Beijing and Washington, DC Clash Over Excess Capacity: A Guide for the Bewildered

Simon J. Evenett, 29 July 2026

On 28 July 2026 China's MOFCOM published a position paper on the trade-related aspects of excess capacity. This follows the initiation in March 2026 of a U.S. investigation into such matters as they relate to 16 trading partners, including China. That investigation may soon result in further import restrictions being imposed by the United States. By posing 10 specific questions about excess capacity, this note sheds light on the substantive disagreement between Beijing and Washington, DC on this salient trade policy matter.

Excess capacity in China remains a major point of contention in business and policy discourse this year. Some governments and commentators connect it to trade tensions, global imbalances, deindustrialisation in China's trading partners, and threats to their economic and national security.

Accusations of excess capacity in *particular sensitive sectors*, such as steel, were first levelled a decade or more ago. Now, some seek to delegitimise the *entire Chinese economic system* by contending that it is based almost entirely upon state measures that allow excess capacity to persist in manufacturing sectors. Combined with slow growth of domestic demand in China, this is said to result in China "venting" its surplus production on to world markets. The resulting Chinese export "surge" is said to be causing a "China Shock 2.0". Such exports could not occur if there was insufficient production capacity, hence the contention that excess capacity is a driver of Shock 2.0.

Therefore, excess capacity is at the centre of this delegitimisation campaign. Careful analysts will have noticed that excess capacity is not the sole factor mentioned and that alternative explanations for Chinese export success and the upgrading of its firms ought to be considered. None of this is to deny that the Chinese state actively intervenes in its economy. What matters for businesses abroad and for trade policy deliberation is cross-border fallout from Chinese state measures and whether trading partners have tools that can effectively curb adverse fallout or the causes of such fallout.

Section 301 investigation: Excess capacity accusations widen beyond China

On 11 March 2026 the United States invoked Section 301(b) of the Trade Act of 1974 and opened an investigation into what the associated Federal Register notice calls "structural excess capacity in production and manufacturing sectors". The investigation names sixteen jurisdictions: Bangladesh, Cambodia, China, the European Union, India, Indonesia, Japan, Malaysia, Mexico, Norway, the Republic of Korea, Singapore, Switzerland, Taiwan, Thailand, and Vietnam.

Notice that this Section 301 investigation does not target only China. Several of those American trading partners that supported the campaign mounted by the United States at the OECD on sectoral excess capacity (which largely targeted China) now find themselves under investigation on the same grounds. Trade officials in those trading partners should have an interest in what follows as it sheds some light on how the U.S. views the matter of excess capacity.

Beijing's July 2026 intervention allows for a systematic comparison of views

On 28 July 2026 the Ministry of Commerce of the People's Republic of China (MOFCOM) published a position paper on what it terms the so-called excess capacity question. Its release allows for a systematic comparison of the American and Chinese positions on excess capacity, set out in the table that follows.

The table organises this comparison around ten questions, each of which is stated precisely there. These questions fall into five groups:

1. Definition of excess capacity: what excess capacity means (Question 1)
2. Measurement of excess capacity: how excess capacity is measured and how far it extends (Questions 2 and 3)
3. Causes of excess capacity: identification and assessment of the relative importance of policy- and private sector-related causes of excess capacity (Questions 4, 5, and 6)
4. Impact of excess capacity: whether excess capacity harms trading partners and through what mechanism (Questions 7 and 8)
5. Nature and effectiveness of remedies: what trade policy response is proposed, how is the remedy supposed to work in practice, and whether such responses have reduced excess capacity in a trading partner before (Questions 9 and 10)

Question 1 asks for a definition of excess capacity. A comparison between the two documents should start with an examination of what this term means to each party. Questions 2 and 3 turn to measurement: once a definition exists, the next question is what scale the phenomenon reaches and how often it occurs across countries and sectors.

Questions 4, 5, and 6 then ask why excess capacity arises, testing stated causes against evidence and against rival, typically market-based, explanations. These questions sit after measurement because a claim about cause can be judged only once the scale of the thing to be explained is known.

Questions 7 and 8 move from cause to consequence, asking whether excess capacity harms other countries and what evidence supports that claim. Questions 9 and 10 close the sequence by asking what trade policy-related remedy is proposed, whether its logic connects to the causes identified, and whether such a remedy has worked in the past. A remedy can only be judged once the questions of cause and effect of excess capacity have been answered.

Notice that this sequence of questions builds on each other. Contending that excess capacity is pervasive is not enough to justify restrictive trade measures because excess capacity may be the outcome of competition between firms uninfluenced by state action. Moreover, evidence ought to be provided that excess capacity has produced demonstrable harm to the commercial interests of trading partners (keeping in mind the possibility that benefits may have been created too.)

