

**Written Testimony Of David Horn
Before The Congressional-Executive Commission On China
January 15, 2014**

Introduction

Chairman Brown, Chairman Smith, and Members of the Commission, I appreciate the opportunity to participate in today's hearing and to present the views of AK Steel regarding China's failure to comply with its obligations as a Member of the World Trade Organization ("WTO").

My name is David Horn. I am Executive Vice President, General Counsel, and Secretary of AK Steel Corporation. Headquartered in West Chester, Ohio, AK Steel is a leading producer of flat-rolled carbon, stainless and electrical steels, primarily for automotive, infrastructure and manufacturing, construction and electrical power generation and distribution markets. Through a wholly-owned subsidiary, the company also produces tubular steel products for truck, automotive, and other markets.

China's adherence to its WTO commitments is extremely important to AK Steel and its 6,100 employees. The WTO system is intended to encourage trade and investment, break down artificial trade barriers, and promote efficiency and increase wealth for all. China was admitted into the WTO system in 2001 based on its pledges to adhere to international rules. Upon its accession, China obtained significantly improved access to most of the world's markets, including the U.S. market. WTO membership has paid off handsomely for China. For example, China is now the world's largest exporter.

From AK Steel's perspective, China has embraced the opportunities offered by WTO membership but not the obligations. China's compliance with WTO rules is severely lacking, and AK Steel and its employees are suffering as a result. China's failure to follow the rules has hurt AK Steel in at two very concrete ways. First, the Chinese government's subsidization of its

steel industry has created a huge oversupply of steel products in the global market, which depresses steel prices in the United States and foreign markets. Second, China continues to impose antidumping and countervailing duty measures on AK Steel's exports of Grain Oriented Electrical Steel ("GOES") notwithstanding the fact that the WTO has found that these duties are not justified and never should have been imposed.

I will discuss those two issues and conclude by offering a few modest suggestions for addressing these problems.

China Subsidizes Its Steel Industry To An Unprecedented Degree

The Government of China has encouraged steel production from the earliest days of the People's Republic. During the Great Leap Forward, for example, Chairman Mao oversaw construction of millions of small, backyard furnaces to smelt iron in rural areas. The Chinese government invested billions upon billions in its efforts to build an industry capable of dominating not only the Chinese market but also the global market. There is no doubt that China has achieved its objective of global dominance in steel. Six of the ten largest steel producers in the world today are Chinese companies.¹

In 2000, the year before China's WTO accession, the country's annual crude steel production was reported to be approximately 128 million metric tons,² already the largest in the world. A U.S. government report published in 2000 noted that although China's steel industry was large, it suffered from structural problems. The report stated, however, that the Government of China was working to address these problems by fostering the development of bigger, more efficient steel companies:

¹ World Steel Association, "World Steel in Figures 2013."

² World Steel Association, "Crude Steel Production, 1980-2012."

[T]he Chinese government is undertaking a concerted effort to upgrade key producers. Government planned and supported investment projects will improve production techniques and product quality. And a government-directed consolidation of the industry will concentrate steel production around a small number of large industrial conglomerates. The Chinese government intends for these producers to enjoy the full benefits of economies of scale and diversified business operations.³

In the years that followed, government assistance flowed to China's largest steel companies, and production continued to increase. From 2000 to 2005, steel production nearly trebled.⁴ Apparently not satisfied, the Chinese government in 2005 promulgated an industrial plan entitled the *Iron and Steel Policy*.⁵ This plan continued and refined earlier policies promoting consolidation in the industry and upgrading equipment and technology. Article 16 of the policy specified that the Chinese government would support the industry directly through "taxation, interest subsidies, and scientific research funds." It also provided instructions for reorganizing existing steel producers into more efficient, larger companies and called for discriminatory treatment of foreign companies and technologies. Article 23, for example, specified that foreign investors would not be "allowed to have a controlling share" of a Chinese iron or steel company. The Chinese government made clear that it would support the growth of its steel industry and ensure that it remained Chinese.

