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NME Request for Comments

**PUBLIC DOCUMENT**

**BY HAND DELIVERY**

The Honorable Carlos M. Gutierrez  
Secretary of Commerce  
Attn: Import Administration  
Central Records Unit, Room 1870  
U.S. Department of Commerce  
14th and Constitution Ave., N.W.  
Washington, D.C. 20230

On behalf of Nucor Corporation ("Nucor"), we hereby submit the following response to the Department of Commerce's ("the Department" or "Commerce") request for comments on two issues with regard to the methodology it employs in antidumping proceedings involving non-market economy ("NME") countries.<sup>1</sup> First, the Department requested comments on two aspects of its surrogate country selection methodology regarding economic comparability and the availability of

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<sup>1</sup> *Antidumping Methodologies in Proceedings Involving Non-Market Economy Countries: Surrogate Country Selection and Separate Rates Request for Comments*, 72 Fed. Reg. 13,246 (Dept of Commerce Mar. 21, 2007)("Request for Comments") .



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data. Second, the Department requested public comment on the “separate rates” test as a whole and on the Department’s implementation of the test.

**I. SURROGATE COUNTRY METHODOLOGY**

First, the Department requested comments regarding two aspects of its surrogate country selection methodology: 1) the proper method by which the Department should measure economic comparability among countries; and 2) whether and under what circumstances the Department should disregard certain countries based on a lack of data regarding the factors of production.

**A. Economic Comparability**

The Department’s statutory mandate grants broad discretion in surrogate country selection, especially with respect to judging the economic comparability between a prospective surrogate and the subject NME country. Yet, the Department’s current practice seldom reflects this statutory flexibility, often relying solely on relative per capita gross national income (GNI) and, at least in practice, drawing an arbitrary distinction between countries with a lesser or greater GNI relative to the subject country.

Currently, the Department relies on a list of potential surrogate countries prepared by the Office of Policy for each investigation and review involving a NME country.<sup>2</sup> The Office of Policy chooses these potential surrogates on the basis of each country’s GNI as reported in the World Bank’s World Development Report.<sup>3</sup>

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<sup>2</sup> See *Non-Market Economy Surrogate Country Selection Process*, Import Administration Policy Bulletin No. 04.1(Mar. 1, 2004) (“Policy Bulletin No. 04.1”).

<sup>3</sup> *Id.*



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The Office of Policy typically only identifies potential surrogate countries whose per capita GNI is less than that of the subject NME country.

Consistent with its statutory mandate, however, the Department may and should consider potential surrogates with GNIs greater than that of the subject NME country as well. This approach is wholly consistent with the Department's mandate to identify potential surrogate countries that are "at a level of economic development comparable to that of the nonmarket economy country."<sup>4</sup> Indeed, if GNI is the sole factor of comparable development, a country that is slightly less economically developed than the NME country should be indistinguishable from a country that is slightly more economically developed than the NME. In short, the Department's apparent distinction between lesser and greater GNI is inapt.

Moreover, by shifting its policy to include a case-by-case consideration of countries with a greater GNI than the subject country, the Department would better account for the fact that the level of economic development in individual NME countries may be materially different today than in the past. When dealing with a highly developed NME – China, for example – a country with a higher per capita GNI might likely be more economically comparable to the subject country than a potential surrogate with a lesser GNI.

And especially with respect to China, the Department should continue to identify the range of potential surrogates on a case-by-case basis. Indeed, the Department should increase the size of its sampled countries from five or six to perhaps ten or more as a means of ensuring a plentitude of surrogate data. Many

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<sup>4</sup> 19 U.S.C. § 1677a.



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countries have a GNI within a close range of China's. As such, restricting the list of potential surrogates to five countries is arbitrary and may not always produce the most economically comparable surrogate. This approach would allow the Department to identify potential surrogate countries before the parties address the issue of production of subject merchandise.

Moreover as noted in Policy Bulletin 04.1, the Department is not required to choose as a surrogate the country that is most closely comparable to the NME country.<sup>5</sup> Section 773(c)(4) of the statute further affirms the Department's broad discretion in requiring only that a surrogate be at a "comparable" level of development; the surrogate's level of development need not be "equal" to the subject country or even the "most comparable."<sup>6</sup> This flexibility is also apparent in the Department's regulations, which specify that the Department is to "place *primary* emphasis on per capita GDP as the measure of economic comparability."<sup>7</sup> According to the regulations, then, gross domestic product (GDP) should be an important, but *non-exclusive* factor. Indeed, the Department ultimately abandoned GDP for GNI given that the latter figure is generated by a more authoritative source and is considered to be a better measure of income.<sup>8</sup>

The Department would be well within its statutory purview to look beyond countries that are "closest" to the subject NME country in terms of per capita

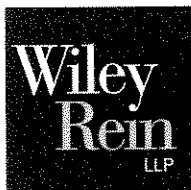
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<sup>5</sup> See Policy Bulletin No. 04.1

<sup>6</sup> 19 U.S.C. § 1677a.

<sup>7</sup> 19 CFR § 351.408(b) (emphasis added).

<sup>8</sup> See, e.g., Request for Comments. GDP is a measure of output, while GNI, which is equivalent to GNP, is a measure of income.



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income to consider additional factors. Other helpful factors could include a potential surrogate's level of urbanization, the scale of its economy, the size of its domestic market, and the country's level of integration into global markets.

