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BY HAND DELIVERY

The Honorable James J. Jochum
Assistant Secretary for Import Administration
Attn: Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th Street and Constitution Ave., NW
Washington, D.C. 20230

Re: Comments on Status of China as a Non-Market Economy

Dear Mr. Secretary:

These comments are submitted on behalf of the Rebar Trade Action Coalition in response to a notice by the U.S. Department of Commerce ("the Department") requesting comments for the purpose of identifying topics relevant to the issue of whether China can be considered a market economy under U.S. antidumping law.[1] These preliminary comments are intended to assist the Department and the U.S.-China Joint Commission on Commerce and Trade Working Group on Structural Issues ("the Working Group") so that, as Secretary Evans recently stated, China can know "exactly what steps they must take" to be considered a market economy under U.S. law.[2] Secretary Evans also stated, "[u]ntil these reforms are made - and the statutory

[1] U.S.-China Joint Commission on Commerce and Trade Working Group on Structural Issues, 69 Fed. Reg. 24,132 (May 3, 2004).

[2] Statement from Commerce Secretary Donald R. Evans on America's Economic Relationship with China dated (Apr. 28, 2004), *available at* http://www.commerce.gov/opa/press/2004_Releases/April/28_Evans_China_stmt.htm.

criteria are met - China will continue to be considered a non-market economy under U.S. anti-dumping law . . . ."[3] This submission assumes China's current status as an NME as a given that will not change without specific additional reforms by the Chinese government.

This submission outlines the areas in need of further investigation by the Working Group and reform by the Chinese government. Only the Department, however, can make the actual determination regarding China's market economy status, and it can do so only after a comprehensive investigation of its own. The Working Group's activities should not be used to short-circuit the Department's statutorily required procedure for making NME determinations.

Relevant Factors

The antidumping statute identifies several factors the Department will consider in assessing whether a given country is a market economy, including:

(i) the extent to which the currency of the foreign country is convertible into the currency of other countries;

(ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management,

(iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country,

(iv) the extent of government ownership or control of the means of production,

(v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises, and

(vi) such other factors as the administering authority considers appropriate.[4]

The following comments address issues relevant to each of these factors. These comments provide an overview and are preliminary in nature, given the short amount of time

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[3] *Id.*

[4] 19 U.S.C. § 1677(18)(B) (1999).

provided by the Department for this submission. The Working Group should identify the current situation in China with respect to each factor, and attempt to identify precisely what China will need to do to satisfy the requirements for classification as a market economy.

1. Currency convertibility

The Chinese currency, the RMB, is not freely convertible. The exchange rate between the RMB and other currencies, including the U.S. dollar, is managed by the Chinese government, rather than being set by the market. "For nearly ten years now, the Chinese have maintained a fixed exchange rate for their currency, the yuan, relative to the dollar. The rate has been pegged at about 8.28 yuan/dollar for the entire period."[5] While holders of yuan are in practice readily able to convert yuan into dollars and to send dollars abroad, each transaction requires formal approval by the Chinese government, even if such approval is practically always given.

The Chinese government has stated that it intends to move, in a deliberate manner, towards the full convertibility of the RMB on market terms. The Working Group should obtain full information regarding the Chinese government's plans and, more importantly, any steps actually taken to allow the RMB to be freely converted *at a rate determined by the free market*. The Working Group should also examine in detail the regulations governing currency conversion in China, the actual manner in which the regulations are applied to restrict conversions of RMB to other currencies, and the extent to which those regulations allow conversions to be made at market rather than fixed rates. Free convertibility of currency at market-determined rates is a requirement for the treatment of China as a market economy country.

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[5] *China Exchange Rate Regime and its Effects on the U.S. Economy: Hearing Before the Subcomm. on Domestic and International Monetary Policy, Trade, and Technology*, 108th Cong. (2003) (testimony of John B. Taylor, Under Secretary of Treasury for International Affairs), *available at* http://www.ustreas.gov/press/releases/js774.htm.

2. Wages

Although some government restrictions remain, an International Monetary Fund working paper reports that "a more market-oriented labor market has emerged in China in the past twenty years with growing importance of the urban private sector, as state-owned enterprises have downsized."[6] Chinese companies appear to have increasing flexibility in setting wages.[7] The percentage of workers whose wages and other work conditions are governed by contracts with their employer has grown.[8] China has minimum wages laws, with minimum wages varying by province and even locality.

Restrictions on the ability of workers to switch jobs between firms have been removed. The enormous migration of workers from rural areas into the cities, where good jobs are more plentiful,[9] indicates increased practical mobility of Chinese workers. However, some formal and informal restrictions on internal migration remain, especially for workers seeking to leave rural areas.[10]

The growing freedom of workers to move, and to bargain with their employers over compensation, has been a positive step towards a market economy in China. However, the Working Group must examine in detail the remaining legal barriers to free migration by workers between localities and between firms. It should also examine the extent to which enterprises are able to set wages without government guidance or restriction. This is especially important with respect to state-owned enterprises ("SOEs"). Finally, the Working Group should review the role

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6 Ray Brooks and Ran Tao, *China's Labor Market Performance and Challenges*, International Monetary Fund Working Paper WP/03/210 at 1 (2003).

7 *Id.* at 16.

8 *Id.*

9 *See id.* at 12.

10 *Id.* at 19.

played by unions to determine whether in fact unions are able to bargain effectively with employers.

3. Joint ventures and foreign investment

China allows joint ventures and other forms of foreign investment, including wholly foreign-owned enterprises.[11] China has become one of the leading recipients of foreign investment in the world.[12] China is a member of the World Trade Organization ("WTO"), which specifically required China to open several key sectors, including telecommunications, insurance, and banking, to foreign investment. Some restrictions on foreign investment remain, especially in sensitive national security areas.