China's 2005 steel policy had the desired effect. Chinese steel production increased to more than 535 million metric tons in 2009 – almost half of global steel production.⁶ Not content,

³ U.S. Department of Commerce, "Global Steel Trade: Structural Problems and Future Solutions" (2000).

⁴ World Steel Association, "Crude Steel Production, 1980-2012."

⁵ P.R.C. National Development and Reform Commission, "Policies for Development of Iron and Steel Industry" (July 8, 2005).

⁶ World Steel Association, "Crude Steel Production, 1980-2012."

the Chinese government issued another policy calling for additional government support for “backbone” enterprises.⁷ This new plan continued support through export rebates, grants, and loans. In 2011 China issued yet another industrial policy for the steel industry calling for additional support to “certain enterprises” to help them attain “strong competitiveness and influence in the international market.”⁸

The Chinese Government’s sustained support has created an industry bigger than either China or the world needs. In 2013 its steel industry reportedly produced 780 million metric tons of steel,⁹ more than seven times all U.S. production. Some reports have the number being even higher. The vastness of the Chinese steel industry is difficult to comprehend. Consider, for example, that after subtracting apparent consumption from production,¹⁰ the Chinese steel industry has more than 70 million tons of excess production. This volume exceeds steel production in almost all other countries. In fact, the only countries other than China producing more than 70 million tons of steel per year are Japan, the United States, and India.¹¹ China’s industry is so large that its excess production alone would qualify as the fifth largest steel-producing country in the world.

The opaqueness of China’s governmental and economic systems makes it difficult to find, let alone quantify, the subsidies that benefit Chinese industry. China did not make its first

⁷ P.R.C. State Council, “Steel Adjustment and Revitalization Plan” (Mar. 23, 2009).

⁸ P.R.C. Ministry of Industry Information and Technology, “Iron and Steel Industry 12th Five Year Plan” (Oct. 24, 2011).

⁹ “China’s Steel Output to Hit Record High in 2013 – NDRC,” *Reuters* (Aug. 2, 2013).

¹⁰ “China Steel Demand Rebounding as Nation Adds Railways, Cars,” *Bloomberg News* (Mar. 13, 2013).

¹¹ World Steel Association, “Crude Steel Production, 1980-2012.”

subsidies notification required by the WTO until 2006, five years after it joined.¹² This belated disclosure was grossly inadequate. It provided almost no information on the amount of funds paid out under identified subsidy programs and it offered no information at all about subsidies provided by provincial and municipal authorities. It failed to disclose one-off subsidies such as the government-directed gift of 51 percent of the shares in the Ercheng Iron and Steel Group to another Chinese steel producer in 2004.¹³ The recipient paid nothing for control of an enterprise with three million tons of capacity. China's WTO notification also ignored rampant debt-for-equity swaps in which State-Owned Banks forgave non-performing debt in exchange for often valueless shares.¹⁴

The information that is available indicates that the subsidies provided to Chinese steel companies are substantial. In the first U.S. countervailing duty investigation addressing a steel product from China, the U.S. Department of Commerce found in 2008 that Chinese producers of circular welded pipe were subsidized at rates ranging from approximately 30 to 45 percent *ad valorem*.¹⁵ The countervailed subsidy programs included export assistance grants, other types of grants, and the provision of hot-rolled steel to pipe producers for less than adequate remuneration.

In a 2009 decision on oil country tubular goods ("OCTG") from China, the Department of Commerce found that the producers examined were subsidized at rates ranging from

¹² See Office of the United States Trade Representative, "United States Details China and India Subsidy Programs in Submission to WTO" (Oct. 2011).

¹³ See Citigroup Global Markets, "China Steel Industry: Capacity Continues to Grow, So Does Surplus" (Feb. 21, 2006).

¹⁴ See generally Song and Liu, *The Chinese Steel Industry's Transformation* (2012).

¹⁵ *Circular Welded Carbon Quality Steel Pipe from the People's Republic of China: Final Affirmative Countervailing Duty Determination and Final Affirmative Determination of Critical Circumstances*, 73 Fed. Reg. 31966 (June 5, 2008).

approximately 10 to 16 percent *ad valorem*.¹⁶ The subsidy programs included policy loans for OCTG production; export financing; the provision of steel rounds for less than adequate remuneration; grants from various government funds; income tax breaks for companies with foreign investment and companies with high technology; tax breaks for purchasing Chinese equipment; accelerated depreciation; debt forgiveness for State-Owned Enterprises; and the provision of electricity for less than adequate remuneration.