In sum, per capita GNI should remain at the base of the Department's determination of economic comparability. But the Department should approach GNI flexibly and on a case-by-case basis, cognizant that a country with a greater GNI than that of the subject country may serve as an effective surrogate. And nor should the Department be limited by one potential surrogate's GNI where another country may provide for a more accurate, predictable, and transparent comparison with the subject NME country given other factors.

**B. Availability of Data**

The Department's central aim in revising its surrogate country methodology should be to establish a process that is flexible, predictable, and transparent for all parties. The availability and integrity of surrogate country data regarding factors of production are often critical elements in such a process. In this respect, the Department should generally hold certain countries in higher regard than others based on the integrity and availability of surrogate data, while preserving so much procedural flexibility as is necessary to consider data from other countries where appropriate.

As an example, consider the Department's treatment of India as a surrogate country. India provides a wealth of surrogate values from a variety of reliable public sources. Historically, but not exclusively, the Department has relied upon India as a source of surrogate values in NME proceedings. While not precluding



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the possibility of using data from other countries, the Department's consistent use of Indian import values provides petitioners with a predictable measure of surrogate values, which petitioners can then use to analyze whether an antidumping case is appropriate. Similarly, respondents in NME countries can look to the Department's consistent reliance on India to measure their exports and to proactively moderate potential dumping.

Thus, while the Department should strive to be flexible in analyzing prospective surrogate countries and should not necessarily disregard a particular country because of a lack of data, the Department should continue to place emphasis on the availability of reliable public data sources. Continued transparency and predictability is helpful to all parties.

## II. SEPARATE RATES TEST

With respect to the second issue, the Department has requested public comment on two aspects of the procedures by which it chooses to assign separate rates in NME anti-dumping proceedings. First, the Department has asked for comment on potential alternatives to the traditional separate rates test first enunciated in *Sparklers from the People's Republic of China*.<sup>9</sup> At present, the Department employs separate rates only where a respondent exporter can demonstrate the absence of both *de jure* and *de facto* governmental control, as judged by a multi-factor analysis. Certain parties have alleged that testing individual firms for their independence is no longer necessary given the reforms that have taken place in certain NME countries. Second, the Department seeks comment

<sup>9</sup> *Sparklers from the People's Republic of China*, 56 Fed. Reg. 20,588 (final) (Dep't of Commerce May 6, 1991).



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on whether to consider changes to the implementation of the current test. In particular, the Department has requested comment on the proper balance between efficiency and enforcement in implementing the separate rates test; concerns have been raised about both the volume of requests for separate rate treatment and the effectiveness of the separate rates test, particularly as regards the *de facto* element.

As a general matter, Commerce should retain its traditional separate rates test and not make unnecessary changes solely for purposes of simplicity. A streamlining of the separate rates process increases the risk of an inappropriate grant of separate rates status. If Commerce is seeking balance between efficiency and enforcement, while it seeks to loosen the requirements for extending separate rate status to those companies it has already determined are eligible, it should conversely recognize a dramatic reversal of PRC corporate governance that prevents eligibility for a portion of its economy.

**A. Separate Rates Criteria**

In its request for comments, Commerce cites anonymous, unsourced input, presumably from respondent parties, that suggests that “testing firms for independence over their export activities is no longer necessary in light of economic reforms that have occurred in particular NME countries.” We disagree. It is unclear which “particular NME countries” are referenced, nor is it clear which economic reforms have occurred. However, nothing could be farther from the truth regarding China’s role in controlling its state-owned enterprises (SOEs).<sup>10</sup>

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<sup>10</sup> Our comments are focused on China and state-owned enterprises. We rely upon and concur with other parties’ comments regarding the separate rates criteria. However, in general we strongly disagree that the test should be loosened. Rather, the test should be bolstered to focus on the involvement of local government ownership and controls of enterprises.



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Currently, the Department uses a two-pronged test to determine eligibility for a separate rate:

Absence of De Jure Control: The Department considers the following de jure criteria in determining whether an individual company may be granted a separate rate: (1) an absence of restrictive stipulations associated with an individual exporter's business and export licenses; (2) any legislative enactments decentralizing control of companies; and (3) any other formal measures by the government decentralizing control of companies.

Absence of De Facto Control: Typically, the Department considers four factors in evaluating whether each respondent is subject to de facto governmental control over its export activities: (1) whether the export prices are set by, or subject to the approval of, a governmental authority; (2) whether the respondent has authority to negotiate and sign contracts and other agreements; (3) whether the respondent has autonomy from the central, provincial, or local governments in making decisions regarding the selection of its management; and (4) whether the respondent retains the proceeds of its export sales and makes independent decisions regarding disposition of profits or financing of losses.

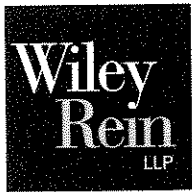
This test was developed in the mid to late 1990s, when China was in the process of decentralizing its control of the economy. However, the decentralization process resulted in numerous instances of abuse of power, mismanagement of assets, and general corruption. As a response to this, the government of China executed a stark reversal of the decentralization process and has, in fact, recentralized government control of SOEs through the formation of a central government authority under the direct supervision of the State Council, the State-Owned Assets Supervision & Administration Commission ("SASAC"). SASAC's actions as well as its legal authority under the State Council and its implementing regulations contradicts numerous aspects of the Department's separate rates test as stated above.

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Consequently, Commerce should determine that SOEs within SASAC's ambit of control are not eligible for a separate rate.

