

China's Specialty Steel Subsidies: Massive, Pervasive, and Illegal

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CHINA'S SPECIALTY STEEL SUBSIDIES – MASSIVE, PERVASIVE, AND ILLEGAL

EXECUTIVE SUMMARY

In two previous reports, the Specialty Steel Industry of North America (“SSINA”) has described how the Government of the People’s Republic of China (“China”) has been using a wide range of direct and indirect subsidies as well as other support measures to carry out the Chinese government’s overarching plan to encourage the development of the Chinese specialty steel industry and to ensure its on-going viability. This report supplements SSINA’s earlier studies by explaining how China has been protecting and fostering, on an enormous scale and contrary to China’s international legal obligations at the World Trade Organization and at the International Monetary Fund, the long-term development of the primary downstream industries in China’s specialty steel sector by means of a striking array of illegal subsidies and other interventionist measures. These downstream industries represent competitors of SSINA’s customer base, which is struggling to compete with Chinese companies subsidized by their government.

- The Chinese government’s industrial policies have encouraged and directed certain “pillar” industries, which the Chinese government considers to be essential to China’s national economy and security. These favored industries – “the life-blood of the national economy” – include many of the specialty steel sector’s primary downstream industries.
- State-owned enterprises in these “pillar” industries have been modernized and restructured to create large enterprises that are the principal actors or “national champions” in their industries and to displace imported products into China’s domestic market.
- The Chinese government has implemented a raft of direct and indirect governmental support measures to carry out its industrial policies, many of which violate China’s international legal obligations. These governmental support measures include:
 - massive amounts of direct subsidies that the Chinese government has conferred upon specialty steel mills and downstream industries in China’s specialty steel sector, such as debt-to-equity swaps, subsidized financing, tax subsidies, export

subsidies, and subsidies contingent on the use of Chinese goods in place of imports; and

- carefully-crafted indirect support measures, such as non-tariff barriers and other administrative procedures, that encourage the production and exportation of goods produced by downstream industries in China's specialty steel sector. The Chinese government, for instance, imposes stiff taxes to discourage Chinese steel producers from exporting raw materials or semi-finished specialty steel products, but excuses or rebates taxes to encourage exportation of downstream products subject to a greater degree of manufacturing and value-added in China by not imposing similar export taxes and by providing rebates of taxes upon exportation.
- The Chinese government's interventionist industrial policies to develop downstream industries in the specialty steel sector and the support measures used to carry out those policies have had a devastating impact on domestic industries and their workers in the United States by giving Chinese firms an unfair advantage when competing against U.S. domestic firms in the United States, in China, and in third countries. In 2007 alone, the Chinese government's industrial policies resulted in unfairly-traded exports that contributed to the United States' US\$262.1 billion trade deficit with China and the loss or displacement of more than 366,000 jobs in the United States.
- China's interventionist industrial policies have also unduly influenced the investment decisions of U.S. domestic firms operating in downstream industries in the specialty steel sector by providing an incentive for U.S. firms to cease manufacturing and curtail research and development in the United States and to relocate their production facilities to China. The billions of dollars invested in China by U.S. automakers provide just one example of the benefits Chinese industries are reaping from their government's industrial policies and the harm caused by the policies to companies and workers in the United States. General Motors, for instance, plans to increase its investment in China by over US\$1 billion in each year between 2007 and 2009 and has committed to purchase US\$10 billion annually from Chinese auto parts producers by 2009.
- Perhaps the most critical component of China's overall plan and the Chinese government's single greatest subsidy is China's substantial undervaluation of its currency. Through protracted, large-scale interventions in the exchange markets, the Chinese government has kept the renminbi undervalued by an estimated 30 percent to 40 percent relative to the U.S. dollar for many years. This undervaluation is contributing to dangerous global imbalances in trade and investment and has enabled China to amass at least US\$2 trillion in foreign reserves. It can reasonably be expected that some of this vast pool of funds will be applied to further protect and strengthen China's specialty steel sector.

I. INTRODUCTION

Since entry into force of the General Agreement on Tariffs and Trade in 1947 (“GATT”),¹ the global trading system has been structured to minimize and, to the extent possible, avoid mercantilism and “beggar-thy-neighbor” policies by the nations of the world against each other. Underlying this international economic structure has been the widely shared conviction that all countries stand to gain generally as tariff and non-tariff barriers to international trade are reduced. Today, however, the U.S. specialty steel industry and its downstream customers are being confronted by a striking array of illegal subsidies and other interventionist measures employed by the Chinese government to support downstream industries in China that use specialty steel.

Unlike their competitors in the United States, the downstream industries in China’s specialty steel sector have not been forged by market forces. Rather, the Chinese government has implemented a comprehensive set of industrial policies to create industries and SOEs able to compete internationally following China’s accession to the World Trade Organization (“WTO”) in December 2001.²

The Chinese government’s industrial policies have encouraged and directed certain “key” or “pillar” industries considered by the government to be essential to China’s national economy and security. As described further in section II below, these favored industries include many of the specialty steel sector’s primary downstream industries.³ SOEs in these industries have been

¹ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194.

² See China Achieves Steel Import Substitution Plan, Asia Pulse (Mar. 20, 2000); Goal set for iron, steel, China Daily (Apr. 6, 1996).

³ China has designated 14 “key” industries and seven “pillar” industries that largely overlap. The 14 key industries include the following: machinery; automotive; metallurgy; nonferrous metals; (...continued)

modernized and restructured to create large-scale enterprises that are the principal actors or “national champions” in their industries and to displace imported products into China’s domestic market. These policies are discussed in section III below.

Section IV of this report identifies a raft of direct and indirect governmental support measures that Chinese authorities have been using to carry out China’s industrial policies.⁴ As documented in the previous studies of China’s specialty steel industry, the Chinese government has conferred massive amounts of subsidies upon specialty steel mills in China.⁵ The same types of subsidies available to specialty steel mills also are available to downstream industries in China’s specialty steel sector. In addition to direct subsidization, the Chinese government has employed carefully-crafted indirect support measures, such as non-tariff barriers and other administrative procedures, to encourage the production and exportation of goods produced by downstream industries in China’s specialty steel sector. The Chinese government, for instance,

(...continued)

petroleum; petrochemical; chemicals; medicine; coal mining; building materials; light industry textiles; electric power; and gold. See Tenth 5-Year Plan of Industrial Structure Adjustment Published, People’s Daily Online (Nov. 19, 2001), available at http://english.people.com.cn/200111/19/print20011119_84877.html. The seven “pillar” industries designated by China include the automotive, electronics, oil and gas, aviation and aerospace, construction, pharmaceutical, and machinery industries.

⁴ Indeed, the Chinese government has been utilizing all of the basic policy tools at its disposal in implementing its industrial policies. Studies of the Chinese government’s economic and industrial policies have confirmed that the government’s policy tools fall into the following basic categories: (1) central governmental financing and planning; (2) empowering key industries with direct financing; (3) preferential interest and tax rates and favorable financing for target industries; (4) infant industry (trade) protection; (5) pricing policies; (6) administrative means; and (7) channeling of foreign direct investment into desired industries. See Lu Ding, Prospect of Industrial Policy Regime After the WTO, at 8-9 (2000).

⁵ See, e.g., SSINA, Chinese Government Subsidies to the Stainless Steel Industry (April 2007) (“SSINA April Report”), at 8-23 available at http://www.ssina.com/news/releases/pdf_releases/chinese_govt_subsidies0407.pdf. See also SSINA, Chinese Government Subsidies to the Stainless Steel Industry – An Update (August 2007) (“SSINA August Report”), available at http://www.ssina.com/news/releases/pdf_releases/20070823_UnfairTradeAdvantages.pdf.

has altered its tax regime to provide differential tax treatment that discourages Chinese steel producers from exporting raw materials or semi-finished specialty steel products through the imposition of export taxes, while encouraging exportation of downstream products subject to a greater degree of manufacturing and value-added in China by not imposing similar export taxes and by providing rebates of taxes upon exportation.

The Chinese government's industrial policies to develop downstream industries in the specialty steel sector and the support measures used to carry out those policies have had a devastating impact on domestic industries in the United States and their workers. Chinese firms have been given an unfair advantage when competing against U.S. domestic firms in the U.S., Chinese, and third-country markets. In 2007 alone, the Chinese government's industrial policies resulted in unfairly-traded exports from China that contributed to the United States' US\$262.1 billion trade deficit with China and the loss or displacement of more than 366,000 jobs in the United States.⁶

China's industrial policies also have provided an incentive for U.S. domestic firms to cease manufacturing in the United States and relocate their production facilities to China. In addition to weakening U.S. manufacturing, these actions on the part of the Chinese government have resulted in the loss of many skilled jobs in the United States. Recent investments by U.S. carmakers in China provide evidence of the effectiveness of China's industrial policies and the harm caused by the policies to companies and workers in the United States. General Motors

⁶ See Robert E. Scott, The China trade toll: Widespread wage suppression, 2 million jobs lost in the U.S., Economic Policy Institute Briefing Paper No. 219, at 1 (Jul. 30, 2008). See also Charles W. McMillion, China's Soaring Financial, Industrial and Technological Power, at 26 (Sept. 2007) (explaining that the U.S. trade deficit with China in high-tech, value-added products manufactured by downstream industries in the Chinese specialty steel sector was US\$109.3 billion in 2006).

(“GM”), for instance, plans to increase its investment in China by over US\$1 billion in each year between 2007 and 2009 and has committed to purchase US\$10 billion annually from Chinese auto parts producers by 2009.⁷ In addition to the hundreds of millions of dollars that Ford Motor Company has spent already in China, the company is planning to invest US\$1 billion on a new engine plant in Nanjing and a new production line at an existing factory in Chongqing and has also made substantial commitments to purchase approximately US\$3 billion in Chinese-produced auto parts for its automobile manufacturing plants worldwide.⁸ As discussed below, the investment decisions of these U.S. automakers and many other U.S. firms operating in downstream industries in the specialty steel sector have been unduly influenced by China’s interventionist industrial policies.

II. THE CHINESE GOVERNMENT CONSIDERS DOWNSTREAM INDUSTRIES IN CHINA’S SPECIALTY STEEL SECTOR TO BE “PILLAR” INDUSTRIES THAT ARE “THE LIFE-BLOOD OF THE NATIONAL ECONOMY”

While China has taken deliberate steps since the late 1970s to reform China’s economy, such as allowing certain foreign investment into the country and allowing SOEs a small degree of autonomy, a fundamental element in China’s drive to become a leading international economic power has been the Chinese government’s extensive industrial policies that direct and manage the country’s economic and industrial development by defining which industries, enterprises, and products should be targeted for preferential support and controlled by the

⁷ Id. at 35; China ups auto parts to U.S., but Mexico is top shipper, Automotive News (Feb. 27, 2007), available at <http://www.plasticsnews.com/china/english/automotive/headlines-arc2.html?id=1172276211>.

⁸ See GM and VW: How not to succeed in China, Business Week (May 9, 2005), available at http://www.businessweek.com/magazine/content/05_19/b3932010_mz001.htm; Ford Motor, Asian Automotive Newsletter, No. 84, at 2 (Dec. 2006).

government.⁹ The overarching objective of China's industrial policies has been to foster the growth of certain industrial sectors that the Chinese government considers are essential to the country's overall economic prosperity and social stability, while maintaining control of those sectors by encouraging the expansion of SOEs in the industries and protecting them from foreign competition.

The Chinese government has identified 14 "key" industries and seven "pillar" industries that are the "life-blood industries of the national economy."¹⁰ These favored industries are supported by the Chinese government through its industrial policies.¹¹ The industries designated by China as "pillar" industries, for instance, include the automotive, electronics, oil and gas, aviation and aerospace, construction, pharmaceutical, and machinery industries. Id.

Primary downstream consumers of specialty steel are among the seven "pillar" industries supported by the Chinese government through its industrial policies.¹² Indeed, given specialty steel's resistance to corrosion, fire, and heat, hygienic qualities, aesthetic appearance, strength-to-weight advantage, ease of fabrication, and impact resistance, it is an essential material consumed by a broad range of industries in numerous applications:¹³

⁹ See The First China International Auto Parts Expo to be Held in Beijing this November, available at <http://bj2.mofcom.gov.cn/aarticle/chinanews/200708/20070804955333.html>.

¹⁰ See Tenth 5-Year Plan of Industrial Structure Adjustment Published, People's Daily Online (Nov. 19, 2001), available at http://english.people.com.cn/200111/19/print20011119_84877.html.

¹¹ See, e.g., As a pillar industry in the national economy, China's petroleum industry faces unprecedented opportunities and challenges, PRinside.com (May 5, 2008), available at <http://www.pr-inside.com/as-a-pillar-industry-in-the-r585530.htm> (explaining that China's petroleum industry is a pillar industry in the national economy).

¹² See Stainless Steel Information Center, Specialty Steel Industry of North America, available at <http://www.ssina.com/overview/features.html>.

¹³ The importance of specialty steel is also demonstrated through its use in the ten broadly-defined fields for advanced technology products identified by the U.S. Census Bureau, which
(...continued)

- Automotive Industry – cars are using more specialty steel than previously, primarily for exhaust system parts, gaskets, air bag inflator housings, windshield wipers and blades, fuel systems, fasteners, powertrain, structural parts, and many other critical components. Austenitic specialty steels are used by truck manufacturers to produce tanks for food and dairy containment, cryogenic applications, chemicals, and acids.
- Electronics Industry – electronics and communications equipment, including computers, mobile phones, and personal electronic devices, use alloys that have unique electrical, magnetic and corrosion-resistant properties.
- Oil and Gas Industry – specialty steel is used in offshore, down-hole, and refinery applications. Other material applications support the production of LNG, biofuels, ethanol, gas-to-liquid technology, and oil sands recovery. On oil platforms, specialty steel is used for blast walls, cable ladders, and walkways, and also is used in down-hole gas and oil flow systems, including tanks, pipes, pumps and valves.
- Aviation and Aerospace Industry – specialty steel is used in commercial, military, business, and general aviation aircraft, jet engines, and space vehicles (including satellites, rockets, and missiles). Certain nickel-based alloys and specialty steels are necessary to support the high-temperature effects of oxidation and stress present in critical aerospace environments.
- Construction Industry – architecture, building, and construction are growing markets for specialty steel as more buildings are using specialty steel for cladding, roofing, and facades.
- Pharmaceutical Industry – specialty steel meets the stringent specifications this industry requires for internal cleanliness, surface quality, mechanical properties, chemistry control, and corrosion properties. Specialty steel is used by pharmaceutical companies for pill funnels and hoppers and for piping creams and solutions.
- Machinery and Equipment Industry – specialty steel is used by general purpose machine shops with multi-axis computerized machine centers to produce intricately machined parts for the oil and gas, aerospace, and power-generation markets, among others.

In addition to encouraging and guiding the growth of downstream industries in China's specialty steel sector, China's governmentally-issued industrial policies also have been used to maintain ownership and control of these key industries. The Chinese government's position in opposition to ceding control of these industries was explained succinctly by former Party

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include biotechnology, life sciences, opto-electronics, information and communications, electronics, flexible manufacturing and equipment, advanced materials, aerospace, weapons, and nuclear technology. See U.S. Census Bureau List of Advanced Technology Products.

General Secretary Jiang Zemin in 1997 at the 15th National Congress of the Communist Party Central Committee:

The dominant position of public ownership should manifest itself mainly as follows: Public assets dominate in the total assets in society; the state-owned sector controls the life-blood of the national economy and plays a leading role in economic development. This is the case for the country as a whole. ... We should make a strategic readjustment of the layout of the state-owned sector of the economy. The state-owned sector must be in a dominant position in major industries and key areas that concern the life-blood of the national economy. But in other areas, efforts should be made to reorganize assets and readjust the structure so as to strengthen the focal points and improve the quality of the state assets as a whole. On the premise that we keep public ownership in the dominant position, that the state controls the life-blood of the national economy and that the state-owned sector has stronger control capability and is more competitive, even if the state-owned sector accounts for a smaller proportion of the economy, this will not affect the socialist nature of our country.¹⁴

The central, provincial, and local governments in China have heeded Former Party General Secretary Jiang Zemin's call for the continued and pervasive role of the Chinese government in the economy. The Tenth Five-Year Plan, for instance, stipulated that the “[s]tate must hold a controlling stake in strategic enterprises that concern the national economy” and must also “uphold the dominance of the public sector of the economy {and} let the state-owned sector play the leading role.”¹⁵

¹⁴ See Jiang Zemin's Report at the 15th National Congress of the Communist, available at <http://www.fas.org/news/china/1997/970912-prc.htm> (emphasis added). The Chinese government has also ruled out privatizing SOEs as contrary to China's national interest. Former Party General Secretary Jiang Zemin stated that, “[p]racticing privatization in [China's] reform efforts is tantamount to digging at the base of the socialist system on which it depends for its very existence.” See Focus of State-Owned Enterprise Reform: State-Owned Enterprises Reform Seeks Breakthrough but Will Never Engage in Privatization, Zhongguo Xinwen She (Sept. 22, 1999).

¹⁵ See The Tenth Five Year Plan for National Economic and Social Development-People's Republic of China, available at http://www.logos-net.net/ilo/195_base/en/init/chn_1.htm.

With respect to downstream industries in China’s specialty steel sector, in particular, the Chinese government maintains control over these industries through direct and indirect means. The government directly controls these key industrial sectors through the large, internationally-competitive SOEs that dominate many of the industries and continue to function as extensions of China’s government and instruments of its industrial policies. For example, “national champions” in the principal, downstream specialty-steel-consuming industries include the following:¹⁶

Industry	National Champions
Automotive	Shanghai Auto Industrial Corp. and First Automobile Works
Electronics	Legend, Panda Group, and Changhong Group
Oil and Gas	China Petroleum and Chemical Corp. (Sinopec) and China National Petroleum Corp. (CNPC)
Aviation and Aerospace	Aviation Industries of China and Shanghai Aviation Industrial Corporation
Construction	China State Construction Engineering Corp. (CSCEC) and China National New Building Materials Group (CNNBMG)
Pharmaceutical	Sanjiu Group and Shandong Xinhua
Machinery and Equipment (including Electric Power)	First Tractor and Construction Machinery Group, Harbin Power Equipment Co., and Dongfang Electric Power Group

Another means of effectively controlling these key industries is exercised indirectly by the Chinese government through its ownership and control of vital, upstream raw materials. Specifically, the Chinese government can restrict the flow of essential specialty steel raw materials (such as stainless steel ingots and blooms) to downstream consumers through its ownership of a significant portion of the initial stage of the specialty steel supply chain, the “Meltshop” stage.¹⁷ In China, there are 12 “Meltshop” producers, each possessing a production

¹⁶ See Peter Nolan, China and the Global Business Revolution, at 101-135 (2001).

¹⁷ See Study to Prepare Various South African Manufacturing Sectors for Effective Negotiations for the Proposed SACU/China and SACU/India Trade Negotiations – Report No. 8 (China
 (...continued)

capacity of greater than 50,000 tons per year. Id. at 89. The two largest producers, Taiyuan Iron & Steel Co. (Group) (“TISCO”) and Baosteel Co., Ltd. (“Baosteel”), are SOEs that together account for 42 percent of China’s “Meltshop” production capacity. Id. Because small-scale downstream consumers are largely dependent upon TISCO and Baosteel for stainless steel billets and similar raw materials, the Chinese government can control the output of ostensibly non-state-owned enterprises.

China’s control of upstream raw materials also gives it considerable influence over foreign producers that have been lured (or compelled) to relocate their production facilities to China. Chinese governmental regulations and other direct administrative measures provide further leverage over these foreign enterprises. Many of these interventionist measures, such as conditioning investment approval upon technology transfer, are discussed below along with China’s industrial policies and support measures that have encouraged the development of downstream industries in the specialty steel sector while, at the same time, ensuring that the government maintains control of these industries. Absent these Chinese governmental policies and measures, these key industries in China would likely be a fraction of their current size.

III. THE CHINESE GOVERNMENT’S INDUSTRIAL POLICIES SUPPORT DOWNSTREAM INDUSTRIES IN CHINA’S SPECIALTY STEEL SECTOR

The primary tools for setting long-term industrial strategy in China are the Five-Year Plans and other national policies issued by the Chinese government. The national Five-Year Plans guide long-term industrial policies of China’s provincial and local governments as well as sector-specific industrial policies.

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Stainless Steel), at 84 (April 2006) (“NEDLAC Report”). In the “Meltshop” stage, raw materials are processed into stainless steel ingots, rods, bars, wire, and sheets. Id.

As set forth below, the industrial policies implemented in China since the early 1990s have been following four basic objectives: (a) fostering industries that are critical to China's overall economic prosperity and social stability ("key," "pillar," or "life-blood" industries); (b) reforming and modernizing SOEs operating within those industries to withstand foreign competition and to secure the government's control of those industries; (c) expanding indigenous production to eliminate imported products in China's domestic market; and (d) progressing up the value-added production chain – from mass-production of low-quality products, to the manufacture of high-quality products, and finally to the development of proprietary technologies through independent innovation. The Chinese government's efforts to encourage downstream industries in China's specialty steel sector have followed this blueprint.

A. The Chinese Government's Overarching Five-Year Plans and Other Long-Term Industrial Policies

China's means to achieve its objective of becoming a leading international economic power are set forth principally in the Five-Year Plans issued by the Central Committee of the Communist Party of China. According to the Chinese government, Five-Year Plans aim to "arrange national key construction projects, manage the distribution of productive forces and individual sectors' contributions to the national economy, map the direction of future development, and set targets."¹⁸ Thus, the Five-Year Plans are long-term industrial blueprints that direct and manage China's economic and industrial development by defining which

¹⁸See What is the Five Year Plan, available at <http://www.china.org.cn/english/MATERIAL/157595.htm>.

industries, enterprises, and products should be targeted for preferential support and controlled by the government.¹⁹

Under “the Ninth Five-Year Plan and 2010 Long-Term Program for National Economic and Social Development,” China created a guide for industrial development during the period 1996 through 2000.²⁰ The Plan called for the Chinese government to promote the growth of industries considered to be critical for economic development, important to the survival of other industries, and significant contributors to social employment and welfare.²¹ These industries include the pillar industries (machinery, electronics, petrochemical, automotive, and construction), high-technology industries, and certain basic industries (such as the steel industry) upon which other industries depend. Id. In order to protect these strategic industries and direct resources toward these key industries, China implemented various support measures, such as controlling foreign investment, discriminating against foreign products, and promoting exports.²²

Another important industrial policy implemented during the Ninth Five-Year Plan was “SOE reform and development,” reflecting China’s view of SOEs as pillars of the national economy and critical to China’s long-term peace and stability and the consolidation of China’s

¹⁹ See The First China International Auto Parts Expo to be Held in Beijing this November, available at <http://bj2.mofcom.gov.cn/aarticle/chinanews/200708/20070804955333.html>.

²⁰ See Lu Ding, Prospect of Industrial Policy Regime After the WTO, at 7 (2000).

²¹ See The First China International Auto Parts Expo to be Held in Beijing this November, available at <http://bj2.mofcom.gov.cn/aarticle/chinanews/200708/20070804955333.html>.

