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May 10, 2017

Ronald K. Lorentzen
Acting Assistant Secretary
for Enforcement and Compliance
International Trade Administration
U.S. Department of Commerce
1401 Constitution Ave NW
Washington, D.C. 20230

RE: Inquiry Into the Status of the People's Republic of China as a Nonmarket
Economy Country Under the Antidumping and Countervailing Duty Laws,
ITA-2017-0002

Dear Mr. Lorentzen:

In response to a request from the Department of Commerce,¹ the American Iron and Steel Institute (AISI), on behalf of its U.S. producer members, is pleased to submit the following comments regarding China's non-market economy status.

AISI believes that a review of the six factors set forth in section 771(18)(B) of the Tariff Act of 1930² establishes conclusively that China today is properly classified as a nonmarket economy country. These factors are:

- (i) The extent to which the currency of the foreign country is convertible into the currency of the other countries;
- (ii) The extent to which wage rates in the foreign country are determined by the free bargaining between labor and management;
- (iii) The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country;
- (iv) The extent of government ownership or control of the means of production;
- (v) The extent of government control over allocation of resources and over price and output decisions of enterprises; and
- (vi) Such other factors as the administering authority considers appropriate.

¹ See Notice of initiation and request for public comment and information, 82, Fed. Reg. 06535 (Dept. of Commerce March 29, 2017).

² 19 U.S.C. § 1677(18)(B).

As detailed further below, each of these factors as it applies to China demonstrates that China remains very much a state-directed, nonmarket economy country.

Introduction

While China's leaders who negotiated its entry into the World Trade Organization (WTO) appeared to recognize that market forces needed to be given a more significant role in its economy, new leadership that took office in 2003 began moving in the opposite direction. As the Office of the U.S. Trade Representative (USTR) has noted in its annual reports to Congress, "the Chinese government increasingly emphasized the state's role in the economy, diverging from the path of economic reform that had driven China's accession to the WTO."³ Indeed, as one economist noted: "The increasing non-marketization of China's economy was so universally obvious that native Chinese speakers developed a token expression: *guo jin min tui*, which means, 'the state advances while the private sector retreats.'"⁴

More recently there have been renewed calls in China for economic reform, such as the Third Plenum's call for the market to play a "decisive role" in the allocation of resources in the Chinese economy. But these promises have not yet been realized. "The pronouncements of the Third Plenum have faced strong resistance from entrenched interests, and significant economic reform has yet to be realized."⁵ Furthermore, as has been detailed in significant research by the Center for American Progress (CAP), despite the reforms announced at the Third Plenum and since then, China's economy still operates with very broad state and Communist Party involvement in the ownership and financing of key economic entities in China, and the state retains fundamental authority over key economic decisions and prices.⁶ "Rather than establishing a 'decisive role for the market,' the Third Plenum decision has simply put a new gloss on what

³ United States Trade Representative, 2016 Report to Congress on China's WTO Compliance (January 2017) at 3, *available at* <https://ustr.gov/sites/default/files/2016-China-Report-to-Congress.pdf>.

⁴ Adam Hersh, "Assessing China's Economic Reform Agenda," Center for American Progress (May 1, 2014), *available at* <https://www.americanprogress.org/issues/economy/reports/2014/05/01/88864/assessing-chinas-economic-reform-agenda/>.

⁵ USTR 2016 Report to Congress on China's WTO Compliance at 4.

⁶ Hersh, Assessing China's Economic Reform Agenda (May 1, 2014); China's Path to Financial Reform (October 8, 2014) *available at* <https://www.americanprogress.org/issues/economy/reports/2014/10/08/98477/chinas-path-to-financial-reform/>; China's State-Owned Enterprises and Nonmarket Economics *available at* <https://www.americanprogress.org/issues/security/reports/2014/03/05/85372/chinas-state-owned-enterprises-and-nonmarket-economics/>.

remains fundamentally a nonmarket economic system dominated by the party and the state.”⁷

Analysis of Statutory Factors

AISI’s analysis of each of the statutory factors as they apply to China is set forth below.

1. The extent to which the currency of the foreign country is convertible into the currency of the other countries

There is general consensus that while China’s currency is convertible for trade transactions, its convertibility remains limited for other purposes, such as financial transactions.⁸ Indeed, in some respects, China’s currency regime has moved away from full convertibility in recent years. Chinese officials have been tightening regulations to restrict capital outflows, for example in the Renminbi Qualified Domestic Institutional Investor (RQDII) investment program, which was established in late 2014 to permit domestic Chinese institutional investors to buy RMB-denominated assets in the offshore market.⁹ The expectation of observers is that the Chinese authorities are likely to continue to tighten capital controls, especially on local residents, until capital outflows are brought under control.¹⁰

- “For now, given the recent market volatility, the consensus is that full convertibility of the yuan is not on the agenda. ‘Stability is more important.’”¹¹
- “Firms are already complaining that it has become harder to move money in and out of the country for normal trade purposes. The micro-management of foreign exchange transactions is analogous to government actions to prevent firms from closing, discussed above; it throws sand in the wheels of normal commerce.”¹²

⁷ Hersh, Assessing China’s Economic Reform Agenda at 16.