SASAC's legal authority over SOEs rests on the "*State Council Institutional Reform Scheme* approved at the First Session of the 10<sup>th</sup> National People's Congress of PRC and SASAC's implementing regulations.<sup>11</sup> Under the implementing regulations, SASAC's duties include:

1. exercising all the responsibilities of the investor and "upholding the benefits of the owner [*weihu suoyouzhe quanyi*]" The benefits of ownership as laid out in the Company Law include (in its Article 4), the right to distribution of income from assets, the right to participate in major strategic decisions, and the right to select managers.
2. carrying out the reform and reorganization of SOEs;
3. appointing Boards of Supervisors to oversee SOEs;
4. appointing and dismissing enterprise managers.
5. auditing state assets
6. carrying out any other tasks entrusted to them by the appropriate level of government.<sup>12</sup>

In short, SASAC represents the ownership rights in SOEs on behalf of the State Council, and retains regulatory power over SOEs and SASACs organized at the provincial and local level.<sup>13</sup>

<sup>11</sup> See <http://www.sasac.gov.cn/eng/zrzc.htm> and [http://www.sasac.gov.cn/eng/eng\\_zcfg/eng\\_zcfg\\_0001.htm](http://www.sasac.gov.cn/eng/eng_zcfg/eng_zcfg_0001.htm).

<sup>12</sup> See Barry Naughton, *SASAC: The Exercise of State Ownership in Contemporary China* at 3-4 (Dec. 6, 2006), attached as Exhibit 2

<sup>13</sup> *Id.* at 4.



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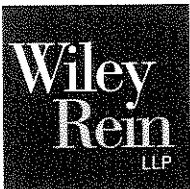
SASAC's legal authority reverses the decentralization of SOEs that occurred during the 1990s and establishes a central apparatus under the direct supervision of the State Council as the sole legal authority. Thus, SASAC's legal imperative to assume central government control over SOEs directly contradicts two of the three elements of Commerce's *de jure* control test: (2) any legislative enactments decentralizing control of companies; and (3) any other formal measures by the government decentralizing control of companies. On this basis alone, enterprises under SASAC supervision automatically fail the *de jure* control test. Because Commerce's presumption of governmental control requires a party to demonstrate freedom from both *de facto* and *de jure* control, the separate rate procedure should not apply to SOEs. However, SASAC's authority over SOEs also provides a basis for automatic failure of the *de facto* control test.

SASAC's implementing regulations give SASAC, and/or its local satellite SASACs,<sup>14</sup> total control over the selection and removal of management and other, financial matters for SOEs.<sup>15</sup> As such, SASAC's activities and authority necessarily fail two of the four elements of Commerce's *de facto* control test: (3) whether the respondent has autonomy from the central, provincial, or local governments in making decisions regarding the selection of its management; and (4) whether the respondent retains the proceeds of its export sales and makes independent decisions regarding disposition of profits or financing of losses.

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<sup>14</sup> See Exhibit 1 for a partial listing of local SASACs.

<sup>15</sup> See also Memorandum from Shauna Lee-Alaia to David M. Spooner Re: *Antidumping Duty Investigation of Certain Lined Paper Products from the People's Republic of China, China's Non-Market Economy Status* at 36-37 (Aug. 30, 2006).



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Commerce clearly recognizes SASAC's direct role in the management and financial direction of SOEs. As Commerce stated in the August 30, 2006 Memorandum from Shauna Lee-Alaia *et al* to David M. Spooner regarding the China's status as a NME for purposes of the antidumping duty investigation of *Certain Lined Paper Products from the People's Republic of China*:<sup>16</sup>

The Sixteenth National Party Congress presented the *Guiding Principles for State-owned Assets* in 2002, which reinforced the State's role as owner of SOEs.<sup>17</sup> The State-owned Asset Supervision and Administration Commission ("SASAC") was created in May 2003 and manages SOEs registered under the *Company Law* "on the principle of separating government administration from enterprise management and separating ownership from management."<sup>18</sup> The SASAC "shall not interfere in production and operation" activities, but rather will act as the majority shareholder to take major policy decisions and choose managers.<sup>19</sup> A priority of the SASAC is to improve the performance of SOEs' boards of directors by appointing and removing directors based on performance measures.<sup>20</sup> The SASAC may authorize directors to take independent decisions on "important matters of the company." However, the State nevertheless decides any matter related to the increase or reduction of capital, issuance of bonds or changes in corporate structure, such as mergers, divisions or liquidation. The chairman and vice-chairman of the board are appointed by the SASAC from among the board members.<sup>21</sup>

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<sup>16</sup> *Id.*

<sup>17</sup> *Governance in China*, OECD Report at 305 (2005) ("OECD Report").

<sup>18</sup> *Trade Policy Review, People's Republic of China* at 133 (World Trade Organization, Feb. 28, 2006) ("Trade Policy Review").

<sup>19</sup> *Id.* at 133-134.

<sup>20</sup> OECD Report at 305.

<sup>21</sup> Trade Policy Review at 129.

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Thus, there is no question that SASAC directly controls managerial selection and all financial, legal, and corporate structural issues for SOEs, in direct negation of two elements of the *de facto* prong of the separate rates control test. Indeed, the Department cannot disregard these facts without rendering moot four of the seven criteria in its two-pronged test. Moreover, SASAC retains indirect control because it can appoint and remove directors, even though SASAC may grant the directors independence to manage the day-to-day operations of the enterprise. In this respect, SASAC control also undermines the two remaining elements of the *de facto* test for SOE respondents.