²² See Guoyong Liang, New Competition: Foreign Direct Investment and Industrial Development in China, at 187 (2004). The Chinese government also has managed investments in “projects of a foundation nature” by serving as the primary financier or the leading fundraiser for such projects. The “projects of a foundation nature” primarily have related to infrastructure and basic industry (e.g., energy supplies, steel production). See also Lu Ding, Prospect of Industrial Policy Regime After the WTO, at 7 (2000).

socialist system.²³ The Chinese government has employed a series of strategies to make SOEs in the key industries internationally competitive. Among the development strategies implemented during the Ninth Five-Year Plan were the modernization of production facilities (“technological progress and industrial upgrading”), the restructuring and/or consolidation of SOEs to develop large enterprise groups, the adjustment of product mix to emphasize quality rather than increasing output, and the imposition of stricter controls on imports while promoting exports.²⁴

China also has encouraged SOE reform and development through various support measures. In urging the financial sector to play a greater role in supporting China’s SOE reforms, Vice Premier Wen Jiabao stressed

that preferences should be given to key SOEs in terms of credit and loans and more financial support for high-tech enterprises and upgrading technology. . . . Wen also called for further improvement of export credit insurance and active support in increasing exports for SOEs.²⁵

Additionally, the Chinese government implemented a “three-year SOE bailing plan” between 1998 and 2000.²⁶ Under this “bailing plan,” key medium- and large-sized SOEs benefited from various support measures (such as debt-to-equity swaps and preferential loans discussed in section IV below). As explained in section IV, specialty steel producers in China received

²³ See Providing Theoretical Support for SOE Reform and Development, People’s Daily Online (Nov. 18, 1999).

²⁴ Id. See also Liang, New Competition: Foreign Direct Investment and Industrial Development in China, at 187 (2004); Lu Ding, Prospect of Industrial Policy Regime After the WTO, at 7 (2000).

²⁵ See Vice-Premier Urges Financial Sector to Further Support SOEs Reform, China People’s Daily Online (Nov. 3, 1999).

²⁶ See Chinese Economy Takes Turn for Significant Improvement, China People’s Daily Online (Mar. 6, 2001).

various direct and indirect benefits from the Chinese government under the steel-specific industrial policy of the Ninth Five-Year Plan.

The Tenth Five-Year Plan for National Economic and Social Development, covering the period 2001-2005, extended many of the industrial policies implemented under the Ninth Five-Year Plan that provided for the continued and pervasive role of the Chinese government in the economy through industry-related and SOE-related policies.²⁷

Another important industrial policy emphasized by China under the Tenth Five-Year Plan followed the government's slogan of *zhua da fang xiao* ("grasp the large, let go the small"). Specifically, the Chinese government called for the "establishment of a number of large companies and enterprise groups through stock listing, merging, association and reorganization."²⁸ Identified as the "national champions," these large-scale SOEs operate primarily in capital-intensive industries with the potential to benefit from economies of scale and scope.²⁹ The Chinese government considers the "national champions" to be "the backbone of the national economy and the country's main force to participate in international competition."³⁰

"National champions" have been established in the industries that the Chinese government deems to be essential to the success of China's industrial policies: automotive;

²⁷ See Tenth 5-Year Plan of Industrial Structure Adjustment Published, People's Daily Online (Nov. 19, 2001), available at http://english.people.com.cn/200111/19/print20011119_84877.html.

²⁸ See The Tenth Five Year Plan for National Economic and Social Development-People's Republic of China, available at http://www.logos-net.net/ilo/195_base/en/init/chn_1.htm.

²⁹ See Sutherland, Policies to Build National Champions: China's "National Team" of Enterprise Groups (China and Global Business Revolution), at 72 (2005). China has provided less support for the development of large SOEs in industries in which economies of scale are not as important. "A minister responsible for light industry, for instance, commented in 1997 that 'to develop state sectors is critical to the economy but not to light industry because light industry isn't influential enough to national security and the economy.'" Id.

³⁰ Jiang Qiangui, Vice-Minister of SETC, China Daily, Business Weekly (Jan. 17, 2000).

electronics; machinery; energy supply; iron and steel; pharmaceuticals; aviation and aerospace; and oil and gas.³¹ All of these industries are important downstream consumers of specialty steel. Thus, national champion SOEs were created in many of the primary downstream industries in the specialty steel industry, including Sinopec and CNPC in oil and petrochemicals; Sanjiu, Dongbei, and Shandong Xinhua in pharmaceuticals; Harbin, Shanghai, and Dongfang in power equipment; Yiqi, Erqi, and Shanghai in automobiles.³²

China's new Eleventh Five-Year Plan, covering the period 2006-2010, has extended many of the policies begun under the Ninth and Tenth Five-Years Plans, such as retaining control of key industries and modernizing its SOEs to make them globally competitive.³³ Consistent with its continuous drive to produce higher-value-added products, the Chinese government is implementing industrial policies that emphasize progress in China's science and technology ("S&T") and "coordinative development." These areas have been designated as priority national development strategies under the Eleventh Five-Year Plan, with the Chinese government playing a leading role in this endeavor. Id.

One of China's primary objectives under the Eleventh Five-Year Plan is to improve the capability of independent innovation in China through a comprehensive science-and-technology industrial policy that is infused with economic nationalism. The policy stems in part from the

³¹ See Sutherland, Policies to Build National Champions: China's "National Team" of Enterprise Groups (China and Global Business Revolution), at 72 (2005).

³² See Peter Nolan, Evaluation of the World Bank's Contribution to Chinese Enterprise Reform, at 8 (2005), available at [http://lnweb18.worldbank.org/oed/oeddoelib.nsf/DocUNIDViewForJavaSearch/115BD744564229F85256FF000590B8C/\\$file/china_cae_enterprise_reform.pdf](http://lnweb18.worldbank.org/oed/oeddoelib.nsf/DocUNIDViewForJavaSearch/115BD744564229F85256FF000590B8C/$file/china_cae_enterprise_reform.pdf).

³³ See Guideline for the National Medium- and Long-Term Science and Technology Development Plan (2006-2020), available at http://www.gov.cn/english/2006-02/09/content_184426.htm. See also Changes in Five-Year Plans' Economic Focus, available at <http://www.china.org.cn/english/2005/Nov/148163.htm>; Key Points of the 11th Five-Year Guidelines, available at <http://english.hanban.edu.cn/english/2006/Mar/160397.htm>.

Chinese government's criticism of foreign investors for abusing intellectual property laws, which allegedly stymies Chinese enterprises' capacity for independent innovation.³⁴ In response, China plans to increase value-added production by directing foreign investment to certain areas, such as research and development as well as sophisticated design.³⁵ According to China's plan, "by 2020, China will invest more than 2.5% of its GDP in R&D, with the contribution of S&T to economic development exceeding 60% and with dependence on foreign technologies reduced to below 30%."³⁶

The Chinese government is implementing numerous plans and policies to achieve these objectives.³⁷ For instance, according to China's national development plan for S&T through 2020, the Guideline for the National Medium- and Long-Term Science and Technology Development Plan (2006-2020) ("S&T Development Plan (2006-2020)"), China will advance "into the rank of innovative countries" by centralizing and increasing spending on research and development ("R&D") and by fostering a group of globally-competitive companies with

³⁴ See, e.g., China's Laws, Regulations and Practices in the Areas of Technology Transfer, Trade-Related Investment Measures, Subsidies and Intellectual Property Protection Which Raise WTO Compliance Concerns, Trade Lawyers Advisory Group, at 22 (September 2007).

³⁵ See New Policy Stresses Quality of Foreign Investment, Chinese Government's Official Web Portal (Nov. 9, 2006), available at http://english.gov.cn/2006-11/09/content_437842.htm.

³⁶ See China's Industrial Subsidies Study: High Technology, Trade Law Advisory Group, at 6 (April 2007). Additionally, in the 11th Five-Year Plan on Promoting Trade through Science and Technology, the Chinese government explains its plan to improve China's export structure by implementing various measures, including expanding exports of high-tech products, fostering export innovation bases for high-tech products, and reinforcing independent innovation. Id. at 6-7.

³⁷ See, e.g., Comments for Construction of National S&T Infrastructure Platforms in the 11th Five-Year Period (2006-2010), Chinese Ministry of Science and Technology, State Development and Reform Commission, Ministry of Finance, and Ministry of Education (explaining that the Chinese government will establish important S&T infrastructure platforms to provide effective support for S&T advancement and proprietary innovations in China).

autonomously-controlled, intellectual property (“IP”) and well-known brands.³⁸ By committing the government to significant expenditures directed at creating market-viable products and enterprises, this S&T development plan represents the Chinese government increasing its involvement in product innovation.³⁹ “Thus, it is not simply a matter of the government investing in knowledge creation, a pure public good whose benefits will spill over into a range of related activities. Instead, the government is to step up its investment in particular high-technology projects.” Id.

The Chinese government provides a summary of the measures to be implemented during the period of the 11th Five-Year Plan in order to achieve its S&T-related policies in Article 4 of Opinions of the Ministry of Commerce, the National Development and Reform Commission, the Ministry of Science and Technology, the Ministry of Finance, the General Administration of Customs, the State Administration of Taxation, State Intellectual Property Office and the State Administration of Foreign Exchange on Encouraging Technology Importing and Innovation and Promoting Changes in Pattern of Trade Growth:⁴⁰

³⁸ See Guideline for the National Medium- and Long-Term Science and Technology Development Plan (2006-2020), available at http://www.gov.cn/english/2006-02/09/content_184426.htm. See also China’s Industrial Subsidies Study: High Technology, Trade Law Advisory Group, at 6 (April 2007);

³⁹ See “China’s State Sector, Industrial Policies and the 11th Five Year Plan,” Testimony of Barry Naughton, Professor, before the US-China Economic and Security Review Commission Hearing on the “Extent of the Government’s Control of China’s Economy, and Implications for the United States” (May 24, 2007) available at http://www.uscc.gov/hearings/2007hearings/written_testimonies/07_05_24_25wrts/07_05_24_25_naughton_statement.php.

⁴⁰ See Opinions of the Ministry of Commerce, the National Development and Reform Commission, the Ministry of Science and Technology, the Ministry of Finance, the General Administration of Customs, the State Administration of Taxation, State Intellectual Property Office and the State Administration of Foreign Exchange on Encouraging Technology Importing and Innovation and Promoting Changes in Pattern of Trade Growth, Shang Fu Mao Fa [2006] No. 13, at Article 4 (Jul. 14, 2006) (“Plan on Technology Importing and Innovation”), available (...continued)

General Objectives: to optimize the technology importing structure and improve its quality and efficiency, for the purpose of raising the proportion of the contracts of proprietary and patented technologies to about 50% of the total by 2010, increasing the counterpart funds for the imported technologies absorption, establishing a technology importing and innovation promoting system which has enterprises as the main body and is oriented towards the market, steered and promoted by the government and supported by the scientific forces of all parties concerned, and achieving a benign cycle in this regard, i.e. "importing the technologies - absorbing them - re-innovating and developing of new technologies - improving the international competitiveness.

China, moreover, identifies numerous downstream consumers of its specialty steel industry as among the favored industries that will receive "special assistance ... in importing technologies with market potential and possible advantages in future competitions or with great significance to national well-being and the people's livelihood, such as those in biology, civil aerospace industry, machine building, petrochemical industry, clean power generation, new materials, energy saving and environmental protection." Id. at Article 6.

With respect to supporting China's SOEs, in September 2005 Li Rongrong, the Chairman of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), outlined specific S&T-related, industrial-policy measures that the Chinese government is implementing to ensure that its "SOEs play a better role as the leading force in the national economy."⁴¹ Among the measures identified by the Chairman of SASAC that "energetically spur technological advances as well as scientific and technological innovation" in

China's SOEs were the following:

(...continued)

at <http://www.asianlii.org/cn/legis/cen/laws/ootmoctndarctmosattmoftgaoctsaotsipoatsaofeotiai apcipotg3749/>.

⁴¹ See Promoting the Structural Adjustment and the Scientific and Technological Innovation and Enhancing the Core Competitiveness of State-owned Enterprises, Speech by Li Rongrong at the International Investment Forum 2005 of the 9th China International Fair for Investment and Trade, (Sept. 8, 2005).

- control the direction of investment and promote structural adjustment to improve the R&D capabilities of SOEs in S&T;
- adopt hi-tech, advanced, and key technologies to renovate traditional industries;
- enhance SOEs' level of technologies and equipment;
- increase investments in R&D, foster R&D talents, establish and perfect technological centers, and create a vital technological development system;
- form as quickly as possible China's innovation capacity in dominant products, key technologies, and integrated technologies;
- master a series of core technologies, possess a set of independent intellectual property rights, and create a group of internationally renowned brand names; and
- intensify the efforts in industrializing R&D.

Id.

As discussed in section IV below, the Chinese government is putting in place numerous measures to reinforce the development of China's high-tech industries.⁴² For example, China has pledged to “[p]rovide domestic enterprises with necessary financial support for importing advanced technologies and their re-innovating” and has authorized its policy banks and commercial banks to “grant loans for technology importing, absorbing and re-innovating . . .”⁴³

The Chinese government also is supporting the development of downstream industries in China's specialty steel sector through another fundamental policy guiding China's economic

⁴² See China's Industrial Subsidies Study: High Technology, Trade Law Advisory Group, at 7 (April 2007).

⁴³ See Opinions of the Ministry of Commerce, the National Development and Reform Commission, the Ministry of Science and Technology, the Ministry of Finance, the General Administration of Customs, the State Administration of Taxation, State Intellectual Property Office and the State Administration of Foreign Exchange on Encouraging Technology Importing and Innovation and Promoting Changes in Pattern of Trade Growth, Shang Fu Mao Fa [2006] No. 13, at Article 16 (Jul. 14, 2006), available at <http://www.asianlii.org/cn/legis/cen/laws/oootmoctndarctmosattmoftgaoctsaotsipoatsaofeotiaiapcipotg3749/>.

development, “coordinative development.”⁴⁴ Pursuant to the policy of “coordinative development,” the Chinese government plans, inter alia, to: (1) reorganize and upgrade the energy and raw materials industries for purposes of “improving their international competitive power, and creating conditions for the downstream industries to participate in the international competition” and (2) to “enable the industries in the eastern, the central and the western regions to develop coordinately.” Id. at 3 (emphasis added).

The industrial policies set forth in China’s Five-Year Plans and other governmental decrees from the early 1990s to the present have had the objectives of (1) improving the international competitiveness of China’s key industries and “national champion” SOEs and (2) reinforcing the Chinese government’s control over those industries. Today, the Chinese government continues actively to support its key industries and “national champion” SOEs. As turned to next, these objectives guide sector-specific, steel industrial policies and the industrial policies issued by China’s provincial and local governments.

B. The Chinese Government’s Sector-Specific Industrial Policies

Consistent with the national objectives set forth in the overarching Five-Year Plans, China has introduced sector-specific industrial policies aimed at encouraging the development of key industries and enterprises. Indeed, recognizing the importance of downstream industries in the specialty steel sector to China’s economic growth and security, the Chinese government has implemented industry-specific industrial policies that have boosted these industries by expanding their production capacity, upgrading and modernizing their existing facilities, and ensuring

⁴⁴ See Circular of the State Economy and Trade Commission on the Promulgation of the Guidance of Recent Development in the Industrial Sector (Sept. 28, 2002) at 2-3 available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51268.

markets for their products. These sector-specific industrial policies provide special guidance and support to downstream industries in China's specialty steel sector.

In the automotive sector, for instance, the Chinese government has implemented a comprehensive set of policies to encourage the development of its automobile and auto parts industry. The automotive sector is an important downstream industry in China's specialty steel sector. Specialty steel is required by automobile and auto parts manufactures for many applications. Indeed, as remarked earlier, cars are using more stainless steel than ever, primarily for exhaust system parts, gaskets, air bag inflator housings, windshield wipers and blades, fuel systems, fasteners, powertrain, structural parts, and many other critical components.

Because the automotive sector is a significant contributor to China's economic growth, the Chinese government has enacted comprehensive industrial policies to protect and develop China's automotive sector.⁴⁵ The Eighth Five-Year Plan for the Chinese Automotive Industry (1991–1995) designated the automotive industry as a “pillar industry” that would drive the economy in the twenty-first century. In 1994, the government issued the Automotive Industry Policy (“1994 AIP”) that protected and developed the Chinese automotive industry and key enterprises within the industry. The 1994 AIP also put into practice various measures to foster the growth of the industry, such as encouraging foreign investment, requiring foreign investors to establish research and development (“R&D”) capabilities in China and to manufacture high-tech automotive products in China, and mandating high local-content requirements.⁴⁶ Additionally, the primary SOE car manufacturers were established in the 1994 AIP as the national champions

⁴⁵ See Charles W. McMillion, China's Soaring Financial, Industrial and Technological Power, at 33 (Sept. 2007).

⁴⁶ Andrew Szamosszegi, How Chinese Government Subsidies And Market Intervention Have Resulted In The Offshoring Of U.S. Auto Parts Production: A Case Study, at 11.

for the automotive industry: First Automotive Works Corp. (“FAW”); Dongfeng Motor Corp. (“Dongfeng”); Shanghai Automotive Industry Corp. (“SAIC”).⁴⁷

The Tenth Five-Year Plan for the Chinese Automotive Industry, covering the period 2001 through 2005, extended many of the policies of previous Five-Year Plans and the 1994 AIP. For instance, the Tenth Five-Year Plan stipulated that key enterprises in the sector should be supported. “Powerful corporations will be encouraged and supported to develop further and become bigger and stronger. Distribution of resources will be optimized and a pattern of large automobile corporation groups will be established.”⁴⁸ China’s automotive manufacturing industry was to be consolidated from 118 existing companies to only two or three companies, while the auto parts industry would be reduced from several hundred parts producers to 5–10 large supplier groups.⁴⁹ The plan also promoted the production of vehicles that would be competitive in the international market.

In June 2004, the State Development and Reform Commission issued the Automobile Industry Development Policy No. 8 Decree (“2004 AIP”).⁵⁰ This document designated the automobile industry as a pillar industry in the national economy to be achieved by the year 2010. The plan furthers China’s goal of controlling the automotive sector by creating large-scale SOE groups that will dominate the automobile manufacturing and parts industry. Indeed, the main

⁴⁷ See China’s New Automobile Policy Fails to Comply with Its WTO Commitments, quoting Policy on the Automobile Industry, adopted by the State Council in 1994, available at <http://business.sohu.com/2004/06/02/31/article220353167.shtml>.

⁴⁸ The Tenth Five Year Plan of the Automotive Industry and its Development, China Daily, available at <http://bizchina.chinadaily.com.cn/guide/industry/industry2.htm>.

⁴⁹ China Britain Business Council, available at www.cbcc.org/the_review/review_archive/sectors/10.html.

⁵⁰ See Automobile Industry Development Policy No. 8 Decree, State Development and Reform Commission of the People’s Republic of China, (Jun. 18, 2004), available at http://www.tdctrade.com/report/reg/reg_040601.htm.

objectives of the 2004 AIP has been to “form a number of large competitive automobile groups” and to “develop a number of vehicle parts enterprises that will realize scale production and edge into the international automobile parts procurement system, and take an active part in international competition.”⁵¹

To achieve the government’s objective of creating a globally-competitive automotive sector led by national champion SOEs, the 2004 AIP establishes numerous governmental support measures. The plan, for instance, provides “support for automobile parts and components production” by

directing social funds to flow into automobile parts production and help parts production enterprises with comparative advantages to form specialised and industrialised production and module-type supply capability. The State gives preferential treatment to parts production enterprises which can supply parts to several independent complete vehicle production enterprises and participate in the international automobile parts procurement system in the areas of technical import and transformation, financing, merger and restructuring.

2004 AIP, Article 31, Chapter 8. The 2004 AIP also protects the industry through “investment management” and “import management” measures that restrict foreign investment and imports of foreign auto parts into China.⁵²

While China’s automotive sector is still guided today by many of the policies set forth in the 2004 AIP, many of the Chinese provisions of the 2004 AIP have been found to be inconsistent with commitments assumed by China upon acceding to the WTO.⁵³ In July 2008, a

⁵¹ The Tenth Five Year Plan of the Automotive Industry and its Development, China Daily, available at <http://bizchina.chinadaily.com.cn/guide/industry/industry2.htm>.

⁵² These governmental measures are discussed in section IV, below.

⁵³ See Panel Report, China – Measures Affecting Imports of Automobile Parts, WT/DS340/R, Jul. 18, 2008, at para. 8.4.

WTO Panel concluded that the Chinese government's measures supporting Chinese automobile parts and components producers are: (1) inconsistent with Article III:2, first sentence of the GATT 1994 in that they subject imported auto parts to an internal charge in excess of that applied to like domestic auto parts; (2) inconsistent with Article III:4 of the GATT 1994 in that they accord imported auto parts less favorable treatment than like domestic auto parts; and (3) not justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with laws or regulations which are not inconsistent with the GATT 1994. Id.⁵⁴

In the Eleventh Five-Year Plan for the Automotive Industry, covering 2006 through 2010, the Chinese government extended many of the earlier policies and implemented a new industrial policy aimed at creating an independent, domestic automotive sector. The Plan promotes the development of Chinese brands and independent intellectual property rights ("IPRs"). The government intends that brands of domestic cars with independent IPRs will increase their share of the car sales in China from 30 percent in 2007 to 50 percent by the end of the Eleventh Five-Year Plan period in 2010.⁵⁵ In accordance with this policy, China's three national champion car manufacturers (FAW, SAIC, and Dongfeng) are investing a total of US\$5.28 billion in programs to develop brands with independent IPRs.

The implementation of these industrial policies by automakers in China is reflected in the description offered by Shanghai Volkswagen ("SVW"), a joint venture between SAIC and Volkswagen, of its operations in Shanghai. SVW explains that by using "foreign capital and introducing overseas technology" it accelerated development of the Chinese car-making

⁵⁴ With respect to the United States' claims that provisions of China's 2004 AIP are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Panel decided to exercise judicial economy and did not resolve these claims on the merits.

⁵⁵ See Car giants to develop own brands, available at http://en.ce.cn/Industries/Auto/200708/14/t20070814_12531297_1.shtml.

industry.⁵⁶ Additionally, consistent with the industrial policy's focus on developing the automobile parts industry in China, the company

started the Santana localization endeavor to revitalize the Chinese parts supply industry. This grand trans-regional, inter-departmental, cross-industry and systematic project has helped a large number of local parts suppliers achieve their technical advancement, thus laying a solid foundation for manufacturing parts and components up to the international standard. Now over 400 domestic suppliers are able to supply SVW with locally made parts. SVW-accepted parts makers are now accepted by other carmakers as their parts suppliers, and some of them have become suppliers for global sourcing manufacturers.

Id.

The explosive growth in China's automotive sector since the late 1990s evinces the effectiveness of the Chinese government's industrial policies for the automotive sector. China's vehicle production capacity has tripled in the past ten years, reaching 12.69 million units in 2007,⁵⁷ and its exports of automobiles increased in 2007 alone by 79 percent.⁵⁸ In 2006, China surpassed Germany to become the world's fourth largest producer of automobiles.⁵⁹ Vehicle production capacity is expected to surpass that of the United States in 2010, as it is forecast to reach 17.16 million units in 2010 and 18.49 million units in 2013.⁶⁰ Further evidence of these industrial policies' success is found in the significant investments made by foreign car

⁵⁶ See Shanghai Volkswagen Website, SVW Introduction, available at www.csvw.com/csvw/english/gsj/gsj/index.shtml.

⁵⁷ See Charles W. McMillion, China's Soaring Financial, Industrial and Technological Power, at 33 (Sept. 2007).

⁵⁸ See Plastics News – Automotive, available at <http://www.plasticsnews.com/china/english/automotive/headlines2.html?id=1203640690>.

