Law Offices

TELEPHONE (202) 785-4185

TELECOPIERS

(202) 466-1286/87/88

STEWART AND STEWART

2100 M STREET, N.W.

WASHINGTON, D.C. 20037

E-MAIL

GENERAL@STEWARTLAW.COM

WWW.STEWARTLAW.COM

December 10, 2007

By Hand and Via E-Mail
Honorable David Spooner
Assistant Secretary for Import Administration
Attention: Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
International Trade Administration
14th Street & Constitution Avenue, N.W.
Washington, D.C. 20230

Re: Request for Comments on Market Oriented Enterprises in Dumping Proceedings Involving China

Dear Assistant Secretary Spooner:

These comments are submitted on behalf of the law firm of Stewart and Stewart in response to the Department's request for comments on its proposal to grant market-oriented enterprise ("MOE") treatment to individual respondents in antidumping proceedings involving China.[1] In its request for comments, the Department of Commerce (the "Department") solicited comments on three specific areas of concern to the Department. First, the Department asked parties to further consider whether there is a legal basis for a market oriented enterprise test. Second, the Department asked parties to consider the administrative feasibility of identifying an

[1] *See* Antidumping Methodologies in Proceedings Involving Certain Non-Market Economies: Market-Oriented Enterprise; Request for Comment, 72 Fed. Reg. 60649 (Dep't Comm., Oct. 25, 2007) (hereinafter "Second Request for MOE Comments").

market-oriented enterprise operating within a broader non-market economy environment. Third, and final, Commerce asked parties to consider to what extent, and under what conditions, the Department should rely on a market oriented enterprise's prices and costs, particularly for those inputs that are inextricably linked to the broader operating environment, *i.e.,* labor, land and capital. [2]

We address the Department's request for comments in our submission, which contains the following points: (1) an overview of our argument that the Department should not adopt a methodology that would permit individual respondents in antidumping cases before the Department involving the People's Republic of China ("China") to be eligible for market oriented enterprise status; (2) the law does not contemplate market oriented treatment of Chinese enterprises; (3) acceptable legal frameworks already exist for recognizing market orientation; (4) any test aiming to accurately capture market orientation of individual Chinese firms would be difficult to administer; (5) the activities of firms operating within China are inextricably linked to the government's regulation of the economy; (6) specific distortions exist that affect firm behavior at all levels of the economy; and (7) proposed criteria to evaluate market orientation of Chinese enterprises, if the Department creates such a test.

I. OVERVIEW

As parties aptly noted in their June 2007 comments to the Department, China does not operate as a market economy. There exist significant distortions in the economy that preclude designation of China as a market economy. These distortions result from heavy government involvement designed to boost economic growth.

[2] *Id.*

To meet its objectives for growth, the Chinese government directs the allocation of critical resources such as capital, labor, land and energy. These resources are integral to the market operations of every economic actor, yet not every actor obtains equal access to them. Resources are often allocated to less efficient users creating imbalances that skew the pricing and output decisions of all actors within the economy.

Although the government has made progress towards liberalizing aspects of the economy, the economic conditions in China still remain far from market oriented as the government continues to guide the growth of the economy. The Department recently recognized the extent of government involvement in the Chinese economy when it conducted a detailed survey of the national economy. In that survey, the Department concluded that the "state retains for itself considerable levers of control over the economy" such that "market forces in China are not yet sufficiently developed to permit the use of prices and costs in that country for purposes of the Department's dumping analysis."[3] The findings of the Department are unambiguous and rule out the use of Chinese prices and costs in antidumping duty analysis.

Economic conditions in China have not significantly evolved since the Department issued its Memo on China's NME Status on August 30, 2006. The very same factors[4] relied on by the Department to conclude that China's prices and costs are distorted by government intervention

[3] *See* Antidumping Duty Investigation of Certain Lined Paper Products from the People's Republic of China ("China")-China's status as a non-market economy ("NME") (Dep't Comm., Aug. 30, 2006) (hereinafter "Memo on China's NME Status"), at 80-82.

[4] The factors that the Department considered in its analysis were: (1) the extent to which the currency of the foreign country is convertible into the currency of other countries; (2) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management; (3) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country; (4) the extent of government ownership or control of the means of production; (5) the extent of government control over the allocation of resources and over the price and output decisions of enterprises; and, (6) such other factors as the administering authority considers appropriate (the Department considered trade liberalization and rule of law in its Memo on China's NME Status). *Id.* The Department is required to examine these factors in making a non-market economy determination under 19 U.S.C. 1677(18)(B).

remain unchanged today. In support of the position taken by the Department in that memo, we provide in this submission additional information suggesting that the Chinese government may wield considerable control over sectors of the economy and, furthermore, may be increasing control over certain enterprises deemed critical to the national economy.[5]

Given the non-market economic conditions that pervade China's economy, any policy aimed at granting market oriented status to respondent companies operating within China are not ripe for consideration. At this point in time, the implementation of any such policy is just too premature as controls remain in many areas of the economy that are yet to be liberalized.

II. THE LAW DOES NOT CONTEMPLATE MARKET ORIENTED TREATMENT OF CHINESE ENTERPRISES

As opponents to the proposed methodology pointed out in their June 2007 submissions to the Department, antidumping laws do not contemplate application of a market oriented enterprise test. In this section, we consider legal provisions governing this issue: the statute, the Department's regulations, and China's Protocol of Accession to the World Trade Organization ("WTO"). A thorough examination of these sources reveals that, not only is the adoption of a market oriented enterprise test not feasibly contemplated under governing laws, there also is no legal requirement for the Department to engage in a company-by-company analysis of market orientation.

[5] As discussed in Section VI.F.3, *infra*, a study published in October 2007 by the Bank of Finland explains that, recently, the Chinese government has been reasserting control over the economy by acquiring ownership in enterprises operating within important sectors. In fact, the government established a legal administrative body, called the State-owned Assets Supervision and Administration Commission, to take control of such enterprises and put them under the unitary supervision of the State Council. *See* Mikael Mattlin, *The Chinese Government's New Approach to Ownership and Financial Control of Strategic State-Owned Enterprises*, Bank of Finland, October 2007 ("*Control of Strategic State-Owned Enterprises*")

A. The Statute Does Not Provide For the Construction of a Market Oriented Enterprise Test

The Tariff Act of 1930, as amended, has been codified in statute and embodies Congressional intent with respect to the authority of the agency to administer antidumping laws. Section 1677b of the statute prescribes methods for calculating normal values in antidumping investigations.[6] Subsection (c) delineates the method of calculating the normal value of subject merchandise in a non-market economy and specifically describes the manner in which the Department must consider the prices within non-market economy countries.[7] According to the statute, when prices are unreliable in the non-market economy country under review, the Department must look to a surrogate country(s) for surrogate market economy prices.[8] Because Chinese prices are deemed unsuitable for use in antidumping duty calculations, the Department is directed by statute to use surrogate values from a market economy country(s) in lieu of actual non-market economy prices:

> "If...the administering authority finds that available information does not permit the normal value of the subject merchandise to be determined {according to actual prices generated within the exporting country}, the administering authority shall determine the normal value...on the basis of the value of the factors of production utilized in producing the merchandise...{and}the valuation of the factors of production shall be based on the best available information regarding the values of such factors in a market economy country or countries considered to be appropriate by the administering authority."[9]

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[6] *See* 19 U.S.C. 1677b.

