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DELIVERY BY ELECTRONIC TRANSMISSION

The Honorable James J. Jochum
Assistant Secretary for Import Administration
U.S. Department of Commerce
Attn: Import Administration
Central Records Unit, Room 1870
14th Street and Constitution Avenue, N.W.
Washington, DC 20230

Re: U.S.-China Joint Commission on Commerce and Trade Working Group on Structural Issues

Dear Mr. Secretary:

On behalf of the Municipal Castings Fair Trade Council ("MCFTC"), an organization comprised of companies engaged in the U.S. manufacture of iron construction/municipal castings products, we are providing these comments in response to the May 5, 2004 Federal Register notice (69 Fed. Reg. 24,132 (May 3, 2004)) concerning relevant topics and issues for discussion in the working group established at the April 21, 2004 meeting of the U.S.-Joint Commission on Commerce and Trade. The MCFTC also hereby notifies the Department of its intent to have witnesses testify at the June 3, 2004 hearing on these issues, and requests at least 5 minutes for its presentation. The testimony at the hearing will be based on these comments, and will be presented by Mr. Robert Cassidy (Director of International Trade Services), Paul Rosenthal (member of the firm), and Robin Gilbert (member of the firm) of Collier Shannon Scott, PLLC, 3050 K Street, N.W., Washington, DC 20007, Tel: 202.342.8414, 202.342.8485, and 202.342.8478, respectively.

I. THE PRC BEARS THE BURDEN OF SHOWING THAT IT HAS MET THE CRITERIA FOR MARKET ECONOMY STATUS

As discussed in the comments being concurrently filed on behalf of the Committee to Support the U.S. Trade Laws ("CSUSTL"), the Department's starting point in these consultations must be the obligations of the People's Republic of China ("PRC") undertaken as part of its accession to the World Trade Organization. As an explicit condition of its admission to the WTO, China agreed to be treated as a non-market economy country for the first 15 years of its WTO membership. This 15-year period was expressly advanced as a reason why the United States Congress should support China's WTO accession. Moreover, the Draft Protocol on the Accession of the People's Republic of China contains specific provisions that place the burden squarely on China to satisfy the criteria for graduation to market economy status. Only under the most unusual circumstances and following close, careful, and above all public scrutiny and discussion should this or any Administration prematurely waive China's agreed-upon condition of WTO admission. With the specific conditions of China's WTO accession in mind, we offer the following comments concerning appropriate topics for discussion by the Working Group.

II. THE RENMINBI IS NOT FREELY CONVERTIBLE

Discussions should include detailed inquiry into China's protection of the renminbi from market forces by use of an artificial, fixed exchange rate. In addition, questions should address the lack of full access to, and commercial rights of disposal of, foreign currency, and the selective methods by which the state permits use of foreign currency to foster its economic planning.

The renminbi is not at all convertible on the capital account and is subject to significant regulations and limitations on convertibility on the current account. This currency has been artificially pegged to the U.S. dollar at a fixed, constant rate for over a decade, leading to both internal and external distortions in the value of PRC goods and services and significant complaints from market-economy nations.[1] Economists estimate that the renminbi is undervalued by as much as 75 percent.[2] Although certain PRC producers/exporters may be able to retain foreign currency proceeds, most proceeds must be converted into renminbi. As discussed in the Asian Development Bank's ("ADB") 2003 Private Sector Assessment of the PRC (the "ADB Study"), foreign exchange received by enterprises in current account transactions, unless otherwise approved by the PRC State Administration of Foreign Exchange ("SAFE"), "are required to be sold to authorized foreign exchange banks in the PRC."[3] Until recently, companies could only retain up to 20 percent of foreign-currency income, based on limits set in October 2002.[4] New regulations that took effect May 1, 2004 still limit the degree to which companies may retain foreign currency. Id.

III. WAGE RATES IN THE PRC ARE NOT DETERMINED BY FREE BARGAINING BETWEEN LABOR AND MANAGEMENT

Discussions should include detailed inquiry regarding the rights of Chinese workers to engage in free determination of wages, including the right to engage in collective bargaining, strikes, and other organized activities. Questions should be raised regarding the lack of workers' individual political rights, the lack of collective labor rights, and the lack of opportunities for economic remuneration, such as the inability to market shares earned during corporate tenure.