In conclusion, the recentralization of government control over SOEs represents a significant event both in China's economy and within the context of Commerce's NME methodology. Commerce should, in reevaluating its separate rate test, conclude that SOEs under the supervision of central or local SASACs are not eligible for separate rates, because the legal authority granted to SASAC directly contradicts four of the seven criteria in Commerce's two-pronged test and casts doubt on an SOE's ability to disprove two additional criteria. Commerce should revise its policy accordingly.

**B. Administering The Separate Rates Test**

While we recognize that Commerce faces an administrative burden in evaluating applications for separate rate status, we urge Commerce to use caution in loosening or streamlining the requirements for eligibility. One area of particular concern that is not covered by either the current separate rate application or the proposed certification is the type of shares that represent an enterprise's equity.



For example, there are seven classes of shares for Chinese companies:

- A SHARES
  - Shares held by the Chinese public, denominated and payable in Chinese currency (rinyin).
- B SHARES
  - Shares denominated in renminbi and payable in foreign currency are designated for foreign investors.
- C SHARES
  - Shares denominated and payable in renminbi and held by state-owned "legal persons" (i.e., state-owned companies and banks).
- G SHARES
  - Shares of companies that have undergone "gugai" or share reform - formerly non-tradable government controlled shares sold back into the A and/or B share markets.
- H SHARES
  - Shares floated and listed on the Hong Kong Stock Exchange. The best rated H shares are called "Red Chips."
- N SHARES
  - Shares floated and listed on the New York Stock Exchange.
- L SHARES
  - Chinese companies listed on the London Stock Exchange.<sup>22</sup>

Commerce's separate rates questionnaire fails to distinguish how a company's equity is divided amongst these different classes of shares. Importantly, the Department fails to take into account the C class of shares, which are not tradable and in fact represent the state's equity ownership in the company.<sup>23</sup> Indeed, this class of shares is the vehicle by which the government exercises control of SOEs. Failure to require information about these shares results in a gap in the record for establishing eligibility for separate rates.

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<sup>22</sup> <http://www.sinomania.com/CHINASTOCKS/#shares>

<sup>23</sup> Around two-thirds of the shares in the Chinese stock market are non tradable, and there are three different types of non tradable stock in a Chinese company; 1) state owned stock, 2) stock held by juridical persons, 3) stock held by the company's employees. *See Wuhan Steel, Others Join Share Reforms* (MOFOM, Oct. 10, 2005), available at <http://english.mofcom.gov.cn/article/counselorsreport/asiareport/200510/20051000532642.html>, attached at Exhibit 3.



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For example, a company may state that its shares are publicly traded on the Shanghai stock exchange. This may be an accurate statement, but this answer only applies to a company's A-class shares. But, a company's A-class shares may well represent only a small portion of the total equity. Consider, for example, the state-owned steel companies such as Anshan, Wuhan, and Baosteel. While these companies have issued A-class shares tradable on various stock exchanges, the state retains non-tradable C class shares.<sup>24</sup>

Thus, the Department should increase the depth of its separate rates questionnaire regarding ownership by requiring respondents seeking a separate rate to divulge information about all classes of shares and the number and nature of shareholders within each class. In addition, the Department should revise the certification format to require respondents to report changes to all classes of shares.

\* \* \*

Please contact the undersigned if you have any questions regarding this submission.

Respectfully submitted,

Alan H. Price  
Timothy C. Brightbill

Counsel to Nucor Corporation

Michael F. Panfeld  
Trade Analyst

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<sup>24</sup> In addition to a favorable business outlook, Baoshan is also in the process of shedding one of its biggest risk factors — the large nontradable shares owned by its parent Shanghai Baosteel Group Corp. See *Baosteel Likely to Weather Steel Glut*, (July 15, 2005), available at <http://www.chinaesteel.com/more/morec/2005.htm>.

## **EXHIBIT 1**

## Central SASAC websites:

Regulations

[http://www.sasac.gov.cn/eng/eng\\_zcfg/eng\\_zcfg\\_0001.htm](http://www.sasac.gov.cn/eng/eng_zcfg/eng_zcfg_0001.htm)

Main web site

<http://www.sasac.gov.cn/index.html>

English web site

[http://www.sasac.gov.cn/eng/eng\\_index.htm](http://www.sasac.gov.cn/eng/eng_index.htm)



## **Local State-owned Assets Management Authorities**

Shanghai Municipal State-owned Assets Administrative Office

<http://www.shgzb.gov.cn>

Xuzhou Municipal State-owned Assets Administrative Bureau

<http://www.xz.gov.cn/zfsw/ssjg/gzj>

Wuhan Administrative Bureau of the State Property

<http://www.whgz.gov.cn>

Zhuhai Municipal State-owned Assets Management Bureau

<http://zhgjj.org>

Hebei Province Municipal State-owned Assets Management Bureau

[http://www.sasac.gov.cn/xxfw/dfgz\\_hb/jgqy/gjqy\\_005.htm](http://www.sasac.gov.cn/xxfw/dfgz_hb/jgqy/gjqy_005.htm)

Fujian Province Municipal State-owned Assets Management Bureau

[http://www.sasac.gov.cn/xxfw/dfgz\\_fj/jgqy.htm](http://www.sasac.gov.cn/xxfw/dfgz_fj/jgqy.htm)

Shandong Province Municipal State-owned Assets Management Bureau

[http://www.sasac.gov.cn/xxfw/dfgz\\_shd/jgqymd.htm](http://www.sasac.gov.cn/xxfw/dfgz_shd/jgqymd.htm)

## **EXHIBIT 2**

# **SASAC: The Exercise of State Ownership in Contemporary China**

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A Research Report prepared December 6, 2005.