[7] *See* 19 U.S.C. 1677b(c). The statute defines a "nonmarket economy country" as "any foreign country that the administering authority determines does not operate on market principles or cost of pricing structures, so that sales of merchandise in such a country do not reflect the fair value of the merchandise." *See* 19 U.S.C. 1677(18)(A).

[8] *See* 19 U.S.C. 1677b(c)(2).

[9] *See* 19 U.S.C. 1677b(c)(1).

Although the statute acknowledges that margins for firms in non-market economy settings may be calculated using other methods, [10] the statute does not expressly sanction market economy enterprise treatment of individual firms. Furthermore, while we recognize that the law may permit a theoretical option to rely on actual costs and prices in non-market economy cases, that option is not viable because prices within China are substantially distorted by government interference in the economy to such a degree that the activities of individual firms cannot be separated from the distortions in the overall economy.

B. The Department's Regulations Do Not Provide For a Market Oriented Enterprise Test

The Department's regulations are consistent with the statute in directing the Department to value a non-market economy producer's factors of production using prices from a surrogate country. The regulations carve out only one exception to this rule—if a non-market economy producer purchases its factors from a market economy supplier and pays for it in a market-economy currency, the factors will be valued using the price paid to the market economy supplier.[11] As discussed below, this provision constitutes one of two practical ways in which the Department may treat non-market economy firms as marketed oriented. The express language of the regulations, however, does not provide for the proposed market oriented enterprise methodology.

[10] We point out that, to date, the Department has never deemed it appropriate to use actual Chinese transaction prices in calculating margins for Chinese respondents.

[11] *See* 19 C.F.R. 351.408(c).

C. China's Protocol of Accession to the WTO Does Not Accommodate MOE Treatment

China's 2001 Protocol of Accession does not contemplate market oriented treatment for individual Chinese firms.[12] China's Protocol of Accession to the WTO includes China's express agreement to be treated as a non-market economy for purposes of antidumping duty trade disputes. The Protocol of Accession delineates the non-market economy treatment of Chinese enterprises in antidumping cases, and nowhere in the text of the agreement does it expressly authorize market oriented status for individual enterprises:

> **15. Price Comparability in Determining Subsidies and Dumping**
>
> Article VI of the GATT 1994, the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ("Anti-Dumping Agreement") and the SCM Agreement shall apply in proceedings involving imports of Chinese origin into a WTO Member consistent with the following:
>
> (a) In determining price comparability under Article VI of the GATT 1994 and the Anti-Dumping Agreement, the importing WTO Member shall use either Chinese prices or costs for the industry under investigation or a methodology that is not based on a strict comparison with domestic prices or costs in China based on the following rules:
>
> (i) If the producers under investigation can clearly show that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product, the importing WTO Member shall use Chinese prices or costs for the industry under investigation in determining price comparability;
>
> (ii) The importing WTO Member may use a methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product.

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[12] *See* Accession of the People's Republic of China: Decision of 10 November 2001, World Trade Organization, 23 November 2001 (01-5996), *available at* http://www.mac.doc.gov/China/ProtocolandDecision.pdf ("Protocol of Accession").

* * *

> (d) Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession. In addition, should China establish, pursuant to the national law of the importing WTO Member, that market economy conditions prevail <u>in a particular industry or sector</u>, the non-market economy provisions of subparagraph (a) shall no longer apply to that industry or sector.[13]

The text of the Protocol of Accession accounts for the possibility that Chinese *industries* may be considered market oriented. However, the protocol noticeably stops short of extending market oriented treatment to individual enterprises. The fact that the agreement does not recognize market oriented treatment for individual entities is both logical and firmly grounded in economic principles—firms operate within the economic environment of the greater industry, and when the industry is tainted by non-market forces, firm operations are impacted by such forces. The drafters of the Protocol of Accession incorporated this economic principle into the text of the agreement, and the agreement was accepted by Congress. Constructing a narrower concept of market oriented treatment may run the risk of undermining important elements of the WTO Protocol.

D. Conclusion

Until China demonstrates that its economy operates largely on market principles or until Chinese industries demonstrate market orientation, the Department is required to treat Chinese firms as non-market economy enterprises and calculate antidumping margins using surrogate values in accordance with existing law.

[13] *Id.*, Part I, Section 15 (emphasis added).

III. ACCEPTABLE LEGAL FRAMEWORKS EXIST FOR RECOGNIZING MARKET ORIENTATION

If the Department seeks to account for the evolving nature of the Chinese economy, the Department need look no further than the market oriented industry ("MOI") test developed in 1992.[14] Under the MOI test, firms may obtain market economy treatment if they are able to sufficiently demonstrate to the Department that economic conditions guiding their industry are market based. The Department's MOI test is realistic and economically sound because it is designed to accurately assess the economic settings in which firms operate. The test recognizes that firms do not operate in isolation from their economic environments and, consequently, requires that market orientation be demonstrated for industries rather than individual firms.

During the MOI tests's 15 years in existence, no industry to date has been able to sufficiently demonstrate market orientation. This is not surprising given that non-market forces permeate the Chinese economy. As detailed below, the Chinese government imposes considerable restrictions on the Chinese economy to suppress market forces, *e.g.*, restricting the flow of capital to controlling the allocation of resources. Given that no Chinese industry has been able to satisfy the requirements of the MOI test, it would be inappropriate for the Department to create a less rigorous standard so that individual firms could receive market oriented treatment despite significant economic distortions in their home markets. Moreover, the proposed market oriented enterprise policy does not reflect true market conditions in China

[14] *See* Preliminary Determination of Sales at Less Than Fair Value: Sulfanilic Acid from The People's Republic of China, 57 Fed. Reg. 9409, 9411 (Dep't Comm., Mar. 18, 1992). Under the MOI test, the Department may grant non-market industry market-economy status if the industry meets the following criteria: (1) that there be virtually no government involvement in production or prices for the industry; (2) that the industry be marked by private or collective ownership that behaves in a manner consistent with market considerations; and that producers be found to pay market-determined prices for all major inputs, and for all but an insignificant proportion of minor inputs.

because it presumes that firm behavior can be disentangled from the economy—an assumption that has no basis in reality.

In their June 2007 comments, parties pointed out an additional test that permits Chinese companies to obtain market oriented treatment. This is the Department's market economy input methodology, referenced in 19 CFR 351.401(c) and recently amended in a Department Policy Bulletin.[15] According to this methodology, when non-market economy respondent firms purchase over 33% of any particular input from a market economy supplier(s), they may qualify to have that input valued at prices paid rather than surrogate values. We believe this methodology to be a viable test for assessing market oriented firm behavior because it takes into account actual market transactions experienced by Chinese firms, *i.e.*, market economy purchase prices. When the Department's analysis is limited to market economy-based transactions, it guarantees that distortions of non-market economies are not introduced into the mix. The proposed methodology, however, would be unable to ensure the same.