⁵⁹ See Charles W. McMillion, China's Soaring Financial, Industrial and Technological Power, at 33 (Sept. 2007).

⁶⁰ China's Vehicle Production Capacity: China to Become No. 1 in 2010, Fourin China Auto Weekly (Dec. 25, 2007), available at http://www.fourin.com/chinaautoweekly/new_issue.html.

companies in China. GM, Ford, and Chrysler, for instance, have committed to purchase substantial quantities of auto parts produced by Chinese parts manufacturers.⁶¹ Delphi, an auto parts producer, imports from China more than \$100 million in auto parts annually after having invested more than \$500 million in China over the past decade. Id. at 3.

The Chinese government has implemented similar, comprehensive industrial development plans to foster the growth of other key industries. Pursuant to a “five-year development blueprint,” for example, the Chinese government plans to carry out numerous “key projects for the revitalization of China’s equipment manufacturing industry during the 2006-2010 period.”⁶² China identifies the following “key projects” that are being used to support Chinese equipment/machinery producers:

- large high-efficiency, clean-generating equipment, such as million kilowatt-grade nuclear generating units;
- super high voltage power transmission equipment;
- complete set of large ethylene equipment, such as complete set of equipment for paraxylene, terephthalic acid, and polyester;
- large coal chemical equipment, such as equipment for liquefaction and gasification of coal;
- comprehensive coal mining equipment, such as large underground mining and conveyance/dressing equipment;
- large metallurgical equipment, such as continuous rolling mills for cold- and hot-rolled steel sheet and complete sets of plating equipment;
- large shipping equipment, such as large offshore oil engineering equipment and liquefied natural gas tankers;
- rail transport equipment, such as commercial production of trains and new subway cars; and
- equipment for environmental protection and comprehensive utilization of resources, such as equipment for treatment of urban and industrial wastewater and solid waste.

Id.

⁶¹ Andrew Szamosszegi, How Chinese Government Subsidies And Market Intervention Have Resulted In The Offshoring Of U.S. Auto Parts Production: A Case Study, at 11.

⁶² See Key Projects for Revitalizing Equipment Manufacturing Industry, Xinhua News Agency (Mar. 6, 2006), available at <http://www.china.org.cn/english/2006lh/160261.htm>.

The Chinese government, moreover, is providing significant subsidies “for the purpose of raising core competitiveness and capacity for independent innovation of domestic enterprises, promoting the development of equipment manufacturing and implementing the preferential policies of import taxation to invigorate the equipment manufacturing.”⁶³ These and other subsidies used to foster the development of China’s equipment manufacturing industry are discussed below in section IV.A, below.

C. **Five-Year Plans and Other Industrial Policies Implemented by Provincial and Local Governments**

To reinforce the central government’s policies, provincial and local governments in China have formulated corresponding industrial policies that identify the key sectors and enterprises to be encouraged through additional support measures applicable in their territories. Provincial and local governments use their Five-Year Plans to achieve the same objectives as those of the national government, including establishing levels of assistance granted to industries and individual companies, setting detailed production and capacity targets, determining which company will produce which products, and specifying which technologies will be used in production.⁶⁴

The Five-Year Plans of almost every provincial and local government in China identify one or more of the primary downstream industries in the specialty steel sector as “pillar” or “key” industries subject to preferential treatment and provide substantial governmental direction for the growth and evolution of the industries. For example, the relationship between Haier, an

⁶³ See Circular of the Ministry of Finance, State Development and Reform Commission, General Administration of Customs and State Administration of Taxation on Import Taxation Policies to Implement the Opinions of the State Council of Invigorating Equipment Manufacturing, Cai Guan Shui [2007] No. 11, available at <http://www.asianlii.org/cn/legis/cen/laws/cotmofsdarpgaocasaotoitptitootscoiem2494/>.

⁶⁴ See The Chinese Steel Industry, International Iron and Steel Institute, Issue 4 (Jan. 2007).

appliance manufacturer that is considered to be one of China's most successful modern enterprises, and the local governments in Qingdao City and Shandong Province is instructive as to how local governments in China have been bolstering the development of key enterprises in downstream industries in the specialty steel sector.

China's most famous international brand belongs to the electrical appliance company, Haier. Its CEO, Zhang Ruiming, is the only Chinese CEO to have appeared in Fortune's list of the "world's top 100 CEOs". Far from being the product purely of the free market, Haier's growth is explained by a combination of the entrepreneurial drive of its CEO, Zhang Ruiming, allied to the strong support of the local government in Qingdao City and Shandong Province. Haier received strong financial support from the local government through their relationship with the local banks; was supported by the government in its merger with other local firms, in negotiations with other governments to take over their local firms in gaining permission to list on the domestic stock market; and through the preferential allocation of high quality industrial land to help it expand through establishing a science park.⁶⁵

China's automotive industry, moreover, has been designated as a pillar industry by numerous provincial and municipal governments, with 24 provincial governments designating the automotive industry as a pillar industry by the mid-1990s.⁶⁶

Today, the primary downstream industries in China's specialty steel sector remain key industries supported by provincial and local governments throughout China.⁶⁷ The Provincial

⁶⁵ See Peter Nolan, Evaluation of the World Bank's Contribution to Chinese Enterprise Reform, at 8 (2005), available at [http://lnweb18.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/115BD744564229F85256FF000590B8C/\\$file/china_cae_enterprise_reform.pdf](http://lnweb18.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/115BD744564229F85256FF000590B8C/$file/china_cae_enterprise_reform.pdf).

⁶⁶ Andrew Wedeman, Crossing the River by Feeling for Stones or Carried Across by the Current? The Dynamics of Reform in Post-Mao China, at 28.

⁶⁷ Another example of an industrial policy implemented by a municipal government is Hefei's "industrial development plan," which identifies eight "key industries." See Hefei Municipal Government Catalogue of Favored Industries, available at www.hefei.gov.cn/english/zjhj.jsp?section=015003005&module=common&id=015003005. The key industries include: automotive; machinery; household appliances; chemical industry and tires; information (...continued)

Government of Guangdong, for instance, has identified many important, downstream consumers of specialty steel among the nine provincial pillar industries that are supported by the Guangdong provincial government (such as automotive, petrochemical, household appliances, construction, electronics, and information technology).⁶⁸ According to the “Prospect of the Nine Pillar Industries,” which sets out Guangdong’s industrial policies for the period 2005 through 2010, the Provincial Government of Guangdong is to increase the nine pillar industries’ international competitiveness and accelerate restructuring in the industries. Id. In the automotive industry, the government plans to increase the province’s annual production capacity to 1.6 million automobiles and to export 10 percent of its products. Id.

In Shanghai, another important manufacturing base, the Municipal Government of Shanghai provides incentives to enhance the competitive advantages of Shanghai’s six pillar industries – automotive, petrochemical and fine chemicals, refined steel, complete equipment manufacturing (machinery), information technology, and biomedical and pharmaceuticals.⁶⁹ Shanghai’s plans to develop its pillar industries is also set out in the Development Plan for Industry.⁷⁰

For instance, as discussed above, the Chinese government has identified numerous “key projects for the revitalization of China’s equipment manufacturing industry during the 2006- (...continued) technology and software; new materials; biotechnology and new medicine; and agriculture and food processing. Id. The industrial development plan calls for the government to support the industrial structure, product mix, and the structure of enterprises.

⁶⁸ See [Industry] Prospects of GD’s nine pillar industries (Mar. 30, 2005), available at <http://www.newsgd.com/business>.

⁶⁹ See Comprehensive Economic Development, Shanghai Foreign Economic Relation & Trade, available at www.smert.gov.cn/gb/2/node498/node580/userobject1ai10688.

⁷⁰ See Development plan for the industry, Shanghai Economic Committee (Investment Guidebook on Industry and Commerce in Shanghai), available at www.shec.gov.cn/shec/english/guidebook_content.jsp?id=12718&num=47-1-4.

2010 period . . .”⁷¹ Following the central government’s blueprint, the Municipal Government of Shanghai has set out the following plan to promote the development of its equipment (machinery) industry in its Development Plan for Industry:

Efforts shall be made to drive the upgrade and breakthrough of the equipment industry, while taking the opportunities of urbanization process to precisely elect the key point of breakthrough. In the meantime, the industry shall propel R&D by industrial, college/university and research institutions, while accelerating international cooperation and enhancing the level of industrialization. By 2010, technologies of core products shall reach leading international level. There shall be a number of large enterprises and system integration companies with international competitiveness. Technologies of power generating equipments, micro-electronics and coal liquefying equipments shall be among the world leading levels. A state-level advanced equipment manufacturing base shall be basically in place. It is predicted that the equipment industry shall turn out a gross industrial output of RMB 1 trillion by 2007, and RMB 1.5 trillion by 2010, accounting for about 50% and 54% respectively of that of the municipality.

Id. The government expects to advance in eight key segments within the equipment/machinery industry: (1) power station and power transmission/distribution equipments; (2) railway; (3) microelectronics equipment; (4) precision processing equipment; (5) key special equipment;⁷² (6) energy equipment; (7) new environmental protection equipment; and (8) smart test and automatic control equipment.

The Shanghai municipal government also has established a comprehensive plan to support its automotive industry. For instance, Shanghai’s industrial policy for the automotive

⁷¹ See Key Projects for Revitalizing Equipment Manufacturing Industry, Xinhua News Agency (Mar. 6, 2006), available at <http://www.china.org.cn/english/2006lh/160261.htm>.

⁷² The government will ensure that enterprises have the capacities to self-design and manufacture key equipment, such as ultra-large cylinders, ultra-large rotors, large high-pressure containers, large metallurgic and heavy mechanical rackets, large forged/cast parts, primarily shield bulldozers, port machinery, and heavy machine equipment. Id.

sector directs the industry to “focus on autonomous product development, brand building, exporting and maintaining the leading position” and to “enhance its core competence and the international operation capability.”⁷³

The Municipal Government of Tianjin, a significant specialty steel production base, has provided substantial assistance to important specialty-steel-consuming industries, which are among its six pillar industries (information technology, chemical and metallurgical, automotive, biotechnology and modern pharmaceutical, and new energy and environmental protection).⁷⁴ In 2005 alone, Tianjin’s government invested 160 billion yuan in 560 projects undertaken by its pillar industries. Id.

Lastly, provincial and local governments have been actively implementing the policy of “coordinative development.” An important implementation method used by these governmental authorities has been to attract investment by concentrating and unifying the production chain within specific areas known as “industrial clusters.”⁷⁵ Industrial clusters represent geographic concentrations of interconnected enterprises in a particular industry that share related production

⁷³ Comprehensive Economic Development, Shanghai Foreign Economic Relation & Trade, available at www.smert.gov.cn/gb/2/node498/node580/userobject1ai10688. See also Development plan for the industry, Shanghai Economic Committee (Investment Guidebook on Industry and Commerce in Shanghai), available at www.shec.gov.cn/shec/english/guidebook_content.jsp?id=12718&num=47-1-4.

⁷⁴ See China’s Tianjin Allocated More Investment for Pillar Industries, Asia Pulse (Feb. 22, 2005).

⁷⁵ See, e.g., Industrial Clusters in the Pearl River Delta (PRD), Industrial Cluster Series (Issue 2), Li & Fung Research Centre (May 2006), available at http://www.idsgroup.com/profile/pdf/industry_series/LFIndustrial2.pdf; Industrial Clusters in Yangtze River Delta (YRD), Industrial Cluster Series (Issue 3), Li & Fung Research Centre (May 2006), available at http://www.idsgroup.com/profile/pdf/industry_series/LFIndustrial3.pdf.

inputs, specialized labor pools, distribution and communication channels, and network associations.⁷⁶

In the Province of Guangdong, for instance, the provincial and local governments, with the approval of the People's Congress, have implemented a plan for the development of township clusters in the Western Pearl River Delta ("PRD"), the Plan for the Coordinated Development of the Pearl River Delta (PRD) Township ("PRD Coordinated Development Plan").⁷⁷ According to the PRD Coordinated Development Plan, the provincial and local governments in Guangdong are creating "three major processing manufacturing cluster areas," which include many of the primary downstream consumers of specialty steel, such as the home appliance industry. Indeed, the Guangdong provincial government has designated certain districts to be "cluster" areas for home electrical appliances, such as Zhongshan, Foshan, and Shunde. Id. at 17 and Appendix 3.

⁷⁶ See Overview of the Industrial Clusters in China, Industrial Cluster Series (Issue 1), Li & Fung Research Centre (May 2006), available at http://www.idsgroup.com/profile/pdf/industry_series/LFIndustrial1.pdf.

⁷⁷ See The Development of Western Pearl River Delta Region and its Prospects for Collaboration with Hong Kong, Greater Pearl River Delta Business Council, at 13 (Aug. 2006). The importance of the PRD Coordinated Development Plan, which was jointly formulated by the Ministry of Construction and the Guangdong provincial government, to the industrial policies implemented in Guangdong is explained as follows:

the "PRD Coordinated Development Plan" has the effect of local by-law, become the action guideline for co-ordinated development of township clusters in the PRD, and the legal basis for various relevant industries planning, special projects planning and the overall town planning within the region. Although all municipalities in the PRD are currently formulating new strategic planning schemes, the overall spatial strategy for development in the PRD and the positioning of each city would not deviate significantly from the "PRD Coordinated Development Plan."

Id.

Local governments have also actively fostered the development of appliance-specific “industrial clusters” in their jurisdictions. In Guangdong, both the Shunde district in Foshan, which is known as the “Kingdom of Household Appliances,”⁷⁸ and the Nantou district in Zhongshan, “a renowned home appliances production base with the title of ‘Specialized Town for Home Appliances in Guangdong,’” have used preferential measures to successfully attract many electrical appliance producers.⁷⁹

D. Summary

As a whole, the industrial policies implemented by the Chinese government at all levels to ensure the viability of downstream industries in China’s specialty steel sector are a prime example of China’s extensive governmental efforts to manipulate the market and dictate outcomes by involving itself in decisions that should be made by the market. As next discussed in section IV, these industrial development policies and strategies provide the framework for a variety of direct and indirect support measures executed by the Chinese government to ensure that its “pillar” industries and “national champion” SOEs do not fail.

⁷⁸ See PRD Economic Profile, Pearl River Delta Business, available at <http://www.prdbiz.com/prd/economicprofile.php> (explaining that “electrical appliances” is an industrial cluster in the Shunde district of Foshan City).

⁷⁹ See Overview of the Industrial Clusters in China, Industrial Cluster Series (Issue 1), Li & Fung Research Centre (May 2006), at 10, available at http://www.idsgroup.com/profile/pdf/industry_series/LFIndustrial1.pdf. See also The Development of Western Pearl River Delta Region and its Prospects for Collaboration with Hong Kong, Greater Pearl River Delta Business Council, at 29-30 (Aug. 2006) (explaining that “{u}nder the municipal administration of Zhongshan are a number of specialised town {sic}, each engaging in developing a different pillar industry”).

IV. MEASURES EMPLOYED BY THE CHINESE GOVERNMENT TO SUPPORT AND DEVELOP DOWNSTREAM INDUSTRIES IN CHINA'S SPECIALTY STEEL SECTOR

To carry out China's industrial policies to develop and protect downstream industries in China's specialty steel sector, various direct and indirect support measures have been implemented by governments at the national, provincial, and local levels. Specific support measures used by the Chinese government to encourage the production and exportation of downstream industries in China's specialty steel sector are detailed below.

Obtaining information regarding the nature and type of assistance received by Chinese producers is complicated, because corporate reporting in China is limited and often unavailable, particularly from SOEs. Indeed, a report issued by the Office of the United States Trade Representative has described the difficulty of obtaining information regarding Chinese support measures as follows:

China's subsidy programs are often the result of internal administrative measures that are not publicized. Sometimes they take the form of income tax reductions or exemptions. They can also take a variety of other forms, including mechanisms such as credit allocations, low interest loans, debt forgiveness, and reduction of freight charges.⁸⁰

Accordingly, due to the lack of publicly available information in China, the beneficiaries of subsidies granted by the Chinese government are not identified, in most instances, in this report.

A. Subsidies Provided to Downstream Industries in China's Specialty Steel Sector

1. Debt-to-Equity Swaps

Debt-to-equity swaps are one of the primary tools utilized by the Chinese government to carry out its reform and restructuring of favored industries and SOEs under its national industrial

⁸⁰ See United States Trade Representative, 2006 National Trade Estimate Report on Foreign Trade Barriers, at 120 (March 2006).

policies. China has employed this technique to prop up state-owned enterprises through direct government infusions of cash. Indeed, the Chinese government has acknowledged that the debt-to-equity swap program is “designed to free key SOEs from debt burdens.”⁸¹

In the typical debt-to-equity swap, non-performing loans (“NPLs”) owed by steel companies are transferred from their state-owned creditor banks to one of four asset management companies (“AMCs”).⁸² The four AMCs, which are owned by the Chinese government’s four largest state-owned banks, include: (1) China Huarong Asset Management Corp. (“Huarong AMC”), owned by Industrial and Commercial Bank of China (“ICBC”); (2) China Great Wall Asset Management Corp. (“Great Wall AMC”); (3) China Orient Asset Management Corp. (“Orient AMC”); and (4) China Cinda Asset Management Corp. (“Cinda AMC”), owned by China Construction Bank (“CCB”).⁸³ The AMCs then exchange the debt for shares in the companies. The companies often receive an additional benefit pursuant to these transactions, because many debt-to-equity swap agreements require the AMCs and creditor banks to continue providing assistance to the companies after the swap had occurred. Id.

Numerous SOEs in downstream industries in China’s specialty steel sector have participated in China’s debt-to-equity swap program. SOEs in the automotive and chemical industries, for instance, were among the beneficiaries of debt-to-equity swaps in Chingqing

⁸¹ See Goal of SOE Reform Achieved, People’s Daily Online (Dec. 27, 2000), available at http://english.people.com.cn/200211/01/print200012/27/print20001227_58958.html.

⁸² See China’s Bad-debt Disposal Speeds Up, People’s Daily Online, available at http://english.people.com.cn/200211/01/print20021101_106096.html.

⁸³ See China’s debt-for-equity swaps proceed despite concern, Japan Economic Newswire Plus (Nov. 13, 1999).

Province.⁸⁴ In Beijing, 17 SOEs in various industrial sectors, including the machinery industry (Beijing Heavy Electrical Machinery Plant) and the high-tech industry, reduced their debts by 16.84 billion through this subsidy program.⁸⁵

These debt-to-equity swaps constitute countervailable subsidies because they are not on commercial terms. As an initial matter, the Chinese government does not act as a reasonable private investor when it exchanges unpaid debt for equity shares, because it already owns these enterprises. By converting the debt owed to the government-owned banks into equity, the Chinese government does not change its ownership position in the enterprises. It does, however, give up its right to payments of the principal and interest owed on the debt.

Further evidence of the non-commercial nature of the debt-to-equity swap transactions is demonstrated by the Chinese government's failure to act as a reasonable private investor when it assesses whether to exchange the unpaid debt for equity shares. China does not conduct an analysis of whether the investments will generate a reasonable rate of return in a reasonable period of time. Rather, the Chinese government views the deals as a means to reduce the companies' liabilities-to-assets ratio and thereby boost the companies' competitiveness.⁸⁶ According to the Director of Development and Planning Department under the State

⁸⁴ See Major Deb-to-Equity Swap Project in Chongqing Signed, People's Daily Online (Feb. 25, 2000), available at http://english.peopledaily.com.cn/english/20007/08/print20000508_40335.html.

⁸⁵ See Beijing State-Owned Enterprises Accomplish Debt to Equity Task, People's Daily Online (Jan. 27, 2001), available at http://english.peopledaily.com.cn/english/20007/08/print20000508_40335.html.

⁸⁶ See Tisco, South China Morning Post (Jan. 4, 2000).

Administration of Metallurgical Industry (“SAMI”), the debt-to-equity swap program is, “a big boon for debt-stricken steel enterprises struggling for profits.”⁸⁷

Further evidence of the noncommercial nature of the debt-to-equity swap transactions is provided in the unwillingness of international investors and financiers, including the World Bank, to participate in the program. The World Bank has criticized the deals as being “flawed in their financing plans and in identification and transfer of such funds.” Id. The foreign investment community, moreover, has been skeptical of the process and has not participated in the debt-to-equity swap program. Id. Many Chinese companies, moreover, consider the debt-to-equity swap program “as a one-time debt write-off sanctioned by Beijing.”⁸⁸

2. Equity Infusions

Chinese producers in key industries also have been heavily subsidized by equity infusions from the Chinese government. While this scheme has enabled the government to provide substantial cash subsidies to favored enterprises, the government has gained no additional rights by acquiring ownership shares in companies in which it already has been the dominant shareholder. As shown in the following example, the terms of the equity transactions confirm that the Chinese government fails in these arrangements to obtain a reasonable commercial return on its investment.

On April 27, 2005, Baosteel issued five billion new public shares, of which two billion were placed with public investors, and three billion were purchased by Baosteel Group,

⁸⁷ See China Debt-to-Equity Swaps Help Steel Makers, China Daily (Mar. 26, 2000).

⁸⁸ Id. The two remaining AMC’s are China Great Wall Asset Management Corporation and China Orient Asset Management Corporation. See Foreign bankers remain skeptical as Cinda takes equity in five companies – Debt-swap deals to test reform plan, South China Morning Post (Oct. 14, 1999).

Baosteel's wholly state-owned parent company and majority shareholder.⁸⁹ Of the two billion shares placed with public investors, 1.65 billion were listed on the Shanghai Stock Exchange and placed preferentially to current shareholders. Id. The remaining shares were placed with institutional investors. The issue price was set, by inquiry, at RMB 5.12 per share, yielding funds totaling approximately RMB 25.6 billion (\$3.19 billion). Id.

The new share issuance provided a substantial subsidy to Baosteel because the government, through the 100-percent state-owned Baosteel Group, paid an overvalued price for its three-fifths portion of the new share issuance.⁹⁰ While the government paid the same price as the shares sold to private parties, RMB 5.12 per share, the government's shares had different rights and restrictions that should have made them worth less. Id.

Specifically, the Chinese government's shares were encumbered by various restrictions: (1) prior to August 18, 2005, the shares owned by the government were not tradable -- including the new shares issued on April 27, 2005; (2) after August 18, 2005, the trading rights obtained by the government are highly conditional, with only certain portions of Baosteel Group's shares allowed to be traded as per a specified schedule and further limitations imposed if the trading price falls below a certain level; (3) the government is prohibited from selling its shares for less than RMB 5.63 after the initial period; and (4) the government may never own less than 67 percent of the total number of shares. Id. at 5, 110 n.30. Further, the Chinese government has stated that it would prevent Baosteel's share price from ever falling below RMB 4.53 in order to "protect the interests of investors." Id. at 110 n.30. The government would protect the investors' interests by manipulating the share price, if necessary, through further injections

⁸⁹ See 2005 Baosteel Annual Report at 5.

⁹⁰ Any amount paid over fair market value would constitute a subsidy.

and/or purchases of public shares on the Shanghai Stock Exchange. Id. Nonetheless, Baosteel Group purchased three billion of these limited shares for the same price that private investors paid for tradable shares.