⁸ Charles Wolf Jr., China’s Yuan as a Reserve Currency, *Weekly Standard* (June 13, 2016) available at <http://www.weeklystandard.com/chinas-yuan-as-a-reserve-currency/article/2002668>; Adam S. Hersh, Testimony before the U.S.-China Economic and Security Review Commission on China’s Shifting Economic Realities and Implications for the United States, (February 24, 2016), available at https://www.uscc.gov/sites/default/files/Panel%20IV_Hersh%20statement_022416.pdf.

⁹ China’s Currency Test: Can It Get Capital Controls Right? (February 17, 2016) at 6, available at <http://knowledge.wharton.upenn.edu/article/chinas-currency-test-can-it-get-capital-controls-right/>.

¹⁰ *Id.*

¹¹ *Id.* at 7.

¹² David Dollar, China is struggling to keep its currency high, not low, Order from Chaos, Brookings Institution (Jan. 26, 2017) available at <https://www.brookings.edu/blog/order-from-chaos/2017/01/26/china-is-struggling-to-keep-its-currency-high-not-low/>.

The International Monetary Fund (IMF) currently characterizes China's exchange rate policy currently as an "other managed arrangement."¹³

Starting in 2004, China began the process of internationalizing the Renminbi and it is now the fifth-most used currency worldwide, though it is only used for around 2.5 percent of global payments.¹⁴ These steps were recognized by the international community, highlighted by the IMF's recent announcement that the currency would join the U.S. dollar, Euro, Yen and British Pound in the Special Drawing Rights (SDR) basket, an international reserve asset created to supplement member countries' official reserves.¹⁵ Private parties do not hold these reserve assets; they are only used by IMF member countries, the IMF itself, and a select group of organizations licensed to do so by the IMF.¹⁶ As a result, the implications of the Renminbi being in the SDR basket are limited, primarily to a status and a source of pride.¹⁷

While China loosened restrictions on convertibility for trade and is now in the SDR basket, restrictions for financial transactions remain. Earlier this year, amidst a weakening economy and an outflow of Renminbi, China announced a new policy that forces customers to sign a pledge that they will not purchase foreign currency for property, securities or life insurance. Customers also must track and provide a detailed account of their use of foreign currencies.¹⁸

In addition to restrictions on convertibility for financial transactions, the Renminbi is still managed by the central bank, which buys and sells U.S. dollars and Renminbi. Zhou Xiaochuan, the People's Bank of China (PBOC) Governor, describes China's

¹³ International Monetary Fund, Annual Report on Exchange Arrangements and Exchange Restrictions 2016 at 4.

¹⁴ Sean Miner, Renminbi Series Part 1: A Primer on China's Currency, Peterson Institute for International Economics, (September 2016) available at <https://piie.com/blogs/china-economic-watch/renminbi-series-part-1-primer-chinas-currency>.

¹⁵ International Monetary Fund press statement, IMF Adds Chinese Renminbi to Special Drawing Rights Basket (September 30, 2016) available at <http://www.imf.org/en/News/Articles/2016/09/29/AM16-NA093016IMF-Adds-Chinese-Renminbi-to-Special-Drawing-Rights-Basket>.

¹⁶ International Monetary Fund, Making the Global Economy Work For All (2000) available at <https://books.google.com/books?id=JTnJIFlvwfkC&lpg=PP1&dq=international%20monetary%20fund%20annual%20report&pg=PA74#v=onepage&q&f=false>.

¹⁷ Tim Worstall, IMF's Addition Of China's Renminbi To SDR Basket Won't Make Much Difference, Forbes, (November 14, 2015) available at <https://www.forbes.com/sites/timworstall/2015/11/14/imfs-addition-of-chinas-renminbi-to-sdr-basket-wont-make-much-difference/#4f2e3a325185>.

¹⁸ Bloomberg News, China Gets Strict on Forex Transactions to Stop Money Exiting Abroad (January 3, 2017) available at <https://www.bloomberg.com/news/articles/2017-01-03/china-drills-down-into-forex-transactions-as-money-exits-abroad>.

exchange rate policy as “a managed floating exchange rate regime”¹⁹ and acknowledged that the Chinese government’s “aim is to have the exchange rate ‘broadly stable at an adaptive and equilibrium level.’”²⁰ Exchange rates for freely-traded currencies are not stable; exchange rates for managed currencies are. A managed, stable currency as a result of government interventions is an advantage for Chinese companies, and one that is not enjoyed by American companies.

In the April 2017 Semi-annual Report on Foreign Exchange Policies, the U.S. Treasury Department stated: “Market participants remain highly sensitive to signals from the Chinese authorities on the exchange rate, highlighting the importance of clear communication of policy actions and greater transparency. China should make further efforts to clarify its exchange rate and reserve management operations and goals, and continue to underscore that devaluation will not be used to support domestic growth.” Treasury added: “China continues to pursue a wide array of policies that limit market access for imported goods and services, and maintains a restrictive investment regime which adversely affects foreign investors.”²¹

Market participants remain highly sensitive to signals from Chinese authorities on exchange rates in large part because between 2003 and 2014, China bought more than \$300 billion per year to maintain an artificially weak Renminbi – an unprecedented effort to manage the currency’s value. At the height of its interventions, it is estimated the Renminbi was almost 40 percent weaker than it should have been,²² resulting in a nearly 40 percent subsidy offered to Chinese exporters that fueled annual double-digit growth for China’s economy at the expense of American companies and workers, as well as other trading partners’ economies. Estimates vary, but economists believe China’s currency manipulation led to the loss of several million American jobs.²³

¹⁹ “Transcript of Governor Zhou Xiaochuan’s Exclusive Interview with Caixin Weekly,” February 14, 2016, available at <http://www.pbc.gov.cn/english/130721/3017134/index.html>.