In 2013, the European Commission completed its first subsidies investigation of a Chinese steel product. The Commission found that the manufacture of organic coated steel products in China benefited from a variety of subsidies including the provision for less than adequate remuneration of land use rights, hot rolled steel, cold rolled steel, electricity, and water; policy loans; debt for equity swaps; equity infusions; tax breaks for research and development; tax concessions for designated geographical regions; and a variety of grant program.¹⁷ As it has in many U.S. cases, the Chinese Government declined to fully participate in the investigation, forcing the Commission to base several decisions on the facts available. The Commission found countervailing duty rates ranging from 14 to 45 percent *ad valorem*.

Researchers Usha and George Haley recently published a study showing that, following WTO accession, the Chinese government has provided financing for 20 percent of the expansion of the country's manufacturing capacity, leading to "massive excess global capacity, increased exports, and depressed worldwide prices, and have hollowed out other countries' industrial

¹⁶ *Certain Oil Country Tubular Goods from the People's Republic of China: Final Affirmative Countervailing Duty Determination*, 74 Fed. Reg. 64045 (Dec. 7, 2009).

¹⁷ Council Implementing Regulation (EU) No. 215/2013 imposing a countervailing duty on imports of certain organic coated steel products originating in the People's Republic of China (Mar. 11, 2013).

bases.”¹⁸ The Haleys report that the Chinese “subsidies took the form of free or low-cost loans; artificially cheap raw materials, components, energy, and land, and support for R&D and technology acquisitions.” The Haleys calculate that the Chinese steel industry received \$27 billion in energy subsidies alone between 2000 and 2007, which allowed Chinese steel companies to sell their products for up to 25 percent less than comparable U.S. and European products.¹⁹

Toward the end of last year, AK Steel filed antidumping and countervailing duty petitions against imports of GOES and non-oriented electrical steel (“NOES”) from China. The evidence collected by AK Steel in connection with these petitions indicates that Chinese producers of electrical steel receive numerous subsidies. For example, we cited China’s *Iron and Steel Industry 12th Five-Year Plan*, which covers 2011 through 2015, and designates electrical steel as a “development priority” for China. This plan instructs Chinese government agencies to provide special treatment to “leading specialty steel enterprises” and to “strongly promote specialty steel enterprises.” The *Iron & Steel Plan* further requires that government entities “coordinate” policies to this effect, “including fiscal policy, taxation policy, finance policy, trade policy, land policy, energy saving policy, [and] environmental protection policy.” The Department of Commerce is now investigating some 30 different subsidy programs appearing to benefit the production of GOES and NOES in China.

Another Chinese government program that benefits its steel producers is currency undervaluation. Although the U.S. Department of the Treasury has not named any country a currency manipulator in two decades, and although the U.S. Department of Commerce has

¹⁸ Haley and Haley, “How Chinese Subsidies Changed the World,” *Harvard Business Review* (Apr. 25, 2013).

¹⁹ *Id.*

declined to investigate whether currency undervaluation constitutes a countervailable subsidy, the fact is that the Chinese government manipulates the value of its currency, the Yuan. Although the Yuan has been appreciating in recent years, the International Monetary Fund reported in 2013 that the Yuan remains undervalued by up to 10 percent.²⁰ This provides Chinese steel exporters with a significant price advantage when selling their products overseas. AK Steel feels this pressure every day. We feel it directly when China floods the U.S. market with dumped and subsidized Chinese steel. We feel it indirectly when China floods foreign markets with dumped and subsidized Chinese steel and the manufacturers in those markets which cannot sell their products domestically then come to the U.S. to sell their products here, flooding the U.S. market with even more excess capacity and driving prices even lower.