3. “Policy Loans” from State-Owned Banks

Downstream industries in China’s specialty steel sector, particularly key SOEs in these industries, have benefited from massive amounts of subsidized loans provided by the Chinese government through its state-owned banks. As referenced earlier, China’s banking system is dominated by four state-owned banks – the ICBC, the CCB, the People’s Bank of China, and the Agricultural Bank of China – which account for over 60 percent of all loans.⁹¹ In accordance with the industrial policies of central or local governments, these banks have made loans based on political directives (so-called “policy loans”), rather than the borrowers’ creditworthiness or other market-based factors. The Chinese government has instructed banks in China to provide loans to further its industrial policies on numerous occasions.

For instance, in mid-1996 the People’s Bank of China (“PBC”) announced that state banks would increase “circulating capital loans” in the second half of the year to key state enterprises to ease shortage of operation funds.⁹² In 1998, China put banking reform on hold to lend billions of yuan to key SOEs and infrastructure projects to maintain economic growth targets.⁹³ Policy loans have also been used by the Chinese government to carry out the

⁹¹ Luo Ping, Challenges for China’s Banking Sector and Policy Responses (Nov. 14-16, 2003).

⁹² See The Mineral Industry of China, U.S. Geological Survey – Minerals Information, at 3 (1996).

⁹³ See The Mineral Industry of China, U.S. Geological Survey – Minerals Information, at 1 (1998).

restructuring and modernization of favored industries and SOEs.⁹⁴ The ICBC, for example, reports that “{a} considerable part of its loans have been channeled to the State’s key corporations and key projects.”⁹⁵ In 2000 alone, the ICBC made loans in the amount of RMB 67 billion to favored SOEs for restructuring and modernization projects.⁹⁶

Because capital allocation is driven by political concerns and official edict rather than market mechanisms, these “policy loans” generally have gone to SOEs and to industries favored by the Chinese government, such as the primary downstream consumer industries in the specialty steel sector.⁹⁷ Local officials have supported inefficient SOEs through bank lending, fearing the social disturbances that might be triggered by disgruntled, unemployed workers.⁹⁸ Currently, SOEs account for 25 percent of China’s GDP, but receive over 65 percent of loans from state-owned banks.⁹⁹

⁹⁴ See Goal of SOE Reform Achieved, People’s Daily Online (Dec. 27, 2000), available at http://english.people.com.cn/200211/01/print200012/27/print20001227_58958.html.

⁹⁵ See ICBC’s Assets Exceed 4 Trillion Yuan, People’s Daily Online (Dec. 28, 2000), available at http://english.peopledaily.com.cn/english/200012/28/print20001228_59047.html.

⁹⁶ See ICBC Puts in 139 Billion Yuan in Fixed Assets, People’s Daily Online (Jan. 2, 2001), available at http://english.peopledaily.com.cn/english/200101/02/print20010102_59423.html.

⁹⁷ See Reform of China’s Banks, Burdened by Bad Loans, Is Priority for Government. A recent IMF report concludes that “banks remain exposed to several sectors that are likely over invested, such as steel, cement, aluminum, and construction and, are therefore vulnerable to an economic slowdown and/or consolidation in these sectors.” Richard Podpiera, Progress in China’s Banking Sector Reform: Has Bank Behavior Changed?, No. WP/06/71, at 11 (Mar. 1, 2006).

⁹⁸ See Minying Enterprises and High-Technology Zones, available at http://www.law.gmu.edu/nctl/stpp/us_china_pubs/6.8_Minying_Enterprises_High_Tech_Zones.pdf.

⁹⁹ See Reform of China’s Banks, Burdened by Bad Loans, Is Priority for Government (Jun. 1, 2005), available at <http://knowledge.wharton.upenn.edu/index.cfm?fa=printArticle&ID=1202>.

Additionally, the Chinese government has channeled its finances to preferred industries at extremely low, non-market interest rates.¹⁰⁰ Indeed, WTO member countries concluded in late 2005 that China continues to provide “preferential bank financing to producers of agricultural and industrial goods, despite a clear commitment by China four years ago to eliminate all prohibited subsidies upon its accession to the WTO.” Id. at 13. Since 1998, these banks collectively have benefited from repeated governmental capital injections and nonperforming loan purchases in excess of \$250 billion.¹⁰¹ The U.S. delegation at the WTO further stated that:

[S]tate-owned banks continue to make policy-driven loans that are not commercially justified, and when those loans fail, the loans are written-off and passed to the asset management companies to be dealt with. The recent inauguration of Huida Asset Management Ltd., set up to specifically deal with the non-performing loans of the state-owned People’s Bank of China is one such example.¹⁰²

In its 2005 report to the U.S. Congress, the U.S.-China Economic and Security Review Commission determined low- and no-cost financing to be “one of the most pervasive forms of subsidies in the Chinese economy.”¹⁰³ The Commission reported that this system of policy lending, whereby capital is allocated for political or strategic reasons using subsidized interest rates and other noncommercial terms, arguably amounts to a massive governmental subsidy for Chinese firms that is used both to bolster their operations and to fund acquisitions. Id.

¹⁰⁰ According to Morgan Stanley, prices on a variety of financial instruments, such as interest rates, bank credit lines and bond prices, are tightly controlled by leadership decisions made at the highest levels of the Chinese government. See Stephen S. Roach, Inside the China Debate, at 2 (2006).

¹⁰¹ WTO No. G/SCM/Q2/CHN/14, at 3 (Sept. 29, 2005).

¹⁰² Id.

¹⁰³ See 2005 Report to Congress of the U.S.-China Economic and Security Review Commission, at 39.

These preferential loans, granted on non-commercial terms to inefficient SOEs, have subsidized downstream industries in the specialty steel sector and have given the industries an unfair advantage in the market.¹⁰⁴ Today, Chinese producers in pillar industries continue to have access to subsidized financing from state-owned banks that have a strong incentive and Chinese governmental direction to lend to these preferred industries. Without access to the records of the state-owned banks, asset management companies, and other lenders, it is impossible to know the full extent to which these industries have benefited from China's subsidized loans. Given the importance of these industries to China's economic growth and development, however, it is reasonable to conclude that the level of borrowing and the benefits to the industries have been substantial. In just one example, SAIC, China's largest automaker, received "huge amounts of bank credit for its market expansion."¹⁰⁵

4. State Bond-Financed Projects

This program carries out China's Five-Year Plans by restructuring certain key industries, including the many downstream industries in China's specialty steel sector, to make them internationally competitive and to promote domestic production in China to take the place of imports. Since 1999, the Chinese government has used State Bond-Financed Projects ("SBFP") to restructure and modernize SOEs in key industries.¹⁰⁶ According to the Chinese government,

¹⁰⁴ These state-owned banks are, in essence, acting as the government when they provide loans. Indeed, according to the Working Party Report on China's accession to the WTO, "when state-owned enterprises, including banks, provide financial contributions they are doing so as government actors." Thus, to the extent that the loans are being provided at preferential or below-market rates, they constitute a subsidy. See WTO No. G/SCM/118, at 12 (Nov. 9, 2005).

¹⁰⁵ See Bank Backs Shanghai Auto Industry, People's Daily Online (Jul. 8, 2000), available at <http://english.peopledaily.com.cn/english/200007/08.html>.

¹⁰⁶ See 19.5b Yuan T-Bonds Stimulate 240b Yuan of Investment in Technological Upgrading, People's Daily Online (Mar. 21, 2001), available at http://english.peopledaily.com.cn/english/200103/24/print20010324_65893.html.

by the end of 2000, 880 projects had been “helped with interest-discount T-bonds to a sum of 240 billion yuan. Of the 240 billion yuan, 145.9 billion yuan were bank loans and 195 billion yuan {sic} government grants.”¹⁰⁷

China has prioritized technological updating of enterprises and products in numerous downstream industries in the specialty steel sector. Government-funded modernization projects have, for example, been undertaken by SOEs “in such major industrial sectors as metallurgical, petrochemical, nonferrous metal, machinery, textile and information and others involving papermaking, medicine, building material, chemistry.” Id.

5. State Key Technology Renovation Project Fund

The Chinese government also has provided downstream industries in China’s specialty steel sector with significant subsidies in the form of subsidized (or reduced interest) loans for the strategic restructuring of key SOEs and technical transformation of key production technologies. In this regard, the Chinese government implemented the State Key Technology Renovation Project Fund (“SKTRPF”) in 1999, with 15.3 billion yuan earmarked “for technological renovation efforts of the country’s old industries, including the key metallurgical industry.”¹⁰⁸

Under the aegis of the SKTRPF, China has granted these subsidies pursuant to at least two State Economic and Trade Commission (“SETC”) programs, Loan Interest Subsidy Fund program and Key Technology Project program, which were promulgated in 1999 and 2000,

¹⁰⁷ Id. It is believed that the figure of 195 billion yuan in government grants should be 95 billion yuan in order to be added to the 145.9 billion yuan in bank loans to equal the total of 240 billion yuan.

¹⁰⁸ See China on Way to World Steel Power (Sept. 13, 1999), available at <http://www.people.com.cn/english/199909/14/chnmedia.html>.

respectively.¹⁰⁹ The Loan Interest Subsidy Fund set up a discretionary fund to subsidize interest on loans for industry technological upgrades, while the Key Technology Project program provided further, specific guidance as to what technology projects are “key,” so that they should receive support.

These programs fit hand-in-glove with the overarching industrial policy set forth in China’s Five-Year Plans. Indeed, the Loan Interest Subsidy Fund program stated that the “subsidy fund shall follow the principles . . . {of} the national industrial policies,” with the goal of “aggressively impel{ling} economic growth through sped up {technological} transformation.”¹¹⁰ Likewise, the Key Technology Project program was formulated “in accordance with the national industrial policy.”¹¹¹ Notably, one of its stated goals was to “expand exports” of “key products” and “key industries.” Id.

The Key Technology Project program, moreover, is essentially a list that identifies 27 key product areas and industries. The specialty steel industry and specialty steel products are first on the list of 27. Section 1 on “Key Steel Varieties” indicates several “urgently needed, technically difficult, high added-value varieties of steel products” that must be developed. Id. at Sec. 1.

¹⁰⁹ See Management Measures of Technology Renovation Projects Loan Interest Subsidy Fund, State Economic and Trade Commission (Apr. 2, 1999) (“Loan Interest Subsidy Fund”); National Key Technology Renovation ‘Shuang Gao Yi You’ Project, State Economic and Trade Commission (Jun. 2000) (Chinese language document) available at <http://www.jzgy.net/qgb/zcfg/fg26.htm> (“Key Technology Project”).

¹¹⁰ See Loan Interest Subsidy Fund, at Ch. 2, Sec. 3.1 and Ch. 1, Sec. 1, respectively.

¹¹¹ See Key Technology Project, at Preamble.

6. Science and Technology Development Subsidies

As discussed in section III above, the Chinese government is implementing a comprehensive S&T industrial policy that is infused with economic nationalism under the Eleventh Five-Year Plan.¹¹² China has significantly increased governmental funding to support enterprises and projects involved in R&D or high-technology projects that include: (1) preferential support from policy banks; (2) directly grants of money; (3) encouragement of government agencies to use procurement policy to support targeted technologies; (4) reduced rate of income taxes at 15 percent; (5) VAT rebates on high-tech exports; and (6) repayment guarantees to induce support from commercial banks. Id.

Additionally, under the Technology Importing and Innovation Plan, Chinese policy banks and commercial banks may grant “domestic enterprises with necessary financial support for importing advanced technologies and their re-innovating.”¹¹³ China also uses the 11th Five Year Plan for High Technology Sector Development and the S&T Development Plan (2006-2020) to identify favored industries and developmental priorities for certain of these industries. The Chinese government, for instance, has established research goals for the semiconductor industry that are funded by government labs.¹¹⁴ The Chinese government also supports development of

¹¹² See “China’s State Sector, Industrial Policies and the 11th Five Year Plan,” Testimony of Barry Naughton, Professor, before the U.S.-China Economic and Security Review Commission Hearing on the “Extent of the Government’s Control of China’s Economy, and Implications for the United States” (May 24, 2007), available at http://www.uscc.gov/hearings/2007hearings/written_testimonies/07_05_24_25wrts/07_05_24_25_naughton_statement.php.

¹¹³ See Technology Importing and Innovation Plan at Art. 16.

¹¹⁴ See “China’s State Sector, Industrial Policies and the 11th Five Year Plan,” Testimony of Barry Naughton, Professor, before the U.S.-China Economic and Security Review Commission Hearing on the “Extent of the Government’s Control of China’s Economy, and Implications for the United States” (May 24, 2007), available at http://www.uscc.gov/hearings/2007hearings/written_testimonies/07_05_24_25wrts/07_05_24_25_naughton_statement.php.

S&T in China through specific engineering projects (or *Gongcheng*), such as the development of civilian passenger aircraft. Id.

7. Provision of Land at Preferential Rates

The Chinese government also subsidizes enterprises in China through the provision of land at preferential prices.¹¹⁵ Given the importance of downstream industries in China's specialty steel sector, it is likely that enterprises in these favored industries have benefited from these significant subsidies.

Private land ownership, either by individuals or corporations, is prohibited in China.¹¹⁶ China's constitution declares, "Land in the cities is owned by the state. Land in the rural and suburban areas is owned by collectives except for those portions which belong to the state."¹¹⁷ Thus, to the present time, all real property officially remains in the hands of the state. Within this framework of public ownership, the Chinese government offers lease agreements or other forms of land-use rights rather than transferring actual ownership.¹¹⁸ As this section will demonstrate, the bifurcation or separation of land use from land ownership creates a unique land

¹¹⁵ See, e.g., Memorandum from David M. Spooner, Assistant Secretary for Import Administration, to Stephen J. Claeys, Deputy Assistant Secretary for Import Administration, Issues and Decision Memorandum for the Final Affirmative Countervailing Duty Determination: Laminated Woven Sacks from the People's Republic of China, at Comment 1 (Jun. 16, 2008) ("LWS I&D Memo") (finding that Chinese companies received subsidies in the form of a complete waiver of land-use fees within the parks or the form of land-use rights at preferential rates).

¹¹⁶ See Memorandum from David M. Spooner, Assistant Secretary for Import Administration, to Joseph A. Spetrini, Deputy Assistant Secretary for Import Administration, Antidumping Duty Investigation of Certain Lined Paper Products from the People's Republic of China ("China") – China's Status as a Non-Market Economy (Aug. 30, 2006) (recognizing that the Chinese government, "either at the national or local level, is the ultimate owner of all land in China").

¹¹⁷ Chinese Constitution, Ch 1, Art. 10. Agricultural collectives, are state entities.

¹¹⁸ See Barry Naughton, The Assertive Center: Beijing Moves Against Local Government Control of Land, China Leadership Monitor, No. 20 (Winter 2007). See also Cao Pei, Real Estate Law in China, at 10 (1998) ("Real Estate Law in China").

market that is easily manipulated to subsidize key industries, such as downstream industries in China's specialty steel sector. Indeed, China itself has acknowledged that Chinese producers receive subsidized land. Chinese Premier Wen Jiabao recently said publicly that the key Chinese industries in fact receive discounts on land, stating that "local governments . . . routinely offer free or cut-rate real estate . . . to developers looking to set up job-creating businesses . . ." Id.

China has established two distinct manners in which corporations may utilize the land without actually owning it: (1) "allocated" land-use rights; and (2) "granted" land-use rights.¹¹⁹ Both have been used to support favored industries in China. As China underwent the process of nationalizing real property following the Communist party's ascendancy in 1949, it allocated the right to use parcels of land to SOEs, state agencies, social organizations, and other enterprises without fee and for an indefinite term.¹²⁰ These "allocated" land use rights ("ALRs") were not transferable, and land-users were limited to the land-use specified by the Chinese government at the peril of forfeiting the land-use right.¹²¹ The transition to China's current real property regime began in 1981 with the introduction of the fee-for-use concept, first by local law in Shenzhen, and then by similar laws in other municipalities.¹²² Under these laws, an individual or organization seeking land for a proper purpose can obtain for a fee a "granted land-use right" ("GLR"), essentially an agreement allowing the individual or organization exclusive right to a

¹¹⁹ See, e.g., LWS I&D Memo, at Comment 1.

¹²⁰ Tung-Pi Chen, Emerging Real Estate Markets in Urban China, 8 Int'l Tax & Bus. Lawyer 78, 81 (1990).

¹²¹ Real Estate Law in China at 9.

¹²² The first law allowing issuance of "granted land-use rights" was the 1981 Shenzhen SEZ Provisional Statute on Land Administration, administered by the Shenzhen Municipality. Real Estate Law in China at 28.

particular parcel, for a particular use, for a definite period of time, by applying to the local government. Id.

In 1988, China amended its Constitution to allow sale and transfer of these GLRs,¹²³ and in 1990, the GLR concept was implemented nationally with promulgation of the Interim Regulations of the PRC on Granting and Transferring the Right to the Use of State-owned Land in Cities and Towns.¹²⁴ These regulations replicated the local GLR laws issued in previous years, but still allowed for a variety of divergent practices. Id. The regulations also set the standard terms for GLRs based on the purpose of the grant -- for example, land-use rights for industrial purposes have a term of 50 years.¹²⁵

China promulgated a comprehensive national real estate law effective January 1, 1995, which standardized state policies and certain practices with regard to land-use rights. The 1995 Land Law clarified the conditions and methods to which local governments must adhere when granting and pricing land-use rights.¹²⁶ Specifically, when a local land authority grants a GLR, it must execute a written contract with the land-user. Id. at Art. 14. Land-use rights “may be granted in a manner of auction, invitation to bid” or, significantly, “bilateral negotiations,” *i.e.*, negotiations between “the land administration department of the city or county . . . government

¹²³ See Seventh National People’s Congress, Amendments to the 1982 Constitution of the People’s Republic of China (adopted 1st sess., April 12, 1988), as reported in “China’s Constitutional Framework,” U.S. Congressional-Executive Committee on China (Jun. 3, 2004), available at <http://www.cecc.gov/pages/virtualAcad/gov/stateconst.php?made=print> (last visited Mar. 7, 2007).

¹²⁴ Real Estate Law in China at 30.

¹²⁵ Interim Regulations of the PRC on the Assignment and Transfer of the Land Use Right of State-Owned Land in the Urban Areas, at Art. 12 (1990).

¹²⁶ See Law of the People’s Republic of China on Management of Urban Real Estate – 1995,” (July 5, 1994) (“1995 Land Law”), available at <http://www.lehmanlaw.com/resource-centre/laws-and-regulations/real-estate/the-law-of-the-peoples-republic-of-china-on-urban-real-estate-administration-1994>.

and the land user.”¹²⁷ Notably, when the price of a GLR is set via bilateral negotiations, the *only* limitation is a “minimum price fixed in accordance with the State’s regulations.” Id. at Art. 12. As a result, local governments have substantial discretion in initial land-use pricing and thus can easily set artificially low prices to favor key enterprises or industries.

Moreover, this minimum “fixed” price does not appear to be based on market principles. To the contrary, mandatory real property valuation methods indicate that governmental policies, not market forces, primarily drive land-use pricing in China. Pursuant to the 1995 Land Law, the “datum land price, labeled land price and re-purchase price for various types of premises shall be fixed and made public on a regular basis,” according to measures adopted by the State Council of China. Id. at Art. 32. The law further indicates that all land-use rights’ valuations must be performed on the basis of these fixed prices, while merely “taking reference of the local market price.” Id. at Art. 33. Thus, where the value of a GLR is concerned, market forces are only a secondary consideration to state policy.

The effects of these laws are highly predictable. First, when a state-owned entity sells GLRs to a favored SOE, the 1995 Land Law’s non-market valuation methods facilitate artificial land pricing, virtually ensuring significant land subsidies. Second, as local governments compete for tax income and jobs, these governments are likely to manipulate the fixed prices and weight “reference” to local market prices to maximize their already substantial discretion, allowing significantly undervalued GLR sales to favored enterprises. Such subsidies are particularly widespread because local governments stockpile land to grant land use-rights. According to the World Bank, Chinese municipalities use various methods to acquire as much land as possible for little or no cost, and then grant land-use rights on the acquired lands for

¹²⁷ Id. at Arts. 12 and 14.

revenue purposes, often at below-market rates to favored enterprises.¹²⁸ For example, municipalities often acquire rural land from agricultural collectives, converting it to non-rural use by granting GLRs. *Id.* at 8. Because the municipality may resell land acquired from farmers for a price as large as 100 times what it cost the municipality to acquire it from the farmers, it can easily grant a land-use right to a steel producer for a price that is much less than this -- for example, five times its acquisition cost -- and thereby confer a large subsidy upon the steel producer, while still generating considerable revenue. *Id.* Municipalities also often designate rundown urban areas for re-development and forcibly resettle the inhabitants, increasing the supply of land for new GLRs and thus facilitating local subsidies to favored land-users.

Because Chinese law ensures that all use of land and land-planning conforms to China's macroeconomic plans and industrial policies, there can be no doubt that land use planning makes more and better-suited land available for favored industries and enterprises, including the steel industry. Article 11 of the 1995 Land Law explicitly commands local governments to set the "purpose, terms of use, and all other conditions regarding each individual land use right . . . in accordance with land use plans to be promulgated by city and county land administration departments."¹²⁹ These local land-use plans must be approved by the provincial government, which must follow the land-use planning of the Chinese government.¹³⁰ All sales of land-use

¹²⁸ See George E. Peterson, Land Leasing and Land Sale as an Infrastructure-Financing Option, World Bank Policy Research Working Paper 4043, at 7 (Nov. 2006).

¹²⁹ See 1995 Land Law at Art. 11. Moreover, the extreme penalty for failing to properly use land underscores the level of governmental control of land-use and market-interference: if the holder of a land-use right does not "commence" the planned use of the land within two years of the grant, or if a holder uses land for an improper purpose, the state can reclaim the land-use right without compensation. *Id.* at Art. 25.

¹³⁰ *Id.* at Art. 11; Real Estate Law in China at 59.

rights must also conform to all land-use plans.¹³¹ In 1998, China further strengthened land-use control by promulgating the “Land Use Purpose Control System.”¹³² Pursuant to this system, comprehensive land-use plans are now promulgated by the State Council, while provinces, counties, and townships each create land-use plans conforming to the State Council plan. *Id.* at Arts. 17-18. Plans by counties include land-zoning and uses purpose definitions, while township plans must define the specific use of each plot. *Id.* at Art. 20

Importantly, all land-use plans must conform to the requirements of China’s industrial policies. *Id.* at Arts. 17 and 24. The conclusion is inescapable that land-use planning, and the GLR grants and transfers made pursuant to such planning, subsidize key enterprises, such as downstream industries in the specialty steel sector.

Finally, the 1995 Land Law includes provisions regarding ALRs. This confirms that the practice of “allocating” land-use rights, unlimited in duration and without any fee, continues to the present time. Specifically, local governments may provide ALRs for “construction lands . . . used for such projects as energy, communications and water enjoying priority support by the State” and “other lands as provided for by laws and administrative regulations.” *Id.* at Arts. 23.3 and 23.4. Because significant quantities of specialty steel are required in all of these projects, such as the construction of power plants and water facilities, these provisions strongly suggest that producers in downstream industries in the specialty steel sector receive land from the government for such purpose at substantially-preferential prices.

¹³¹ Specifically, when a GLR is transferred or sold, the use may not be changed unless both the original granting authority and the responsible land-use planning department consent to the change and execute a new grant contract with an adjusted land-use fee. 1995 Land Law at Art. 43.

¹³² See The Law of Land Administration of the People’s Republic of China (1998, effective Jan. 1, 1999) available at <http://product.chinawe.com/cgi-bin/lawdetail.pl?LawID=434>.