²⁰ *Id.*

²¹ U.S. Department of the Treasury Office of International Affairs, Report to Congress: Foreign Exchange Policies of Major Trading Partners of the United States (April 14, 2017) available at <https://www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/2017-04-14-Spring-2017-FX-Report-FINAL.PDF>.

²² Fred Bergsten, China Is No Longer Manipulating Its Currency, Peterson Institute for International Economics, (November 18, 2016) available at <https://piie.com/blogs/trade-investment-policy-watch/china-no-longer-manipulating-its-currency>.

²³ Bergsten, Currency Manipulation: Why Something Must Be Done, Forbes, (February 25, 2015) available at <https://www.forbes.com/sites/realspin/2015/02/25/currency-manipulation-why-something-must-be-done/#16b0cea97762>.

2. The extent to which wage rates in the foreign country are determined by the free bargaining between labor and management

While wage negotiations do take place in China, various restrictions on labor rights and mobility prevent wage rates in China from being determined by free bargaining between labor and management. Instead, the state continues to play a large role in determining wages.

Those workers that are members of a union must join one under the umbrella of the state-run union federation, the All-China Federation of Trade Unions (ACFTU). Top jobs within the ACFTU are ministerial-level positions within the Chinese government and are not chosen by labor. Chinese workers do not have the right to establish truly independent labor unions; nor do they have the ability to elect their own representatives at the local factory level. This process is controlled by company management in both state-owned enterprises and foreign-invested enterprises.²⁴

Since the state's interests and business's interests are often aligned, labor's bargaining power is minimized. Additionally, there are prohibitions on collective bargaining and China does not recognize basic International Labor Organization rights. As a result, many workers' rights that are agreed to are not enforced. Examples include employers withholding overtime pay and falsifying retirement and health care savings contributions.²⁵

In the 2016 Report to Congress on China's WTO Compliance, the USTR stated: "China does not effectively enforce its labor laws and regulations concerning issues such as minimum wages, hours of work, occupational safety and health, bans on child labor, forced prison labor, and participation in social insurance programs. Many foreign-invested enterprises have expressed concerns about their domestic competitors' lack of compliance with labor and social welfare laws due to lax enforcement... China does not adhere to certain internationally recognized labor standards, including the freedom of association and the right to bargain collectively."²⁶

Additionally, China's Hukou system also plays an important factor in limiting the influence of market forces on wages by restricting labor mobility and effectively

²⁴ Hersh, Testimony before the U.S.-China Economic and Security Review Commission on China's Shifting Economic Realities and Implications for the United States at 18 (February 24, 2016), *available at* https://www.uscc.gov/sites/default/files/Panel%20IV_Hersh%20statement_022416.pdf.

²⁵ *Id.*

²⁶ USTR 2016 Report to Congress on China's WTO Compliance at 174. .

discriminating against labor originating in rural areas.²⁷ The Hukou system, created in the 1950s, ties access to services such as grain rations, education, employer-provided housing or healthcare to workers' residential status – either rural or urban. Workers generally prefer to live in areas designated as urban, since the benefits are better there, however quotas limit migration. The system has fueled growth in certain cities and limited population decline in other parts of the country.²⁸

In the summer of 2014, China began to ease restrictions on migration to urban-designated areas as a part of Hukou reforms to be implemented by 2020. But experts have warned that the reforms announced do not provide for comprehensive reform and will have only a limited impact, in part because the reforms include exemptions for major cities and key provisions are not enforceable by the central government.²⁹ While there are more opportunities in urban areas, migrants from rural areas, especially women, are seen as replaceable and tend to make less money than those who are not migrants. On average, male migrants earn 26 percent higher wages than female migrants.³⁰

In addition, different cities continue to have different standards for Hukous, and inequalities created by the system have prevented migrants from receiving the same access to services. Currently there are 277 million migrant workers who live in cities but do not receive the same benefits as those who live in urban areas with a Hukou.³¹

²⁷ Markus Taube and Christian Schmindkonz, Assessment of the normative and policy framework governing the Chinese economy and its impact on international competition, Executive Summary at 8 (June 25, 2015) *available at* https://static1.squarespace.com/static/5537b2fbe4b0e49a1e30c01c/t/558ba6f7e4b006eedbcf7074/1435215607844/MES+China+Study_Taube_Executive+summary-25June15_F.pdf.

²⁸ Sara Hsu, China's Urbanization Plans Need To Move Faster In 2017, *Forbes*, (Dec 28, 2016) *available at* <https://www.forbes.com/sites/sarahsu/2016/12/28/chinas-urbanization-plans-need-to-move-faster-in-2017/#18e50da474db>.

²⁹ Tania Branigan, China reforms hukou system to improve migrant workers' rights, *The Guardian*, (July 31, 2014) *available at* <https://www.theguardian.com/world/2014/jul/31/china-reform-hukou-migrant-workers>.

³⁰ James J. Brown, Sabu S. Padmadas, Bohua Li, Jianan Qi and Jane Falkingham and Min Qin, Gender inequalities in employment and wage-earning among internal labour migrants in Chinese cities, *Demographic Research* Volume 34 Article 6, , (January 22, 2016) *available at* <https://www.demographic-research.org/volumes/vol34/6/34-6.pdf>.