In 2003, the Chinese government established a new institutional set-up to exercise government ownership the State-Owned Assets Supervision & Administration Commission (“SASAC”). This arrangement marked a major transformation both in the formal definition and allocation of ownership rights, and in the procedures through which such rights were to be exercised. In spite of this progress, the relationship between the central and local government institutions and ownership rights is still far from clear in principle, and extremely complex in practice. The following research report first reviews the formal de jure relationships, and then discusses the de facto exercise of authority. Three specific types of authority are discussed: disposition of profit and other asset income; appointment of managerial personnel; and conversion of share ownership rights of listed companies.

## **I. Legal Authority. The De Jure Authority of SASAC**

Before the 2003 reforms of the institutions of ownership, China’s system of public ownership was characterized as “state ownership, with management at different levels (*guojia suoyou, fenji guanli*).” In other words, local governments exercised managerial authority of many state-owned enterprises (SOEs), but that authority was delegated to it by the central government, and was in principle revocable at any time. After the 2002 Sixteenth Party Congress, this formulation was changed to one of “state ownership, with different levels of government representing [the ownership function]. (*guojia suoyou, fenji daibiao*).” Local government was no longer simply to be the agent of central government control, but rather to be the direct representative of government as owner of the SOE. Each level of government was to exercise all the powers of ownership, as laid out in the Company Law for the SOEs under its jurisdiction.<sup>1</sup>

The basic charter for the new asset management system was the 2003 “Interim Regulations on the Management of Enterprise State-owned Assets.”<sup>2</sup> The Interim

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<sup>1</sup> Wang Shengke, “SASAC Again Tries to Establish Principles of Delegation to Clarify Grey Boundaries,” in 21<sup>st</sup> Century Economic Herald, August 3, 2005, at <http://www.nanfangdaily.com.cn/jj/20050804/zh/200508030005.asp>

<sup>2</sup> State Council, “Interim Regulations on the Management of Enterprise State-owned Assets [企 国 有 管理 行 条例],” May 27, 2003, [http://news.xinhuanet.com/fortune/2003-06/04/content\\_905211.htm](http://news.xinhuanet.com/fortune/2003-06/04/content_905211.htm)

Regulations are quite clear about the origins of the ownership authority which they describe. Article Four: “The state carries out a system of state asset management in which the State Council and the Local People’s Governments respectively represent the state, and carry out the responsibility of investors; enjoy the benefits, rights, obligations and responsibility of ownership in a unified way; and unite management of assets, people, and affairs.” But the actual authority to represent state ownership is vested in the State Council, as the central government’s executive organ, and the People’s Governments at the provincial level, and the municipal level (that is, the level immediately below the province.) The State Council and local governments at these two levels will set up agencies to exercise their ownership rights. Provincial level governments *will* do so, while municipal level governments *may* do so, but have permission to not set up a specialized asset management agency if they prefer administrative simplification. In any case, the local government must report their actions to the higher level of government (Articles 5 and 6).

It is important to note, that the ownership principles established along with the SASAC system make it clear that subsidiaries of central government firms are themselves under the purview of central SASAC.

## **2. Specification of the Powers of Ownership**

The Interim Regulations establish SASAC as a special administrative unit directly subordinate to the State Council. SASAC’s powers under Article 13 include:

1. exercising all the responsibilities of the investor and “upholding the benefits of the owner [*weihu suoyouzhe quanyi*]” The benefits of ownership as laid out in the Company Law include (in its Article 4), the right to distribution of income from assets, the right to participate in major strategic decisions, and the right to select managers.
2. carrying out the reform and reorganization of SOEs;
3. appointing Boards of Supervisors to oversee SOEs;

4. appointing and dismissing enterprise managers.
5. auditing state assets
6. carrying out any other tasks entrusted to them by the appropriate level of government.

In addition to these six points, there are longer, multi-article sections on management of top enterprise personnel; major enterprise affairs; control and supervision of state assets; and legal responsibilities.

SASAC has a broad mandate that includes elements that we would recognize as regulatory power, as well as elements that reflect direct ownership rights. But central SASAC makes regulations about state ownership that are binding on local SASACs. It combines regulatory and ownership functions. Moreover, central SASAC frequently intervenes in individual cases to tell local SASACs when it can or cannot do something (for example, in the shift to all-circulating shares on the stock market). Therefore, it is impossible to determine what the scope of central SASAC guidance really is. In different cases, central SASAC may be acting as a regulator, or as an owner, and sometimes those two roles are inextricably mixed together. These concerns are especially prominent because SASAC has an over-riding political imperative which is to prevent asset-stripping. It's mandate to "protect and increase the value of state-owned assets" is in fact a mandate to prevent the emergence of obviously scandalous cases of corruption, theft, and asset-stripping in general. This concern motivates much of central SASAC's activity.

In general, SASAC has experienced "mission creep," in which its regulatory power has been expanded. It makes sense to discuss this broader question in the context of specific types of power exercised by SASAC.