IV. ANY TEST AIMING TO ACCURATELY CAPTURE MARKET ORIENTATION OF INDIVIDUAL CHINESE FIRMS WOULD BE DIFFICULT TO ADMINISTER

The implementation of a test seeking to assess market orientation of individual firms would be difficult, if not impossible, to administer. Any such test would pose impractical challenges on parties as well as the Department. These cannot have been envisioned by the lawmakers.

[15] *See* Antidumping Methodologies: Market Economy Inputs, Expected Non-Market Economy Wages, Duty Drawback; and Request for Comments, 71 Fed. Reg. 61716, 61717-61718 (Dep't. Comm., Oct. 19, 2006)

First, the mere establishment of any such test will naturally give rise to countless claims by Chinese entities alleging market orientation. Regardless of their merits, a thorough analysis will be required for them, and legal records will need to be compiled to address the validity of the claims. This effort will entail countless hours on the part of petitioners and interested parties, raising the cost of litigation for respondents, petitioners and interested parties alike.

Second, simply allowing individual Chinese firms to claim market orientation will create a significant burden on domestic parties with respect to rebutting those claims. Given the non-transparent nature of the Chinese economy, it will be quite easy for companies to raise claims of market orientation but extremely hard for domestic parties to accumulate accurate evidence to sufficiently rebut those claims.[16] Domestic interested parties residing in the United States are not similarly situated in terms of access to Chinese company records and industry information in the same way that Chinese respondents and suppliers are. If the Department were to adopt a market oriented enterprise policy, it would impose on domestic interested parties a burden that is not shared by respondent companies. As a result, the ability of domestic parties to meaningfully participate in a proceeding would be materially impaired.

Third, the adoption of any market oriented enterprise test will strain an already constrained timeframe for conducting antidumping proceedings. The timelines established for antidumping duty proceedings were designed to accommodate the legal provisions and fact-finding objectives already included in the laws and regulations, but not more. If the market oriented enterprise test is adopted, it will effectively add an extra procedural layer to a currently

[16] Evidence required of domestic parties to rebut claims of market orientation may include information on precisely how the respondent in question and its suppliers operate vis-a-vis the other firms in their respective industries, the decision-making process of the how input suppliers price their products, and whether input prices are based on a competitive market.

stringent timeline, one which was not designed to accommodate the extra analysis. This will condense timeframes in which parties have to address case-specific legal issues already codified in law, and as a result, may give rise to due process challenges.

Fourth, proponents of the proposed methodology suggest that the Department conduct a market orientation analysis for each company requesting market economy treatment. This will be an exceptional undertaking given that the Department has been facing an unprecedented number of respondents in recent non-market economy cases. By engaging in a company-specific review of every firm requesting market oriented treatment, the Department would be diverting already scarce resources, in terms of human capital and time, from conducting statutorily mandated elements of a review (*e.g.,* U.S. price analyses and normal value calculations).

Fifth, if certain companies within a single proceeding are determined by the Department to be market oriented while others are not, there would be no clear, practical way in which the Department can simultaneously administer both market economy and non-market economy methodologies within a single case.[17] Moreover, if both methodologies are employed in a given proceeding, the appropriate treatment of separate rate applicants will be called into question—such as whether each applicant should obtain an opportunity to demonstrate market orientation and how a single "separate rate" will be calculated.

Sixth, the predictability of antidumping proceedings will be compromised by the adoption of a market oriented enterprise test. Parties engaged in international trade should be able to reasonably determine whether their trading behaviors violate U.S. law and international

[17] Some respondents may superficially argue market treatment even though economic distortions exist within their industry. However, it would be impractical to calculate margins for respondents that claim market orientation using home market prices because distortions within the industry affect price equilibrium and output decisions of all actors.

agreements. Trade remedy laws should, accordingly, be transparent and afford parties with a reasonable means of determining whether they risk liability. If two inconsistent non-market economy methodologies exist such that their application is unpredictable, firms will be unable to determine whether their pricing behavior is susceptible to antidumping duty liability.

Predictability also impacts the ability of respondent companies to participate meaningfully in a proceeding. Specifically, exporters will have difficulty anticipating what type of data will be used by the Department in its antidumping duty calculations. In order to provide the Department with adequate information for its calculations, respondent firms may be compelled to submit dual forms of data—cost data and surrogate value data. This will invariably result in increased litigation costs for respondent firms.

Predictability also impacts the ability of domestic industries to calculate and allege reliable margins of dumping. If petitioners cannot predict which prices will be used by the Department in its dumping calculation (*i.e.,* whether the Department will use surrogate values or transaction prices within China), it will be much harder for them to estimate the level at which Chinese firms are dumping. This, in turn, will impact their ability to assess whether there are reasonable grounds to file a dumping petition. Costs of participating will also increase for domestic parties.

Finally, if the proposed methodology is implemented, there will be no reliable basis from which to calculate the normal value component of the antidumping duty margin. Although the Department has not articulated the manner in which it proposes to calculate normal values for entities that it deems to be market oriented, it might look to market economy margin calculations for guidance. The Department may choose to base normal values on: (1) the constructed value methodology using Chinese transaction prices; (2) home market sale prices within China; or (3) third country sale prices. Yet, none of these approaches form a reliable basis for calculating normal value. Economic distortions pervade the Chinese economy and render prices within China wholly unreliable. Prices that are largely influenced by economic distortions for purposes of constructed value yield largely flawed margins. For the same reasons, normal values based on home market sales prices of subject merchandise (*i.e.,* within China) would also yield unreliable margins. Lastly, transaction prices to third country markets would also be inherently unreliable for the same reasons as domestic prices.

V. THE ACTIVITIES OF FIRMS OPERATING WITHIN CHINA ARE INEXTRICABLY LINKED TO THE GOVERNMENT'S REGULATION OF THE ECONOMY

The existence of market economy conditions within the Chinese economy can only be reliably ascertained if one looks to the broad, structural aspects of the country's national economy rather than to isolated, individual actors. In any dynamic industry, firms operate with respect to each other rather than in isolation. Acting as price takers, firms react to market signals set by their competitors, suppliers, customers and other forces acting within the economy. Market signals at work in Chinese industries are distorted by government involvement, whether direct or indirect, in capital and resource allocation. These distorted market signals affect firm behavior with respect to pricing and output decisions.

In practice, it is virtually impossible to isolate any individual firm from the industry and economy in which it operates. For example, any firm that is a rational, profit maximizing actor will depend on various sectors within its industry for its supplier base and customer base. It will, from time to time, make decisions regarding the prices it will pay for inputs, the amounts of inputs that it will purchase, the amount that it will sell to its customers, and the prices it will charge for its products. To the extent that its suppliers and customers fail to operate on commercial terms, it will necessarily distort the cost and price signals of the rationally acting firm.