It is well settled in economic theory that production subsidies tend to expand output.²¹ As a result, there has been a tremendous buildup of excess production in China. Chinese producers look to export markets to sell their excess production. Estimates from the National Development and Reform Commission, China's most important industrial planning agency, indicate that in 2013 the country exported approximately 61 million tons of steel.²² This amount is greater than all of the steel produced in South Korea or Germany, which are the world's sixth and seventh largest steel producing countries, respectively.²³

China's overcapacity and overproduction are causing serious problems for producers in other countries, including AK Steel. As reported by the *Wall Street Journal* in May 2013, a

²⁰ International Monetary Fund, "2013 Pilot External Sector Report—Individual Economy Assessments" (Aug. 1, 2013).

²¹ *See generally* World Trade Organization, "World Trade Report 2006."

²² "China's Steel Output to Hit Record High in 2013 – NDRC," *Reuters* (Aug. 2, 2013).

²³ World Steel Association, "Crude Steel Production, 1980-2012."

“surge in Chinese steel production and a flood of exports are pressuring world-wide steel prices.”²⁴ A May 2013 article in the industry publication *Platts* quotes an industry observer as noting that “Overcapacity is ensuring steel mills globally have ‘zero pricing power.’”²⁵

The unprecedented degree to which the Chinese steel industry is subsidized means that Chinese companies are not playing according to same market rules and principles as U.S. steel companies like AK Steel. Large Chinese steel companies have access to virtually limitless low-cost loans from government-owned banks. They continue to expand production notwithstanding low prices, low profits, and mounting inventories.²⁶ In market economies, companies cannot rely on endless supplies of money from the government and cannot ignore market conditions and produce for the sake maintaining employment for extended periods. These market rules do not apply in China, which increases capacity year after year irrespective of market signals.²⁷

China’s mammoth steel industry also squeezes foreign competitors by driving up costs for the raw materials used to make steel. China is, for example, the world’s largest purchaser of iron ore, accounting for approximately 60 percent according to some reports. China’s insatiable demand for raw materials has driven up global prices for raw materials while its overcapacity and overproduction have driven down prices for finished products. The result is that, for many

²⁴ “Surging Chinese Steel Exports Put Pressure on World Prices,” *The Wall Street Journal* (May 16, 2013).

²⁵ Forster, “Steel Prices, Raw Material Costs Out Of Sync,” *Platts* (May 2013).

²⁶ A state-owned news agency reported in 2013 that data from the China Iron and Steel Association indicated that the profit rate at China’s steel companies in the first half of 2013 was only 0.13 percent. “Overcapacity sends China steel sector into Loss,” *Xinhua* (July 31, 2013).

²⁷ In the years since China’s WTO accession, data from the World Steel Association show that China’s steel production has increased fourfold, whereas production in the United States has been steadily declining.

products, the margins are either small or non-existent. This is not sustainable for market economy steel companies which must earn a profit to survive.

This is the reality in which AK Steel exists: The Chinese Government has heavily subsidized its industry in order to dominate the world steel market. These subsidies are inconsistent with China's WTO obligations and detrimental to the world trading system.

The WTO Ruled That China Violated Its WTO Obligations By Imposing Antidumping and Countervailing Duties Against GOES From The United States

AK Steel has also been harmed by China's use of trade remedies as a sword instead of a shield. In the 2013 National Trade Estimate, the Office of the United States Trade Representative ("USTR") reported that:

The United States and other WTO members have also expressed serious concerns about China's evolving practice of launching antidumping and countervailing duty investigations that appear designed to discourage the United States or other trading partners from the legitimate exercise of their rights under WTO antidumping and countervailing duty rules and the trade remedy provisions of China's accession protocol. This type of retaliatory conduct is not typical of WTO members, and it may have its roots in China's Foreign Trade Law and antidumping and countervailing duty implementing regulations, which authorize "corresponding countermeasures" when China believes that a trading partner has discriminatorily imposed antidumping or countervailing duties against imports from China. Further, when China has pursued investigations under these circumstances, it appears that its regulatory authorities imposed duties regardless of the strength of the underlying legal and factual support.²⁸

AK Steel has first-hand experience with the punitive and arbitrary nature of China's trade apparatus. China initiated antidumping and countervailing duty investigations of GOES from the United States in June 2009. Many of the subsidy programs China investigated had no basis in

²⁸ Office of the United States Trade Representative, "2013 National Trade Estimate Report on Foreign Trade Barriers."

reality, and the authority made multiple demands for substantial volumes of confidential and irrelevant information, in an apparent effort to make participating impossible.