Workers in the PRC cannot freely organize and are punished when they attempt to advance their economic rights by attempting to establish collective bargaining rights, protest

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[1] See "Will China Revalue the Yuan?" (available at http://www.sounddollar.org/mnews74.html).

[2] Vincent Dropsey, China's Accession To The WTO, Real Exchange Rate Changes And Their Impact On U.S. Trade With Greater China at 22 (2001).

[3] See Asian Development Bank, Private Sector Assessment: Peoples Republic of China at 26 (Nov. 2003) (available at http://www.adb.org/Documents/Reports/PSA/PRC) (last visited May 19, 2004).

[4] See China Economic Net, Firms allowed to keep more foreign currency (Apr. 19, 2004) (available at http://en.ce.cn/Markets/ Currencies/t20040419_691934.shtml) (last visited May 19, 2004).

working conditions, or expose graft and corruption.[5] The Communist Party's monopoly of political power denies alternative voices the ability to seek reforms of workplace safety, changes in wage levels, social security rights, and other goals that influence and determine labor costs in a market economy. The U.S. State Department's 2002 Country Report on Human Rights Practices provides substantial evidence of the lack of PRC labor rights or freedom, such as the ability to form free labor associations that can represent workers' interests before the government, engage in collective bargaining, or call strikes.[6]

As result of the lack of labor freedom, Chinese manufacturers will rely on greater labor input at an artificially low, non-market valuation. Along with the non-market valuation of other inputs, China's severe restrictions on labor rights distort the true economic cost of production. In stark contrast, labor practices of U.S. companies operating in the PRC are relatively so advanced that they are recognized by the State Department as examples of influences that may advance PRC labor conditions in the long-term.[7]

A recent Oxford University study demonstrates that even such a fundamental element of

[5] See Human Rights Watch World Report 2001: China and Tibet, China: Labor Rights Violated Despite New Treaty (available at www.hrw.org/press/2001/03/chinalabor.htm) (last visited May 19, 2004); International Confederation of Free Trade Unions, Chinese accession to WTO must be accomplished by progress on core labor standards says world union (ICFTU Online Doc. 214/991116/DD, Nov. 16, 1999) (available at www.hartford-hwp.com/archives/55/169.html) (last visited May 19, 2004).

[6] U.S. State Department, Country Reports on Human Rights Practices – 2002 at 3 (Mar. 31, 2003) (available at http://www.state.gov/g/drl/rls/hrrpt/2002/18239pf.htm) (last visited May 19, 2004).

[7] See June 5, 2003 Remarks of Assistant Secretary of State Lorne W. Craner To The U.S.-China Business Council, Craner Says U.S. Companies Have Role in Promoting Human Rights (June 6, 2003) (available at www.usembassy.it/file2003_06/alia/A3060606.htm) (last visited May 19, 2004).

labor rights such as worker mobility is compromised in the PRC.[8] The study states that partial reform of the *hukou* system has just begun and notes that one can "expect to see increased voluntary mobility" in the future.[9] Based upon empirical data, the report concludes that "a labor market is emerging for urban workers, but it is occurring gradually, and many workers are not directly affected" by these developments. The mobility of urban workers is still significantly stifled, a pattern "unlikely to be equalized while they continue to be treated differently."[10] Even the mobility of migrant labor is still in transition: "both the voluntary mobility rate of urban workers and the mobility rate of migrants are moving in the right direction, but it is doubtful that either of them have {sic} yet moved far enough." Id.

The ADB Study, discussed above, identifies other impediments to private enterprise in China related to human resources. Non-market forces in one area, such as financing, have wide-ranging negative consequences that reinforce non-market distortions in other areas of the PRC economy. The ADB Study reports that a 2000 International Finance Corporation ("IFC") economic survey found that private domestic firms had difficulty retaining qualified employees, because the use of share incentives was undermined by "the lack of financial transparency and clear asset ownership," which makes it difficult to value shares or to sell them when employees leave a firm.[11]

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[8] John Knight & Linda Yueh, Job Mobility of Residents and Migrants in Urban China (Oxford Univ., Dept of Economics Discussion Paper Series No. 163, June 2003)

[9] Id. at 16.

[10] Id.

[11] ADB Study at 48.

IV. JOINT VENTURES OR OTHER INVESTMENTS BY FOREIGN FIRMS ARE SUBJECT TO IMPEDIMENTS TO FREE ENTERPRISE GREATER THAN THOSE IMPOSED ON CHINESE FIRMS

Discussions should include detailed questions regarding limitations faced by foreign companies in founding and operating companies in the PRC, barriers to market entry and exit, and inadequate IPR protection.