A credible theory of harm must be articulated and evidence provided (based on actual firm and market behaviour, not speculation or cherry-picked examples.) Moreover, a credible theory of remedy is needed as well. If an import restriction does not eliminate or sufficiently reduce the offending foreign excess capacity then the source of the harm will not have been dealt with—so any claims that the import restriction is only a temporary corrective measure can be set aside.

It follows from this sequence of questions that there is a significant burden on those making the case that excess capacity is a pervasive, harm-creating feature of the world trading system and that there is a case for deploying import restrictions to "fix" the problem.

Advocates of import restrictions need to provide compelling answers to all 10 questions outlined in the table that follows. U.S. law may demand less of officials conducting the Section 301 investigation. However, for those interested in the commercial logic for intervention, these 10 questions get to the substance of the matter.

In contrast, and here is a key asymmetry, the logical chain implied by this sequence of questions implies that claims about damaging excess capacity can fail at several points. Still, one should make clear that failure to demonstrate that a trading partner's excess capacity has harmed U.S. commercial interests does not mean that that partner's government policies have not harmed American interests through other means.

Use cases

Three uses follow from this rubric of ten questions. First, the questions offer readers, officials, journalists, and corporate executives a systematic method to compare the Chinese and American positions on the trade-related implications of excess capacity in manufacturing.[1]

[1] For reasons that are unclear to me, excess capacity in agricultural and service sectors is not in the spotlight. There again, the United States has significant trade surpluses in various lines of business in agriculture and services.

Second, trade diplomats in Geneva, officials in national capitals, and officials at international organisations such as the OECD and WTO can use this sequence of 10 questions to thoroughly explore the trade-related consequences of excess capacity. Consideration of these 10 questions will reveal where unwarranted shortcuts have been taken in current discussions on excess capacity.

Third, should U.S. officials find that harmful excess capacity exists in certain countries under investigation, the same ten questions then offer a method to evaluate the substance of any such determination.

Corporate executives operating in the sectors and jurisdictions under investigation by the U.S. have should apply this method too. Why? Any measure subsequently adopted will bear on the conditions under which their company competes in the U.S. market in the near term and upon their expectations about the drivers and coherence of U.S. trade policy formation which, in turn, may affect their commercial footprint decisions.[2]

Given the widespread scepticism of the merits[3] of the recent forced labour-related import tariffs imposed by the U.S., coupled with the credibility gap surrounding last year's fentanyl[4] tariff penalties, import restrictions introduced on excess capacity grounds will attract scrutiny.

Sweeping U.S. tariff measures that lack credible evidence and supporting logic undercut the high-level reindustrialisation objective of the Trump Administration. The contention of this Administration is that by erecting import barriers, the United States is incentivising foreign firms keen on supplying its markets to establish production facilities there. Doing so requires foreign corporate executives to have sufficient confidence in the business conditions within the United States.

Having an unpredictable and empirically unjustifiable trade policy raises questions about the processes, predictability, and credibility of the decisionmakers involved. That casts a shadow over whether policy towards the U.S: business environment will be made in a similar capricious manner going forward. Given the time and significant capital outlay involved in establishing manufacturing facilities, multi-year commitment to stable pro-business policies is vital.

Asking foreign executives to accept that U.S. trade policy is capricious does not sit well with cultivating a reputation for improving the business climate at home. Foreign executives would be right to ask if domestic tax, regulatory and other policies towards the U.S. business environment will soon become as inconsistent and unfounded as U.S. trade policy. The ten questions stated in the table that follows will enable foreign corporate executives and those that advise them to assess the case made in whatever report the United States Trade Representative publishes on its ongoing investigation into foreign excess capacity.

The trade policy of the second Trump Administration continues to break new ground. In the case of excess capacity, its fallout, and remedy, the incentives created for the private sector to invest in and maintain such capacity are central considerations and ought to receive more scrutiny. This is where an understanding of market processes—informed by corporate executive and economic insight—ought to contribute to formulation of trade policy. The trade-related implications of excess capacity are not solely a legal matter or a matter of geopolitical narrative.

The questions outlined here integrate a number of pertinent considerations that can be used to hold policymakers to better account. Should Beijing move on excess capacity matters, these considerations apply as much to them as to their counterparts in Washington, DC.

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[2] For their part, economists may be interested in learning how the microeconomic concept of excess capacity has been (mis)applied in trade policy circles.

[3] Perhaps the most glaring mismatch is between the "examples" and "case studies" presented in the relevant USTR investigation report and the across-the-board nature of the import tariffs imposed. Using the latter to tackle localised problems is akin to using a sledgehammer to crack a nut. In short, it is not a proportionate policy response.

[4] Multiple U.S. news reports indicate that official U.S. statistics show few seizures of fentanyl that originated or passed through Canada. Yet, Canadian products were hit with tariffs.