Regulation of foreign investment in China is to a large degree conditioned by the terms under which China joined the WTO. The Working Group should review China's compliance with those obligations, including its progress towards meeting future goals and all required notifications to WTO bodies. The Working Group should also solicit information regarding the actual situation joint venture partners and other foreign investors face in pursuing projects in China.

4. Government ownership or control of the means of production

The Chinese government continues to own, directly or indirectly, thousands of enterprises in practically all sectors of the economy. State-owned enterprises account for approximately 40 percent of Chinese Gross Domestic Product.[13] Many SOEs are now organized as joint stock companies, with the shares being held by municipal, county, or provincial

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11 Wanda Tseng and Harm Zebregs, *Foreign Direct Investment in China: Some Lessons for Other Countries*, International Monetary Fund Working Paper PDP/02/3 at 5-6 (2002).

12 *Id.* at 3.

13 *Id.* at 2.

government bodies. A number of major SOEs have minority private ownership, with their stock being traded on the Shanghai, Shenzen, or Hong Kong stock exchanges.

It is essential that the Working Group analyze not just the extent of government ownership of businesses in China, but also the degree of control the Chinese government in fact asserts over SOEs. The Working Group should also investigate any other indirect methods the Chinese government may use to control or "guide" companies.

5. Government control over resources, prices and production

In general, Chinese companies are free to purchase their inputs from any supplier and to sell their products at prices they establish. However, significant inputs remain subject to price controls, including utility services provided by local governments. The Chinese government announced on May 10, 2004, that it was imposing limited price controls on products and services sold by local and provincial governments with the aim of restraining inflation. The products covered include electricity, water, and transportation services, all of which were previously regulated.[14]

The Chinese government exerts total control over one very important resource – land. There is no private ownership of land in China; all land is legally owned by the state. Enterprises and individuals are allowed to conclude long-term leases for the use of land, and to some extent to trade those leases, but this is not equivalent to a system of private ownership of land. Because the Chinese government controls all land use, it is able to set the terms for leases, which means it can favor or penalize producers by setting low or high lease rates.

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[14] Keith Bradsher, *Limited Price Controls Among Steps by China to Curb Inflation*, N.Y. Times, May 11, 2004 at W4.

The freedom of the market to set prices and allocate resources is one of the most important criteria for a market economy. The Working Group should identify precisely what goods and services remain subject to price controls. The Working Group should also examine whether the Chinese government indirectly allocates resources through other administrative means. The Group should examine in particular whether the system of permits for making payments to foreign firms effectively forces Chinese enterprises to favor domestic over foreign suppliers. Finally, the Working Group should examine in detail the Chinese system of land ownership and use, and assess the extent to which state ownership of all land in fact distorts the price of this key input.

6. Banks and credit

One especially important resource in any economy is credit. As noted above, the Department's notice asked for comments specifically on China's banking sector. The banking industry in China remains overwhelmingly state-owned. While the banks ostensibly operate on an independent, commercial basis, the fact remains that the Chinese government may be able to allocate credit through its ownership and control of the main banks.

In the past the Chinese government has "encouraged" the banks to make massive loans to the large SOEs. Moreover, there is evidence that banks do not always require repayment of loans, especially to SOEs, so that bank loans are in effect converted into government grants. Significantly, the four largest state-owned banks have approximately $400 billion in "bad" loans outstanding, largely to SOEs.[15] The Chinese government has announced that it intends to sell shares in some of the state-owned banks, although not necessarily to privatize them completely.[16]

China also appears to lack certain key components of a commercial banking system. For example, there is no national system for credit analysis and reporting. It is similarly unclear what the rights of creditors are, including the ability to declare bankruptcy.

The Working Group should examine in detail the overall operation of the Chinese banking system, including the means the Chinese government can use to allocate credit through the banks. It should examine the extent to which repayment of loans is actually required, and whether the accounting controls in place for banks are adequate for a market-based system. The Working Group should investigate whether China has developed the other necessary components of a market-based banking system, including a workable system for credit reporting and effective and enforceable laws regarding bankruptcy and creditor's rights. The Working Group should also request information regarding the Chinese government's plans for privatization of the banking sector, and the extent of ownership and supervision the Chinese government intends to maintain.

7. Other factors

There are a number of other factors the Working Group should examine in assessing what China must do to qualify as a market economy country. One key factor is the extent to which China has developed market-oriented accounting standards that are actually applied to enterprises. A workable accounting system is absolutely essential in a market economy. More importantly, the Department's antidumping methodology for market economy countries largely

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15 *China to Hand Out Another $52bn to Bad-Loan Banks to Pave Way for Floats*, Sydney Morning Herald, Jan. 12, 2004.

16 Keith Bradsher, *China Announces $45 Billion Bailout of 2 State-Owned Banks*, N.Y. Times, Jan. 6, 2004.

assumes the accuracy of a company's accounting records. The Department cannot make this assumption unless it has satisfied itself that the country has reliable accounting standards and accountants. The Working Group should request information regarding this technical but very important issue.

Another essential requirement for a market-based economy is a legal system that can resolve commercial and financial disputes in a transparent manner. The Working Group should investigate the operation of China's legal system, with particular attention upon the way it handles commercial disputes.

The Department's notice specifically references China's tax policies. Local, regional, provincial, and national governments all use taxes and tax incentives as a means of encouraging development and, potentially, favoring individual enterprises.

The Working Group should investigate thoroughly tax policies at all levels of government in China.

Respectfully submitted,

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Counsel to the Rebar Trade Coalition and its individual members