In April, 2010 China issued its final determination. China found that imports of GOES from the United States had been dumped at prices below normal value and subsidized by the U.S. Government. China also found that low-priced imports had injured the domestic industry and that additional import duties were justified as a result. China imposed antidumping duties of 7.8 percent and countervailing duties of 11.7 percent on GOES manufactured by AK Steel. Virtually the entire countervailing duty rate was based on adverse assumptions that AK Steel sold all of its production – not just GOES, but all of its products – to the U.S. Government at a premium under the “Buy America” Act. There was, of course, no evidence supporting this assumption, because it was clearly false.

With a combined duty rate of nearly 20 percent, AK Steel was shut out of the Chinese GOES market. The other U.S. producer of GOES, ATI, faced an even higher combined duty of more than 30 percent. Prior to the start of the investigation, U.S. GOES exports to China totaled more than \$270 million annually. Today the value is nearly zero.

AK Steel was pleased when USTR filed a WTO complaint against China in September 2010, challenging many procedural and substantive flaws in China’s investigation and findings. In June 2012, a WTO dispute settlement panel ruled in favor of the United States. It found that China violated its WTO obligations in numerous respects by imposing duties on imports of GOES from the United States. For example, the Panel found that

- China failed to require the Chinese petitioners to provide adequate public summaries of the confidential portions of their petition and thus impaired the ability of foreign respondents, including AK Steel, to defend their interests.
- China’s finding that its domestic producers suffered adverse price effects failed to reflect an objective examination of the evidence and was not based on positive evidence. For example,

China found that the “low prices” of imports forced down the Chinese producers’ prices, when, in fact, imports were priced higher than the Chinese producers’ prices.

- China’s finding that imports from the United States were a cause of injury to the domestic industry failed to reflect an objective examination of the evidence and was not based on positive evidence. For example, China ignored the fact that the huge increase in capacity resulting from a new Chinese production facility created an oversupply of GOES in the Chinese market, which caused the two Chinese producers to aggressively compete on price and to lead market prices down. Imports had nothing to do with this race to the bottom by the Chinese producers.
- China failed to disclose the “essential facts” on which certain of its key findings were based.
- China’s assumption that all of AK Steel’s sales benefited from overpayments under the “Buy America” program had no factual basis. The WTO Panel stated that on this issue China’s “determination is particularly flawed in its treatment of AK Steel.”²⁹

China appealed certain aspects of the WTO panel’s findings, but China’s claims were rejected by the WTO Appellate Body in October 2012.³⁰

Under the relevant WTO Agreements, antidumping and countervailing duties cannot be imposed without valid findings that dumped and/or subsidized imports caused material injury to a domestic industry producing a similar product. The WTO Panel and the Appellate Body ruled that China’s findings did not meet this standard. In particular, the WTO found China failed to make a WTO-consistent finding that imports either (1) had adverse price effects on Chinese producers or (2) were a cause of material injury to the Chinese industry. As a result, no duties should ever have been imposed.

China Has Refused To Comply With The WTO Rulings

Antidumping and countervailing duties have remained in place for over 18 months since the WTO panel found them to be inconsistent with China’s international obligations – and for

²⁹ *Panel Report, China — Countervailing and Anti-Dumping Duties on Grain Oriented Flat-rolled Electrical Steel from the United States*, WT/DS414/R (circulated June 15, 2012).