Table: USTR and MOFCOM Excess Capacity Statements Assessed Against the Ten-Question Rubric

Question	USTR (Section 301 Notice, March 2026)	MOFCOM (Position Paper, July 2026)
Q1. What definition of excess capacity does the document use? How does the definition provided relate, if at all, to Chamberlin's microeconomic concept (output below the cost-minimising level as a normal feature of monopolistic competition)?	Defines it as capacity "sustained through governmental interventions" — a causal, not neutral, definition, attributed in a footnote to a private research report (Rhodium Group). No definition based on accepted understanding of this term is provided, whether from economic analysis (Chamberlain) or from international organsiations.	Paper provides these definitions: "Economists mostly explain excess capacity from both macro and micro perspectives. At the macro level, excess capacity is a phenomenon where the production capacity of the whole industry substantially surpasses the total effective market demand. At the micro level, excess capacity refers to a situation where firms' actual output falls short of the optimal level due to monopolistic competition." The microeconomic definition mentioned is substantively Chamberlin's concept, though this is an inference. This position paper never cites Chamberlin. Nor is monopolistic-competition theory mentioned more than once. States explicitly that WTO agreements contain no definition and the IMF treats it as a complex, context-dependent concept.
Q2. In what ways was excess capacity measured in the report? What measures were used?	Global capacity-utilisation range (75.0–75.9%); US-specific trend (79.9% peak during President Trump's first term → 75.2% low in Nov. 2024); China-specific figure (74.4% in 2025, down from 75% in 2024). Trade-surplus/bilateral-deficit dollar figures per country. An ~80% "healthy" benchmark is asserted, sourced to one steel-specific proclamation; not defended generally. Flags a data-quality caveat for China specifically: "data transparency is limited" and available data "contains statistical anomalies that may suggest an even higher surplus."	Same core metric (utilisation rate; China 74.4% in 2025; EU — 169 of 725 industries below 70%; US Fed data 75.7% with subsector breakdown). Explicitly argues no single benchmark applies across countries or sectors; offers a development-tier range instead (75–80% advanced economies; 50–64% less-developed).

Question	USTR (Section 301 Notice, March 2026)	MOFCOM (Position Paper, July 2026)
Q3. What evidence of the frequency or pervasiveness of excess capacity is found in the report?	Names 16 economies; lists 21 sectors said to be affected (steel, autos, batteries, chemicals, semiconductors, etc.). Cites a forward-looking scale claim: global steel excess capacity projected to reach 721 million metric tons by 2027 (GFSEC). No aggregated "share of world/sector trade affected" figure is calculated.	Cites a single statistics on pervasiveness: 169 of 725 EU industries below 70% utilisation, plus China's own subsector breakdown. No global frequency estimate is offered either.
Q4. What causes of excess capacity are stated in the document?	Lists seven specific state-related mechanisms: subsidies/export promotion untethered from demand, suppressed wages, non-commercial SOE activity, market-access barriers, weak labour/environmental standards, subsidised lending, and FX/financial repression — list explicitly non-exhaustive ("...and others").	States there is no necessary link between subsidies and excess capacity (Section II.A). Separately frames capacity fluctuation generally as a normal outcome of technological change and business cycles (Section I.B) — note this is a synthesis across two different sections of the document, not one continuous argument. Does not offer its own list of state-related causes.
Q5. What evidence is given on the actual causes of excess capacity?	Country-wide pattern, not China-only: e.g. Malaysia's steel capacity grew 22% (2018–22) despite a 25% demand decline; Vietnam's cement sector runs near 100% overcapacity relative to demand. More mechanism-specific evidence exists for some countries' currency practices (Norway's SOE-based FX recycling; Switzerland's intervention/sterilisation) than for China's subsidies, for which no dollar figure is given. One distinct mechanism not in the seven-item list: Chinese PET (polyethylene terephthalate) overcapacity is attributed to firms' access to discounted Russian oil — an input-cost mechanism, not subsidy/SOE/FX.	Evidence offered concerns its own compliance (WTO subsidy notifications, negative-list mechanism) rather than rebutting USTR's specific figures; does not engage the steel-share or battery evidence directly. Also cites comparative subsidy scale (US IRA ~$750B; EU ~€1.44T), used in the text to argue major subsidisers should "set an example" and thereby implies a double standard. Read here as an inference against a size-predicts-overcapacity logic — larger subsidizers are not treated as having overcapacity — though the document does not state that logic explicitly.