8. Provision of Raw Materials at Preferential Rates

Downstream industries in China's specialty steel sector benefit from government programs that subsidize the cost of raw materials, including outright grants and price discounts as well as export-restriction schemes.

a. Provision of SOE-Produced Raw Material Inputs

The Chinese government provides raw materials to producers in key industries at preferential, subsidized prices. A recent report by the U.S.-China Economic and Security Review Commission concluded that “[p]rovincial and municipal governments subsidize purchases of ... raw materials ... by requiring other SOEs or pressuring their own suppliers to provide these inputs at below-market or even below-cost prices.”¹³³ Indeed, the U.S. Department of Commerce has found in recent countervailing duty investigations of products imported from China that the Chinese government confers substantial countervailable subsidies upon producers of downstream products, including specialty steel products, the provision of raw material inputs at below-market prices.¹³⁴

¹³³ See 2007 Report to Congress of the U.S.-China Economic and Security Review Commission, November 2007, at 40.

¹³⁴ See, e.g., Memorandum from David M. Spooner, Assistant Secretary for Import Administration, to Stephen J. Claeys, Deputy Assistant Secretary for Import Administration, Issues and Decision Memorandum for the Final Affirmative Countervailing Duty Determination: Certain New Pneumatic Off-the-Road Tires (OTR Tires) from the People's Republic of China, at 9-12 (Jul. 7, 2008) (“OTR Tires I&D Memo”) (finding the Chinese government's provision of natural and synthetic rubber to constitute a countervailable subsidy); Memorandum from David M. Spooner, Assistant Secretary for Import Administration, to Stephen J. Claeys, Deputy Assistant Secretary for Import Administration, Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Circular Welded Carbon Quality Steel Pipe from the People's Republic of China at 9-12 (May 29, 2008) (“CWP I&D Memo”) (concluding that the Chinese government conferred a countervailable subsidy upon steel producers that purchased government-produced hot-rolled steel at preferential prices); LWS I&D Memo, at 18 (finding Chinese companies received countervailable subsidies through the provision of biaxial-oriented polypropylene at preferential rates from state-owned petrochemical (...continued)

For example, Angang Steel has received significant raw-material subsidies through its relationship with its government-owned parent. Angang Holding, a government-owned entity, has provided guaranteed price discounts to Angang Steel with respect to the steelmaker's purchases of iron ore.¹³⁵ According to the company's financial reports, Angang Holding has guaranteed a 10-percent price discount on the average import price paid by Angang for iron ore. Chinese producers of specialty steel and downstream specialty steel products are likely to benefit from similar arrangements involving the purchase of raw materials, such as nickel and molybdenum, and specialty steel at subsidized prices.

b. Restraints on Exports of Raw Materials

The Chinese government also has utilized a number of export-restriction schemes, including export-licensing schemes and differential-export-tax ("DET") schemes, to ensure abundant domestic supplies of critical raw materials and to maintain artificially low pricing for those inputs. The stated position of the government with respect to the increased export restrictions is that they "reduc[e] exports of high energy-consuming and highly polluting products, while encouraging the import of low energy materials and low-level resource products in an attempt to address China's trade imbalance."¹³⁶ However, the main beneficiary of the

(...continued)

producers); and Circular Welded Austenitic Stainless Pressure Pipe from the People's Republic of China: Preliminary Affirmative Countervailing Duty Determination and Alignment of Final Countervailing Duty Determination With Final Antidumping Duty Determination, 73 Fed. Reg. 39,657, 39,663-665 (Jul. 10, 2008) (finding the sale of government-produced stainless steel to downstream consumers at preferential prices to constitute a countervailable subsidy).

¹³⁵ Angang Steel Company Limited 2006 Annual Report, at 74.

¹³⁶ See China's Planned Aluminum-Product Export Tax Rebate Reduction Worries Industry, Resource Investor (May 21, 2007). See also See Steel and Iron Industry Development Policy, Order No. 25 of the National Reform and Development Commission, July 2005 ("Steel Policy 2005"), at Art. 30 (stating specifically that "[t]he export of such preliminarily processed products as coke, iron alloy, pig iron, waste steel and steel base (ingot) with high energy consumption and serious pollution shall be restricted ...").

restrictions on essential raw material inputs is the domestic specialty steel industry and downstream consumers of specialty steel products. According to one recent article, the tax is necessary as “controlling exports of zinc and nickel is imperative given domestic demand.”¹³⁷

Until recently, the Chinese government used a licensing system to restrict the exportation of vital raw materials, such as metallurgical coke. In 2004, the European Union complained that the licensing scheme created significant imbalances in the global market and demanded that the Chinese government eliminate its program.¹³⁸ While the central government agreed to a minimum quantity of coke to be supplied to the European Union, the Chinese government sought ways to ensure that the licensing scheme stayed in place and was vigorously enforced. The Chinese Ministry of Commerce, for example, began enforcing regulations forbidding the trading or selling of export licenses for metallurgical coke among Chinese coke producers.¹³⁹

In addition to the licensing scheme, the Chinese government has altered its tax regime to provide a differential export-tax scheme to restrain exports of key raw materials and basic specialty steel products while encouraging exportation of downstream products subject to a greater degree of manufacturing in China by not imposing similar export taxes and continuing to provide export rebates on value-added downstream products.¹⁴⁰ Nickel, for instance, is subject to the government’s increased export restrictions -- in November 2006, the Chinese government

¹³⁷ David Harman, [China To Impose Or Increase Export Tax On Metal Products On June 1](http://www.resourceinvestor.com/pebble.asp?relid=32114), Resource Investor (May 22, 2007), available at <http://www.resourceinvestor.com/pebble.asp?relid=32114>.

¹³⁸ See Philip Shawcross, [Steel Or Coke, The Compass Is Pointing To Asia’s Giant: EU Set To Challenge Chinese Licensing](#), American Metal Market (May 12, 2004). See also, Nancy E. Kelly, [US, EU Protest Chinese Coke Export Controls](#), American Metal Market (Jun. 1, 2004).

¹³⁹ See Kit Ling Wong, [Chinese Ministry Issues Warning On Resale Of Coke Export Licenses](#), American Metal Market (Jul. 28, 2004).

¹⁴⁰ As discussed above, the DET also confers a direct benefit upon downstream specialty steel consumers in the form of lower-priced specialty steel inputs.

increased the export tax levied on nickel raw materials and products from 2 percent to 15 percent for purposes of limiting exports of these items.¹⁴¹ According to one recent article, China considers the tax to be necessary as “controlling exports of zinc and nickel is imperative given domestic demand.”¹⁴² The Chinese government has also levied export taxes to restrict the export of various semi-finished specialty steel products consumed by downstream consumers.¹⁴³

At the same time, China has not imposed export taxes and has provided a rebate of the VAT on many products produced by downstream industries in the specialty steel sector.¹⁴⁴ In this way, China discourages Chinese producers from exporting raw materials and semi-finished materials.

China’s reliance upon this differential export-tax scheme distorts trade and promotes exports of downstream products made in China to the detriment of competing U.S. producers. First, the levying of export taxes on upstream products at the rate of between 5 and 15 percent has the effect of increasing the supply, and thereby lowering the price, in China of raw materials that are consumed in producing the downstream products. Second, the imposition of no export tax on these downstream products encourages increased exports of the value-added products. The implementation of this differential export-tax scheme by the Chinese government, therefore,

¹⁴¹ See China’s Jinchuan Group Limits 2007 Nickel Export Target, Resource Investor (Mar. 29, 2007) available at www.resourceinvestor.com/pebble.asp?reid=30361. See also Chinese Nickel Industry, BGRMM (Apr. 2008) available at http://www.insg.org/presents/Ms_Wang_Apr08.pdf (reporting that the taxes assessed on the exportation of nickel products range from 15 to 20 percent).

¹⁴² See China To Impose Or Increase Export Tax On Metal Products On June 1, Resource Investor (May 22, 2007) available at <http://www.resourceinvestor.com/news.php?id=1235>.

¹⁴³ See China’s export tax hits same 83 products that lost rebate, Steel Business Briefing (May 23, 2007). See also China Raises Export Duties to Save Resources, The Daily Star, available at <http://www.thedailystar.net/story.php?id=16970>.

¹⁴⁴ See Adjustment of Temporary Tariffs for Exports, Appendix II.

discourages the exportation of basic products, while encouraging the production and exportation of further-manufactured products. As observed in a study by the Organization for Economic Cooperation and Development (“OECD”), “The two main reasons for imposing export duties are 1) fiscal receipts or revenue and 2) promotion of downstream processing industries, i.e. by providing domestic manufacturing and processing industries with cheap raw materials and other inputs.”¹⁴⁵

In addition to export taxes, China continues to use VAT rebates to promote exports. In terms of exports of products using specialty steel, China grants domestic producers a rebate at varying levels depending on the exported good.¹⁴⁶ Because Chinese producers benefit from this preferential tax rate only upon exportation of those products, the subsidy is contingent upon exportation and therefore is trade-distortive. The benefits gained by these VAT rebates enable Chinese producers to sell in the U.S. market and third countries at prices that undercut U.S. domestic producers.

Importantly, the Chinese government’s systematic use of various export restraints to manipulate the price of raw materials in China assists Chinese producers in their purchasing large quantities of raw materials, including specialty steel, at subsidized, below-market rates and then to export downstream products at low prices. These subsidy programs enable Chinese producers to target the U.S. market without being affected by the cost-price squeeze affecting U.S. producers.

¹⁴⁵ See Analysis of Non-Tariff Measures: the Case of Export Duties, at 14, TD/TC/WP(2002)54/FINAL (OECD Working Party of the Trade Committee, Jan. 31, 2003).

¹⁴⁶ See, e.g., China’s Export Rebate Adjustment on Steel Coming to An End, Asia Pulse (Jun. 20, 2007).

9. Provision of Utilities and Energy Resources at Preferential Rates

The Chinese government also grants electricity subsidies to producers in downstream industries in China's specialty steel sector. Indeed, many preferred industries are eligible for discounted electricity rates in the effort to promote production.¹⁴⁷ While data on the actual rates given to individual companies are unavailable, China has acknowledged that subsidies on energy inputs are provided to "special industrial sectors."¹⁴⁸ Indeed, very recently, Chinese Premier Wen Jiabao said publicly that the Chinese steel industry in fact receives discounts on electricity, stating that "local governments . . . routinely offer free or cut-rate . . . electricity to developers looking to set up job-creating businesses. . . ." Id.

A comprehensive study on the price of electricity in China released in 2008 concludes that energy subsidies to China's steel industry "shot up sharply in 2004 and later, synchronizing with the buildup in steel capacity in China and the rise in steel exports from China."¹⁴⁹ This study calculated that between 2000 and 2007 total electricity subsidies to the steel industry, including the specialty steel industry, reached approximately US\$ 916 million.¹⁵⁰ Indeed, the steel industry, like many other Chinese industries, was built with the help of subsidized

¹⁴⁷ In 2004, Commerce Secretary Donald Evans cited Chinese utility subsidies as an unfair trade advantage. See Peter Navarro, Report of 'The China Price Project', at 12 Merage School of Business, University of California-Irvine (Jan. 2007).

¹⁴⁸ "Notification Pursuant to Article XXV of the Agreement on Subsidies and Countervailing Measures," Annex 5A, Section XV.

¹⁴⁹ See Usha C.V. Haley, Shedding Light on Energy Subsidies in China: An Analysis of China's Steel Industry from 2000-2007, at 41, prepared for Alliance for American Manufacturing (Dec. 2007). Moreover, a recent report by the U.S.-China Economic and Security Review Commission concluded that "provincial and municipal governments sell energy and other utilities to their SOEs at below-market prices." 2007 Report to Congress of the U.S.-China Economic and Security Review Commission, November 2007, at 40.

¹⁵⁰ See Usha C.V. Haley, Shedding Light on Energy Subsidies in China: An Analysis of China's Steel Industry from 2000-2007, at 35.

electricity costs. Moreover, because much of the electricity is generated by SOEs, the government continues to use energy prices as a tool of coercion by rewarding companies in line with stated policies with lower rates, and withdrawing preferred rates from those companies that are not. Recent reports indicate that the price of non-compliance with certain governmental directives can be the loss of electricity altogether.¹⁵¹

10. Import Substitution

a. Import Substitution Policy

A primary objective of the Chinese government's industrial policies has been to reduce import penetration by encouraging the production of specialty steel products in China in lieu of like products being imported into China.¹⁵² Governmental policies of this type are referred to as "import substitution."¹⁵³ The Steel Policy 2005, for instance, requires the use of domestically-produced steel-manufacturing equipment and domestic technologies whenever domestic suppliers exist.¹⁵⁴ This policy also discriminates against foreign equipment and technology imports by calling for a variety of government financial support for steel and iron projects utilizing newly developed domestic equipment. Id.

In recognition of the importance of specialty steel to China's key industries, the replacement of imported specialty steel and specialty steel products with domestic products has

¹⁵¹ See, e.g., Polluters Must Pay More, China Daily, June 27, 2007.

¹⁵² See section III, above.

¹⁵³ An example of import-substitution policies are provisions regarding local content and other localization requirements under China's industrial policies for its automotive sector. A WTO Panel ruled recently that these requirements are inconsistent with China's international legal obligations. See Panel Report, China – Measures Affecting Imports of Automobile Parts, WT/DS340/R, Jul. 18, 2008, at para. 8.4.

¹⁵⁴ See Steel and Iron Industry Development Policy, Order No. 25 of the National Reform and Development Commission, July 2005.

been a priority of the central, provincial, and local governments in China. For example, China's central government established TPCO to avoid reliance on imports of stainless steel seamless pipe that were perceived as hindering the development of the domestic Chinese petroleum industry.¹⁵⁵ Similarly, following completion of TPCO's 500,000-ton seamless pipe project at a cost of 14 billion yuan in 2002, the Chinese government reported that 50 percent of the output would be exported to the United States, the Middle East and Southeast Asia and that the other 50 percent of the output would be consumed in the domestic market in China to decrease import penetration from 90 percent to 30 percent.¹⁵⁶

The Chinese government has implemented various measures aimed at making China self-sufficient in terms of producing specialty steel products.¹⁵⁷ These measures include both formal subsidy programs, such as the import substitution programs discussed below, as well as informal measures, such as transactions among SOEs.¹⁵⁸

A recent agreement between TISCO and China National Petroleum Company ("CNPC") provides just one example of how the Chinese government has used transactions among SOEs to support domestic downstream consumers of specialty steel in displacing imports of specialty

¹⁵⁵ See China's State-Directed Expansion in Oil Country Tubular Goods: A Case Study, at 60, citing Basic Information of Tianjin Steel Pipe Co., Ltd., Report on Representative State-Owned Enterprises in China in 2004, State-owned Assets Supervision and Administration Commission (2004).

¹⁵⁶ See Tianjin Steel Pipe Co. Targets World Top 4 Rank, The Information Center of the Metallurgical Industry of the P.R.C. (Jul. 2, 2002), available at http://www.mmi.gov.cn/mmi_en/more/morec/2002.htm.

¹⁵⁷ See Goal set for iron, steel, China Daily (Apr. 6, 1996) (with the development strategy for its steel industry during the Ninth Five-Year Plan and beyond to the year 2000, the Chinese government expected the steel industry reforms to increase domestic production to at least 70 percent of all stainless rolled steel consumed in China by 2000).

¹⁵⁸ See CNPC sources all steel from domestic with Taigang become {sic} the first cooperation partner, Information Center of Metallurgical Industry of P.R.C. (Dec. 19, 2007), available at www.mmi.gov.cn/mmi_en/more/morec.htm.

steel and specialty steel products into China. According to the Information Center of the Metallurgical Industry of China,

[t]o increase the ratio of steel sourcing from domestic in the total steel demand for containers of oil and gas, CNPC (China National Petroleum Company) signed strategic cooperation frame agreements with Taigang recently. . . . CNPC will boost the ratio of steel sourcing from domestic, up to 100% finally, through purchasing high quality steel from Taigang. The agreement between Taigang and CNPC has an important meaning to securing the large oil and gas transferring line, liquid natural gas and large refining projects moving on smoothly. And also it will help raise the ratio of steel sourcing from domestic in the total demand for containers of oil and gas, and to 100% finally, boost the improvements of technology and product mix in China iron and steel industry and the economy growth.

Id. Thus, through transactions by SOEs with one another, China has advanced its import substitution objectives, replacing imported specialty steel products with domestically-produced specialty steel products.

b. Steel Import Substitution Program

In recognition of the importance of specialty steel products to China's key industries, the replacement of imported specialty steel products with domestic products has been a priority of the central, provincial, and local governments in China. In 1998, the Chinese government introduced a subsidy program to further this objective, the Steel Import Substitution Program ("SISP").¹⁵⁹ The SISP encouraged export-oriented processing enterprises that would otherwise have used imported steel to increase their purchases from domestic steel works by granting 17-percent VAT rebates to the purchasers. Id. In discussing the steel import substitution tax rebate exemption, the Export-Import Bank of China explained in 2005 that "the goal is to implement

¹⁵⁹ See China Achieves Steel Import Substitution Plan, Asia Pulse (Mar. 20, 2000). See also China's State-Directed Expansion in Oil Country Tubular Goods: A Case Study, at 106-117 (Oct. 2007).

the government's 'import substitution' policy, and encourage processing enterprises to use domestic steel; it is a way to promote national trading.”¹⁶⁰

According to the SBMI, 27 steel producers sold 3.2 million tons of steel under this program in 1999. TISCO and Baosteel participated in the SISP and were among 12 steel producers that over-fulfilled their annual targets. Id. Baosteel alone delivered 1.37 million tons, accounting for over 45 percent of the year's target. Id.

Effective July 1, 2005, China terminated its tax incentives available under the “special steel for processing and export products” program. According to the China Iron and Steel Association, during the six years this program was in effect “a total of more than 30 million [tons of] China's domestic steel production was put into the processing trade market and replaced imported steel. The total amount of exemption tax for the ‘special steel for processing and export products’ reached over RMB 12 billion [\$1.4 billion].”¹⁶¹

11. Special Economic Areas and Industrial Parks

The Chinese government also provides various financial incentives to manufacturers operating in specified Special Economic Areas (“SEA”), such as Special Economic Zones (“SEZs”), High Technology Industrial Development Zones, Export Processing Zones, free ports, bonded zones, and the like. These SEAs promote investment with unique tax packages and other incentives, many of which benefit the downstream industries in China's specialty steel sector. The incentives generally include significant reductions in, or exemptions from, national and local income taxes, land-use fees, import and export duties, and priority treatment in obtaining basic

¹⁶⁰ See 2005 Steel Import Substitution Tax Rebate and Related Policies, Export-Import Bank of China Website (Apr. 20, 2005).

¹⁶¹ See Special Steel for Processing and Export Products Accumulated RMB 12 Billion in Tax Exemption, Ningbo Foreign Trade and Economic Cooperation Website (July 27, 2005).

infrastructure services.¹⁶² The government also has created special incentives for projects involving export-oriented investments and for certain key industries. Id.

Downstream industries in China's specialty steel sector are among the industries that benefit from subsidies provided to enterprises located in SEAs, such as the SEZ of the Pudong New Area of Shanghai.¹⁶³ Non-wholly foreign-owned FIEs established in SEZs, FEs (wholly foreign-owned FIEs) established in SEZs, joint-venture Chinese firms, and single-investor Chinese firms established in the SEZ of the Pudong New Area of Shanghai pay income tax at a reduced rate of 15 percent.¹⁶⁴ The eligibility criteria for this program relating to FIEs located in the Pudong New Area of Shanghai can be found in the *Circular on Income Tax Rate Applied to Chinese Joint Ventures in Pudong New Area of Shanghai*, which specifically identifies Chinese joint ventures and single-investor Chinese firms established in the Pudong New Area of Shanghai as being eligible for the reduced income tax rate of 15 percent.

Additionally, China's subsidies notification to the WTO identifies preferential tax policies for enterprises recognized as high- or new-technology enterprises established in the high- or new-technology industrial development zones. Enterprises located in such areas pay a 15-percent income tax rate and are exempt from income tax for their first two years.¹⁶⁵ The

¹⁶² See U.S. & Foreign Commercial Service and U.S. Department of State, *Doing Business in China: A Country Commercial Guide for U.S. Companies*, ch. 6, Investment Climate (2005).

¹⁶³ See http://www.baosteel.com/group_e/e12steel_n/index.htm.

¹⁶⁴ See Statement of Reasons Concerning the Making of a Final Determination With Respect to the Dumping of Certain Laminate Flooring Originating in or Exported From the People's Republic of China and France and the Making of a Final Determination With Respect to the Subsidizing of Laminate Flooring Originating in or Exported From the People's Republic of China, Nos. 4214-4, 4218-19 at Appendix 3 (Jun. 1, 2005) (hereinafter "Canada Statement, Nos. 4214-4, 4218-19 (Jun. 1, 2005)").

¹⁶⁵ China Subsidies Notification at 10.

China Association of Development Zones cites additional tax incentives, including the following:

- Loss compensation schemes whereby any losses experienced by companies in development zones can be offset through reductions in income taxes for a period of 5 years after the loss is incurred. See National Development Zones.
- Regional tax incentives whereby companies in specified regions, including the “Middle Western Areas,” are eligible for a 15-percent reduction in income tax after the original exemption-reduction period ends. Id.
- Export-oriented tax incentives whereby taxes are reduced by as much as 50 percent for export-oriented enterprises which export 70 percent or more of their total annual output. Id.

12. Northeast Revitalization Program

The Government of China has undertaken an industrial revitalization program that a study by the WTO has found provides “potentially unfair advantages to businesses locating to or operating in Northeast China.”¹⁶⁶ Since 2003, China’s central government has been executing a plan to resuscitate the old industrial base in the three northeastern provinces of Heilongjiang, Jilin, and Liaoning, aiming to build the region into a world-class industrial base.¹⁶⁷ Together, these provinces account for about 10 percent of China’s steel production.

Under this program, China is implementing a “strategic restructuring and technical transformation of key enterprises in sectors manufacturing oil, petrochemical, iron and steel, automotive, shipbuilding and aircraft products in Northeast China in a bid to establish production bases of advantaged industries.”¹⁶⁸ In support of the Northeast Revitalization Program, China’s

¹⁶⁶ WTO No. G/SCM/Q2/CHN/14, at 2 (Sept. 29, 2005).

¹⁶⁷ China’s Old Industrial Base Eyes Bright Future With Ambitious Plan, People’s Daily Online, http://english.peopledaily.com.cn/200401/09/print20040109_132185.html.

¹⁶⁸ WTO No. G/SCM/Q2/CHN/14, at 2 (Sept. 29, 2005).

government has offered preferential policies and financial support to industry, including tax incentives and low-interest rate financing.¹⁶⁹

The November 2005 report by the WTO concluded that China's state-owned banks were continuing to extend "subsidized financing for large-scale investment projects in China which were designed to increase the competitiveness of state-owned enterprises, particularly in the Northeast, in industries such as oil and gas, petrochemicals, iron and steel, and ship-building."¹⁷⁰ Furthermore, the WTO's study cited a report on the MOFCOM website claiming that the Dalian Branch of the Export-Import Bank would provide RMB 5 billion in export credits to companies in Northeast China to enter global markets. According to MOFCOM, since November 2003 low-cost credit provided by the bank had saved the enterprises 150 million yuan in interest. *Id.*

13. Preferential Tax Measures

The central, provincial, and local governments in China provide a variety of tax exemptions, reductions, and credits that directly benefit downstream industries in the specialty steel sector.¹⁷¹

a. Exemption of Customs Duty and VAT on Imported Capital Equipment

Chinese firms that import capital equipment used exclusively to make products for export are eligible to receive a full refund of customs duties and VAT on the imported capital equipment. The exemptions from tariffs and import-linked VAT are set forth in the Circular of

¹⁶⁹ See China's Old Industrial Base Eyes Bright Future With Ambitious Plan, People's Daily Online, available at http://english.peopledaily.com.cn/200401/09/print20040109_132185.html.