### **3. Disposition of Profit, or “Capital Income.”**

SASAC is supposed to fulfill all the characteristics of ownership. Not surprisingly therefore, SASAC would like to develop its own budgetary resources. At the end of 2004, the Ministry of Finance approved the concept of a Capital Income Management Budget, which would be primarily managed by SASAC.<sup>3</sup> There are four basic arguments in favor of this approach. First, if SASAC indeed unites all the characteristics of ownership as the representative of the state, it ought to enjoy the disposition over profits or distributed dividends that owners enjoy. Second, leaving after-tax profits with the enterprise encourages excessive, low rate-of-return investment, and discourages transparency and accountability. Third, enterprise reform and restructuring requires substantial sums of money to relocate workers, pay off debt, and fund pensions. The capital income management budget would be a logical source of these funds. Finally, it is pointed out that the fiscal budget is now intended only for public finance, and is not to be used to invest in profit-generating activities

What is the income remitted to SASAC to be used for? The more revenue SASAC claws back, the more likely it is to engage in expansion projects or “industrial policy” that involves substantial new investment..

### **4. Appointment of Managers and Personnel Power**

SASAC has the right to appoint SOE managers and members of the Board of Directors.<sup>4</sup> This is established in Article 13 of the Provisional Regulations, and, as discussed above, each provincial SASAC has a similar article. In each case, the regulation specifies that SASAC controls personnel appointments “in accordance with legally designated procedures.” However, in practice, this is an extremely sensitive and

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<sup>3</sup> “The disposition of dividends on state-owned capital is still awaiting new ideas[国有 ▪ 本 “ ▪ 利” 收 ▪ 亟待破 ▪ ]” Friday, November 11, 2005 at <http://www.yngzw.gov.cn/wwwroot/gzyw/804.aspx>

<sup>4</sup> In addition, SASACs have a special responsibility to appoint Supervisory Board members.

complex issue. The Communist Party of China in fact exercises nearly complete control over personnel decisions throughout the state sector. This system, copied from the Soviet Union but still fully in use in China today, requires Communist Party committees to make appointments to a namelist, or *nomenklatura* of professional and managerial positions. It is not an exaggeration to say that the political power of the Communist Party is based on its control of job appointments. Along with control of speech and publishing (“propaganda”), control of human resources is what the Communist Party does, and how it exercises its political control.

SASAC shares appointment power with the highest ranks of the Communist Party. A specific determination was made that the 53 largest enterprises, for whom the top manager and chairman of the Board had been appointed by the Communist Central Committee Organization Bureau would continue to be appointed directly by the party. These positions are too important, as patronage posts and controllers of resources, to slip out of the hands of the Party. The Party is directed to make these decisions “in coordination with the Communist Party Committee within SASAC.” On the other hand, the SASAC Communist Party Committee itself is to manage the vice-CEO level, which means concretely through the First Personnel Bureau of SASAC. Managerial positions in the other 143 enterprises are to be managed by the Second Personnel Bureau of SASAC.<sup>5</sup>

In Shanghai, a single individual, Qiang Sixian, is simultaneously Director of Personnel for the City of Shanghai and head of the Party Committee within Shanghai SASAC (as well as a member of the Municipal Party Committee).<sup>6</sup> Guangdong Provinces enabling legislation is unusually specific and concrete, stating that Guangdong SASAC will take over from the Provincial Communist Party Organization Committee the appointment of SOE directors, managers, and Party and Disciplinary Committee

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<sup>5</sup> Communist Party of China, “Party Center Notification on a Few Matters Relating to the Establishment of State Council SASAC,” March 24, 2003, in *2004 Zhongguo Guoyou Zichan Jiandu Guanli Nianjian [China State-owned Assets Supervision and Management Yearbook]*. Beijing: Zhongguo Jingji, 2004. P. 99.

<sup>6</sup> “The two Commissions, Municipal and SASAC, call a System-Wide Meeting on Human Resources,” 市国 ▪ 两委召 ▪ 全系 ▪ 人才工作会 ▪ , November 16, 2005, at <http://www.shgz.gov.cn/gb/gzw/xxzh/gzdt/userobject1ai37646.html>



members. The Hebei enabling legislation specifically states that SASAC will appoint Managers of traditional SOEs and Chairman of the Board and Board members for state companies; as well as nominate candidates for managers to the Board for Board-governed companies.<sup>7</sup>

When Central SASAC issued its guidance to local SASACs urging them to set up SASACs at the immediately subordinate municipal level, it specifically instructed them to “uphold the principal the Party manages cadres [i.e., managers], perfect the cadre management system, and guarantee that the local party committee strengthens its management of the responsible personnel at important keypoint SOEs in the locality.”<sup>8</sup>

SASAC has a very important role in defining the scope of permissible incentive mechanisms. In this sense, suggesting and diffusing effective incentive mechanisms is part of SASAC’s mission to spread reform and increase efficiency; while defining the limits to permissible incentive systems is part of its mission to prevent asset-stripping. However, all these initiatives develop in the context of a system in which the ultimate say in the development of an individual’s career path is retained by the Communist Party. Needless to say, that imposes limits on the incentive characteristics of whatever mechanisms SASAC introduces.

## 5. Share Conversion.

One of the most important policy processes with which SASAC has been involved is the conversion of the status of state-owned shares in publicly listed companies. This process, herein called “share conversion” for simplicity, involves a shift in the legal status of state-owned shares in listed companies from “non-circulating” to

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<sup>7</sup> <http://www.hbsa.gov.cn/show.asp?id=1687>

河北省企 国 有 督 管 理 施 法, [2004]第 6 号, Approved October 21, 2004, by the 33rd meeting of the Provincial Government Standing Committee. Effective December 1, 2005. Article 13.