³¹ Spencer Sheehan, China's Hukou Reforms and the Urbanization Challenge, *The Diplomat*, , (February 22, 2017) *available at* <http://thediplomat.com/2017/02/chinas-hukou-reforms-and-the-urbanization-challenge/>.

3. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country

The Chinese government continues to play a very active role in regulating foreign investment to serve the state's goals. Since 1995, a positive list has set out the areas of the economy in which investment is encouraged, restricted, or prohibited for non-state and foreign investors has governed China's investment regime. The list details which industries are to be protected as strategic industries, those needing to develop their technological and manufacturing capabilities, and those industries where Chinese policymakers see little risk of upsetting state economic control.³² Despite a series of reforms and liberalization announcements, a significant number of industries and sectors remain closed off to foreign investment as the Chinese government seeks to protect the market position of domestic companies, in particular state-owned enterprises (SOEs).³³

As it relates to the steel industry, a foreign investment project must be approved by the Ministry of Commerce (MOC), the National Development and Reform Commission (NDRC), the State Owned Assets Supervision and Administration Commission (SASAC) (if it involves state-owned assets), and/or the China Securities Regulatory Commission (CSRC) (if it involves a PRC-listed company), and must be registered with other relevant authorities. Until 2015, steel was on the list of "restricted" foreign investment industries. While controlling investments in Chinese steel enterprises are no longer expressly prohibited by law, in practice, authorities may exercise their discretion to reject or withhold their approval of any foreign investment application. To date, AISI is unaware of any foreign attempts to acquire a controlling stake in a Chinese steel enterprise since the 2015 change in policy. While the announced change was a welcome step towards liberalizing the Chinese steel market, barriers to such investments appear to remain in place as a practical matter.³⁴

While the Third Plenum called for moving to a negative list that would only specify those areas where investment was not allowed, the limited pilot programs for this approach established in free trade zones in Shanghai, Tianjin, Fujian and Guangdong³⁵

³² Hersh, Assessing China's Economic Reform Agenda at 10; China's Path to Financial Reform at 13.

³³ Taube and Schmindkonz, Assessment of the normative and policy framework governing the Chinese economy and its impact on international competition, Executive Summary at 12.

³⁴ See AISI Comments to USTR Regarding Foreign Trade Barriers To U.S. Exports for 2017 Reporting, Docket No. USTR-2016-0007, at 23-25, available at <http://www.steel.org/~media/Files/AISI/Public%20Policy/Letters/AISI%202016%20NTE%20Comments%20-%20Final.pdf?la=en>

³⁵ China tests 'negative list' approach in four region, Xinhua (April 9, 2016) available at http://news.xinhuanet.com/english/2016-04/08/c_135262307.htm

have only created a “mirror image” of the previous positive list, resulting in no real change in how China regulates joint ventures and other foreign investment.³⁶

For sectors where foreign investment is allowed, joint ventures are permitted, and frequently are required for foreign businesses to enter the China market.³⁷ The inflows of foreign investments as well as technology transfer have helped the Chinese economy to grow and develop, but often at the expense of foreign market-oriented competitors.

China has used these policies to develop state-owned companies that rival other global companies. According to the United Nations Conference of Trade and Development, some sectors are closed to foreign investment, while China allows other joint ventures but with restrictions. A 2015 U.S. State Department report stated: “foreign investors often temper their optimism regarding potential investment returns with uncertainty about China's willingness to offer a level playing field vis-à-vis domestic competitors. In addition, foreign investors report a range of challenges related to China's current investment climate. These include industrial policies that protect and promote state-owned and other domestic firms, equity caps and other restrictions on foreign ownership in many industries, weak IPR rights protection, a lack of transparency, corruption, and an unreliable legal system.”³⁸

For example, foreign automobile manufacturers that want to access the China market, which in some years has been the biggest auto market in the world, are forced into joint ventures with Chinese automakers, with the foreign automaker's share capped at 50 percent.³⁹ Technology transfers are expected in exchange for market access, though frequently foreign automakers guard their most valuable technologies.⁴⁰

Given all of the restrictions, it is not surprising that the OECD FDI Regulatory Restrictiveness Index - which measures restrictions on foreign direct investment in 62

³⁶ Hersch, Testimony before the U.S.-China Economic and Security Review Commission on China's Shifting Economic Realities and Implications for the United States at 16.

³⁷ *Id.* at 15.

³⁸ State Department, China Investment Climate Statement (2015) *available at* <https://www.state.gov/documents/organization/241728.pdf>.

³⁹ China Carmakers May Be 'Destroyed' If Foreign Venture Cap Lifted, Bloomberg News, (April 19, 2017) *available at* <https://www.bloomberg.com/politics/articles/2017-04-18/china-carmakers-may-be-destroyed-if-foreign-venture-cap-lifted>.