A 2004 study published by the Heritage Foundation summarized the substantial barriers in the PRC that continue to impede foreign investment, finding that "China's foreign investment policy is designed to prevent foreign companies from competing with some state-owned industries while directing them toward desired sectors . . .."[12] The report summarized findings of multiple governmental agencies, including the U.S. Trade Representative and the IMF:

> According to the U.S. Trade Representative, "Barriers to investment include opaque and inconsistently enforced laws and regulations and a lack of a rules-based legal infrastructure." New foreign investment regulations that took effect on April 1, 2002, require that various Chinese bureaucracies must regularly update a Foreign Investment Catalogue for the government to use as a guide for approving foreign investment projects. * * * The International Monetary Fund reports that the government imposes restrictions, prohibitions, and requirements for government approval on nearly all transactions involving capital and money market instruments, derivatives, credit operations, real estate, and direct investment.

Similarly, the ADB Study noted that new guidelines have been issued to open more industries to foreign investment.[13] Nevertheless, the state still forbids foreign investors from establishing wholly-owned subsidiaries in some 10 percent of all industries. Id. Although since early 2002 domestic Chinese enterprises have received liberal import and export rights from the Ministry of Foreign Trade and Economic Cooperation ("MOFTEC"), those same rights have not been

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[12] See Marc A. Miles, Edwin J. Feulner, Jr., Mary Anastasia O'Grady, and Ana I. Eiras, 2004 Index of Economic Freedom at 140 (available at http://www.heritage.org/research/features/index/countryFiles/English/individual_pdfs/China.pdf) (the "2004 Heritage Report") (last visited May 19, 2004).

[13] See ADB Study at 19.

provided to foreign invested enterprises ("FIEs"). Id. at 19. By the middle of 2003, the ADB was able to note only that MOFTEC was drafting an approval to grant FIEs the same rights to import and export goods not subject to state trading or designated trading. Id. Even if FIEs attain parity with domestic PRC companies in trading rights, however, they will be subject to other non-market forces, discussed below, that affect PRC firms. Any firm that seeks liberal import/export rights must meet certain requirements, such as minimum registered capital. Id.

Finally, a variety of non-market forces affect all truly private enterprises in the PRC. Those impediments to free enterprise affect FIEs as much as, if not more than, domestic private firms. Venture companies face several obstacles, including (1) limited availability of resources both for seed money and subsequent funding due, in part, to underdeveloped legal mechanisms to channel savings into funds and lack of long-term investors, such as pension and mutual funds; (2) a limited pool of venture capitalists with fund management capability; (3) a lack of reliable exit mechanisms and restrictions; and (4) legal obstacles and inconsistency of laws and regulations. Id. at 76.

Certain of these obstacles affect foreign firms more than domestic firms. The single biggest restraint on free enterprise is the lack of a reliable exit mechanism. There are no channels for a venture capitalist to cash out its investment through an initial public offering or other comparable exit mechanism. Id. Without the ability to sell holdings in enterprises, foreign capital is held captive in the PRC economy.

Foreign firms also are at a high risk of losing their intellectual property. There is "weak and inconsistent" enforcement of laws and regulations in the PRC, which are particularly pernicious with respect to intellectual property rights (IPRs). Id. at 39. For foreign-owned firms, weak and inconsistent IPR protection is tantamount to forced transfers of technology. The high rate of IPR piracy is best illustrated in the computer sector, where the Business Software

Alliance estimates that "more than 90% of business software in the PRC is pirated." Id. at 40. Although the PRC government has engaged in "enforcement campaigns," a study by the European Union Chamber of Commerce in China described concerns of foreign investors "that the relatively limited effectiveness of recent enforcement campaigns indicates that enforcement measures and penalties lack a deterrent impact." [14]

V. THE PRC HAS SIGNIFICANT AND GROWING GOVERNMENT OWNERSHIP AND CONTROL OVER THE MEANS OF PRODUCTION

Discussions should include detailed questions regarding state ownership in the PRC, the extent of central, provincial, and local government control or favoritism for "red hat" firms, and the degree to which the state maintains and/or expands the power and influence of both state-owned firms and "red hat" companies as instruments of economic policy.