<sup>8</sup> SASAC, “Guiding Opinions on Setting up State Asset Supervision and Management Organs at the Level of the Municipal (Prefectural) People’s Government [ 于 立 市 (地) 人 民 政 府 国 有 督 管 理 机 构 的 指 意 ],” November 1, 2004, at [http://www.gov.cn/zwgk/2005-08/15/content\\_23237.htm](http://www.gov.cn/zwgk/2005-08/15/content_23237.htm)

“circulating.” Non-circulating shares are restricted in that they cannot be bought and sold openly on the market, although certain types of private placement are allowed. These shares have long been a drag on the market, since they represent an overhang of potential share supply that could drive down prices. At the same time, since non-circulating shares represent the majority of total market capitalization, they prevent the market from serving as a market for corporate control. In 2001, a policy to sell off some state shares collapsed amid broad market declines. During 2005, a new approach has been adopted in which individual companies develop their own share conversion programs. For these programs to be adopted, holders of circulating shares must agree to the overall conversion. In practice, this means that share conversion includes the allocation of bonus shares to circulating shareholders from the holdings of non-circulating share owners, in an attempt to protect the total value of their holdings.

During the experimental stages of share conversion, from April through September, 2005, Central SASAC was deeply involved in setting the guidelines and approving the specific programs of individual enterprises.<sup>9</sup> To some extent this was to be expected, since the policy touches on two of the most important elements of SASAC’s overall mission. First, share conversion raises fears of asset stripping because it inevitably involves some degree of dilution of government ownership. Therefore, SASAC feels that it must oversee the process to insure fairness and transparency. Second, share conversion touches on the broader issues of the reform of incentive systems within public firms, and SASAC is tasked with pushing forward reform in this broad area. Both of these are essentially regulatory functions. However, in the experimental phase of share conversion, central SASAC was directly involved in the case-by-case approval of the 46 individual firm share conversions. Central SASAC’s direct approval or disapproval of individual share conversion programs was carried out with regard to the actual level of governmental ownership of the specific firms. Thus, the boundary

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<sup>9</sup> For descriptions and analysis of the earlier stages of share conversion, see Barry Naughton, “SASAC Rising,” *China Leadership Monitor*, Issue 14, Spring 2005; and *idem.*, “Incremental Decision Making and Corporate Restructuring,” *China Leadership Monitor*, Issue 15, Summer 2005. Both at <http://www.chinaleadershipmonitor.org>

between ownership and regulatory functions was blurred, and SASAC at the central level seemed to absorb significant new powers.

## 6. The Nature of SASAC Guidance

SASAC played the decisive role in the establishment of local SASACs in the first place, and therefore it has enormous influence over them. Wang Shengke quotes a Shanghai SASAC official as saying, “We generally follow central SASAC regulations; and if they have rules for central enterprises, we generally follow them for our own enterprises as well.”<sup>10</sup>

In late 2004, central SASAC directed local SASACs to set up asset management organs at the immediately subordinate municipal level.<sup>11</sup> While the guidance document was short, it managed to specify a number of important principles, including the continued Communist Party control of personnel. The Guidance included as well the fact the provincial SASACs should exercise “guidance and supervision” over subordinate levels in exactly the same formulation that central SASAC exercises guidance and supervision over provincial SASACs. Finally, provincial SASACs were specifically enjoined not to make uncompensated transfers of property among subordinate SASACs (or from subordinate to provincial level SASACs).<sup>12</sup>

Immediately following this administrative guidance, central SASAC head Li Rongrong issued further guidance on enterprise reform. Perhaps the most interesting

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<sup>10</sup> Wang Shengke, “SASAC Again Tries to Establish Principles of Delegation to Clarify Grey Boundaries,” in 21<sup>st</sup> Century Economic Herald, August 3, 2005, at <http://www.nanfangdaily.com.cn/jj/20050804/zh/200508030005.asp>

<sup>11</sup> SASAC, “Guiding Opinions on Setting up State Asset Supervision and Management Organs at the Level of the Municipal (Prefectural) People’s Government [ 于 立市(地) 人民政府国有 督管理机构的指 意 ],” November 1, 2004, at [http://www.gov.cn/zwgk/2005-08/15/content\\_23237.htm](http://www.gov.cn/zwgk/2005-08/15/content_23237.htm)

<sup>12</sup> SASAC, “Guiding Opinions on Setting up State Asset Supervision and Management Organs at the Level of the Municipal (Prefectural) People’s Government [ 于 立市(地) 人民政府国有 督管理机构的指 意 ],” November 1, 2004, at [http://www.gov.cn/zwgk/2005-08/15/content\\_23237.htm](http://www.gov.cn/zwgk/2005-08/15/content_23237.htm), Item 5.

aspect was Li Rongrong's identification of the two most important current tasks: first was to continue with the process of inventorying and revaluing capital; and clarifying ownership relations, in order to lay the groundwork for further capital mobility; and second was setting up Boards of Directors in more (all?) corporations, to hasten the development of a modern corporate governance system.<sup>13</sup>