⁴⁰ China's Auto Industry Explained, Hogan-Lovells, (January / February 2015) *available at* <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0ahUKFwjthq2kzsXTAhWBcSYKHUTWC7sQFggUAI&url=https%3A%2F%2Fwww.hoganlovells.com%2F~%2Fmedia%2Fhogan-lovells%2Fpdf%2Fpublication%2F1501clp-china-auto-industry-explainedmichael-chinyitong-wang-and-hong-xin.pdf&usq=AFQjCNF1N8GqB3jRcjq4gZSgXZrn75Jdvw&sig2=BG9J9Wq0hcRDVm-e6O-guw>.

countries, including all OECD and G20 countries – ranks China the most restrictive country for foreign direct investment.⁴¹ In its latest report to Congress, USTR noted: “All of these regulatory requirements appeared to be inconsistent with commitments that China made in its WTO accession agreement. Specifically, China agreed not to tie investment approvals to the transfer of technology, the conduct of research or the use of local content, and China also agreed to eliminate all restrictions on the types of cars foreign enterprises could produce or sell in China.”⁴²

In 2008, following encouragement and pressure from foreign governments and accession into the WTO, China implemented its anti-monopoly law (AML). But the AML gives limited confidence to many foreign companies investing in China, in part because Article 1 of the law states that the law’s purpose is to “promote the healthy development of the socialist market economy.”

Complaints about regulators targeting foreign companies and using heavy-handed tactics under AML are common. “There is a concern about procedure, about how the AML has been administered,” said Martyn Huckerby, partner at the Shanghai-based law firm, King & Wood Mallesons. “Even if you’ve done the wrong thing, has China gone about investigating the case in a fair manner? Have they carried out due process when they’ve investigated companies?”

Natalie Yeung, partner at the Hong-Kong-based law firm Slaughter and May, has similar criticisms of China’s implementation of AML: “In China, it’s pretty much the case they can do what they want. One of my clients had the experience of being forced to sign something that wasn’t true.”⁴³

As a result of investment restrictions and unpredictable targeting by the state, many companies now feel less welcome in China than before. In a 2016 survey by the American Chamber of Commerce in China, 77 percent of companies said they felt less welcome in China than the prior year. At the time, then-Treasury Secretary Jack Lew said: “Concerns about the business climate have grown in recent years with foreign business confronting a more complex regulatory environment and questioning how welcome they are.”⁴⁴

⁴¹ OECD FDI Regulatory Restrictiveness Index, *available at* <http://www.oecd.org/investment/fdiindex.htm>

⁴² USTR 2016 Report to Congress on China’s WTO Compliance at 107.

⁴³ Colin Shek, Understanding China’s Anti-Monopoly Law, Cheung Kong Graduate School of Business, (June 29, 2015) *available at* <http://knowledge.ckgsb.edu.cn/2015/06/29/policy-and-law/understanding-chinas-anti-monopoly-law/>.

⁴⁴ Jethro Mullen, Western businesses say China is 'increasingly hostile', CNN, (June 7, 2016) *available at* <http://money.cnn.com/2016/06/07/news/economy/china-western-companies-business-environment/>

4. The extent of government ownership or control of the means of production

China's government plays a large role in the means of production. This role is written into its constitution. Article 7 of the Constitution of the People's Republic of China states: "The State-owned economy, namely, the socialist economy under ownership by the whole people, is the leading force in the national economy. The State ensures the consolidation and growth of the State-owned economy."

Two recent studies found that SOEs account for approximately 50 percent of China's GDP and that the state owns many of the largest companies, including the largest 12 by market capitalization. SOEs dominate numerous sectors, including: petroleum, mining, telecommunications, utilities, transportation, steel and automotive.⁴⁵ As it relates to the steel industry, the Chinese government has ownership interests in nine of the ten largest steel producers in China.⁴⁶ A study prepared for the U.S. China Economic and Security Review Commission in 2011 showed that after years of limited efforts to open its economy to private enterprise, the Chinese government reversed its policy in the mid-2000s and begun reasserting its economic control, particularly in certain "strategic" and "heavyweight" industries that include the iron and steel industry.⁴⁷

When China joined the WTO in 2001, it committed that it "would not influence, directly or indirectly, commercial decisions on the part of state-owned enterprises."⁴⁸ But despite this commitment, China continues to both directly and indirectly influence decisions on the part of SOEs.

Subsidies and other market-distorting policies make it very difficult to compete with Chinese SOEs. While it is possible to enter the market, corruption is frequently required. It is common for private firms to bribe party-state officials to obtain government contracts and other favors from the state.⁴⁹

⁴⁵ Written Statement of Alan H. Price Before the U.S.-China Economic and Security Review Commission at 2 (February 24, 2016) *available at*

https://www.uscc.gov/sites/default/files/Panel%204_Price%20statement_022416.pdf.

⁴⁶ Alan H. Price, Christopher B. Weld, Laura El-Sabaawi and Adam M. Teslik, *Unsustainable: Government Intervention and Overcapacity in the Global Steel Industry* at 13-14 (April 2016) *available at* http://www.wileyrein.com/media/publication/204_Unsustainable-Government-Intervention-and-Overcapacity-in-the-Global-Steel-Industry-April-2016.pdf.

⁴⁷ USCC Report, 2011 Annual Report to Congress (Aug. 2011) ("2011 USCC Report") at 48.

⁴⁸ World Trade Organization, Report Of The Working Party On the Accession Of China (October 1, 2001) *available at* https://www.wto.org/english/thewto_e/acc_e/cbt_course_e/c5s2p3_e.htm.

⁴⁹ Curtis J. Milhaupt and Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, Columbia Law School, (2015) *available at* <http://www.law.columbia.edu/node/5344/beyond-ownership-state-capitalism-and-chinese-firm-curtis-j-milhaupt-and-wentong-zheng>.