According to the ADB Study, private enterprises contributed 33 percent of the PRC GDP in 2000.[15] As a result, 67 percent of PRC GDP is either fully governmentally controlled, or partially governmentally controlled at the state, provincial, and/or local levels. The same study, in its assessment of factors impeding private enterprise development in China, notes that

> Although private firms are allowed to list on the stock market, and the quota system previously imposed that favored SOEs has been abolished, policy bias in favor of SOEs continues to prevail because the Government's top priority remains to recapitalize ailing state-sector companies. *Fortune China* magazine revealed that the China 100 – the largest publicly traded companies in the PRC – are all SOEs, most of which are heavy industries, and none of which are agribusiness companies....

Id. at 35 (footnote omitted). A July 2003 interview with Li Rongrong, minister in charge of the State Economic and Trade Commission, reveals that the influence of SOEs in the Chinese economy is growing and will continue to grow under the state's directives, even if the number of

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[14] See ADB Study at 40 (citing European Union Chamber of Commerce in China, Position Paper on Intellectual Property Rights (2002) (available at http://www.euccc.com.cn)) (last visited May 18, 2004).

[15] See ADB Study at Executive Summary & 4.

SOEs declines:

> Li said public ownership, as the foundation of the socialist economic system, is a basic force of the State to guide and promote economic and social development, and a major guarantee for realizing the fundamental interests and the common prosperity of the majority of people. The public economy, particularly the State-owned economy, has remained as a pillar of the national economy. Over the past 13 years, with the continuous increase in the overall strength and structural optimization of State-owned enterprises (SOEs), the overall quality of the public economy has improved considerably. Between 1989 and 2001, although the number of SOEs dropped from 102,300 to 46,800, the industrial added value of SOEs and State-controlling industrial enterprises soared from 389.5 billion yuan to 1,465.2 billion yuan, showing an average annual growth of 11.67 percent.[16]

These renewed and extended governmental interventions will increase the influence of SOEs in the Chinese economy. Enterprises accounting for some 67 percent of China's GDP are not privately controlled. These firms, according to the ADB Study (at 2), " opt to be defined as collectives or town and village enterprises (TVEs) by sharing ownership with local governments . . ." and "have better access to land assets, finance and markets." Many of these firms are run as "private" companies, but retain economic ties to the state in order to receive preferential governmental treatment.

The effort by the Chinese government to reinforce its SOEs was addressed in the 2004 Heritage Foundation's 2004 Index of Economic Freedom, which summarized the economically regressive developments in the PRC over the last two years:

> China's new leaders seem inclined to slow down or even halt massive economic reforms undertaken previously. President Hu and Premier Wen have already ordered the government to bail out state-owned banks burdened with cumbersome nonperforming loans. Beijing has abandoned its privatization program, levied new rules to hamper foreign investment in the retail sector, added new restrictions on the importation of farm

[16] See China Internet Information Center, Joint Development of China's Public and Non-Public Economies (available at http://china.org.cn/baodao/english/newsandreport/2003july1/1-5.htm) (last visited May 18, 2004).

> goods, and replaced tariffs with tax rebates to protect the semiconductor industry.[17]

The same report noted that the government actively utilizes both state-owned and non-state-owned enterprises to direct the economy:

> According to the American Enterprise Institute . . . "China's system ... {has} a large state sector, party committees even in private enterprises, {and} corporate boards that are unable to fire managers ...." In addition, reports the Financial Times, "China's 150,000 state-owned enterprises … still employ more than 50m workers." The Chinese government actively intervenes in the stock market.

Id. The Chinese government's active expansion of the non-private sector of its national economy, together with other indicators of non-market forces active in the PRC, earned the PRC a rating of "Mostly Unfree" in the 2004 Heritage Report.

Last, as noted in the 2004 Heritage Report, China's judicial system is an ineffective instrument of economic justice:

> The Economist Intelligence Unit reports that "many [foreign firms] prefer arbitration because of concerns about the speed and impartiality of the courts. A related concern for foreign companies is the weak tradition of consistent implementation of court rulings...." In addition, "The spread of corruption in post-reform China has also affected the courts…. [T]he security of contracts remains problematic…. [F]oreign investors often complain of the maze of regulatory difficulties they encounter in pressing their local partners to adhere to previously agreed understandings."[18]

VI. THE PRC GOVERNMENT EXERCISES CONTROL OVER THE ALLOCATION OF RESOURCES AND PRICE AND OUTPUT DECISIONS OF ENTERPRISES

Discussions should include detailed inquiry regarding the extent of state ownership and/or control of the energy sector. Any study of the PRC must detail the extent and nature of central, provincial, and local price control mechanisms.

