomes in the EU and the US in conflict. These go to the heart of what the EU believes it stands to gain from a global shift to low carbon energy generation.

- The EU cannot raise duties on imported solar modules and cells without impacting on the rollout of solar generation in Europe, at least to some degree. But it cannot ignore subsidised Chinese imports without implicitly conceding that Europe will capture the emissions cuts and energy security gains, but not the new manufacturing.

- As in the US, the solar panel dispute raises not just the usual sensitivities about China, but a big question about the extent to which EU trade policy is also energy policy, and the extent to which both are industrial policy. Beijing probably calculates rightly that its strongest suit is the fact that the EU has no single answer to these questions.

Like marital breakups and election defeats, trade disputes tend to have immediate causes and deeper ones. The long dispute between the EU, the US and China over solar panel exports is a case in point. The dispute escalated again this week with both a Chinese WTO challenge to the EU's energy subsidy regime, and the launch of an EU investigation into alleged state subsidies for Chinese solar panel manufacturers. Brussels had already launched an anti-dumping investigation into solar panel imports from China on 6 September. The anti-dumping case alleges price distortions in the Chinese system that allow products to be exported at below their 'true' cost. The European cases are based above all on the allegation that Chinese solar panel fabricators benefit from credit lines with state banks that allow them to absorb losses and roll over bad debts.

The EU anti-dumping case follows a similar US case, which saw the imposition of preliminary anti-dumping duties up to 250% in May 2012 which were confirmed and imposed for five years this week. The EU ProSun coalition, a group of twenty EU solar panel manufacturers, is led by SolarWorld, the same German-based solar multinational that pressed for the US investigation through its American subsidiary. The EU case is wider than the US one, covering not just the finished modules but the silicon wafers that are installed in them.

Covering import flows of over €21bn in 2011, this is the largest anti-dumping case the EU has ever launched. Like most anti-dumping disputes, the case pits not just the EU and the US against China, but also domestic constituencies against each other within the EU and the US (and to some extent China). It also pits politically sensitive domestic policy outcomes in the EU and the US against each other. These go to the heart of what the EU and the US believe they stand to gain from a global shift to low carbon energy generation. This Global Counsel Insight looks at the case and its wider implications.

Solar sells

The development of solar panel exports from China to the US tells a depressing story for European and American producers (Chart 1). In both cases, import volumes have risen sharply since 2009, pulled by western subsidies for solar installation, and pushed by the dramatic expansion of the Chinese solar panel fabrication industry. The effect in Europe, which has a market for solar panels about ten times the size of that of the US, has been particularly stark. European solar panel manufacturers have also seen their own exports rise, but the value of these exports has remained largely stable as unit prices have dropped sharply (Chart 2).

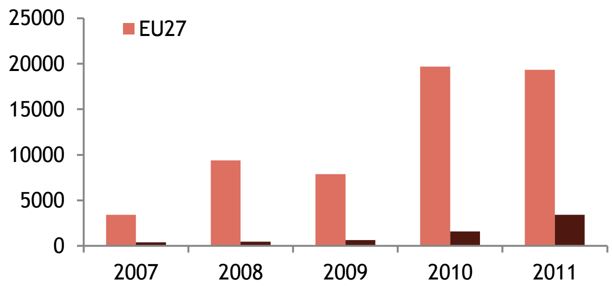

Chart 1: EU and US imports of solar panel technology ($mn)

Source: Comtrade 2012. HTS Tariff Line 854140.

Obviously, this is not universally bad news for either import market. The cost of solar cells and panels has fallen consistently since 2008 in a way that has lowered the cost of installation and of inputs into solar-powered technologies. The export to China of solar-grade polysilicon – a key industrial input in solar cells themselves - has boomed along with surging Chinese production. Much of this polysilicon comes from the US and Germany. China is also a big importer of the machinery used to make solar panels, much of which, again, comes from Germany.