This concept of the inter-dependency between a firm and its industry is not new to the Department. Parties made this very same point in their June 2007 comments to the Department on the proposed market oriented enterprise methodology. Moreover, the Department itself confronted this issue in the past and acknowledged that firms seeking to acquire market oriented treatment must be found to exist in an industry that is effectively sealed off from non-market influences:

> ...{W}e question whether it is possible to have a "bubble of capitalism" in an otherwise non-market economy...Therefore, we have imposed what may be viewed as a strict test for determining whether a "bubble of capitalism" exists in an otherwise non-market economy—the price or cost of all inputs into the production of the product must be market-driven. This test clearly will be met only in exceptional circumstances, which accords with our view that bubbles of capitalism are exceptional events.[18]

The Department also determined that firms can operate according to market principles if they *both* operate within a broader, market-based economic environment and operate within one that is effectively insulated from the government's interference:

> The absence of explicit government involvement in these transactions {purchases of steel and chemical inputs} is not sufficient to warrant the conclusion that the prices for these inputs are market-driven...it is necessary to look beyond direct state involvement in the specific transactions between the manufacturer under investigation and its suppliers

[18] *See* Final Determination of Sales at Less Than Fair Value: Chrome-Plated Lug Nuts From the People's Republic of China, 56 Fed. Reg. 46153, 46154 (Dep't. Comm., Sept. 10, 1991) ("Lug Nuts Final Determination").

to ascertain whether market forces are actually at work in determining input prices.[19]

Since the economy influences the operations of individual firms, it would be extremely difficult, if not impossible, to accurately disaggregate the operations of firms from the broader economic landscape. Therefore, it is essential that any analysis of the degree to which an individual producer and its supplier are market oriented fully take into account their complete economic environment.[20]

VI. SPECIFIC DISTORTIONS EXIST THAT AFFECT FIRM BEHAVIOR AT ALL LEVELS OF THE ECONOMY

The fact that the Chinese economy is substantially impacted by government control is uncontroverted. The question remains, is the extent of government control over the economy so great as to discount findings of market oriented enterprises? Overwhelming evidence suggests that the government's control over the national economy is so significant that it prevents the economy from creating market signals based on genuine supply and demand conditions.[21]

[19] Amendment to Final Determination of Sales at Less Than Fair Value and Amendment to Antidumping Duty Order: Chrome-Plated Lug Nuts From the People's Republic of China, 57 FR 15052, 15053 (Dep't. Comm., Apr. 24, 1992) ("Lug Nuts Amended Final Determination").

[20] For example, in the Preliminary Determinations of Sales at Less Than Fair Value: Oscillating Fans and Ceiling Fans From the People's Republic of China, 56 Fed. Reg. 25664, 25667 (Dep't. Comm, June 5, 1991), the Department stated that it must find that the "claimed market bases of the {Chinese}-sourced inputs are sufficient to overcome the controls inherent to {a non-market economy} prior to any use of those factor values in the final determinations."

[21] Statistical data indicate that economic equilibrium in China is distorted by government interference. For example, whereas in most countries 2-4 percent of GDP growth is associated with 2-3 percent employment growth, in China 10 percent GDP growth is generating about only 1 percent of employment growth. *See* Aziz, Jahangir and Dunaway, Steven, *China's Rebalancing Act*, Finance and Development Vol. 44, No.3 (Sept. 2007) International Monetary Fund, *available at* http://www.imf.org/external/pubs/ft/fandd/2007/09/aziz.htm ("International Monetary Fund:), at 5.

When the Department conducted its most recent analysis of China's non-market economy status, it concluded that the government retains for itself considerable "levers of control" over the economy which has rendered prices and costs within the entire economy unreliable.[22] Given the economic distortions that exist in the Chinese economy, an antidumping law based on a surrogate value methodology is the sole reasonable approach to providing a remedy to U.S. industries.[23]

The economic conditions identified by the Department in its Memo on China's NME Status continue to exist today.[24] As we demonstrate below, government interference in the Chinese economy introduces distortions that are so pervasive that firms cannot fully insulate themselves from their effects.

A. Currency Convertibility—19 U.S.C. 1677(18)(B)(i)

China maintains significant restrictions on its inter-bank foreign exchange market and on capital account transactions.[25] As the Department noted in its evaluation of China's non-market economy status, these restrictions tend to "interfere with the ability of market signals to impact

[22] *See* Memo on China's NME Status, at 2 and 80-82 (noting that the government's "primary levers of control lie in its use of administrative measures...and decentralized control over the banking sector." *Id.* at 81).

[23] *See* Lug Nuts Amended Final Determination, at 15055.

[24] As noted above, the Department's analysis of China's non-market economy status covers six key elements of China's economy. *See* Memo on China's NME Status, at 2; 19 U.S.C. 1677(18)(B). Although these elements are the statutorily-mandated criteria that relate to non-market economy determinations, they can also be used to evaluate the appropriateness of the market oriented enterprise test. In fact, the Department has noted in the past that these elements may be used to determine whether foreign market value for a particular industry could be calculated using a market economy methodology. *See* Lug Nuts Amended Final Determination, at 15055. Moreover, the Department has acknowledged that evaluating a firm's market oriented status is more appropriately performed on an industry-wide basis rather than a firm-specific basis by noting "these criteria have a macroeconomic orientation, {and} they are designed to be applied on an economy-wide basis." *Id.* (*quoting* Lug Nuts Final Determination, at 46154-46155).

[25] *See* Memo on China's NME Status, at 2.

the exchange rate" and prevent the renminbi from being accurately valued.[26] In other words, China's currency regime prevents the market from adjusting currency rates and operates to keep the value of the renminbi artificially low.[27]

The impact of an undervalued currency on the overall economy is substantial and affects the decisions of all actors within the marketplace. The renminbi does not reflect true prices and costs within China and, as such, tends to generate false market signals that are inconsistent with the economic organization of the market. Moreover, the renminbi distorts international competitive conditions because its below-market value disrupts trade balances and encourages excessive exports from China. Simply put, China's currency system does not permit the movements of the renminbi to reflect genuine market forces.

B. Formation of Wages—19 U.S.C. 1677(18)(B)(ii)

Government restrictions have artificially depressed wage rates for Chinese workers to become artificially depressed below their market levels. As the Department noted in its evaluation of China's non-market economy status, institutional and administrative constraints on Chinese wages include the lack of independent unions, prohibitions on the right to strike, and significant restrictions on labor mobility.[28] All of these factors, the Department recognized, limit the extent to which market forces influence the formation of wages,[29] and as a result, wages remain far below their fair market values.

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[26] *Id.*

[27] Although the Chinese currency is slowly rising in value, many scholars believe that the currency is still significantly undervalued by at least 40 percent. *See* China's Exchange Rate Regime and its Effects on the U.S. Economy, U.S. House of Representatives, Subcommittee on Domestic and International Monetary Policy, Trade and Technology, Committee on Financial Services (Oct. 1, 2003) at 21, *available at* http://commdocs.house.gov/committees/bank/hba92336.000/hba92336_0.HTM.