The Chinese State Power Corporation owns 46 percent of the country's generation assets,

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[17] See 2004 Heritage Report at 139.

[18] See 2004 Heritage Report at 141 (bracketing in original).

and 90 percent of the total electricity supply assets.[19] Despite recently announced plans to reform the electricity industry, the status quo is the absence of price competition under a State-owned energy monopoly. The need to introduce energy price competition and deconstruct the State monopoly power attests to the non-market economy status of any industry reliant on energy for manufacturing. Id. The Chinese Government also controls the basic commodities for energy production, namely, all hydroelectric power, oil reserves, and natural gas reserves in China, and owns majority shares of the companies exploiting those reserves.[20] The Chinese state has barely begun to aggregate its coal-producing assets into corporations in which minority shareholdings may be available as public offerings; plans exist to create seven such state-controlled companies by the end of 2005. Id.

The state also intervenes by setting price controls, not only on energy assets and strategic reserves, but even on some retail prices.[21] Even where outright government pricing is not practiced, the state engages in intrusive oversight or interference. An example can be found in the PRC color television industry. Color televisions and color picture tubes have been subject to direct price control measures instituted jointly by the State Planning Committee and the Ministry of Information Industry in 1999.[22] Those measures introduced a PRC-wide price floor and

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[19] See Metering International, Current Affairs – Electricity reforms in China benefit meter manufacturer (Magazine archive – 2002 Issue 2) (available at http://www.metering.com/archive/022/05_1.htm) (last visited May 19, 2004).

[20] See Energy Information Administration, China Country Analysis Brief (June 2003) (available at http://www.eia.doe.gov/emeu/cabs/china.html) (last visited May 19, 2004).

[21] The ADB Study states that more than 90 percent of retail prices "are determined by the market." See ADB Study at 25. Even if that favorable figure were correct, the influence of governmental intrusion for the remaining 10 percent can have disproportional impact depending on the industries relying on the goods under state price controls.

[22] See Ministry of Information Industry, Measures for Inhibition of Unfair Price Competition of CPTs and Color TVs (Mar. 15, 1999) (available at http://www.sdpc.gov.cn/b/b000004.htm (Chinese language version)) (last visited May 19, 2004).

established periodic national reporting of average production costs in order to "normalize" producers' pricing behaviors. Id. The State Planning Committee determines whether producers are complying with their price rationalization scales. Id.

VII. OTHER FACTORS INDICATE THAT THE PRC ECONOMY HAS NOT YET GRADUATED TO A MARKET ECONOMY

A. The Role of the Government Banking Sector

Discussions should include detailed inquiry into the extent of control exerted by the state over the economy through its central banks.

The operations of four state banks have substantially controlled the direction and patterns of economic growth in the PRC. The PRC enacted the Commercial Bank Law in 1995 to commercialize the operations of these entities: the Bank of China (BOC); the China Construction Bank (CCB); the Agricultural Bank of China (ABC); and the Industrial and Commercial Bank of China (ICBC).[23] According to sources cited in the ADB Study, China's banking industry has remained under governmental control even though banks have gained more autonomy:

> The government remains firmly in control of the banking sector and directs lending to state-favored projects, businesses, and individuals. According to The Economist, "The four big state-owned banks that dominate the system direct four-fifths of their lending to state-owned enterprises which destroy value more often than they create it. The vibrant private and export sectors – which have created perhaps 40m new jobs in the past five years. . . are left largely to fend for themselves. They rely on retained earnings and foreign direct investment, or else on informal sources of credit." Although the government is relaxing controls on interest rates, the central bank affects the allocation of credit by setting interest rates on deposits and loans.[24]

An example of the role played by the BOC is provided by the development of China's

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[23] See World Trade Organization, Financing System and Trade in China (available at http://www.chinawto.com/wto/index-e.asp?sel=info&info=finance) (last visited May 19, 2004).

[24] See 2004 Heritage Study at 140.

color television ("CTV") industry, involving tens of billions of yuan of preferential loans organized by the government through the BOC. Two PRC CTV producers, Changhong and Konka, were the primary recipients of government support, receiving packages of "supportive measures" including massive loans at preferential interest rates.[25] The CTV industry also received direct support from the political apparatus of the PRC government. In 1996, Konka sought a loan of 300 million yuan from the Bank of China to fund the acquisition of another troubled television maker. Id. PRC Vice-Premier Zhu Rongji pledged his direct personal support for Konka's loan application, "attesting to the active Government support for Konka's expansion plants." Id. at 6.