Question	USTR (Section 301 Notice, March 2026)	MOFCOM (Position Paper, July 2026)
	China evidence (steel-share, battery ratio, BYD's overseas expansion) mostly shows surplus capacity exists, not why — closer to Q3-type evidence than direct causal attribution.	
Q6. What evidence is given to test the relative importance of rival explanations — state-driven distortion versus market-driven or comparative-advantage causes?	Not addressed. No market-driven or comparative-advantage explanation is considered or tested against the distortion claim.	Demand-driven account (Section II.C): rebuts the "China's inadequate domestic demand causes excess capacity" argument — domestic demand contributed 93% of GDP growth (2013–2024); retail sales of consumer goods doubled, RMB23.8tn → RMB50.1tn (2013–2025); China's PPP-adjusted retail sales are 1.7x the US; services consumption grew at an average 8.5%/year, framed as structural upgrading rather than weak demand; 15th Five-Year Plan domestic-demand expansion measures cited as a forward commitment. Market-driven account: declining labour-intensive export share (20.7% → 15.1%); EU-bound export growth concentrated in green-transition goods. Innovation-driven account: rising R&D spending (~10%/year); power-battery energy density +50% / cost −60% since 2018; a cited Morgan Stanley finding that EV competitiveness has shifted from price to technology. Does not run a direct, head-to-head test against the distortion hypothesis.
Q7. Does the report contain explicit mechanisms by which excess capacity in one country harms its trading partners?	Yes — three named mechanisms: displacement of US production/investment, investment-chilling from idle foreign capacity, and the argument that "Economists have noted that a large manufacturing surplus requires an offsetting deficit in manufacturing elsewhere in the global economy."	No equivalent mechanism is offered. The document argues the underlying premise (that China's capacity is harmfully excessive) is unproven, and separately argues that protectionism itself is what harms trading partners.

Question	USTR (Section 301 Notice, March 2026)	MOFCOM (Position Paper, July 2026)
Q8. To what extent does the report offer actual evidence that trading partners have been harmed by excess capacity?	Correlational figures cited: US capacity utilisation fell 79.9% → 75.2%; bilateral auto-sector deficit of $157B (2024) declining to $128B (2025); declining US manufacturing value-added share of GDP (10.5% vs. Germany 22.7%, China 28.1%, Japan 21.7%, world average 17.2%). Also cites UNIDO data showing sustained manufactured-goods surpluses in China/Asia-Pacific/Europe against growing deficits in North America/Latin America — correlational support for the "mirror image" claim, not a causal isolation of excess capacity as the specific driver. No counterfactual or causal test isolating excess capacity as the cause; the auto-deficit figures show the gap narrowing — in tension with a "large/persistent" harm framing.	No evidence of harm is offered. Instead offers counter-evidence of benefit to trading partners (ECB estimate: a 10% rise in EU imports from China lowers EU import prices 1.6%; IRENA renewable-cost-decline data).
Q9. Does any proposed trade-policy-related remedy — tariff or non-tariff, affecting the conditions of competition faced by foreign firms — address the causes identified? Is a connecting logic provided (remedy addressing cause of excess capacity)? Is any proposed remedy proportionate to the scale of the problem?	Remedy is explicitly trade-policy in character (tariff and/or non-tariff action altering import conditions for foreign firms), so it qualifies as this type of remedy. No explicit logic connects a specific remedy type to a specific one of the seven listed causes; instrument choice is deferred to a later Section 304 determination. No proportionality assessment against problem scale is offered — the investigation spans 16 economies and 21 sectors without a stated trade-share threshold justifying that scope.	Proposed remedies — market opening, subsidy-transparency dialogue, MFN adherence, reducing trade barriers, easing investment-access restrictions (Section IV.D), and WTO reform (Section IV.E) — are trade-policy in character and would affect foreign firms' competitive conditions. But they don't address "causes of excess capacity" as such — MOFCOM's own diagnosis is that the operative problem is protectionism/politicisation, so the remedy targets a different diagnosis than the one nominally under discussion. A connecting logic is provided (protectionism harms trade order → openness/multilateralism is the corrective), but no proportionality argument against a capacity "scale" is offered, since MOFCOM disputes that a substantial capacity problem exists to be proportionate to.

Question	USTR (Section 301 Notice, March 2026)	MOFCOM (Position Paper, July 2026)
Q10. Is there evidence that a trade-policy-related remedy has actually reduced excess capacity in the targeted country (not a forward-looking projection or promise)?	Not addressed. No backward-looking evidence of a prior trade-policy remedy (tariff, quota, market-access change) reducing excess capacity anywhere is cited. A 2021 Section 301 finding that Vietnam's currency practices were "unreasonable" is cited, but only as a prior finding — not as evidence that any resulting remedy reduced Vietnam's excess capacity. The Feb. 2025 steel proclamation is cited only to source the 80% benchmark, not as evidence of that action's effect.	Not addressed under this definition. The only "remedy" evidence offered — China's own domestic supply-side structural reform (not defined but mention is made of “phasing out outdated production capacity” — is an industrial/administrative policy, not a trade-policy instrument affecting foreign firms' conditions of competition. No backward-looking evidence of any trade-policy remedy, by any country, reducing excess capacity is cited.