Regarding China's support for its domestic steel and aluminum industries, USTR has said: "Chinese government actions and financial support in manufacturing industries like steel and aluminum have contributed to massive excess capacity in China, with the resulting over-production distorting global markets and hurting U.S. producers and workers in both the United States and third country markets such as Canada and Mexico, where U.S. exports compete with Chinese exports."⁵⁰

This excess capacity has led to China's steel industry flooding the market with steel sold at 20-50 percent cheaper than any other country's steel. Numerous foreign steel companies across the world, including in the United States, have shut down mills and laid-off employees as a result.⁵¹

SOEs and companies preferred by the state also receive generous land use subsidies. There is no private ownership of land in China – it is all owned by the state. Businesses ask for land-use rights and the government determines how the land is used, putting the government in the position to provide cheap or free land to preferred companies and industries. Companies preferred by the state often pay artificially low rent or receive compensation for land use or relocation funds.⁵²

In recent years, Chinese SOEs have taken on more of the trappings of modern global business entities, often including publicly traded shares and corporate boards with ostensibly independent external directors. These new structures have allowed them to obscure the extent of state ownership and the degree of preferential treatment received from the state. But in practice these firms continue to operate very differently than comparable firms in the United States or other advanced economies.⁵³ As explained in a recent report by the Center for American Progress:

Shareholders do not select the top managers and members of boards of directors of China's major and minor corporations; this duty falls to the Communist Party and its working groups established within most state-owned and many privately owned firms. Senior managers and directors often hold positions of power simultaneously in government institutions, within the party, and on boards of related enterprises. Senior managers of

⁵⁰ USTR 2016 Report to Congress on China's WTO Compliance at 13.

⁵¹ Peter Pham, China's Steel Industry is Dominating the Global Market -- But Will it Last?, *Forbes*, (Apr 27, 2016), available at <https://www.forbes.com/sites/peterpham/2016/04/27/chinas-steel-industry-is-dominating-the-global-market-but-will-it-last/#1d280e14497f>.

⁵² Steel Industry Coalition, Report on Market Research into the Peoples Republic of China Steel Industry (June 30, 2016), available at <https://www.steel.org/~media/Files/AISI/Reports/Steel-Industry-Coalition-Full-Final-Report-06302016>.

⁵³ Hersch, Assessing China's Economic Reform Agenda at 4.

central SOEs – the 117 enterprises controlled by China’s State-owned Asset Supervision and Administration Commission, commonly referred to as SASAC – hold the equivalent of senior minister-level status in China’s political system and run some of the world’s largest corporations.⁵⁴

Similarly, a recent European report on China’s market economy status notes that, in addition to Chinese government’s significant role, large parts of the Chinese economy and its industry are subject to the direct control of the Communist Party of China, “including the operation of commercial entities.”⁵⁵ The report details the overlapping roles between individual Communist Party members and specific enterprises. The report also notes that this relationship between the Chinese State (the Communist Party and the government) and the business sector highlights a specific character of the Chinese economic system, which other experts have defined as “Crony Capitalism with Chinese Characteristics”. In this system “a sine qua non of successful capitalists in China is that they need to be cronies of political leaders” and “the only way for entrepreneurs to succeed is to form special relationships with political leaders, which allows them to either break the formal rules or to obtain exclusive access to resources.”⁵⁶

5. The extent of government control over allocation of resources and over price and output decisions of enterprises

The Chinese government has a great deal of control over allocation of resources and over price and output decisions of enterprises, especially as it relates to the steel industry. Concerns about this have been raised by several steel-producing countries, including the United States.

In a report published earlier this year, USTR stated: “high degree of government direction regarding the allocation of resources into and out of China’s steel industry raises concerns not only because of the commitment that China made in its WTO accession agreement that the government would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, but also more generally because it represents another significant example of China reverting to a reliance on government management of market outcomes instead of moving toward a reliance on market mechanisms. Indeed, this increasing tendency is at the root of many of the WTO compliance concerns raised by U.S. industry.”⁵⁷

⁵⁴ *Id.*

⁵⁵ Taube and Schmindkonz, Assessment of the normative and policy framework governing the Chinese economy and its impact on international competition, Executive Summary at 10.

⁵⁶ *Id.* at 258 (citing Bai, Chong-En; Hsieh, Chang-Tai; Song, Michael, 2014, Crony Capitalism with Chinese Characteristics, Preliminary Manuscript Version May 2014 at 2).

⁵⁷ USTR 2016 Report to Congress on China’s WTO Compliance at 109.

European commentators have reached a similar conclusion about the subsidiary role of markets in China. In a report for a European industry group on the question of China's market economy status, the research and consulting group Think!Desk summarized this issue as follows:

The litmus-test for the existence of a market system is the prevalence of prices that truly reflect relative scarcity, i.e. the relation between demand and supply of the factors of production as well as goods and services, based on the preferences of all individuals in an economic community. In a well-functioning competition-based market economy, scarcity-based prices are responsible for the allocation of the resources available in an economy as well as the economic selection of investments and products.

Since the start of economic reforms in the late 1970s China's policy makers have gradually increased the scope that markets and supply-and-demand determined prices are allowed to play in the national economy. However, even though prices are beginning to have a role, the extensive network of planning documents and governmental guidance, prices are still not allowed to play a decisive role for the coordination of economic activity in most areas of the Chinese economy. Comparing various segments of the Chinese economy, it can be seen that prices do have an increasing role for consumer goods. However, the further up the value chain the analysis advances, the more restricted the role of markets and prices becomes. The prices of raw-materials and basic inputs to the production process continue to be strictly controlled and guided by the Chinese state and do not fully reflect the true degree of scarcity in the economy. And with regard to the allocation of the factors of production, i.e. capital, labour, and land, scarcity-based market prices eventually play only a subordinated role, being more or less entirely overshadowed by discretionary interventions of government bodies in the allocation process (Huang 2010a, Chen 2014).