B. Absence of the Rule of Law in China

Discussions should include detailed inquiry concerning (1) the extent to which changes to PRC laws and regulations have been made on a de jure basis, (2) the extent to which access to laws and regulations is readily available, (3) the degree to which legal standards are equally applied, and (4) the availability and exercise of judicial review when necessary.

The rule of law is comprised of (i) general, abstract rules that are prospective, never retrospective, in their effect; (ii) rules that are known and certain; (iii) rules that are equal in that they do not discriminate based on irrelevant distinctions; and (iv) a separation between regulators and the regulated.[26]

As noted by the ADB, "{t}he rule of law in the business environment is expected to

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[25] See The Asian Business Case Centre, Nanyang Business School, Emerging Chinese MNCs: Konka Group Company Limited at 7-8 (2002) (available at http://www.asiacase.com/konka.pdf (last visited May 19, 2004).

[26] Int'l Finance Corp., China's Emerging Private Enterprises: Prospects for the New Century at 35 (2000) (available at http://www2.ifc.org/publications/china_private_ent.pdf) (last visited May 18, 2004).

guarantee transparency, predictability, and consistency."[27] Id. On a de jure basis, the PRC must completely revise many of its current laws and/or adopt wholly new laws. According to the ADB Study, "{a}s a result of the PRC's entry to WTO, approximately 2,200 laws and regulations need to be modified or repealed (Section II.A.6.c. WTO Accession)." Id. On a de facto basis, the PRC has failed to fairly apply the rule of law even for those laws already on the books, despite the decision by the 15th Communist Party Congress in 1997 to explicitly cite the rule of law as "a guiding principle." Id. The ADB Study noted that

> foreign firms and investors cite weak implementation of the rule of law among the most critical operating challenges of doing business in the PRC. In particular, lack of transparent laws and regulations, inconsistencies among various laws and regulations, weak and inconsistent enforcement, contract repudiation, and weak capacity of the judicial system to enforce or rule on disputes, are cited as factors impeding operations.

Id. at 38. The ADB Study notes that there are significant difficulties for parties even to gain access to the promulgated laws and regulations affecting their industry and/or company. Id. at 39. The study recommends such basic measures as adoption of "a system in which a comprehensive list of all promulgated national and local laws and regulations are accessible in published form", as well as "better coordination between agencies on information exchange, agreements on allowing one agency's information to be disseminated by another, and education of private enterprises about where useful information can be obtained." Id. Lastly, "court decisions should be accessible to help clarify legal requirements." Id.

This lack of transparency and knowledge puts companies at a distinct disadvantage when authorities improperly enforce laws and regulations. The ADB Study notes "{w}eak and inconsistent enforcement of laws and regulations" caused by "(i) decentralized and multiple

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[27] ADB Report at 27.

layers of administration, (ii) local protectionism, (iii) inadequate checks and balances on enforcement actions, (iv) ineffective sanctions and penalties to deter violations, (v) intrusive and excessive regulation, (vi) general weakness of the court system, and (vii) lack of transparency and ambiguity in legal requirements." Id.

C. The Role of Central, Provincial, and Local PRC Governments in Distorting Nascent Market Forces

Discussions should include detailed questions regarding the extent to which the central, provisional, or local governments provide access to land, assets, finance and markets. Discussions should also examine tax and non-tax financial burdens such as fees, arbitrary fines, forced investments, and forced donations. The discussions should take into account the extent of economic harm caused by corruption in central, provincial, or local bureaucracies and the degree to which corruption is linked to the monopoly of power in the hands of the Communist Party.

The ADB Study finds that, despite the 1999 amendments to the PRC Constitution recognizing private enterprise, and the commitments made under WTO entry obligations,

> a policy bias and discrimination against the private sector still exists. SOE-biased mentality among government officials, particularly local governments, seems to prevail. Based in part on fiscal decentralization, protectionism and overregulation imposed by local governments can only be overcome with stronger directives from the central government to promote integration of provincial markets.