Why did central SASAC feel it necessary to issue guidance instructing provincial SASACs to set up subordinate SASACs? It goes back to SASAC's central mission, which is to reduce asset-stripping. The view of central SASAC, strongly reinforced by its annual Third Quarter inspection and audit tours, is that asset-stripping and improper transactions are most prevalent at the sub-provincial level, that is, at the municipal and county levels.<sup>14</sup> Provincial SASACs, however, believe that the value of state assets at these lower levels is not sufficient to justify an additional administrative organ. Moreover, they are not necessarily overjoyed to have additional scrutiny of their own transactions at this level. One of the results was that by the end of 2004, although every province had set up a provincial SASAC, only 45% of the 448 municipal level governments had set up any kind of state asset management body, and only 39% had set up an independent SASAC-like body. In general, the center judged that the pace of implementation had been slow, and problems with asset-stripping at this level still serious.<sup>15</sup>

We can gain further insight into the nature of central SASAC guidance by examining the recommendations of Zhang Wenkui, perhaps the top academic expert on state asset management. Zhang is sympathetic to SASAC's agenda, so his list of four

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<sup>13</sup> [http://news.xinhuanet.com/zhengfu/2004-11/08/content\\_2191312.htm](http://news.xinhuanet.com/zhengfu/2004-11/08/content_2191312.htm)

李·融：地方国·委要·持依法·事·范推·国企改制

<sup>14</sup> Wang Shengke, "It is definitely not prohibited: beginning to establish a legal framework for MBOs," 21<sup>st</sup> Century Economic Herald, December 22, 2004, at

<http://www.nanfangdaily.com.cn/southnews/sjj/jd/200412220889.asp>; Wang Shengke, "SASAC Again Tries to Establish Principles of Delegation to Clarify Grey Boundaries," in 21<sup>st</sup> Century Economic Herald, August 3, 2005, at <http://www.nanfangdaily.com.cn/jj/20050804/zh/200508030005.asp>

<sup>15</sup> Li Baomin [Central SASAC Research Center], "Accelerate the Completion of the Local State Asset Management System," *Jingji Ribao*, July 4, 2005, at [http://news.xinhuanet.com/fortune/2005-07/04/content\\_3172381.htm](http://news.xinhuanet.com/fortune/2005-07/04/content_3172381.htm)

types of guidance to which central SASAC should be restricted is a good indication of the underlying rationale for central SASAC's regulatory-style guidance of local-level SASACs. Zhang's list should be seen as an attempt to clarify what central SASAC is currently doing, and codify it, rather than as a full scale recommendation for change.

Zhang's four items argue that central SASAC unified regulation is required to:

- a. specify the areas where the state needs to maintain a controlling ownership stake;
- b. establish rules to maintain open, competitive procedures to state asset sales, to prevent asset stripping;
- c. specify the uses of revenue from asset sales, and ensure that they are used first and foremost for the resettlement of workers and the repayment of debt; and
- d. delineate the contents and format of the capital budget.<sup>16</sup>

## Conclusion

The *de jure* grant of authority to SASAC at the central and local levels is quite extensive. The trend in the last two years has been toward the steady gathering of power and authority in the hands of SASACs at both central and local levels. Since this incremental trend reflects the *de jure* grant of authority, it is reasonable to argue that the practical trend reflects the underlying ownership relationships, and that an earlier devolution of authority is gradually being reversed. If that is the case, the exercise of ownership will increasingly be consistent with *de jure* authority.

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<sup>16</sup> Wang Shengke, "SASAC Again Tries to Establish Principles of Delegation to Clarify Grey Boundaries," in 21<sup>st</sup> Century Economic Herald, August 3, 2005, at <http://www.nanfangdaily.com.cn/jj/20050804/zh/200508030005.asp>

### EXHIBIT 3

#### Wuhan Steel, others join share reforms(2005/09/30)

Wuhan Iron & Steel Co. Ltd. (SHA: 600005), China's third-largest steelmaker, became the latest major corporation to join the Central Government's effort to float US\$250 billion of nontradable State holdings in listed firms.

Wuhan Steel, which competes with larger rivals Baoshan Iron & Steel Co. Ltd. (SHA: 600019) and Angang New Steel Co. Ltd. (SZA: 000898; HK: 0347), will convene a shareholders' meeting Tuesday to hammer out specifics, it said Monday.

The government revived the share-reform program, aimed at making firms more transparent and financing the pension system, in April after a bungled first attempt in 2001 -- when fears of a deluge of stock on to markets sparked a 30 percent market dive.

Wuhan Steel was among 21 corporations that announced plans to join the State-share reform Monday. Including those, 145 listed firms -- or more than a 10th of 1,400 listed firms -- have either said they would take part in or completed their reforms.

"Trading in our company's shares will be suspended from Monday as we begin the process of reform," it said in a statement published in the Shanghai Securities News.

A legacy of a centrally planned economy, State shares -- owned directly by the government or institutions they control -- account for two-thirds of the US\$415 billion in capitalization of the Shanghai and Shenzhen stock exchanges.

In an effort to calm investors worried about a failure similar to that of 2001, the new plan calls for State-share sales in defined phases over three to four years.

The government would also inject cash into the market and push exchanges to conduct reforms, such as by developing financial derivatives.

Domestic newspapers said Monday that the Shanghai and Shenzhen exchanges had established the China Securities Index Co. Ltd. -- with the express aim of helping develop derivatives such as stock index futures.

That move came after Baosteel listed the country's first warrants in a decade in August as part of its own State-share reform, and analysts have said they expect as many as 40 other companies will follow suit this year.

In a tightening of control intended to protect the value of government-owned assets, the government now directs companies to first gain approval from local-level State-asset management bureaux.

Each provincial bureau must review corporate reform plans in detail, according to new rules published over the weekend by the State-owned Assets Supervision and Administration Commission under the cabinet.