¹⁷⁰ See WTO No. G/SCM/118 (Nov. 9, 2005) at 12.

¹⁷¹ On November 29, 2007, China agreed to remove certain of these tax measures pursuant to a Memorandum of Understanding ("MOU") with the United States following a challenge by the United States before the WTO, but the extent to which China has complied with the terms of the MOU is unclear at this time.

the State Council Concerning the Adjustment in the Taxation Policy of Import Equipment, which was established on December 29, 1997, and came into effect on January 1, 1998. This program was established in order to attract foreign advanced technology and equipment and encourage structural improvement and technological advancement in industry.

Under this program, enterprises meeting the eligibility criteria may apply for exemption from tariffs and VAT on imported equipment and its related technologies, components and parts. To qualify, the enterprise must receive approval of its application from the appropriate authority, and subsequent approval from the local customs officials, verifying that the documents presented are adequate and that the imported items are not listed in the catalogues of commodities that are not eligible for tax exemptions. The program is also limited to: (1) investments by foreign parties investing in encouraged industrial areas defined by the “Catalogue for the Guidance of Foreign Investment Industries,” which is issued jointly by the NDRC and the Ministry of Commerce (“MOFCOM”); and (2) domestic parties investing in encouraged industrial areas defined by “Catalogues of Current Priorities of Industrial Sectors, Products and Technologies Encouraged by the State.”¹⁷²

Downstream industries in the specialty steel sector are among the encouraged industries eligible to benefit from the exemption from tariffs and VAT on imported equipment and its related technologies, components and parts. The Chinese automotive industry, for instance, is eligible to receive subsidies under this program related to numerous investments, including the “manufacture of complete automobiles (including R&D activities)” and “manufacture of key

¹⁷² See Catalogue for the Guidance of Foreign Investment Industries (Amended in 2004), State Development and Reform Commission (Nov. 30, 2004), available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/RegulationsonForeignInvestment/t20060620_51089.jsp.

spare parts for automobiles” Id. The automotive industry, moreover, is likely to have benefited from these subsidies while importing advanced foreign manufacturing technology and equipment during the restructuring and modernization of Chinese automobile and auto parts producers.¹⁷³

b. Enterprise Income Tax Reduction for Purchase of Domestically-Made Machinery and Equipment

The Chinese government provides tax subsidies for the purchase of domestically-produced machinery and equipment. Specifically, pursuant to the Notice Concerning Some Issues on the Deduction of the Investment Made by Enterprises with Foreign Investment and Foreign Enterprises in Purchasing Domestic Equipment from Enterprise Income Tax, issued jointly by the Ministry of Finance and the State Administration of Taxation on 14 January 2000, “40 per cent of the investment made in purchasing domestic equipment can be deducted from the increment of enterprise income tax.”

c. Income Tax Exemption for Investment in Domestic “Technological Renovation” Constitutes a Prohibited Domestic-Content Subsidy

China provides assistance for approved technological renovation projects pursuant to the State Tax Administration’s Technological Renovation of Domestic Equipment Corporate Income Tax Exemption Notice¹⁷⁴ (“Equipment Tax Notice”) and the Enterprise Research and

¹⁷³ See 2004 China’s Non-ferrous Metal Industry Survey, State Economic and Trade Commission (Jul. 19, 2005), available at http://www.fdi.gov.cn/pub/FDI_EN/Economy/Sectors/Manufacturing/Nonferrous%20Metal/t20060422_25076.htm.

¹⁷⁴ See Technological Renovation of Domestic Equipment Corporate Income Tax Exemption Notice, State Tax Administration (Jan. 17, 2000) (Chinese language document), available at <http://www.jsjgs.gov.cn/Page/statutedetail.aspx?statuteid=2965> (“Equipment Tax Notice”).

Development Tax Notice (“R&D Tax Notice”).¹⁷⁵ Under the Equipment Tax Notice, any enterprise may receive a credit for a certain portion of investment in any domestically-produced equipment that relates to an upgrade of the enterprise’s technologies.¹⁷⁶ Tax exemptions for specific equipment investments are obtained by application to the Tax Administration, which has discretion to grant or deny the exemption. Id. Investments eligible for the exemption may be funded by bank loans. Consequently, an enterprise may receive a discount-rate loan under the Measures and the Technology Project to fund “technological renovation,” and then may also claim an income tax exemption in the amount of the state-bank-funded equipment purchase. Id.

Under the R&D Tax Notice, enterprises involved in mining, manufacturing, electricity generation, or gas and water production may deduct a certain portion of their research and development costs related to new product development.¹⁷⁷ Specifically, the R&D Tax Notice provides that any increase in actual R&D expenses of 10% or more from the previous year to develop a new product or technology may be offset by a 150% deduction from the taxable income of the current year.¹⁷⁸

¹⁷⁵ See Enterprise Research and Development Tax Notice, State Tax Administration, Cai Shui Zi 2003 [244]” (Jan. 27, 2003) (Chinese language document), available at <http://www.whgs.gov.cn:7001/cms/whgs03/laws/05/030205/200311270027.html> (“R&D Tax Notice”).

¹⁷⁶ See Equipment Tax Notice.

¹⁷⁷ R&D Tax Notice.

¹⁷⁸ Id.; see also China’s Notification pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement at 31, Art. XXVII .

Numerous Chinese producers have been heavily subsidized pursuant to this program. Though precise figures are not available, the Baosteel website confirms Baosteel's receipt of tax subsidies pursuant to the Equipment Tax Notice and the R&D Tax Notice.¹⁷⁹

d. Refund of Import Duties and Value-Added Taxes to Promote Development of the Equipment Manufacturing Industry

The Chinese government is fostering the development of equipment manufacturing and “key technological equipment.”¹⁸⁰ Specifically, in order to increase the competitiveness and independent innovation capacity of domestic enterprises that manufacture equipment China is implementing the following preferential taxation policies:

refund the previously levied import tariffs and value-added taxes for the key parts and accessories imported for development and manufacturing of these equipment, and {sic} raw materials which cannot be produced domestically. The refunded money will be generally used as national investment to the research and development of new products and the cultivation of capacity for independent innovation.

Id.

e. Fixed Assets Investment Orientation Regulatory Tax

Downstream industries in China's specialty steel sector benefit by being exempted or taxed at a preferential rate under the fixed assets investment orientation regulatory tax.¹⁸¹ The tax is levied on the amount of fixed capital investment made by Chinese enterprises in a given

¹⁷⁹ See Profile of Tang Bang, Baosteel.com (Chinese language document), available at <http://54.baosteel.com/xgcl/show20.nsf/show2?openform&parentUNID=66B698FDD52BC7354825715B002D673F>.

¹⁸⁰ See Circular of the Ministry of Finance, State Development and Reform Commission, General Administration of Customs and State Administration of Taxation on Import Taxation Policies to Implement the Opinions of the State Council of Invigorating Equipment Manufacturing, Cai Guan Shui [2007] No. 11, available at <http://www.asianlii.org/cn/legis/cen/laws/cotmofsdarcgaocasaotoitptitootscoiem2494/>.

¹⁸¹ See Provisional Regulations on Fixed Assets Investment Orientation Regulatory Tax of the People's Republic of China, State Council Order No.82 (Apr. 16, 1991).

year.¹⁸² The Chinese government varies the actual tax rate levied on a particular company, which ranges from zero percent to 30 percent, “in accordance with the state industrial policy and in light of the scale of the project.”¹⁸³ While the general tax rate applied to fixed capital investment has been 15 percent, China has three exceptions from this rate. First, a zero tax rate is applied to fixed capital investment in projects “urgently needed by the state,” including the increase of key raw materials and geological prospecting. Id. Second, projects encouraged by the state but constrained by energy supply and transportation facilities are subject to a five-percent tax rate. Third, the Chinese government penalizes projects that are of an inefficient scale, that employ outmoded technologies, or that make products already in excess supply, by applying the highest rate of 30 percent to these projects. Id. Additionally, projects encouraged by the state and renewal and transformation projects are subject to preferential tax rates of five and ten percent, respectively.¹⁸⁴

As China encouraged the development of specialty steel production as one of its priorities under the Ninth and Tenth Five-Year Plans, specialty steel projects were likely deemed to be urgently needed by the state. Fixed capital investments in these projects, therefore, would have been taxed at a zero rate.

¹⁸² See Lu Ding, Prospect of Industrial Policy Regime After the WTO (2000). This tax is also identified as the coordinating tax for direction of fixed capital investment (“coordinating tax”). Id.

¹⁸³ See Provisional Regulations on Fixed Assets Investment Orientation Regulatory Tax of the People’s Republic of China, State Council Order No.82, at Art. 3 (Apr. 16, 1991).

¹⁸⁴ See also Fixed Assets Investment Orientation Regulation Tax, Beijing Local Taxation Bureau, available at <http://english.tax861.gov.cn/zgszky/zgszky14.htm>.

f. Tax Benefits to Foreign-Invested Enterprises (FIEs)

Pursuant to provisions of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises, the Chinese government provides various tax subsidies to foreign-invested enterprises ("FIEs") in China.¹⁸⁵ These subsidies include:

- income tax exemption and income tax reductions pursuant to Decree No. 85;
- reduced corporate tax rate for FIEs;
- income tax refund for FIEs that reinvest in Chinese businesses;
- exemption of the business tax on technological transfers for FIEs;
- VAT rebate on the purchases of domestic equipment by FIEs;
- income tax exemption or reduction for dividends, interest, rentals, franchising fees and other forms of income earned by FIEs.

China's new tax regime, the Enterprise Income Tax Law of the People's Republic of China ("EITL"), was scheduled to take effect on January 1, 2008. This new tax regime is designed to eliminate the discrepancies between tax rates for domestically-owned companies and tax rates for FIEs and to shift incentives for foreign investment away from focusing on exports and toward high-technology and high-value-added products. Notwithstanding the new EITL, the subsidies conferred by the previous tax regime are still relevant today, for several reasons. First, the targeted companies have likely taken advantage of one or more of these incentives during the period of investigation. More important, the EITL contains a provision that allows most companies enjoying the previous incentives to continue receiving many of those benefits, for the

¹⁸⁵ See Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises, Order of the President of the People's Republic of China, No.45 (Apr. 9, 1999). See also Detailed Implementation Rules of the Income Tax Law of the People's Republic of China of Foreign Investment Enterprises and Foreign Enterprises, (Effective on January 1, 2005).

next five years or longer.¹⁸⁶ Furthermore, the implementation of China's laws involves great complexity and ambiguity, and it is more likely than not that FIEs are still able to take advantage of loopholes in the implementation process to continue to receive preferential tax treatment.¹⁸⁷

14. China's Enforced Undervaluation of Its Currency Further Subsidizes the Manufacture and Exportation of Downstream Specialty Steel Products

a. Background on China's Elaborate System for Undervaluing the Yuan

As important as the many other subsidies are that China's national, provincial, and local governments dispense, the program that probably has had the most far-reaching impact on the manufacture and sale of specialty steel products is China's undervaluation of its currency. This policy has been in effect since 1994 and has contributed substantially to (a) large and growing trade surpluses for China bilaterally with the United States as well as globally, (b) foreign exchange reserves held by China that are now estimated to be in excess of \$1.8 trillion, and (c) historically high foreign direct investment in China at an annual rate of \$60 billion or higher in each of the last several years. All of these phenomena tied to the yuan's undervaluation have greatly benefited downstream industries in China's specialty steel sector.

¹⁸⁶ See EITL, at Art. 57. Moreover, Subsequent government publications have indicated that FIEs that qualified for preferential tax treatment under the old Tax Law on Foreign-Invested Enterprises, and that still meet the conditions imposed under the old Tax Law, are still eligible to receive the preferential treatment. See Circular of the State Administration of Taxation on How to Deal with Related Issues after Cancellation of Several Previous Tax Preferential Policies on Foreign-Invested Enterprises and Foreign Enterprises, Guo Shi Fa No. 23 (Feb. 27, 2008).

¹⁸⁷ See, e.g., Measures for Verification Collection of Enterprise Income Tax for Trial Implementation Article 3 (Mar. 6, 2008) (explaining that taxpayers of "special industries" or those of a certain scale are apparently "not governed" by the standard measures for verifying Enterprise Income Tax).

It would be difficult to overstate how critical the yuan's undervaluation has been to the economic success of China generally and to the promotion of downstream industries in China's specialty steel sector more specifically. In recent years, estimates of the extent of the yuan's undervaluation in real terms have ranged generally from 20 to 50 percent or more.¹⁸⁸ While nominal appreciation of the renminbi relative to the U.S. dollar accelerated beginning in late 2007, the China Currency Coalition and, separately, the Peterson Institute for International Economics calculated that the renminbi continues to be seriously undervalued in real terms and needs to appreciate against the U.S. dollar by approximately 30 percent.¹⁸⁹

How the Chinese government has achieved this much undervaluation for so long a period is worth noting. The basic answer is that the Chinese government has engaged in protracted, large-scale intervention in the exchange markets since 1994. This intervention – pursuant to directive by China's State Council – has been achieved with the help of strict exchange regulations that are implemented by the People's Bank of China and the State Administration of Foreign Exchange. Just how restrictive China's exchange controls are can be seen from a brief review of some of the current regulations that were issued in 1996. Thus –

- Article 6 of the Regulations bans foreign currencies from circulation in China and from being used for pricing or account settlement in China.
- Article 8 of the Regulations stipulates that domestic enterprises located in China shall deposit in China rather than abroad their current account incomes of foreign exchange.
- Article 9 of the Regulations directs that domestic enterprises in China shall sell their current account incomes of foreign exchange to designated Chinese banks.

¹⁸⁸ See U.S.-China Economic and Security Review Commission, 2007 Report to Congress, at 29 (Nov. 2007).

¹⁸⁹ See www.ChinaCurrencyCoalition.org and William R. Cline and John Williamson, New Estimates of Fundamental Equilibrium Exchange Rates (July 2008).

- Article 14 of the Regulations prevents foreign exchange assets held by Chinese citizens from being carried or sent abroad without approval by China's foreign exchange management administration.
- Article 18 of the Regulations requires that domestic enterprises located in China shall bring their capital-account foreign exchange incomes to China unless otherwise permitted by China's State Council.
- Article 19 of the Regulations decrees that domestic enterprises in China shall sell their capital-account foreign exchange incomes to designated Chinese banks.
- Article 26 of the Regulations sets forth that financial institutions in China can handle foreign exchange matters only with approval by China's foreign exchange management administration.
- Articles 38, 40, 41, and 43 of the Regulations are among the provisions that authorize the imposition of severe monetary penalties on various persons, domestic enterprises, and financial institutions in China for foreign-exchange crimes such as depositing foreign exchange abroad without authorization, failure to sell foreign exchange to designated Chinese banks, unauthorized removal of foreign exchange from China, and mishandling of foreign exchange settlements.

Clearly, China's Regulations are geared to have and to keep as much foreign exchange as possible under the Chinese government's control through selected, governmentally-owned and overseen banks. This arrangement results in a broad segregation of foreign exchange from the yuan in China's domestic market and necessitates a series of measures that China's government must take in maintaining this compartmentalization.

In particular, in the absence of a market-clearing mechanism for the very large quantities of foreign exchange that come to China as foreign direct investment and in payment for Chinese exports, the Chinese government first creates demand for that foreign exchange by intervening in the market as the primary buyer of the foreign exchange. Roughly speaking, in this role China must purchase about \$20 billion or more per month from companies and individuals in China. In doing so, China prints and issues massive amounts of yuan at the official exchange rate. This step not only means that the Chinese government obtains huge foreign reserves to invest or spend as it sees fit, but also that China's domestic economy is flush with yuan. In an effort to

avoid inflation in China caused by the excess supply of yuan it has generated in its foreign-exchange operations, the Chinese government then “sterilizes” a significant portion of that increase by selling debt into (*i.e.*, borrowing yuan from) the Chinese domestic economy.

As can be seen, China employs an elaborate system for undervaluing the yuan.

b. China’s Undervaluation of the Yuan Is A Prohibited Export Subsidy

China’s enforced undervaluation of the yuan is a prohibited export subsidy within the meaning of Articles 1, 2, and 3 of the World Trade Organization’s SCM Agreement, because the program (1) involves a governmental financial contribution, (2) bestows a benefit, and (3) is contingent upon exportation.

With regard to the first of these criteria set forth in Article 1.1(a)(1)(i) and (iv) of the SCM Agreement, the Chinese government – acting through selected banks that either are Chinese governmental entities or are private bodies under the direction of the Chinese government and entrusted with the task – makes a direct transfer of funds by exchanging with the exporter yuan for U.S. dollars. As China’s Regulations and exchange controls indicate, there is an extraordinary regulatory structure that the Chinese government has in place in order to make these direct transfers of funds possible.

Second, the prerequisite of a benefit under Article 1.1(b) of the SCM Agreement is satisfied, because the exporter receives more yuan from the Chinese government in return for the U.S. dollars earned than would be the case if the yuan were not undervalued relative to the U.S. dollar. For example, a Chinese exporter who sells \$100 of goods to a customer in the United States receives approximately 680 yuan from China’s banks at the yuan’s currently undervalued exchange rate of 6.8 yuan/U.S. dollar. If, on the other hand, the yuan were realistically valued by market forces at the estimated equilibrium exchange rate of 5.0 yuan/U.S. dollar, the Chinese

exporter would receive only 500 yuan. Thanks to the yuan's undervaluation, therefore, the Chinese exporter has 180 additional yuan in the former situation than in the latter circumstance and so is obviously "better off" with the undervalued yuan.¹⁹⁰

Third, and lastly, China's undervalued exchange-rate regime is a specific subsidy. Article 3 of the SCM Agreement prohibits subsidies that are contingent, in law or in fact, upon export performance. Although it is not clear from the limited availability of China's laws and regulations if the Chinese government's subsidy program described here is explicitly contingent in law on export performance, it is evident that this program is "in fact tied to actual or anticipated exportation or export earnings." See SCM Agreement, Article 3.1(a) n.4. While China perhaps has not expressly stated in its laws that its undervalued exchange-rate regime is designed to increase exports to the United States and other countries in an effort to bolster Chinese manufacturing capabilities and increase China's employment levels and U.S.-dollar holdings, in fact the policy actually does have these effects.

To determine whether a subsidy is de facto contingent upon export performance requires evaluation of three elements: (1) whether the granting authority has imposed a condition based on export performance in providing the subsidy; (2) whether the facts demonstrate that the granting of a subsidy is tied to or contingent upon actual or anticipated exports; and (3) whether,

¹⁹⁰ See Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft, adopted Aug. 20, 1999, WT/DS70/AB/R, para. 157 ("Canada – Aircraft"). See also Panel Report, United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom, adopted June 7, 2000, WT/DS138/R, at paras. 6.66-6.69 (stating that "{t}he existence or non-existence of 'benefit' rests on whether the potential recipient or beneficiary . . . received a 'financial contribution' on terms more favourable than those available to the potential recipient or beneficiary in the market.").

as one relevant fact among others analyzed, the subsidy's recipient is export-oriented. See Canada – Aircraft, WT/DS70/AB/R, paras. 170-173.

Scrutiny of these factors with reference to China's foreign-exchange policy and practice confirms that China's undervalued exchange-rate regime constitutes a de facto export subsidy. First, the Chinese government, as the granting authority, imposes a condition based on export performance in providing the subsidy. The subsidy, derived from the undervalued yuan, is dependent upon the existence of export performance in order to take effect. The nexus between the subsidy of the yuan's undervaluation and the requirement of exportation for a company in China to enjoy that subsidy is so close and inextricably linked that conditionality is indisputable.

Second, the facts demonstrate that the granting of the subsidy is tied to or contingent upon actual or anticipated exports from China, because the subsidization would not occur if exports did not occur. In order for the foreign-exchange program to operate, products must be traded internationally. Without export performance, there would be no foreign currency to exchange. Moreover, the fact that the subsidy results in increased exports to the United States and elsewhere and in the accumulation by China of massive foreign-exchange reserves provides additional evidence of tying. Thus, the required tying/contingency element is satisfied.¹⁹¹

¹⁹¹ The fact that the undervalued yuan's subsidy is also available to non-exporters or domestic Chinese users (as when U.S. dollars are received from foreign direct investment in China or from repatriation of profits from abroad) does not dissolve the export contingency for Chinese exporters. See, e.g., Appellate Body Report, United States - Subsidies on Upland Cotton, adopted Mar. 3, 2005, WT/DS267/AB/R, paras. 564, 576; and Appellate Body Report, U.S. – FSC Article 21.5, WT/DS108/AB/RW, adopted, Jan. 29, 2002, paras. 114, 115, and 119. This conclusion by the Appellate Body is reinforced by Article 3.1(a)'s language in the SCM Agreement that a subsidy can be contingent upon export performance “. . . whether solely or as one of several other conditions. . . .”

Third, the recipients in China of this subsidy are export-oriented. This characterization is confirmed by China's large and growing trade surpluses globally and with the United States and by China's enormous foreign-exchange reserves noted earlier.

For these reasons, China's undervalued currency should be treated as the prohibited export subsidy that it is and should be found in violation of China's obligations at the WTO.

c. **The Adverse Impact of the Yuan's Undervaluation on U.S. Producers of Downstream Specialty Steel Products**

Given the Chinese government's very deliberate steps and effectiveness in undervaluing the yuan, it is not surprising that far-reaching ramifications have followed. As a practical matter, the yuan's undervaluation on this large and protracted scale has given Chinese producers and exporters of specialty steel products substantial advantages vis-à-vis their U.S. counterparts.¹⁹²

The following list illustrates at least some of the principal advantages from the perspective of China.

- The yuan's undervaluation means that the prices of Chinese specialty steel products expressed in U.S. dollars, Euros, or other currencies correspondingly overvalued with respect to the yuan are significantly lower than if the yuan were fairly valued. The

¹⁹² Whether or not China has been engaging in manipulation of the yuan, as the International Monetary Fund ("IMF") defines that term, is debatable. Article IV(1)(iii) of the IMF's Articles of Agreement states that each member of the IMF shall avoid manipulating exchange rates or the international monetary system "in order to" prevent effective balance-of-payments adjustment or to gain an unfair competitive advantage over other members. The IMF interprets the quoted language to mean that a member of the IMF will only be deemed in breach of this standard if the determination is made that the member has manipulated its exchange rate for the purpose of preventing effective balance-of-payments adjustment or gaining an unfair competitive advantage. See Paper by the IMF's Legal Department, "Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework," at 15-16 (June 28, 2006). The IMF has determined in its Article IV surveillances that this element of intent by China has been lacking and so has not found manipulation by China. In its semi-annual reports under 22 U.S.C. § 5305 over the last few years, the U.S. Department of the Treasury has reached the same conclusion as to China. Regardless of these judgments from a monetary perspective, the yuan's enforced undervaluation by China has certainly led to an unfair competitive advantage for China and Chinese companies as a trade matter.

yuan's undervaluation accordingly causes lost sales, price depression, or price suppression for U.S. producers and exporters of specialty steel products, not only in the U.S. market, but also in other countries with currencies that are unnaturally strong against the yuan. The loss of this revenue for U.S. companies is the gain of Chinese companies. A strong yuan would erode Chinese exports, and increase U.S. exports, to third countries.