ADB Study at 34. The influence of provincial and local governmental agencies is usually to the detriment of private firms. The ADB Study noted that

> {p}rivate firms suffer from political interference in their operations. Lack of coordination among relevant government agencies requires private firms to spend a substantial amount of time establishing a "relationship" with both central and local government officials. Some domestic companies cited good relationships with local and central government officials as a crucial factor for their success. Although central government policy has become more and more favorable for private enterprises, not all local governments have consistently implemented corresponding policies.

ADB Study at 36. Provincial and local entities exert sufficient non-market forces so that, in many cases, competition does not eliminate economically unviable firms. Chinese internal barriers to commerce severely restrict the ability to distribute and sell products among different provinces and localities. The combination of provincial and local barriers in the form of tolls, shakedowns, outright prohibitions on using the roads, labor problems in loading and unloading freight, and the lack of an adequate road/rail system makes it difficult for companies to establish an efficient nationwide distribution system. According to the American Chamber of Commerce in Shanghai, these barriers can add about 16 percent to the cost of the product compared to roughly four percent in developed countries.

For example, the PRC television industry continues to include weak producers despite fierce price wars. Although the 1990s witnessed the first reduction of weaker television manufacturers from 200 producers to 70 by 2001, the reduction was halted because of governmental interference to preserve jobs.[28] Because of factors such as the interest of local governments in ensuring full employment, many CTV manufacturers that have already been "officially" closed continue to produce televisions. Id. At times, the central government itself engages in similar behavior. The Ministry of Information Industry, which has been responsible for CTV price management since 1999, also has tried to manage excess capacity by shifting it toward rapidly expanding exportation, rather than allowing market forces to eliminate economically unviable producers. Id. Because market economy forces are not eliminating excess capacity, domestic production results in significant losses for PRC manufacturers of CTVs. Id. Due to the influence of these government bodies,

> {m}any domestic companies decide to remain "red hat firms" to continue to benefit from advantages that they enjoy from local governments in terms of secure access to land, assets, finance and markets, even after private ownership forms were created in 1988. This implies that a bias

[28] See Hong Kong Trade Development Council, Color TVs Facing a Heavy Loss in China (Oct. 2001) (available at www.tdctrade.com/report/indprof/indprof_011002.htm) (last visited May 19, 2004).

> against private firms still exists.

ADB Study at 36. With respect to taxes, the ADB Study noted that actual financial burdens imposed on private enterprises far exceed nominal taxes, where many firms face a substantial "nontax financial burden (fees, arbitrary fines, forced investments, forced donations), which was nearly twice the amount of paid tax in 1998. . . . " Id. at 35. Non-tax financial burdens are sometimes forms of outright graft among public officials. The ADB Study (id.) noted that "corruption remains a serious problem" that caused "during the latter half of the 1990s . . . economic losses ranging from 13.2% to 16.8% of GDP."

D. The State Provides Research and Development Assets to Chinese Producers

> *Discussions should include detailed inquiry into the extent to which the central, provisional, or local governments provide access to research and development programs for domestic firms (whether state-owned or "red hat" collective firms). The discussions should examine the extent to which such producers have participated in and benefited from national technology campaigns, direct technology subsidies, technology transfers, and other instruments of research and development undertaken by PRC state entities on their behalf. Access enjoyed by domestic firms should be contrasted with that available to foreign companies.*

The state intervenes in industry by providing research and development programs for industry and by retaining ownership of crucial industry inputs by the military. Direct state support is provided to many basic industrial sectors through such entities as the National Engineering Research Centres of the People's Republic.[29]

The Department's recent investigation of color televisions revealed examples of the distortions caused by state intervention. Many CTV electronic components are produced by firms, such as the ceramic capacitor manufacturer Guangdong South Hongming Electronic

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[29] See PRC Ministry of Science and Technology, National Engineering Research Centres (http://www.most.gov.cn/English/Programs/Engineer_c/menu.htm) (last visited May 19, 2004).

Science and Technology Co. Ltd. ("SHM"), which have been assisted by direct state support.[30] SHM participated in many state-planned, state-supported and state-directed technology initiatives, including the National High-Tech Plan, the National-Level Torch Plan, and the National High-Tech Industrialization Demonstration Project. Id.

E. The Chinese Military is Active in Many Sectors of the Economy

Discussions should include detailed inquiries regarding the extent of PRC military ownership and influence over companies.