³⁰ *Appellate Body Report, China — Countervailing and Anti-Dumping Duties on Grain Oriented Flat-rolled Electrical Steel from the United States*, WT/DS414/AB/R (adopted Oct. 18, 2012).

nearly four years since the duties were improperly imposed. Following the USTR's victory before both the WTO Panel and Appellate Body, China would not agree to a reasonable timeline for coming into compliance with the WTO rulings. The United States had to request a WTO arbitrator to determine a reasonable period of time for China to comply.³¹

After the arbitrator rejected China's pleas for more time to comply, on July 31, 2013, China issued a revised final determination lowering the punitive subsidy rate of approximately 12 percent for AK Steel in the original decision to 3.4 percent. China did not, however, remedy the serious flaws in its injury and causation findings that the WTO had identified, and it continued to find that imports from the United States were a cause of material injury to its domestic industry. Thus, China has kept the duties in place notwithstanding the WTO's rulings. China's revised determination attempting to comply with the WTO's findings retains almost all of the errors in the original one. Because of China's intransigence, USTR will next need to present evidence and argument to explain why a WTO compliance panel should rule that China has failed to comply with the WTO's earlier findings. The United States will then need to request a WTO arbitrator to determine the amount of retaliation that the United States is authorized to apply in terms of higher tariffs on imports of China.

Observations And Conclusions

Based on AK Steel's experience, China is not complying with its WTO commitments. From our perspective, the Chinese Government appears to have become very skilled in taking advantage of the benefits of WTO membership without accepting the corresponding obligations.

When the United States and other Members accepted China into the WTO, they did so with expectations that China would comply with its WTO commitments to eliminate subsidies,

³¹ See Arbitration Report, *Countervailing and Anti-dumping Duties on Grain Oriented Flat-Rolled Electrical Steel from the United States* - Arb-2013-1/27.

move from a state-controlled economy to a market economy, and adhere to WTO rules in trade remedy proceedings. Instead, subsidization and state capitalism remain not only alive and well in China but appear to be expanding. The GOES case demonstrates that China will ignore its international obligations when applying duties to protect the industries it has chosen to support with vast subsidies.

AK Steel's experience also shows that the WTO dispute settlement system operates too slowly to provide effective relief, especially where the losing party does everything it can to thwart and prolong the process, as China is doing on GOES. In the GOES case, the panel ruled against China in June 2012, and the Appellate Body affirmed that ruling in October 2012. More than one year has passed, yet the duties remain in place. The United States will need to prevail in several additional time-consuming proceedings in order for AK Steel to regain the market access that has been unjustifiably taken away by the Chinese government.

What Should Be Done

AK Steel appreciates the support it has received from the U.S. government in challenging China's flawed antidumping and countervailing duty measures in the GOES case. We would respectfully suggest, however, that more should be done.

USTR should aggressively pursue WTO complaints against China's failure to follow the WTO rules in applying antidumping and countervailing duties against U.S. exports. China has now lost several such cases in a row, including several challenges by USTR and one by the European Commission. The United States should encourage other WTO Members adversely affected by China's trade remedy investigations to do the same. As China loses more and more WTO cases, it is more likely that the Chinese government will bring its practices into WTO compliance.

In order to allow USTR to do more, Congress should appropriate more funds to USTR's WTO dispute settlement function. USTR needs more resources to bring more WTO complaints against China and to do so more quickly. AK Steel fears that those charged with protecting America's trade rights are being outgunned. The Chinese Government hires private lawyers to litigate their WTO cases, many of whom are located here in Washington, DC. These outside lawyers become members of China's official WTO delegation, participate in the dispute, and speak for the Government of China before WTO panels and the Appellate Body. USTR, on the other hand, does not hire outside trade lawyers and does not allow private industry's trade lawyers to observe, much less participate in, the WTO hearings. Thus, USTR must largely rely on its own resources.

Although I know from personal experience that USTR has talented and effective lawyers, I understand that most of its WTO litigators split their time among various responsibilities, including negotiating trade agreements. It would seem to me that if USTR had more lawyers dedicated to WTO disputes, it could launch more cases and litigate them more expeditiously and aggressively.

Finally, Congress should enact The Currency Exchange Rate Oversight Reform Act of 2013, introduced by Senators Brown, Sessions, Schumer, Burr, Stabenow, and Collins, which would have the effect of applying the countervailing duty law to currency manipulation. Alternatively, Congress should attach provisions applying the countervailing duty law to currency manipulation to any Trade Promotion Authority bill passed by the Congress.

Again, I thank you for this opportunity to testify.