- Similarly, the yuan's undervaluation acts to insulate Chinese companies in their home market from exports to China by U.S. firms and leaves the Chinese domestic market to be served more by Chinese producers of specialty steel products than if the yuan were not so fundamentally undervalued. Once again, Chinese producers of specialty steel products realize revenue at the expense of U.S. producers and exporters. A strong yuan would increase U.S. exports of downstream specialty steel products to China and bolster the U.S. economy.
- With greater sales in China, the United States, and third countries than would be the case if the yuan were valued by the forces of supply and demand in the exchange markets, the financial positions of downstream industries in China's specialty steel sector are strengthened, while the financial positions of U.S. producers and exporters of downstream specialty steel products are weakened.
- The increased income for downstream industries in China's specialty steel sector enables Chinese firms in those industries to invest and add capacity in China, which places U.S. producers at a further disadvantage.
- Those U.S. producers of downstream specialty steel products that are not forced into bankruptcy or out of business are given an incentive by the yuan's undervaluation to relocate in China or to enter into subcontracts with Chinese firms and supply the U.S. market in one of these ways.
- Investment and relocation in China augment research and development in China and weaken research and development in the United States, while undercutting the tax bases of local and state governments, as well as of the federal government, and all of the community projects funded by those monies.
- Jobs in the United States are transferred to workers in China, resulting in lost income for the families of the displaced U.S. workers, lower tax bases for the communities of those U.S. workers, and perhaps most critically, loss of skill and knowledge by subsequent generations of U.S. workers in downstream industries in the specialty steel sector.
- At the levels of the Chinese national, provincial, and local governments, the vast foreign exchange reserves collected from foreign direct investment in China and exports from China subsidized by the yuan's undervaluation are a ready source of cash for China to subsidize in turn both the Chinese producers of raw materials needed for the production of specialty steel products and the Chinese producers themselves.

As this recitation sets forth, the yuan's undervaluation has exceptionally debilitating consequences for downstream industries in the United States' specialty steel sector, both over the short-term and the long-term, and these adverse effects are being felt already and will be felt in the future as well by the U.S. economy generally.

d. Summary

At the time of China's accession to the WTO in December 2001, the Chinese government reported to the Working Party on the Accession of China that ". . . since the unification of exchange rates on 1 January 1994, China had adopted a single and managed floating exchange rate regime based on supply and demand." See Report of the Working Party on the Accession of China, WT/ACC/CHN/49, at para. 31 (Oct. 1, 2001) (emphasis added).

This characterization is not accurate. If the yuan's value relative to other countries' currencies, and relative to the U.S. dollar, in particular, were truly based upon supply and demand, the large imbalances in China's trade surpluses and huge foreign exchange reserves would never have become so extreme and would not now exist.

Export subsidies, as opposed to domestic subsidies, have been prohibited under the WTO's agreements since 1947 based upon export subsidies' negative impact, inefficiencies in allocating resources, and lack of redeeming features as far as balanced and sustainable international trade is concerned. These broad observations as to export subsidies are emphatically true with respect to the undervaluation of a currency such as China's yuan. This undervaluation has been skewing prices and costs throughout the Chinese economy since 1994, and the Chinese government has been very adroit at making this exchange subsidization fuel China's economy at the expense of other countries. A more blatant and classic "beggar-thy-neighbor" measure than the yuan's undervaluation is difficult to imagine.

B. Indirect Governmental Support of Downstream Industries in China's Specialty Steel Sector

1. Chinese Governmental Procurement and Purchases by SOEs Support Downstream Industries in China's Specialty Steel Sector

Between 2003 and 2006, China spent US\$1.6 trillion on basic industries and infrastructure, with investments in all fixed assets increasing at a rate of 25-30 percent each year.¹⁹³ In accordance with the “principle of coordinative development” and China’s “proactive fiscal policy,” the Chinese government has used these investments to support key industries and enterprises among China’s downstream specialty steel industries.

A basic tenet of China’s economic development is the “principle of coordinative development,” which means that the Chinese government seeks to match the development of significant, national infrastructure projects with that of basic industries, such as the steel industry.¹⁹⁴ China has emphasized that the “reorganization and upgrading of energy industry and raw materials industry must aim at improving their international competitive power, and creating conditions for the downstream industries to participate in the international competition.” The Chinese government has focused its resources on key upstream raw materials and products, such as specialty steel, that are consumed by high-value-added, downstream “pillar industries,” such as the energy and petrochemical industries, driving China’s economic development.

In 1999, the Chinese government’s State Development Planning Commission (“SDPC”) described how China intended to use a “proactive fiscal policy,” in particular its investments in fixed assets, to implement coordinative development in China and, thereby, support key industries and enterprises. The SDPC explained that China planned to issue 100 billion yuan of

¹⁹³ See Investment benefits infrastructure sector, China Daily (Sept. 22, 2007).

¹⁹⁴ See Lu Ding, Prospect of Industrial Policy Regime After the WTO, at 7 (2000).

long-term treasury bonds to boost investment demand and to adjust the pattern of expenditures, strictly controlling and limiting expenditures for ordinary projects in favor of expenditures for key projects. According to the SDPC, “The function of budgetary funds in directing investment should be given full play.”¹⁹⁵

China has used various measures to implement these policies. The Chinese government, for instance, has provided direct financial support through its state-owned banks, such as the ICBC, which is the ICBC is the leading lender to China’s “key infrastructure projects.”¹⁹⁶ In 2000 alone, the ICBC provided financing for investments in fixed assets totaling 137 billion yuan, with 70 billion yuan invested in basic infrastructure and 67 billion yuan invested in “corporate technological upgrading and innovative projects.”

China also has supported downstream industries in China’s specialty steel sector through massive investments in fixed assets in these industries. As discussed below, China provides this support either through governmental purchases for infrastructure projects, or through purchases of specialty steel products made by SOEs for infrastructure-related projects, such as investments in energy.

¹⁹⁵ See Peiyan, Report on the Implementation of the 1999 Plan for National Economic and Social Development and on the Draft 2000 Plan for National Economic and Social Development (Delivered at the Third Session of the Ninth National People's Congress on March 6, 2000), available at http://english.gov.cn/official/2005-07/21/content_16602.htm.

¹⁹⁶ See ICBC Puts in 130 Billion Yuan In Fixed Assets, China People’s Daily (Jan. 2, 2001), available at http://english.peopledaily.com.cn/english/200101/02/eng20010102_59423.html.

a. **Governmental Purchases (Public Sector Procurement)**¹⁹⁷

In accordance with the “principle of coordinative development,” the Chinese government has sought to match the development of significant, national infrastructure projects with that of key industries, such as downstream industries in the specialty steel sector.¹⁹⁸ Pursuant to this policy, governments at all levels in China have allowed SOEs in these basic industries preferential access to infrastructure projects as means of supporting the enterprises and industries.

The Chinese government’s massive spending on infrastructure development projects, such as the Three Gorges Project, has been used to support key industries and enterprises.¹⁹⁹ Purchases are made by the Chinese government in accordance with its procurement law, which went into effect on January 1, 2003, and was meant to be the first step in China’s effort to create a comprehensive procurement system for the Chinese government at all levels.²⁰⁰ The GP Law, however, discriminates against “non-Chinese” domestic companies. Specifically, under Article

¹⁹⁷ Although China acceded to the WTO on December 11, 2001, China is not yet a member of the WTO’s plurilateral Agreement on Government Procurement (“GPA”). China committed to become an observer to the GPA and to initiate negotiations for membership to the GPA “as soon as possible.” In that regard, China submitted its initial GPA offer in December 2007. Because China is not yet a member of the GPA, it does not have WTO market access obligations in the area of government procurement. When China joined the WTO, it did, however, commit to terms of the SCM Agreement. To the extent that the suppliers receive more than adequate remuneration from the Chinese government, the procurement process confers countervailable subsidies upon the suppliers. China also committed to conduct its governmental procurement in a transparent manner and to provide all foreign suppliers with equal opportunity to participate in procurements opened to foreign suppliers in accordance with the Most Favored Nation principle.

¹⁹⁸ See Lu Ding Prospect of Industrial Policy Regime After the WTO, at 7 (2000).

¹⁹⁹ See Taiyuan Steelworks Wins the Bid for Three Gorges Project, SinoCast China Business Daily News (Jan. 16, 2003) (explaining that China’s largest stainless steel producer, TISCO, won nine or ten bids for stainless steel used in the Three Gorges Project).

²⁰⁰ See Government Procurement Law of the People’s Republic of China, No. 68 (Jun. 29, 2002) (“GP Law”).

10 of the GP Law, Chinese government agencies and related entities are required to purchase equipment and technology from Chinese state- or privately-owned enterprises, unless the goods and services are unavailable or cannot be obtained under reasonable commercial conditions. Moreover, SOEs in the utilities sectors (such as water, energy, and transport) are not covered by Chinese local procurement legislation.²⁰¹

Furthermore, an audit conducted by the Asian Development Bank (“ADB”) of a Chinese steel producer suggests that the Chinese government implemented this policy, at least in part, by ensuring that key steel enterprises were in a position to benefit from the Chinese government’s massive investments in infrastructure.²⁰² Specifically, the ADB found that the steel company was “one of 512 large- and medium-sized companies identified by the national Government for support,” and “one of 126 ‘key enterprises’ identified by the provincial government.” Id. These key steel enterprises also receive “support in such areas as fast tracking infrastructure support projects and receiving priority from other SOEs for procurement of equipment, supplies, and services.” Id.

Given the importance to many public sector projects of pillar industries, including downstream industries in the specialty steel sector, Chinese producers in these industries are likely to have benefited from China’s biased procurement process. Indeed, China’s GP Law ensures that the massive investments made by the Chinese government in infrastructure are funneled to the key enterprises in these favored industries in China.

²⁰¹ China’s public procurement system also has been criticized for a lack of consistency and transparency, limited access to public tenders, and insufficient publicity of all public tenders.

²⁰² Project Performance Audit Report on Laiwu Iron and Steel Company Modernization and Expansion Project in People’s Republic of China, at 11 (Jan. 2003).

b. Purchases by State-Owned Enterprises

In addition to purchases made by the Chinese government through the public procurement process, purchases made by SOEs also have been used to benefit downstream consumers of specialty steel in China. As noted throughout this report, downstream industries in China's specialty steel sector are considered "pillar" industries, and specialty steel products are an essential raw material input consumed by many other key industries in China. By granting producers of downstream specialty steel products (as well as producers of specialty steel) preferential access to these important consumers, the Chinese government provides further support to enterprises in these key industries.

Many industries deemed by the Chinese government as critical to China's economic growth and security (such as the oil refinery, power generation, chemical, transportation, and machinery manufacturing sectors) have been developing rapidly in recent years.²⁰³ These industries require substantial amounts of specialty steel and downstream specialty steel products. In 2006, the state-owned electric power industry invested a record \$56.7 billion, and the state-owned oil and petrochemical industries invested \$52.0 billion.²⁰⁴

Investments of this type consume substantial quantities of specialty steel products. In the petrochemical industry, for instance, China consumed approximately 4.05 to 4.15 million tons of steel in 2005, including 2.156 million tons of seamless pipe applied to the production of oil well pipe.²⁰⁵ In China's forecast of steel demand by its energy industry during the period of the 11th

²⁰³ See China will consume 6.5m tonnes of stainless steel this year, Shanghai Non-Ferrous Metals (Oct. 15, 2007), available at <http://www.smm.com.cn/en/readnews.php?id=12565>.

²⁰⁴ See McMillion, China's Soaring Financial, Industrial, and Technological Power (Sept. 2007).

²⁰⁵ See China's steel consumption forecast for 2006-2010, available at <http://www.steelguru.com/selectednews/index/2006/010/029/archives.html#14766>.

Five-Year Plan (2006-2010), the Chinese petrochemical industry is expected to consume 6.0 to 6.5 million tons of steel products by 2010. Id.

Because foreign producers are largely precluded from competing against Chinese producers to supply China's significant investments in fixed assets, producers in China, particularly SOEs, are supplying the specialty steel products used in these massive investments by downstream industries. TISCO, for instance, signed a strategic cooperation agreement with CNPC to supply all the steel required by CNPC for oil and gas containers. "According to the agreement, the two companies will cooperate on developing line pipe steel for oil and natural gas, specialty steel, steel for low temperature container and welded steel pipe, seamless pipe and new materials."²⁰⁶

Thus, the Chinese government has encouraged the development of downstream industries in China's specialty steel sector by structuring governmental purchases of specialty steel products to provide a secure source of revenue to producers in China. The revenue from these infrastructure-related sales has allowed producers in China to continue expanding their production capacities by providing the requisite capital for such investments.

2. Control and Direction of Foreign Investment in Downstream Industries in China's Specialty Steel Sector

The Chinese government has used foreign investment as a tool to develop downstream industries in China's specialty steel sector by directing needed foreign capital and technology to these preferred industries.²⁰⁷

²⁰⁶ See CNPC sources all steel from domestic with Taigang become {sic} the first cooperation partner, Information Center of Metallurgical Industry of P.R.C. (Dec. 19, 2007), available at www.mmi.gov.cn/mmi_en/more/morec.htm.

²⁰⁷ See e.g., Lu Ding, Prospect of Industrial Policy Regime After the WTO, at 12 (2000) (explaining that among the few categories of foreign investment projects supported by the GOC (...continued)

a. Measures Controlling Foreign Investment

The government controls foreign direct investment into China using the “Catalogue for the Guidance of Foreign Investment Industries,” which is issued jointly by the National Development and Reform Commission and the Ministry of Commerce.²⁰⁸ The catalogue distinguishes between encouraged and discouraged industries, with discouraged industries further broken down into those where foreign investment is restricted and those where foreign investment is prohibited. Industries that are discouraged are generally those that are not in line with the central government’s national economic development goals. Encouraged industries include “manufacture of complete automobiles (including R&D activities)” and “manufacture of key spare parts for automobiles” Id. However, “the proportion of foreign investments shall not exceed 50%.” Id.

Additionally, the Ministry of Science and Technology and the Ministry of Commerce issued the “Catalogue of Encouraged Hi-tech Products for Foreign Investment.”²⁰⁹ In accordance with this catalogue, the Chinese government encourages foreign investment in various automobile parts products, including “anti-skid brakes,” “electron controlled automatic transmission case,” and “electric steering gear with booster.” Id.

(...continued)

are projects that meet the demand of the international market and that open markets and expand exports).

²⁰⁸ See Catalogue for the Guidance of Foreign Investment Industries (Amended in 2004), State Development and Reform Commission (Nov. 30, 2004) (identifying, for example, “prospecting and exploitation of copper ores” as an encouraged activity), available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/RegulationsonForeignInvestment/t20060620_51089.jsp.

²⁰⁹ See Catalogue of Encouraged Hi-tech Products for Foreign Investment, Ministry of Science and Technology and the Ministry of Commerce (Dec. 6, 2004), available at http://www.fdi.gov.cn/pub/FDI_EN/Economy/Investment%20Environment/FDI%20in%20China/Industrial%20Guidelines/t20060422_24931.htm.

Under the “Temporary Provisions on Promoting Industrial Structure Adjustment” and the “Directory Catalogue on Readjustment of Industrial Structure (Version 2005),” issued by the NDRC in December 2005, the Chinese government has designated investments made in certain industries as “encouraged investments” eligible to receive various types of governmental assistance.²¹⁰ Numerous products and projects of downstream industries in China’s specialty steel sector are encouraged by China. For example, projects in the automotive industry (such as design, development, and manufacture of automobiles and parts) are eligible to receive subsidies from the government.²¹¹

To encourage foreign investment in favored industries, the Chinese government has bestowed various subsidies, including tax reductions and import-duty waivers.²¹² Various tax subsidies, which are discussed in section IV.A.13 above, are provided by the Chinese government to foreign-invested enterprises, such as a reduced corporate tax rate, an income tax refund for FIEs that reinvest in Chinese businesses, and an exemption of the business tax on technological transfers for FIEs. The government also has exempted duties on imported equipment.²¹³

Through these measures, the Chinese government successfully has been directing foreign investment and technology transfers into numerous projects in downstream industries in the specialty steel sector. In the automotive sector, for example, all three of China’s national

²¹⁰ See Decision of the State Council on Promulgating and Implementing the “Temporary Provisions on Promoting Industrial Structure Adjustment,” at Article 17, State Council (2005), available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51279.

²¹¹ See Directory Catalogue on Readjustment of Industrial Structure (Version 2005), Decree of the National Development and Reform Commission (No. 40) (Dec. 2, 2005).

²¹² See Revised Catalogue for the Guidance of Foreign Investment Industries, (Jan. 2005), available at <http://www.tdctrade.com/alert/cba-e0501a-5.htm>.

²¹³ See China is World’s No. 1 Stainless Steel Consumer, Asia Pulse (Apr. 11, 2002).

champion SOEs have multiple joint ventures with foreign automakers. SAIC, China's largest car manufacturer, has a joint venture with Volkswagen, SVW, and a joint venture with GM, SAIC GM Wuling. Id. FAW, another major Chinese automaker, has formed joint ventures with Mazda in Jilin and with Toyota, Tianjin FAW Toyota. Lastly, Dongfeng has signed joint venture agreements with Peugeot, Dongfeng Peugeot Citroen, and with Honda. Id.

b. Limits on Foreign Ownership

During the 1990s, China's government began an SOE reform plan that was expected to terminate the Chinese government's ownership and control of SOEs and to privatize much of the SOE sector by 1998.²¹⁴ Rather than privatize certain large- and medium-sized SOEs, however, the Chinese governmental maintained control of these enterprises through stock positions held by various government agencies. Id. These agencies served as stockholders with the power to hire or fire managers and to control mergers, acquisitions, and bankruptcies. Id. As explained by the State Development Planning Committee Minister, "The state must retain the controlling share in key enterprises that have a significant bearing on the national economy and national security."²¹⁵ In the Tenth Five-Year Plan, the Chinese government codified its position that the "state must hold a controlling stake in strategic enterprises that concern the national economy" and also must "uphold the dominance of the public sector of the economy {and} let the state-owned sector play the leading role."²¹⁶

²¹⁴ See The Mineral Industry of China – 1998, U.S. Geological Survey, at 1.2 (1999), available at <http://minerals.usgs.gov/minerals/pubs/country/asia.html#ch>.

²¹⁵ See China to Improve Economic Operation Through Industrial Restructuring, People's Daily (Mar. 06, 2001), available at http://english.people.com.cn/200103/06/eng20010306_64240.html.

²¹⁶ See The Tenth Five-Year Plan for National Economic and Social Development – People's Republic of China, available at http://www.logos-net.net/ilo/195_base/en/init/chn_1.htm.

Given the importance of downstream industries in the specialty steel sector to China's economic and industrial growth, the government has been unwilling to relinquish control of SOEs in pillar industries. In the automotive industry, for instance, Pursuant to Article 47 of the 2004 AIP, the Chinese government limits foreign investors to no more than two joint ventures and restricts foreign ownership in a joint venture to less than 50 percent.²¹⁷ China has imposed similar limitations on foreign ownership in its iron and steel sector pursuant to the new Steel and Iron Industry Development Policy issued in July 2005.²¹⁸ Specifically, foreign investment has been limited to a non-controlling interest under Article 23 of the Steel Policy 2005, which provides that, “[i]n principle, foreign investors that make investment in China's iron and steel industry are not allowed to have a controlling share status.” Id.

c. Local Content and Other Localization Requirements

China has protected and supported the development of downstream industries in the specialty steel sector through local content and other localization requirements. In the automotive sector, for instance, the Chinese government has forced parts producers in other countries to relocate their production facilities to China by making approvals of auto assembly operations contingent upon the purchase of local parts.²¹⁹ While China has removed explicit local content requirements supporting domestic parts production as part of its accession

²¹⁷ See, e.g., China's Laws, Regulations and Practices in the Areas of Technology Transfer, Trade-Related Investment Measures, Subsidies and Intellectual Property Protection Which Raise WTO Compliance Concerns, Trade Lawyers Advisory Group, at 25 (September 2007).

²¹⁸ See Steel and Iron Industry Development Policy, Order No. 25 of the National Reform and Development Commission, July 2005, at Art. 23.

²¹⁹ A WTO Panel found provisions of China's automotive industrial policies regarding local content and other localization requirements to be inconsistent with commitments assumed by China upon acceding to the WTO. See, e.g., Panel Report, China – Measures Affecting Imports of Automobile Parts, WT/DS340/R, Jul. 18, 2008, at para. 8.4.

commitments to the WTO,²²⁰ it has replaced the explicit domestic content requirements with more subtle forms of “persuasion.”²²¹

Because the Chinese government has limited the number of licenses granted for final automobile assembly, the awarding of a license to expand auto production capacity in China is extremely valuable. *Id.* at 14-15. The automakers are forced to substitute parts made in the United States and other countries with parts made in China if they want to introduce new models and succeed in the Chinese market. *Id.* at 15. According to the NDRC, foreign automakers are expected to fulfill localization requirements.²²² The Chinese government, therefore, “is accomplishing via non-tariff barriers the very goals that it previously achieved with WTO-inconsistent tariff measures.”²²³

The effectiveness of China’s localization measures is reflected in the commitments made by foreign automakers to purchase Chinese-made auto parts.

- Press reports indicate that GM has committed to purchasing \$10 billion annually in Chinese-produced auto parts by 2009. By 2005, Buicks manufactured in China by GM’s joint venture already had an 80-percent local content ratio.
- Ford is reported also to have made at least US\$ 3 billion in commitments to buying substantial quantities of Chinese-produced parts for export to Ford plants worldwide. The Wanxiang Group, China’s largest indigenous auto parts supplier, has reported an agreement with Visteon, whereby it will supply the former Ford auto parts affiliate with substantial volumes of auto parts. Visteon reportedly has 21 plants in China.

²²⁰ For instance, under the 1994 AIP, the Chinese government required 40-percent local content at start-up for passenger car production, with this local content requirement increasing to 60 percent by the second year and 80 percent by the third year. See Andrew Szamosszegi, How Chinese Government Subsidies And Market Intervention Have Resulted In The Offshoring Of U.S. Auto Parts Production: A Case Study, at 11.

²²¹ Andrew Szamosszegi, How Chinese Government Subsidies And Market Intervention Have Resulted In The Offshoring Of U.S. Auto Parts Production: A Case Study, at 14.

²²² Witman Liao, Foreign joint venture partners urged to fulfill contract commitments, China Automotive Review (Mar. 2007).

²²³ Andrew Szamosszegi, How Chinese Government Subsidies And Market Intervention Have Resulted In The Offshoring Of U.S. Auto Parts Production: A Case Study, at 15.

- DaimlerChrysler also has stated that it intends to buy more auto parts from China.
- Toyota agreed to expand local parts purchases in order to secure a production license from the government.

Id.

d. Technology Transfer Requirements

The Chinese government is also directing advanced production technologies to its key industries, including downstream industries in the specialty steel sector, by conditioning investment approval upon satisfying technology transfer requirements. In the iron and steel sector, for instance, the Steel Policy 2005 requires that foreign enterprises seeking to invest in Chinese iron and steel enterprises possess proprietary technology or intellectual property in the processing of steel.²²⁴ Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China under Article 23 of the Steel Policy 2005, this requirement would seem to constitute a de facto technology transfer requirement.