The electronics producer SHM identifies itself as a certified provider of ceramic capacitors to the Chinese Military. Id. Most electronics inputs (capacitors, resistors, diodes, switches, computer chips, chip boards, etc.) are dual-use inputs that are widely used in military applications. Many producers of basic electronic components have been owned or controlled by the Chinese military.[31] Attempts to remove the direct and indirect controls of the Chinese military over production assets and companies in the PRC have hit significant roadblocks.[32]

Despite nominal reforms begun in 1998, "there will be no drastic break between military and civilian science and technology."[33] In a recent antidumping proceeding, the Department denied separate-rate status to China National Investment and Guaranty Corporation ("CNIGC")

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[30] See Internet site for Guangdong South Hongming Electronic Science and Technology Co. Ltd. (available at http://www.gdshm.com) (last visited May 19, 2004).

[31] Several major military-associated corporations include Xinxing Corporation, Polytechnologies Corporation, Carrie Corporation, Lantian Corporation, and the Norinco group of companies. See David Phinney, China's Army Marches to Profits (ABCNEWS.com 1998) (available at http://more.abcnews.go.com/sections/world/hongkong97/pla_china1.html) (last visited May 19, 2004).

[32] See Los Angeles Times, Chinese Military Still Embedded in the Economy (Jan. 9. 2000) (available at http://iskran.iip.net:8100/review/january/lat.html) (last visited May 19, 2004).

[33] See James Mulvenson and Richard H, Yang, Eds., The People's Army in the Information Age at 76 (Rand Pub. CF-145-CAPP/AF, 1999) (available at http://www.rand.org/publications/CF/CF145/CF145.chap5.pdf). (last visited May 19, 2004).

and Dalian, because these firms were branches of the Norinco group.[34] These military-associated groups produce a vast range of products, as revealed when the Department again denied a separate rate to CNIGC in a different proceeding.[35] In the CTV industry, many color television producers and color picture tube producers have origins in the state-owned military-industrial complex. Changhong, for example, was founded in 1958 as Changhong Machinery Factory and produced military radar for the PRC army. Only in 1972 did it begin producing CTVs.[36]

F. Government-Owned/Controlled Media and State Propaganda

Discussions should include detailed inquiry into the extent of control or restraint by central, provisional, or local governments over marketing among PRC firms, as well as the extent to which those agencies provide support to PRC firms in direct or indirect discrimination against foreign firms.

The PRC government controls all media outlets, including economic and business data sources that are essential to the efficient operation of markets. Available economic statistics are notoriously inaccurate, preventing efficient operation of markets. The PRC controls all major newspapers, including Renmin Ribao (People's Daily), Zhongguo Qingnian Bao (China Youth Daily), and China Daily (English). Chinese Central TV (CCTV) is a state-run national broadcaster operating 10 channels. The state runs both China National Radio (domestic) and China Radio International (foreign broadcasts). Both Xinhua (New China News Agency) and

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[34] See Brake Drums and Brake Rotors From the People's Republic of China, 62 Fed. Reg. 9160, 9162 (Feb. 28, 1997) (final determination).

[35] See Industrial Nitrocellulose From the People's Republic of China, 62 Fed. Reg. 65,667 (Dec. 8, 1997) (final results).

[36] See Changhong Machinery Company history available at its Internet website (http://en.changhong.com/product/20020528/202_1523.jsp) (last visited May 19, 2004).

Zhongguo Xinwen She – (China News Service) are state run.[37] In addition, the Government has complete legal authority over access to the Internet in the PRC.[38] Government control permits economic as well as political control by the Communist Party and government.

VIII. CONCLUSION

The transition of the People's Republic of China from a Communist-controlled non-market economy to a market economy is a long and difficult process. The extensive barriers to the successful introduction and operation of market mechanisms, along with continued governmental involvement at all levels of Chinese political, business, and personal life, make it impossible to identify all issues that will require close and sustained attention as China seeks to move away from a centrally-controlled economy to an economy that operates using market mechanisms. As the most prevalent issues identified in this and other submissions are addressed and possibly resolved, other issues likely will emerge that have not yet been anticipated. We thus reserve the right to submit comments identifying additional issues for consideration and discussion.

Sincerely yours,

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[37] See BBC News World Edition, Country profile: China (available at http://news.bbc.co.uk/2/hi/asia-pacific/country_profiles/1287798.stm) (last updated Apr. 24, 2004) (last visited May 19, 2004).

[38] See Wired.com, China Tightens Web Controls (Jan. 18, 2002) (available at http://www.wired.com/news/politics/0,1283,49855,00.html) (last visited May 19, 2004).