[28] *See* Memo on China's NME Status, at 2.

[29] *Id.* at 13-22.

Suppressing free formation of wages distorts the equilibrium of the overall economy. When labor mobility is restricted, labor supplies within one geographic region cannot respond to labor demands of another. Consequently, labor does not flow to where it is most needed, there is little incentive for employers to compete for labor by increasing wages, and significant amounts of labor capital are wasted. Additionally, when restrictions are imposed on workers' abilities to bargain for higher wages, market signals are distorted as the marketplace encounters undervalued, rather than natural, wage levels. This stifles competition for labor as wage rates do not reflect actual worker productivity and skill. The inability to bargain for increased wages further reduces workers' incentives to develop their own productivity and skill.

C. Joint Ventures and Investments—19 U.S.C. 1677(18)(B)(iii)

The Chinese government continues to manage corporate investment to a significant degree. Government regulation involves, for example, guiding foreign direct investment toward favored industries and specific regions, shielding certain domestic firms from competition, and restricting investment in certain companies.[30] In fact, the government uses various regulatory measures to control investment according to firm-type. All firms—whether state-owned, privately-owned, or foreign invested—are subject to different, some stringent, investment measures.

The degree of government control over investment flows is not wholly transparent and government agencies appear to have significant amounts of discretion in permitting investments in certain sectors and prohibiting investment in others.[31] Such uneven investment policies

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[30] *Id.*, at 3, 23-33.

[31] *Id.*, at 28.

distort competition in the marketplace by giving firms unequal opportunities to compete. As a result, market prices are not formed through dynamic competition.

D. Government Control Over The Means of Production—19 U.S.C. 1677(18)(B)(iv)

State-Owned Enterprises: The Chinese government has been increasing state control of certain industries by retaining or acquiring control over state-owned enterprises in key sectors of the economy.[32] Depending on its national economic goals, the government shifts objectives over time bolstering different firms within various industries to meet its short-term and long-term development objectives. Regardless of which firms are aided, however, the government's involvement in the activities of firms distorts the overall economic equilibrium of the industry. Inevitably, decisions by privately-owned firms are impacted by the government's presence.

The government may bolster the performance of state-owned companies by giving them advantages that are not available to nonstate, privately-owned firms in order to skew competition in favor of state-owned enterprises. Advantages include access to capital and other resources at little or no cost. Enterprises may take advantage of reduced costs by adjusting production and pricing levels to undercut competition.[33]

Moreover, state-owned firms are not required to pay corporate dividends to their government owners. In recent years, the Chinese government has not sought dividends from state-owned enterprises, including partially state-owned firms that are listed on the stock exchange and pay dividends to their private shareholders.[34] As there is no pressure to achieve profits in order to issue dividends, state-owned firms have little incentive to be productive and

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[32] *Id.*, at 38.

[33] These reduced prices, however, are distorted because they are created by an exogenous economic factor (*i.e.*, government-intervention) rather than by true market conditions.

[34] *See* International Monetary Fund, at 4.

generate revenue. In fact, they tend to be less efficient than their privately-owned counterparts.[35] Also, since state-owned firms are not required to distribute profits to the government, those generating profits may choose to reinvest dividends to increase output, regardless of whether the market demands output increases or whether such increases are wasteful.

As the above examples illustrate, when state-owned enterprises receive economic benefits from the government, their price and output decisions are influenced by those benefits and are thereby distorted. These distortions create false price signals that impact the competitive decisions of all firms within the industry, whether state-owned or privately-owned.

Property Rights: In China, land administration departments at all levels of the government allocate land use rights and exercise monopoly over the primary land market. Land, of course, is the primary and most fundamental factor of production. Because there exist no ownership or transfer rights in land, market forces do not establish its value. As such, land prices do not account for demands and land use rights are not transferred to the most efficient users.

E. Allocation of Resources and Price and Output Decision of Enterprises—19 U.S.C. 1677(18)(B)(v)

The Chinese government's control over the allocation of capital and means of production distorts the operation of the free market.[36] Resources do not flow to their best uses at the firm, industry or sector level, and as a result, are wasted in economically inefficient allocations.[37]

[35] *See* Memo on China's NME Status, at 39. For example, the aggregate productivity of the state sector is half that of the private sector, while the private sector receives only 27 percent of loans but contributes over half of China's GPD. *Id* (citing The McKinsey Quarterly, 2006 Special edition: Serving the New Chinese Consumer, *How Financial-System Reform Could Benefit China.*)

[36] *See, generally,* Lin, Justin Yifu, *Lessons of China's Transition from a Planned Economy to a Market Economy,* Peking University and Hong Kong University of Science and Technology, December 17, 2004, *available at* http://www.tiger.edu.pl/publikacje/dist/lin.pdf ("China's Transformation"). In China, a significant amount of means of production belong to the government, and the government's control over factors of production limit the ability of viable factor markets to form. *Id.* at 6-7.

[37] *See* Memo on China's NME Status, at 77.

When factor allocation is based on non-market principles, prices for goods cannot be formed in a way that reflect true market conditions.[38]

Price Controls: The Chinese government continues to maintain price controls on several products and services for both state-owned enterprises and private sectors.[39] Price controls range from mandated prices and pricing policy guidelines, and include items such as pharmaceuticals, transportation, agricultural products and energy supplies.[40] This interference distorts market-based trade flows.

Control Through Banking System: One of the most effective means by which the government can control pricing and output decisions in the marketplace is through the banking system. In China, the government dominates the banking sector, and all banks are subject to the China Banking Regulatory Commission's control.[41] State-owned banks account for virtually all commercial lending in China, and state-ownership in the Chinese banking sector is more widespread than any other major world economy.[42]

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[38] The Department has recognized that, where resources are not allocated by the market, the Department cannot conclude that home market prices or costs should be used to calculate normal value. *See* Notice of Final Determination of Sales at Less Than Fair Value: Certain Cut-to-Length Carbon Steel Plate From Ukraine, 62 Fed. Reg. 61754 (Dep't. Comm. Nov. 19, 1997).

[39] Stewart, Terrence; Lightizer, Robert; Hartquist, David; Schagrin, Roger; Andros, Linda; Any Change to China's Non-market Economy Status Must be Based on the Criteria Specified Under U.S. Antidumping Law, A Position Paper Prepared for the U.S.-China Economic and Security Review Commission by The Trade Lawyers Advisory Group, August 18, 2005, *available at* http://www.uscc.gov/researchpapers/2005/05_08_18_trade_group_law_postion_paper.htm ("Trade Lawyers Advisory Group Paper"); United States Trade Representative, U.S. Report to Congress on China's WTO Compliance (Dec. 11, 2006), at 43, *available at* http://www.ustr.gov/assets/Document_Library/Reports_Publications/2006/asset_upload_file688_10223.pdf.