This chapter looks at the role of scarcity-based market prices play in various segments of the Chinese economy in greater detail. Starting with the function of prices for the allocation of the factors of production, namely capital, labour and land it moves on to price setting mechanisms for raw materials, utilities as well as commercial goods and services. Box 6 (on page 153 of the Report) looks at how the government controls the allocation of bank loans in Hubei Province. Box 7 (on page 154 of the Report) does the same for Gansu Province.

In the Chinese capital markets the price signals generated on the markets are subjected to government induced distortions first of all due to a repression of interest rates and a manipulation of the exchange rate. Both factors result in a constellation where capital is made available at too low prices and is utilised excessively by those having access to the formal financial system –which are China's state-owned enterprises and those actors upholding close relationships to local government agencies. According to calculations by IMF staff this has resulted in an investment ratio ten percentage points above its equilibrium value and costs to the economy in a range of about 4% of GDP per year (Lee/Syed/Liu 2012, Geng/N'Diaye 2012).

The price of labour continues to hover below its "fair" value due to an expressed low wage policy by Chinese government – at least until the recent initiative to boost domestic consumption –, highly immature wage bargaining processes and the household registration system (hukou) which prevents the constitution of a unified national labour market by effectively discriminating against labour originating in rural areas. These factors plus an inconsequential enforcement of social security systems result in a situation where firms are allowed to acquire labour with lower skill levels at bargain prices and expand business models making extensive use of such labour input.

Chinese land markets feature even higher degrees of distortion as on the one hand prices for commercial land use rights (LUR) are pushed up by local governments in order to generate high revenues from land sales. While on the other hand inter-jurisdictional competition for industrial investments pushes prices down for corresponding land uses. As such industrial LUR have been featuring much lower price increases (multiplied by a factor of 1.55 between 2000 and 2013) than LUR for commercial land (multiplied by a factor of 6.7) and residential land (multiplied by a factor of 4.5) (Chen 2014). As a result the allocation of land becomes removed from the true (national) economic necessities and rather favours industrial business models requiring large stretches of land.

The greatest distortions but in recent years also greatest improvements have been achieved with respect to the pricing of nature, which economists have in recent years learned to include in the concept of "land" as an elementary factor of production. After decades of reckless

growth-fetishism, the wish to contain the on-going degradation of natural environments and attach a price to environmentally hazardous business activities has eventually become a major driver of social activism and elite policy making. As such the distortions resulting in an over-utilisation of natural environments are continuously being dismantled allowing for a better allocation of these resources.

The total costs these multifaceted distortions in the allocation of resources convey to the Chinese economy as a whole can only be estimated. Huang and Tao (2011) estimate the aggregate costs arising from the governmental interventions in the factor markets to lie in the range of about 10% of Chinese GDP each year during the first decade of the 21st century.⁵⁸

China's government involvement is notable in a few key ways:

Capital/financing: Because China's government plays a large role in determining the terms of loans and credits to businesses, it has a large say in the controls the allocation of resources and over price and output decisions of enterprises. Before the U.S.-China Economic and Security Review Commission, Alan H. Price, Partner at Wiley Rein law firm, testified: "The Chinese government continues to play the central role within the Chinese economy in the allocation of resources. The Chinese government uses the financial sector, and especially the mammoth state-owned banks, as a major means of implementing its policy decisions. Banks are subject to legal rules requiring them to provide loans 'according to the needs of the national economy.' In particular, they are required to provide credit to 'encouraged' projects and to give priority to support for certain industries. SOEs are the chief beneficiaries of the system, with the government using the state-owned banks to direct low-cost credit to them. As a result of these policies, SOEs have a privileged position within the Chinese economy."⁵⁹

State-owned banks are used as a means of implementing policy goals and are required to provide loans "according to the needs of the national economy" and are "encouraged" to provide credit for certain industries. As a result, SOEs have an advantageous position within the economy.⁶⁰

⁵⁸ Taube and Schmindkonz, Assessment of the normative and policy framework governing the Chinese economy and its impact on international competition, Executive Summary at 7-8.

⁵⁹ Written Statement of Alan H. Price Before the U.S.-China Economic and Security Review Commission at 3, available at https://www.uscc.gov/sites/default/files/Panel%204_Price%20statement_022416.pdf.

⁶⁰ *Id.* See also AISI Comments to USTR Regarding China's WTO Compliance at 13-16 (Sept. 21, 2016), available at <https://www.steel.org/~media/Files/AISI/Public%20Policy/Letters/AISI-2016->

At a July 2015 House of Representatives Committee on Foreign Affairs hearing, Derek Scissors, an economist at the American Enterprise Institute, said China has made no meaningful progress towards increasing the role of the free market in its economy. Scissors noted that the government frequently orders state-owned banks to loan to preferred industries, creating an un-level playing field for those industries in other countries. Regulatory protections and other benefits given to SOEs “means the private sector is simply not allowed to succeed in the two dozen industries that SOEs dominate.”⁶¹