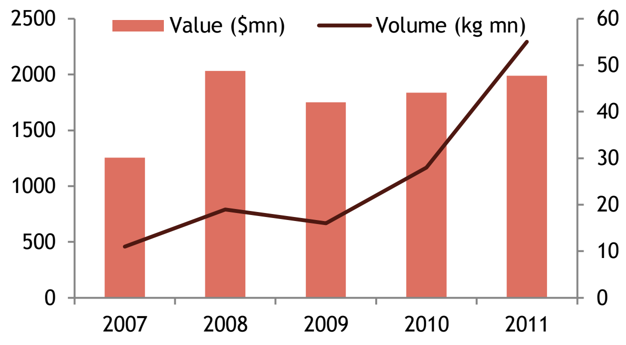

Chart 2: EU exports of solar panel technology value (LH) and volume (RH)

Source: Comtrade 2012. HTS Tariff Line 854140

Even excluding the conclusions of the US authorities, there is plenty of anecdotal evidence that the European complainant's case has some merit. Chinese solar panel manufacturers are reducing capacity sharply after five years of rapid expansion. The Chinese government has tried to absorb some of the excess capacity by raising its 2015 installation targets for solar dramatically and introducing new feed-in tariffs. However, the poor standard of the Chinese grid has hobbled a lot of the new potential capacity and installation targets are well behind forecasts. The Chinese State Grid announced this week measures to assist solar generators in connecting to the network.

In the meantime there is a marked reluctance to allow firms to go out of business to drive consolidation in the sector. China Development Bank (CDB) is widely believed to have an informal commitment to lend at preferential rates to a dozen Chinese solar companies.

A number of companies have also sought and received investment from local governments reluctant to see plants close and jobs destroyed. Two NYSE-listed Chinese manufacturers have received financial support from local authorities. Suntech, who reportedly had debts of $3.6bn, received financing from the city of Wuxi. LDK Solar, the world's second largest polysilicon solar wafer producer, received both debt relief and a capital injection from the city of Xinyu after recording losses of $580 million in the fourth quarter of 2011.

Waiting for Europe to disagree

Irrespective of the evidence, trade disputes with China have a habit of developing into political and diplomatic distractions and a formal anti-dumping investigation is a political irritant for European capitals trying to maintain smooth relations with Beijing - as is the new subsidies case. As if in expectation, German Chancellor Angela Merkel expressed her opposition to an investigation during a trip to China, before it was even announced.

Nevertheless, EU Trade Commissioner Karel de Gucht is instinctively inclined to test Chinese trade distorting practice. He is supported by trade officials who have for a long time quietly resented political pressure to avoid a confrontational stance with Beijing on public trade law. EU industry by contrast has typically been more ambivalent about a confrontational approach. Most of the applicants in the solar panel complaint have maintained their anonymity, fearing retaliation from Chinese authorities. When De Gucht launched an *ex officio* case against subsidies to Chinese telecoms firms operating in the EU earlier this year, their European competitors politely declined to support him publically.

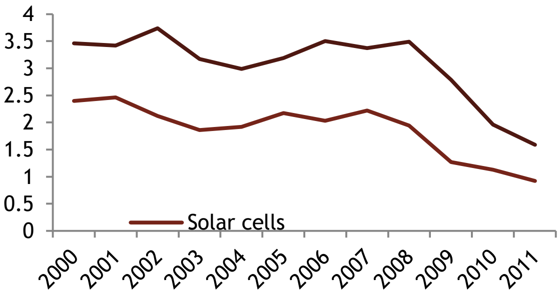

Chart 3: Unit costs for PV solar technology ($/peak watt)

Source: US EIA 2012

Assuming De Gucht sustains the appetite for a big new test case on Chinese practice, Berlin is likely to resist him at each step. But Angela Merkel's public ambivalence about an anti-dumping case was motivated by a lot more than the simple desire not to offend her Chinese hosts at a delicate time. Over the last two years China has developed a *modus operandi* of systematically escalating most challenges, usually through retaliatory dumping investigations or WTO action (see GCI 12/29 *Lawyering Up: China and the WTO*).

Merkel's officials will have calculated that, given China's newfound enthusiasm for responding in kind with retaliatory use of anti-dumping, Beijing was likely to focus on polysilicon in return. Sure enough, on 1 November Beijing announced that the EU would be rolled into its existing anti-dumping investigation into Korean and US polysilicon exports. This week China has requested WTO consultations with the EU on the solar subsidies in unspecified EU states.