[40] *Id.*

[41] *Id.*

[42] *See* Final Determination of Sales at Less Than Fair Value: Coated Free Sheet Paper from the People's Republic of China, 72 Fed. Reg. 60632 (Oct. 25, 2007), and accompanying Issues and Decision Memorandum ("Coated Free Sheet Memo"), at Comment 10.

Within this context, the Chinese banking sector does not operate on a commercial basis and is subject to significant distortions arising primarily out of the continued dominant role of the government.[43] The government controls interest rates at below-market levels. Interest rates available to businesses (*i.e.*, for operating capital and expansion) are artificially low and overstate the actual supply of capital in the marketplace.[44] These conditions often create an oversupply of credit leading to inefficient over-investments in sectors of the economy with access to low-priced credit.

Moreover, the government uses preferential lending policies to finance firms that specifically promote the economic objectives of the state. Such policies are prevalent and codified in law,[45] and banks are encouraged to provide low-cost financing to specific sectors of the economy.[46] However, preferential lending programs distort capital flows, moving capital away from areas where the highest returns can be achieved. As a result, private enterprises are forced to compete against cheaply-financed firms that may be comparably less efficient and productive, but which enjoy massive government financial support. Competition with these financed firms may force more efficient producers out of the marketplace entirely. Finally, when capital is allocated to inefficient producers, overcapacity is likely to result which depresses market prices.

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[43] *Id.*

[44] *See, generally*, International Monetary Fund.

[45] Article 34 of the Commercial Banking Law of the People's Republic of China provides that banks must carry out their loan business upon the needs of the national economy, the state's social development objectives, and under the overall guidance of state industrial policies. *See* Coated Free Sheet Memo, at Comment 8.

[46] *See* Coated Free Sheet Memo, at Comment 8.

F. Other Factors—19 U.S.C. 1677(18)(B)(vi)

In its Memo on China's NME Status, Department identified two additional factors that it deemed relevant to its consideration of China's non-market economy status: trade liberalization and the rule of law. With respect to trade liberalization, the Department recognized that China has made efforts to expand trade relations worldwide.[47] With respect to the rule of law, the Department determined that China's economic environment is unpredictable due to inconsistent legislation and a biased judicial system.[48] This has given rise to widespread uncontrolled corruption.[49] The absence of laws to sufficiently restrain corruption is a factor that impacts the effective operation of the Chinese economy.[50]

G. Additional Evidence of Government Control Over the Economy

Compelling evidence of additional economic distortions in the Chinese economy exists. We address three significant distortions in this section—the lack of intellectual property right protection, the effects of government subsidies, and government control of enterprises through the State-owned Assets Supervision and Administration Commission. Within the discussion of each topic, we discuss economic distortions that result.

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[47] *See* Memo on China's NME Status at 78.

[48] *Id.*, at 78-79.

[49] Examples of the most widespread forms of corruption include backroom deals between brokers and players, brokers misappropriating investor funds, falsified accounts, and members of the accounting profession abet falsifying accounts. *See* Hovey, Martin and Naughton, Tony, *A Survey of Enterprise Reforms in China: The Way Forward*, Department of Finance and Banking, University of Southern Queensland (Australia), Economic Systems, Vol. 31, No. 2 (June 2007), also available at http://eprints.usq.edu.au/2504/1/Hovey_07_A_Survey_of_Enterprise_Reforms.pdf, at 16.

[50] *See* Memo on China's NME Status at 78-79.

1. Intellectual Property Rights ("IPR") Protection

The Chinese government's effort to enforce intellectual property rights has been ineffective.[51] Despite highly publicized periodic crackdowns on counterfeiting and piracy by the Chinese government, much of it remains state sanctioned.[52] As a result, the rate of intellectual property piracy and counterfeiting in China remains high.[53] Inadequate IPR enforcement contributes to ongoing violations spanning numerous industries and products such as pharmaceuticals, electronics, batteries, auto parts, industrial equipment, and various chemicals.[54]

Failure to regulate counterfeiting and piracy provides a classic example of how government inaction leads to subsidies, and reflects the country's discretionary macroeconomic policies.[55] It enables companies using stolen IP interests to gain a false and unfair competitive advantage.[56] Chinese counterfeiting and piracy lower production costs for Chinese manufacturers relative to competitors in a number of ways that vary in degree by industry. For example, Chinese counterfeiters do not incur research and development costs, and these savings have been

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[51] For example, in administrative actions, only 51% of surveyed companies were satisfied with the degree of cooperation from Chinese officials, and overall criminal prosecution remains low. *See* American Chamber of Commerce in China, *2006 White Paper: Creating a Favorable Business Environment, available at* http://www.amcham-china.org.cn/amcham/upload/wysiwyg/20060516094503.pdf ("AMCHAM"), at 39.

[52] *See* Statement of Peter Navarro, Ph.D., Professor, University of California, Irvine, The Paul Merage School of Business, Irvine, California, Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means (Feb. 15, 2007), *available at* http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5464 (Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means").

[53] Anywhere from 20% to as much one third of China's GDP is derived from counterfeit and pirate activity. *See* Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means.

[54] Office of the United States Trade Representative, U.S. Relations With the People's Republic of China, 2007 Special 301 report, *available at* http://hongkong.usconsulate.gov/uscn_t_ipr_2007043003.html.

[55] Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means.

[56] Trade Lawyers Advisory Group Paper.

instrumental to stimulating growth of the automotive and pharmaceutical sectors. Moreover, counterfeiting lowers marketing costs because a product brand does not need to be built. When intellectual property theft lowers production and marketing costs, market prices for products become artificially low. These low prices, in turn, transmit false price signals to the marketplace causing overall supply and demand conditions to be distorted.

2. *Subsidies*[57]

In China, industry-specific subsidies are prevalent and are provided to firms by the government with the intent to advance particular sectors of the economy. The existence of subsidy programs in China and their effects on firm behavior are discussed in the Department's analysis memorandum for the final determination of the countervailing duty investigation of coated free sheet paper from China.[58] For example, in its determination, the Department found that the Chinese government has in place certain policy lending programs, such as the "The PRC Civilian Economy and Social Development 10th Five-Year Plan Outline," under which the government provides loans to firms in an effort to encourage and support the growth of certain

[57] The Department acknowledged in its final antidumping determination of coated free sheet paper from China that the existence of subsidies does not necessarily warrant market economy status in antidumping proceedings if market forces are significantly distorted by government intervention, as they are in China. *See* Final Determination of Sales at Less Than Fair Value: Coated Free Sheet Paper from the People's Republic of China, 72 Fed. Reg. 60632 (Dep't. Comm., Oct. 25, 2007), and accompanying Issues and Decision Memorandum ("AD Coated Free Sheet Paper Final Memo") at Comment 1. The Department noted that the government may provide subsidies which distort prices that have already been distorted by the broader, non-market environment. Within this context, the Department explained that market economy prices can be used in a countervailing duty proceeding to asses the benefit incurred by the recipient firm, yet be rejected in an antidumping proceeding because it will distort the antidumping duty calculation. The Department distinguished the treatment of Chinese prices in countervailing duty cases from antidumping cases by stating that "{s}ince a firm in China may have the discretion to change its export and/or production decisions in response to the incentive provided by, for example, a subsidized input price, it is possible to measure the benefit provided by the subsidy. If the price is set in an environment distorted by significant government interference, however, this price cannot form the basis of normal value in an {antidumping duty} proceeding." *Id.* (material in brackets added).