China's 2004 AIP provides another example of technology transfer requirements imposed by the Chinese government, which uses the Government's control over the licensing and approval of foreign investments to ensure that investments in advanced production technologies are made in the automotive industry.²²⁵ Pursuant to Article 47 of the 2004 AIP, foreign investment projects in China's automotive industry require the establishment of R&D facilities with an investment of at least RMB 500 million. Id. at 25. In Annex II of the 2004 AIP, foreign investors seeking approval of new automobile production plants must file technology-transfer agreements. Id.

²²⁴ See Steel and Iron Industry Development Policy, Order No. 25 of the National Reform and Development Commission, July 2005.

²²⁵ See, e.g., China's Laws, Regulations and Practices in the Areas of Technology Transfer, Trade-Related Investment Measures, Subsidies and Intellectual Property Protection Which Raise WTO Compliance Concerns, Trade Lawyers Advisory Group, at 23-29 (September 2007).

The Chinese government, moreover, has been successful in its efforts to direct foreign-technology transfers into its automotive industry. China has successfully conditioned the approval of joint ventures entered into by U.S. companies in China on the transfer of technology to Chinese automakers.²²⁶

3. Coordination and Manipulation of Raw Materials

The Chinese government supports downstream industries in the specialty steel sector by ensuring that enterprises in these industries are supplied with sufficient quantities of key raw material inputs at low prices. China has been securing control of many vital raw materials, such as nickel, by supporting massive investments made by its SOEs. The Chinese nickel industry, for instance, is controlled by the Chinese government through Jinchuan Group Ltd., which controls approximately 90 percent of the total nickel production in China.²²⁷ As part of a A\$1.3 billion nickel purchase agreement with an Australian nickel producer, Jinchuan Group invested more than A\$12 million in loans and equity immediately.²²⁸ In another project in Australia, the Chinese government awarded RMB 1.30 billion in subsidies to Jiangsu Shagang Steel Group to support the steel group's iron-ore mining project in Australia.²²⁹ Many more examples of the

²²⁶ Andrew Szamosszegi, How Chinese Government Subsidies And Market Intervention Have Resulted In The Offshoring Of U.S. Auto Parts Production: A Case Study, at 15.

²²⁷ See Prospects and Opportunities for the Development of Chinese Nickel and Cobalt Industry, Presentation by Yongjun Li, Chairman of the Board and CEO of Jinchuan Group Ltd., (explaining that Jinchuan is a SOE owned by the Government of Gansu Province (58.44 percent), China State Development Bank (22.55 percent), Shaghai Baosteel Group Corp. (8.11 percent), Taiyuan Iron and Steel (Group) Co., Ltd. (8.11 percent), and Gansu Industry Trans. Investment Company (2.78 percent)).

²²⁸ See Jinchuan Signs Over US\$1 Billion Nickel Offtake Agreement with Allegiance, PR Newswire (Apr. 21, 2005), available at <http://www.prnewswire.co.uk/cgi/news/release?id=168877>.

²²⁹ See China Jiangsu Over 6 M RMB Of Subsidies To Overseas Investors, Financial Times (Feb. 15, 2006).

Chinese government's provision of such subsidies to help defray the costs associated with producers' ventures to obtain domestic- and foreign-sourced raw materials, such as nickel or iron ore, are described in greater detail below.

a. Exclusive Sourcing Agreements

While specific details are difficult to obtain regarding price coordination between the Chinese government and China's specialty steel industry and exclusive sourcing agreements, the fact that the Chinese government is providing preferential land, tax, and financing policies to state-owned producers of specialty steel to expand into downstream production shows that China is using governmental policy to create large, vertically-integrated specialty steel producers that have access to exclusive sourcing arrangements with affiliated mines and refineries to supply raw materials at low prices. Consequently, these downstream producers have significant competitive advantages, both in terms of raw material pricing and availability, in competing not only for domestic but also for export sales. The Chinese government is implementing a comprehensive plan to develop large, vertically-integrated, state-owned producers that will have not only the benefit of governmental subsidization but also the exclusive sourcing of key raw materials at low prices. These actions by the Chinese government have been and will continue to be at the direct expense of China's international competitors, including downstream consumers of specialty steel in the United States.

b. Preferential Mineral Resources Policies

The Chinese government supports its key industries by ensuring that producers are supplied with sufficient quantities of key raw material inputs at reduced prices. Lacking sufficient domestic supplies of nickel, iron ore, and other mineral resources, the Chinese government has developed an "overall plan for the supply of mineral resources . . . which

requires development of both domestic and foreign resources.”²³⁰ According to the terms of the plan, the Chinese government seeks to motivate Chinese mining companies to enter the global market by exploring foreign mineral resources. China accordingly has been aiding its SOEs to secure access to both domestic and international suppliers of the necessary raw materials through various direct measures, such as preferential loans and export credit guarantees, as well as by indirect measures.²³¹

i. Background

China’s first mining law, “The Mineral Resources Law of the People’s Republic of China,” was passed by the National People’s Congress in March 1986 and was revised in August 1996.²³² In February 1998, the State Council of China issued detailed regulations on mineral rights management, implementing the amended Mineral Resources Law of 1996. Id. (explaining that the Chinese government enacted Regulations on Registration for Mineral Exploration, the Regulations on Registration for Exploitation of Mineral Resources, and the Regulations on Transfer of Exploration Rights and Mining Rights).

As part of the natural resources reforms carried out in 1998, the Ministry of Land and Resources (“MLR”) became responsible for all functions relating to the management of mineral resources, including planning, protection, and rational utilization of land resources, mineral

²³⁰ See China to Make Use of Foreign Mineral Resources, People’s Daily Online (Jun. 12, 2001).

²³¹ See Infrastructure Sector Opens Up, People’s Daily Online (Mar. 24, 2001), available at http://english.peopledaily.com.cn/english/200103/24/eng20010324_65849.html (explaining that the “government will offer support for domestic firms wanting to set up abroad by offering preferential loans and providing export credit guarantees”).

²³² See New Century, New Opportunities for the New Mineral Industries in China – An Overview of the Mineral Industries and National Mineral Policy, available at <http://www.natural-resources.org/minerals/CD/docs/regional/unescap/CH10%20China.pdf>.

resources, marine resources, and other natural resources. Id. The MLR shares its responsibilities with local officials at the provincial, prefectural, and mineral-rich county levels.

ii. Preferential Policies Supporting the Exploration and Development of Mineral Resources in China

The preferential mineral resources policies and governmental support measures crafted by the MLR and local government officials have been guided by the National Program for Exploration and Development of Mineral Resources of 1999-2010 (“NPEDMR”), which was enacted in April 2001. Among the program’s major objectives have been: (1) to raise domestic mineral availability by means of both strengthening national geological survey funded by the central government and local governments and promoting commercial geological exploration for mineral resources through appropriate mineral policy; (2) to guarantee the supply of energy and minerals needed by national economic and social development based on “two sources of resources and two markets,” both domestic and international; and (3) to upgrade mining safety. Some of these policies and governmental support are next discussed.

(a) Preferential Policies of the Central Government That Support the Exploration and Development of Mineral Resources in China

The Chinese government has used numerous, preferential policies and measures to support the development of mineral resources available to China’s specialty steel industry as well as downstream industries. In September 2004, for instance, China implemented the “Program of Superseding Resources Prospecting in Crisis Mines in China (2004-2010). Under this program, the Chinese government created a special fund for mineral prospecting in nearly-exhausted mines in China. The fund is comprised of 2 billion yuan from the central government’s budget and 2 billion yuan from the budgets of local governments and mining enterprises.

China also has supported downstream specialty steel products by identifying these projects as “favored” in the “Temporary Provisions on Promoting Industrial Structure Adjustment” and the “Directory Catalogue on Readjustment of Industrial Structure (Version 2005)” issued by the National Development and Reform Commission in December 2005.²³³ By being identified as favored, these projects are eligible for tax and other fiscal incentives. It is noteworthy that “wholly foreigner owned enterprises are not allowed.”²³⁴

The exploration and development of mineral resources in China is also promoted under the Western Development Initiative (“WDI”). Under this program, the Chinese government will support “pillar industries” that include mineral industries, agriculture, and tourism in the twelve Western provinces of Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang, Inner Mongolia, and Guangxi.²³⁵ According to the Chinese government, “The comparative advantages of the mineral resources in the western regions are conspicuous, and their distribution is concentrated, thus providing the resources foundation for the formation of dominant pillar industries.”²³⁶ China supports the development of mineral resources located in the WDI area that have comparative resource advantages over other areas in China, such as nickel, through preferential policies and measures. Id.

²³³ See Decision of the State Council on Promulgating and Implementing the “Temporary Provisions on Promoting Industrial Structure Adjustment,” State Council (2005), available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51279.

²³⁴ See Catalogue for the Guidance of Foreign Investment Industries (Jan. 7, 2003), available at <http://www.chinataiwan.org/web/webportal/W5029562/A5120231.html>.

²³⁵ See New Century, New Opportunities for the New Mineral Industries in China – An Overview of the Mineral Industries and National Mineral Policy, available at <http://www.natural-resources.org/minerals/CD/docs/regional/unescap/CH10%20China.pdf>.

²³⁶ See China’s Policy on Mineral Resources, available at http://english.people.com.cn/200312/23/print20031223_131048.html.

The Chinese government has passed various laws and decrees that authorize a multitude of governmental measures to support the exploration and exploitation of mineral resources in accordance with the WDI.²³⁷ In the “Notification on Policies and Measures for Western Development,” for instance, China identifies certain key regions and mineral resources that are eligible for preferential measures under the WDI.²³⁸ Companies that are located in these areas or that are mining these minerals are eligible for increased financial credit input, tax preferences, preferential land-use policies, preferential mineral policies, and greater foreign investment.²³⁹ For instance, domestic and international firms are encouraged to invest in the exploration and development of certain mineral resources through the reimbursement of fees paid for the exploration or mining rights. *Id.* at 138. The fees paid for the use of exploration rights or the use of mining rights, moreover, may be reduced or exempted as follows:

²³⁷ See China taps more domestic mineral resources to fuel its roaring economic engine, People’s Daily Online (Nov. 18, 2004), available at http://english.people.com.cn/200411/18/eng20041118_164376.html; Huge Mineral Reserves Discovered in Xinjiang, People’s Daily Online (Feb. 13, 2001), available at http://english.peopledaily.com.cn/english/200102/13/print20010213_62252.html; and Preferential Policies on West Development Adopted, People’s Daily Online (Dec. 28, 2000), available at http://english.peopledaily.com.cn/english/20012/28/print20001228_58981.html. See also Circular of the State Council Concerning Several Policies on Carrying out the Development of China’s Vast Western Regions (Oct. 26, 2000); Order of the State Development and Reform Commission and the Ministry of Commerce – Catalogue of Priority Industries for Foreign Investment in the Central-Western Region (Amended 2004); Measures for the Administration of Financial Interest-subsidy Fund concerning Infrastructure Project Loan of State-level Economic and Technological Development Zone in Middle and Western Regions (Jun. 2, 2005); Circular of Ministry of Commerce on Implementing “the Project of Encouraging Investment in Central-Western Region” (Sept. 30, 2006); and Circular of Ministry of Finance and the State Administration of Taxation on Catalogue Change of Preferential Tax Policies for Development of China’s Western Regions (Nov. 16, 2006).

²³⁸ See New Century, New Opportunities for the New Mineral Industries in China – An Overview of the Mineral Industries and National Mineral Policy at 136-137, available at <http://www.natural-resources.org/minerals/CD/docs/regional/unescap/CH10%20China.pdf>.

²³⁹ *Id.* See also Preferential Policies on West Development Adopted, People’s Daily Online (Dec. 28, 2000), available at http://english.peopledaily.com.cn/english/200012/28/eng20001228_58981.html.

The fees for the use of exploration right may be exempted in the first year. Half of the rates are charged during the second and the third year. 75 per cent of the rates are charged during the fourth to the seventh years.

The fees for the use of mining right may be exempted during the period of mine construction and in the first year in which the mine is put into operation. Half of the rates apply in the second and third years of the mine production stage.

Foreign investors are encouraged to invest in exploration for and development of mineral resources in the WDI region. Beside the national preferable policies, the foreign investors are not charged for the first year and half charged for the following two years with the fees for the use of exploration right and the fees for use of mining right. There is no royalty for the exploitation of mineral resources for the first five years of mine production if the mining project with foreign investment is listed in the encouraged category of the Catalogue of Industries for Foreign Investment.

Id. at 139.

(b) **Preferential Policies of Local Governments That Support the Exploration and Development of Mineral Resources in China**

Provincial and other local governments in China also have implemented policies and measures to support the exploration and development of mineral resources in their respective territories. In Sichuan, for instance, the provincial government has established various “preferential policies regarding the mineral resources” that include the following:²⁴⁰

- exploration and mining projects in minority regions are exempted from rights fees for the first two years and pay 50 percent of the rights fees during the third through fifth years of the projects;
- exploration and mining projects encouraged in the “Industrial Guidelines for the Foreign Investment” are exempted from the mineral resources compensation fees for 5 years, and intergrowth mining products from these projects are eligible for a 50-percent deduction in the resources compensation fees;

²⁴⁰ See Preferential Policies for National Development Zones, available at <http://www.sccom.gov.cn/wszs/page/english/htm/tztc/3.htm>.

- exploration and mining projects encouraged in the “Industrial Guidelines for the Foreign Investment” that use the residual mining resources are exempt from resources compensation fees;
- projects that use advanced technology where the existing, domestic technology is inadequate may benefit from a 50-percent deduction in the resources compensation fees for the first 3 years so long as the utilization of the mining resources, mining selection, and re-mining are higher than the domestic averages;
- exploration expenditures in designated regions that create commercial mining potential may be treated as deferred assets and amortized beginning in the first year of the commercial mining; and
- non-permanent, exploration activities are exempt from site-usage fees.

In Shanxi province, for instance, the provincial government transferred an iron-ore mine to TISCO in 2005.²⁴¹ The provincial government explained that it was willing to accept 190 million yuan for the mine because “{t}he deal will facilitate the mass development of the mine and prolong the service period of the mine.” *Id.* A typical market actor would not discount the sale price of a mine by taking these factors into consideration.

iii. Preferential Policies Supporting the Exploration and Development of Mineral Resources Outside China

The Chinese government has supported investments by Chinese firms in overseas mines to supplement scarce domestic mineral resources and has sought to “motivate more competitive mining companies to enter the global market by exploring foreign mineral resources, in addition to regular imports” by using various direct measures, such as preferential loans and export credit guarantees, as well as indirect measures.²⁴²

²⁴¹ See Taiyuan Steelmaker Inks Shanxi Iron Ore Mine, Sinocast China Business Daily News (Dec. 13, 2005).

²⁴² See Infrastructure Sector Opens Up, People’s Daily Online (Mar. 24, 2001), available at http://english.peopledaily.com.cn/english/200103/24/eng20010324_65849.html (explaining that the “government will offer support for domestic firms wanting to set up abroad by offering preferential loans and providing export credit guarantees”).

In 2004, for instance, the Chinese government issued the “Circular of MOC and MFA of Distributing Guide Catalogue of Countries and Industries for Investment Abroad.”²⁴³ That Circular, for the first time, stipulated the countries and industries in which the Chinese government encouraged overseas investment. “The enterprises that meet with the Guide Catalogue and have the certificates of investment abroad have priority to enjoy the preferential policies in funds, foreign exchange, tax, customs, exit and entry.” Id.

China has actively supported investments abroad to shore up access to foreign supplies of any of the metals that it lacks, such as nickel, that are consumed in the production of steel and, in particular, specialty steel. Indeed, the steel industry is the primary consumer of nickel, with the stainless steel sector alone accounting for 65 percent of total consumption.²⁴⁴ The Chinese government has used various means to secure this vital raw material for its specialty steel producers.²⁴⁵

For instance, Jinchuan Nonferrous, China's largest nickel producer, entered into a contract for US\$700 million to purchase nickel from the world's third-largest nickel producer, Australia's WMC Resources, extending their existing agreements through 2010. Jinchuan also entered into a life-of-mine off-take agreement with Australian-listed Sally-Malay Mining.

²⁴³ See Circular of MOC and MFA of Distributing Guide Catalogue of Countries and Industries for Investment Abroad, available at <http://fec2.mofcom.gov.cn/aarticle/laws/200407/20040701240241.html>.

²⁴⁴ The Status of nickel resources in the world and the development of mineral resources in MCC, China Metallurgical Construction Group Corporation (Sept. 10, 2005), available at [http://www.pecc.org/community/minerals-shanxi-2005/papers/wang-yongguang\(paper\).pdf](http://www.pecc.org/community/minerals-shanxi-2005/papers/wang-yongguang(paper).pdf).

²⁴⁵ See Chinese Firms Encouraged to Invest Overseas: Bank, People's Daily Online (Sept. 25, 2000), available at http://english.peopledaily.com.cn/english/200009/25/print20000925_51176.html.

Chinese SOEs also have acquired mines overseas. China Metallurgical Construction Group Corporation (“MCC Group”), a large conglomerate under the direct guidance of the State-owned Assets Supervision and Administration Commission of the State Council, has invested in mines at home and abroad.²⁴⁶ MCC develops and manages mineral resources, such as iron ore and nickel, required by the steel and other industries in China. Relying on financing from the Government of China, MCC has undertaken numerous projects to develop overseas mineral resources. For example, MCC controls 85 percent of the Ramu nickel project in Papua New Guinea. The project is designed to produce 58,000 tons of sulfur, nickel, and cobalt each year, with 32,000 tons of nickel content. MCC also holds a majority interest in the Duddar lead and zinc mine in Pakistan. The mine is expected to have an annual capacity of 100,000 tons of zinc concentrate, 54,000 tons of zinc content, 32,000 tons of lead concentrate, and 20,000 tons of lead content.

In terms of direct financial assistance, one of the Chinese government’s primary tools is the provision of direct financial support through the state-owned “policy banks.”²⁴⁷ MCC has a long-standing relationship with the China Development Bank (“CDB”). CDB financed MCC’s investment in the Duddar project with a loan of US \$54 million.²⁴⁸ China has used these policy

²⁴⁶ The Status of nickel resources in the world and the development of mineral resources in MCC, China Metallurgical Construction Group Corporation (Sept. 10, 2005), available at [http://www.pecc.org/community/minerals-shanxi-2005/papers/wang-yongguang\(paper\).pdf](http://www.pecc.org/community/minerals-shanxi-2005/papers/wang-yongguang(paper).pdf).

²⁴⁷ See Chinese Firms Encouraged to Invest Overseas: Bank, People’s Daily Online (Sept. 25, 2000).

²⁴⁸ See Pakistan Mineral Development Corporation Website, available at <http://www.pmdc.gov.pk/pmdc-final/news.htm>.

loans to provide financial support for projects that develop overseas metal resources, referred to as “Going to the World” projects.²⁴⁹

4. Weak Environmental Regulations

Environmental enforcement in China is primarily the responsibility of local governments that look to those producers to provide employment and tax revenues. These conflicting interests have repeatedly led Chinese governmental authorities to allow important industries, such as the specialty steel industry and its downstream-consuming industries, to continue to pollute.²⁵⁰

The lack of effective environmental regulation for “key” Chinese industries is having profound effects on the world’s environment. China also has emerged as the world’s second greatest emitter of greenhouse gases.²⁵¹ The expansion of downstream industries in China’s specialty steel industry, and their demand for electricity produced in large part by heavily polluting coal-fired generating plants, is a major cause of this production.

Chinese industries are also less energy-efficient than the steel industries in the United States, the European Union, and other developed countries. The Chinese government’s industrial policies fueling the artificial expansion of industrial production capacity are also forcing the transfer of production to high-polluting facilities in China from relatively low-polluting facilities in the rest of the world. While China benefits economically in the short-term from the increased production attributable to its industrial policies, the whole world – including

²⁴⁹ See Chinese Firms Encouraged to Invest Overseas: Bank, People’s Daily Online (Sept. 25, 2000).

²⁵⁰ See SEPA Begins New Onslaught on Polluters, Including Petrochemical and Metals Producers, Metals Weekly (Feb. 10, 2006).

²⁵¹ See Pan Jiahua, China and Climate Change: The Role of the Energy Sector, Science & Dev. Network Policy Briefs (Jun. 2005), available at <http://www.scidev.net/dossiers/index.cfm?fuseaction=policybrief&policy=64&dossier=4>.

China – loses because of the increased pollution and greenhouse gas emissions for which Chinese industry is responsible.

5. Inadequate Labor Laws and Worker Safety Standards

Many workers in China lack minimal health and safety protections and adequate wages. China's labor law prohibits workers from organizing independent unions and does not provide for the right to strike. Without the right to organize independently, Chinese steelworkers lack effective ways to resolve labor issues in the workplace. Workers in China are regularly denied basic labor rights and remain largely unprotected by the weak enforcement of China's existing labor law and policies.²⁵²

Indeed, the U.S. State Department's annual human rights report confirmed China's poor labor record, concluding that China restricts "labor rights, including freedom of association, the right to organize and bargain collectively, and worker health and safety."²⁵³ The report noted that "[p]rotests by those seeking to redress grievances increased significantly" in 2005 and were often suppressed violently by Chinese security forces. Id. It also found that although Chinese law permits collective bargaining, this right is largely illusory. Id. at 30.

The State Department is not alone in finding gross inadequacies in China's labor record. Various human rights organizations also have concluded that China's protection of labor rights is grossly deficient. Freedom House, a prominent human rights and pro-democracy organization, reports that:

Freedom of assembly and association is severely restricted. ...
Independent trade unions are illegal, and enforcement of labor laws
is poor. All unions must belong to the state-controlled All China

²⁵² See Human Rights Watch, Human Rights and the 2008 Olympics in Beijing, available at <http://www.hrw.org/campaigns/china/beijing08/labor.htm>.

²⁵³ See China: Country Reports on Human Rights Practices, United States Department of State, at 1 (2005), available at <http://www.state.gov>.

Federation of Trade Unions, and several independent labor activists have been jailed for their advocacy efforts. Collective bargaining is legal in all industries, but it does not occur in practice.²⁵⁴

Other human rights organizations have documented labor abuses in China, including being forced to work overtime without pay; denying women the right to paid maternity leave; denying workers pay for sick leave and their legal right to national holidays; and illegally denying workers health insurance and then terminating those that are injured on the job.²⁵⁵

In these ways, at terrible human cost, China's government support downstream industries in China's specialty steel sector

V. CONCLUSION

This paper is a catalogue, albeit necessarily incomplete, of some of the major ways in which China's national, provincial, and local governments have been going about effectuating very thoughtfully and carefully a long-term plan to encourage the production of specialty steel and downstream specialty steel products in China. Chinese authorities are resolved to foster the development of domestic downstream industries in the specialty steel sector capable not only of supporting China's economic growth and largely replacing imports into China, but also of exporting large quantities of products from China to destinations such as the United States.

The scale of this endeavor, and the success already attained, are breathtaking and do not bode well for U.S. producers. In the midst of this performance by China, it is important to keep in mind that the neo-mercantilist programs and measures by China's governmental authorities are incompatible with the economic theory of free trade and are fundamentally at odds with

²⁵⁴ See Freedom in the World China (Freedom House 2005), available at <http://www.freedomhouse.org>.

²⁵⁵ See, e.g., Wal-Mart in China: What They Don't Want Us to Know, National Labor Committee (2005), available at <http://www.nlcnet.org>.

major commitments China has assumed at the World Trade Organization under public international law.