Land: In addition to the government distorting the market by playing an outsized role in capital and financing, it also provides other improper subsidies to manufacturers. Because land is state-owned, acquiring it is relatively cheap for SOEs and difficult and comparatively expensive for non-state companies. Additionally, provincial governments can evict non-state companies or force them to reduce competition against SOEs.⁶²

Raw materials: China assists its steel industry and other domestic industries attain raw materials. SOEs can buy raw materials from one another at subsidized costs, a benefit foreign competitors do not enjoy.⁶³ Furthermore, China manipulates raw material prices for non-Chinese competitors, and restrains exports of raw materials, even though these are violations of WTO commitments. Last year, both the United States and European Union challenged China’s raw material export restraints at the WTO.⁶⁴

Over the last several years, to support its steel industry, China has invested in several overseas iron ore deposits. As Graeme Hosie, Chief Executive of London Mining, explained, these investments are possible because the government assists its industry in acquiring raw materials. “You have Chinese banks that can fund these projects at a low

[Comments-Regarding-China-WTO-Compliance.pdf](#); Steel Industry Coalition, Report on Market Research into the Peoples Republic of China Steel Industry (June 30, 2016), available at <https://www.steel.org/~media/Files/AISI/Reports/Steel-Industry-Coalition-Full-Final-Report-06302016>.

⁶¹ Derek Scissors, China’s Stall, available at <https://www.aei.org/publication/chinas-stall/>.

⁶² Heritage Foundation, The Facts About China’s Currency, Chinese Subsidies, and American Jobs (October 4, 2011) available at <http://www.heritage.org/asia/report/the-facts-about-chinas-currency-chinese-subsidies-and-american-jobs>.

⁶³ Usha C.V. Haley and George T. Haley, How Chinese Subsidies Changed the World, Harvard Business Review, (2013) available at <https://hbr.org/2013/04/how-chinese-subsidies-changed>.

⁶⁴ AFP, US challenges China over raw materials duties at WTO (July 13, 2016) available at <https://www.yahoo.com/news/news/us-challenges-china-over-raw-materials-duties-wto-153756488--finance.html>

cost of capital, because they are helping state-owned enterprises strategically ensure supply.”⁶⁵

6. Such other factors as the administering authority considers appropriate

In considering other factors, it is noteworthy that USTR describes China’s adoption of rule of law as “incomplete”⁶⁶ and corruption often is a part of doing business there. A recent study found that 35 percent of companies in China pay bribes or give gifts in order to operate and one Chief Financial Officer described it as “an unspoken rule.” Companies say the main reason corrupt payments are offered is “competitive pressure.”⁶⁷

Corrupt payments are most common in Beijing, Guangdong, Chongqing and Shanghai – areas where wealth and power are concentrated. Said Craig Charney, President of Charney Research and a pollster: “Relationships matter in China, but these are the areas where the temptation to substitute cash for contacts seems strongest – and where the potential to be targeted in overseas or domestic corruption probes may be greatest.” Graft is a little less common in the north and west.⁶⁸

As Jean-Pierre Cabestan, the Head of the department of government and international studies at Hong Kong Baptist University, said: “there are two important conclusions here. There is an unhealthy and close connection between political power and business activities in China. The (Chinese Communist Party’s) leading cadres’ corrupt practices are likely to continue because they have been one of the most efficient recipes of China’s economic success story. This corruption is also unlikely to disappear because, although it has given more space to the market and private entrepreneurship, the party has consolidated its monopoly of political power.”⁶⁹

In addition, it is worth noting the lack of effective bankruptcy procedures in China. Functioning markets require mechanisms to allow those economic actors who lose out in market competition to exit the market in an orderly manner. Thus effective bankruptcy procedures are critical to the operation of a market economy. While China

⁶⁵ William MacNamara, Chinese money to open new iron ore projects, Financial Times, (April 13, 2010) available at <https://www.ft.com/content/a2142bc8-465b-11df-9713-00144feab49a>.

⁶⁶ USTR 2016 Report to Congress at 168.

⁶⁷ Richard Levick, New Data: Bribery Is Often 'An Unspoken Rule' In China, Forbes, , (January 21, 2015) available at <https://www.forbes.com/sites/richardlevick/2015/01/21/new-data-bribery-is-often-an-unspoken-rule-in-china/#347e3c2479c6>.

⁶⁸ *Id.*

⁶⁹ Jean-Pierre Cabestan, Why Corruption Is Here To Stay In China, Huffington Post, , (March 15, 2017): http://www.huffingtonpost.com/entry/china-corruption_us_58c866b2e4b01c029d7731ea

has a bankruptcy law, bankruptcy cases are relatively rare given the size of the Chinese economy. Statistics from the Supreme People's Court indicate that only 2,059 bankruptcy cases were filed in 2014 in all of China, and the number of bankruptcy cases dropped from 3,573 in 2010 and 2,531 in 2012.⁷⁰

Conclusion

As detailed above, a review of the latest information related to the six statutory factors established conclusively that China is properly classified as a nonmarket economy country. AISI appreciates the opportunity to express the views of the American steel industry regarding this very important matter.

Sincerely,

A handwritten signature in black ink, reading "Kevin M. Dempsey". The signature is fluid and cursive, with the first name "Kevin" and last name "Dempsey" clearly legible.

Kevin M. Dempsey
Senior Vice President, Public Policy
and General Counsel

⁷⁰ Taube and Schmindkonz, *Assessment of the normative and policy framework governing the Chinese economy and its impact on international competition*, Executive Summary at 9.