[58] *See, generally,* Coated Free Sheet Paper Issues and Decision Memorandum.

industries.[59] The Department determined that such loans conferred advantages on recipient firms which, in turn, distorted the recipient's market behavior.[60] The Department also determined that the Chinese government authorizes tax breaks for firms under several statutory programs: (1) the Foreign Invested Enterprise and Foreign Enterprise Income Tax Law; (2) laws that encourage local governments to provide tax exemptions and reductions to industries and projects with foreign investments; and (3) laws that reduce income tax rates for foreign investment enterprises located in certain economic and development zones (such as coastal economic development zones, special economic zones, and economic and technical development zones).[61] The Department concluded that such preferential tax rates amounted to saved revenue that conferred benefits onto firms that were distortive and countervailable. Finally, the existence of VAT (value added tax) rebates on purchases of domestically produced equipment for foreign-invested enterprises, and VAT and tariff exemptions on imported equipment for certain firms (both domestically and foreign-owned) provided benefits that also were distortive and therefore countervailable.

As illustrated above, subsidy policies established by the Chinese government are incentive-based and aimed at regulating firms according to the government's economic objectives. However, such policies distort competition within entire industries. Subsidy policies benefit recipient firms by decreasing their operating expenses. Whether in the form of tax breaks, low-interest loans, or government-provided goods and services, such benefits free up capital that can be redirected toward other firm objectives, such as reducing prices or increasing

[59] *Id.*, at Comment 8.

[60] *Id.*, at Comment 10.

[61] *Id.*

output. Recipient firms, in turn, are advantaged vis-à-vis their competitors by having their operating costs reduced. But, the effect of subsidies is not isolated to the benefited firm. Subsidies will indirectly impact the operations of the non-benefitted firms as well as their suppliers, which are often forced to reduce prices or exit the market due to their inability to compete.

3. State-Owned Assets Supervision and Administration Commission

The Chinese government has also begun to increase its control over certain industries through the use of state-owned assets management companies. This trend calls into question the extent to which the government operates on market forces.

State-owned assets management companies operate as an arm of the Chinese government to manage certain target enterprises (*i.e.*, certain state-owned enterprises ("SOEs") and other enterprises with strategic significance to the Chinese government).[62] They obtain management rights over the activities of target enterprises by obtaining shares in such enterprises through use of the joint-stock company structure.

State assets management companies regulate activities of target enterprises for the central Chinese government through the intermediate ministerial body called the State-owned Assets Supervision and Administration Commission ("SASAC"). SASAC was specifically established by the Chinese State Council in 2003 to take control of all target enterprises away from various governmental agencies and put them under the unitary supervision and control of SASAC, which

[62] *See, generally*, "*Guangdong SASAC to Establish Early Next Year,*" TDC Trade.com, December 1, 2003, *available at*, http://northeast.tdctrade.com/content.aspx?data=PRD_content_en&contentid=168454&src=RA_Gua&w_sid=194&w_pid=606&w_nid=9720&w_cid=168454&w_idt=1900-01-01&w_oid=165; *Control of Strategic State-Owned Enterprises*.

reports directly to the State Council.[63] The Chinese government, through SASAC, appears to set up management companies at the provincial and city levels to regulate enterprises located within their respective jurisdictions either directly or through a wholly state-owned holding company.[64]

Through the use of SASAC and its local asset management companies, the government has been able to lawfully strengthen its grip on businesses that it deems to be vital to national security and the economy.[65] Moreover, the 2005 Company Law of the People's Republic of China recognizes SASAC as the organization that wields power on behalf of the state in matters related to the enterprises in which the state invests.[66]

The regulations governing the operations of SASAC ("Interim Measures") identify the manner in which state-owned assets management companies exert control over enterprises on behalf of the Chinese government.[67] Each specific provision of the regulations describes various manners in which the Chinese government controls enterprises. We highlight several of them:

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[63] *See Control of Strategic State-Owned Enterprises*, at 8-9; Liu and Tylecote, *Corporate Governance and Technological Capability Development—Three Case Studies in the Chinese Auto Industry* (Jun. 18, 2007), *available at* http://www2.druid.dk/conferences/viewpaper.php?id=1640&cf=9 ("Corporate Governance and Technological Capability Development"), at 9. SASAC promotes itself as the regulatory branch of the Chinese government which operates to "enhance{} the management of {}assets" and "perfect{ the} corporate governance" of state-owned enterprises. *See* State-owned Assets Supervision and Administration Commission of the State Council, Main Functions and Responsibilities of SASAC, available at www.sasac.gov.cn/eng/zyzz.htm. To achieve these objectives, SASAC claims that it is vested with the authority to "appoint{} and remove{} executives of enterprises," and may perform other "responsbilit{ies} as the investor" of enterprises. *Id.*

[64] *See Control of Strategic State-Owned Enterprises*, at 8-9.

[65] *Id.*, at15-16. In fact, the stated goal of the Chinese government is to acquire 100% state ownership or absolute control over key strategic industries by increasing the state owned assets in these industries. *Id.*, at 16 (*citing* State Council Opinion released 12 May 2006), 44; *Marketization of China's Enterprises Represented by the Key Enterprises,* available at www.china.org.cn/englixh/2003chinamarket/79516.htm.

[66] Company Law (2005) Chapter II, Section 4.

[67] *See* State Council's Interim Measures for the Supervision and Administration of State-Owned Assets of the Enterprise (May 27, 2003) ("Interim Measures"), *available at* http://www.sasac.gov.cn/eng/eng_zcfg/eng_zcfg_0001.htm (Article 12 and 13) (*stating* state-owned assets administration bodies are the "ad hoc bodies directly affiliated to the people's governments that, on behalf of the

- Articles 4 and 6 explain that state-owned assets in regulated enterprises (which can include assets involved in the production of merchandise) belong to the state and are subject to the supervision of the state.

- Article 5 explains that functions of enterprises that have bearing on the national economic lifeline and the state's security should be performed by the State Council.

- Article 13 explains that the state-owned assets supervision body (and thus, for example, SASAC)[68] dispatches the board of supervisors to the "contributed" (*i.e.*, regulated) enterprise, appoints and removes principals, and performs other duties mandated by the "people's government."

- Article 14.1 explains that the SASAC will promote the optimal allocation of state-owned assets, which can include assets relating to the production of merchandise, in order to advance the objectives of the state-owned economy.

- Article 14.2 explains that the SASAC will increase the competitiveness of such companies—which likely includes corporate functions relating to production, output, pricing, and sales to markets—that have bearings on the national economy and state security.