Beijing knows very well that how this plays out will test intra-EU politics as much as EU-China diplomacy. EU anti-dumping investigations last a maximum of 15 months and the Commission can reach provisional conclusions after nine months, at which stage it could impose interim duties. Permanent duties can only be imposed by EU states themselves after a full 15 month investigation. This will push the issue back onto the political agenda next summer. At this point, we can anticipate an EU policy priority car crash.

Solar advocates in the EU and the US argue that the dramatic fall in unit costs of solar cells and modules since 2007 (Chart 3) is key to establishing grid parity for the technology with gas and other forms of electricity generation. European taxpayers have paid substantial sums to incentivise the use of solar technology, and are now, in theory, seeing the cost benefits of some of that new scale. Solar installers argue that they account for the bulk of the estimated 300,000 jobs in the EU in the solar industry and that their jobs are not vulnerable to lower Chinese prices, but could be vulnerable to imposed duties that raised the costs of solar modules and cells.

As we noted back in August (see GCI 12/27 *The coming squeeze on European renewables*), the politics of the low carbon transition in both the EU and the US has often focused on its role as a catalyst for the development of new technological strengths and new manufacturing employment. Watching those potential gains in the solar sector disappear in a puff of Chinese exports has provoked considerable political resentment. The acceptance that Europe's core interest lies in importing cheap panels to facilitate a transition in generation rather than preserving the European capacity to manufacture them would be regarded by many in Brussels and across the EU as a blow for European industrial policy.

It is hard to imagine that a European investigation will not turn up evidence of price distortion. In principle, the Chinese companies challenged by the EU could offer commitments on their cost bases that would allow the EU to terminate the investigation. European anti-dumping rules also provide scope for the European Commission and EU member states to identify dumping but choose to do nothing about it for reasons of 'community interest'. In reality, this rarely happens. This case, however, is likely to present intense pressure to invoke these rules.

Beijing has enough experience in dealing with the complex web of interests created by EU supply chains to know that its biggest asset is probably the European debate itself. The Chinese anti-dumping counter case and the WTO challenge simply adds to the political and diplomatic headache for EU leaders who would like the case to go away. Moreover, by constraining western polysilicon exports to China – and even if the Chinese do not ultimately impose duties, the case itself can have a chilling effect on exports – Beijing also knows it is providing a window for Chinese companies to develop their own capacities in the production of polysilicon.

Losing either way

Brussels will take a certain grim satisfaction from standing up to a system it regards as a systematic breacher of trade norms, and its long-term perspective on challenging Chinese practice is in reality a useful balance to the more tactical instincts of European states. But, as with previous high profile dumping cases, this case is pretty much a political lose-lose for Europe. The EU cannot raise duties on imported solar modules and cells without impacting on the rollout of solar generation in Europe, at least to some degree. But it cannot ignore subsidised Chinese imports without implicitly conceding that Europe will capture the emissions cuts and energy security gains, but not the manufacturing in an emblematic new technology.

The European solar industry arguably has bigger problems than China, in the form of its own changing subsidy regime and overcapacity problem. But Europe standing aside to allow Chinese goods to exacerbate the pain will fuel a deep neurosis in the EU about Chinese industrial competition and European policy passivity in the face of it. The fact that the Chinese system is wasteful and unsustainable and that its own internal debate on it is suppressed in an unhealthy way will not console anyone.

In this respect, the solar wars are a skirmish in a much bigger and longer-running battle about the terms on which Chinese firms compete in manufactured exports. But even in their own right, the solar wars are only just warming up, at least in the EU. When it resurfaces next year, the dispute will quickly spread into the politics of climate change and a deep sensitivity about industrial renewal in the EU. It raises a big question about the extent to which EU trade policy is also energy policy, and the extent to which both are industrial policy. It asks what exactly Europe thinks it is incentivising when it incentivises the installation of alternative energy generation. Beijing probably calculates rightly that its strongest suit may just be the fact that the EU has no single answer to these questions.

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