- Article 14.5 explains that SASAC will enhance the competitiveness of the enterprise it regulates, which can include measures that affect production, pricing, and sales decisions.

- Article 22 explains that the SASAC shall dispatch shareholder representatives and directors to participate in shareholders' conferences and the board of directors, and such representatives will present the opinions and exercise the voting rights of the SASAC.

- Article 24 explains that the activities of the subsidiary enterprises are subject to oversight and control of the SASAC.

- Article 31 explains that the SASAC will regulate the flow of state-owned assets of the regulated enterprises, which can include assets related to production.

- Article 32 explains that the SASAC shall perform investment, financial planning, and development strategy duties of the regulated enterprise. These strategies can affect the regulated entity's production, pricing, cost and sales (including export sales) decisions.

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people's governments at the corresponding levels, perform the contributor's duties and are responsible for the supervision and administration of the state-owned assets in enterprises"). Within the Interim Measures, the term "contributor" signifies shareholder.

[68] For purposes of summarizing the Interim Measures, the "state-owned assets supervision and administration body" will be hereinafter referred to as SASAC.

- Article 35 explains that the SASAC will supervise the financial status of the regulated enterprise, which likely includes directing the enterprise's price and output decisions.

The nature and extent of the Chinese government's actual control over target enterprises, through SASAC's control, appears to be substantial.[69] (As noted above, SASAC effectuates its authority as the principal investor in the enterprises that it controls, either directly or through provincial divisions.)[70] For example, SASAC apparently consolidates the investment funds of companies under its supervision and requires that they turn over a portion of their post-tax profits to the state. Additionally, SASAC manages the functions of enterprises by (1) drafting laws and regulations affecting state-owned assets, (2) managing and restructuring state assets so that their value develops positively, (3) hiring and firing executives of enterprises (at the behest of the Communist Party, which ultimately retains authority over key appointments), (4) directing the disposition of corporate dividends, (5) controlling the allocation of capital, (6) facilitating bank loans for the benefit of the enterprise, (7) controlling ownership transfers and manager buyouts within the enterprise, and (8) directing corporate investments (*e.g.*, limiting investments to certain business ventures).[71]

The creation of SASAC illustrates an additional mechanism that the Chinese government has been employing to guide the economy in a planned direction. The market behavior of firms controlled by SASAC are driven by the objectives of the state rather than the market. By

[69] An example of the ability of SASAC to exert its *de facto* regulatory authority over the enterprises it regulates is in the case of Haier, one of China's most successful companies. In 2005, SASAC ruled that Haier belongs to the Qingdao city government, and that management buyouts in big SOEs were forbidden. *See Control of Strategic State-Owned Enterprises*, at 10 n. 5.

[70] *See Control of Strategic State-Owned Enterprises*, at 9.

[71] *Id,* at 9-11, 35-39, 41-45.

controlling enterprises, the state indirectly influences the market. The unregulated firms and industry suppliers react to market conditions in order to compete, and when economic conditions in the market become distorted through government intervention (*e.g.*, through SASAC-regulated firms), the unregulated firms respond to the distorted signals and adjust their behavior accordingly. As a result, the overall market moves away from economic equilibrium.

H. Conclusion

Despite the progress that China has made in transitioning away from a traditional planned economy, the extent of government control and direction over the country's economy remains significant and distorts the pricing and output decisions of firms within the economy.[72] As the foregoing analysis demonstrates, functioning markets have not completely replaced government controls in China. Overwhelming evidence suggests that prices and costs of both producers and suppliers in China do not adequately reflect market forces, and given the extensive government involvement in the key sectors of the economy, operations of individual firms cannot be reliably separated from the state-influenced economy.[73]

VII. PROPOSED CRITERIA TO EVALUATE MARKET ORIENTATION OF CHINESE ENTERPRISES

As detailed above, it is extremely difficult, if not impossible, for a firm to operate on market principles if it is situated within an industry where market conditions are distorted.

[72] *See* AD Coated Free Sheet Paper Final Memo, at Comment 1.

[73] We note that although firms within China may well operate independently of the government in their export activities and have the full opportunity to demonstrate this independence via the Department's separate rate test, this test focuses on government control over firm's operations. *Id.* The market oriented enterprise proposal seeks to determine a different aspect of firm operations; not whether firm operations are directly controlled by the government, but whether firms' business decisions and domestic prices and costs are distorted by government interference. *Id.*

Accordingly, we do not believe that the Department should create a market oriented enterprise test. If the Department nonetheless creates a test, it should take into account the distortions present in the Chinese economy. Specifically, to be designated as market-oriented, an enterprise should have to demonstrate:

1. The firm is part of a market-oriented industry, as currently defined by the Department; and
2. The company itself also conforms to market principles.

As the second factor has not yet been adopted by the Department, we will elaborate on elements that should be considered under this factor.

Any test of a firm's conformity to market principles should take into account the economic environment in which the firm operates and determine whether that environment is characterized by free exchange and equal opportunity. The test should also assess whether land and capital are allocated at market-determined prices. Investments should reflect relative factor availability. State-owned enterprises within the competing industry should not benefit from preferential governmental lending and must distribute dividends to the government at market-determined prices. Moreover, enterprises within the examined industry should own their assets and be responsible for their profits and losses within the limits of their asset ownership.

The Department's test must also evaluate whether all factors of production, both tangible and intangible, are openly tradable in a competitive market. Market prices should be rational within the entire industry, and should be evaluated based on the economic returns achieved by producers, suppliers, and dealers, as well as by the purchasing decisions of consumers. Moreover, the industry in which the firm operates must have autonomy over all allocation of factors of production. Finally, technology within the industry should be legally acquired.

As detailed throughout this submission, there exist significant levels of economic distortions within the Chinese economy that preclude findings of market oriented enterprises. Nevertheless, if respondents are permitted to demonstrate that economic conditions within their industries warrant findings of market orientation, they should be required to satisfy the criteria outlined above. A rigorous threshold is consistent with the Department's presumptions that China is a non-market economy country and that market orientation should be demonstrated by compelling evidence.[74] Thus, any test that fails to fully evaluate all levels of economic distortion is likely to result in the use of inappropriate prices and costs that do not reflect commercial transactions.

VIII. CONCLUSION

For all these reasons, we respectfully request that the Department not implement its proposal to grant individual respondents market oriented enterprise status in antidumping cases involving China. If the Department nonetheless decides to proceed with its proposal, we believe that it is essential that the Department evaluate market orientation within the context of the greater industry in which the respondent firm operates using the factors provided above. We also respectfully request that if the Department proceeds with its proposal, it grant parties additional opportunity to comment on the specific procedures to be adopted by the Department for purposes

[74] If a respondent cannot satisfy the elements outlined above, it may be that its economic environment is not yet market oriented.

of constructing a market oriented enterprise methodology.

Respectfully submitted,

Terence P. Stewart, *Managing Partner*
Geert De Prest, *Partner*
Stewart and Stewart