A NAFTA Industry Perspective on the Impact of SOEs on the Global Steel Market

American Iron and Steel Institute

CSPA ACPA
Canadian Steel Producers Association
L'Association canadienne des producteurs d'acier

CPTI
The Committee on Pipe and Tube Imports

CANACERO

SSINA
Specialty Steel Industry of North America

SMA
Steel Manufacturers Association

OECD Steel Committee
May 31-June 1, 2012
Paris, France

Prepared By:

Wiley Rein LLP

Alan H. Price, Esq.
Timothy C. Brightbill, Esq.
Christopher B. Weld, Esq.
Laura El-Sabaawi, Esq.

TABLE OF CONTENTS

I. INTRODUCTION 1

II. "STATE CAPITALISM" AND THE RESURGENCE OF STATE-OWNED ENTERPRISES 2

A. The Rise of State Capitalism 2

B. Government Ownership and Control of the Steel Industry 3

C. The Increase in SOE Investment Abroad 5

III. STATE-OWNED ENTERPRISES POSE CHALLENGES TO THE GLOBAL STEEL INDUSTRY AND RELATED UPSTREAM AND DOWNSTREAM INDUSTRIES 7

A. The Impact of SOEs on the Global Steel Industry 7

1. Government Subsidies and Other Benefits Provide SOEs with Unfair and Market-Distorting Competitive Advantages 8

2. Case Study: The Chinese Steel Industry 11

B. The Impact of SOEs on the Trade in Raw Materials 13

1. SOEs and the Race for Raw Materials 13

2. SOE Participation in the Raw Materials Market Causes Major Distortions 16

C. The Impact of SOEs on Downstream Steel-Consuming Industries 18

IV. POLICY OPTIONS FOR ADDRESSING THE MARKET-DISTORTING CHALLENGES POSED BY SOES 20

A. Confronting the Challenges Posed by SOEs 20

B. Principles for State-Sponsored Actors in the Commercial Marketplace 21

V. CONCLUSION 24

A NAFTA INDUSTRY PERSPECTIVE ON THE IMPACT OF SOES ON THE GLOBAL STEEL MARKET

I. INTRODUCTION[1]

Global companies and industries built on capitalism and free markets enjoyed undeniable and unprecedented success in the 20th century. However, that success is now potentially threatened by the rising use of state power in global commerce. Indeed, "[t]he invisible hand of the market is giving way to the visible, and often authoritarian, hand of state capitalism"[2] – a disturbing trend with significant economic implications for market-based companies that compete with state-supported entities for business in North American and global markets.

Particularly troublesome for free-market economies is the growing use of state-owned enterprises ("SOEs")[3] to unfairly tilt the commercial playing field, both within a country's borders and in global markets. China, in particular, has created massive state-owned and -controlled national champions that are designed to be competitive on the international stage. These SOEs are instrumentalities of the state, subject to varying degrees of direction and control by the Chinese government, and are often protected from competition in their own market. They are motivated not only by economic concerns, but also by government objectives, including technology transfer, access to raw materials, job creation, and geopolitical influence.

This "state capitalist" model is not unique to China. Other countries, such as Vietnam and Indonesia, are pursuing a similar agenda of government ownership, control, and direction of key industries and companies, and are creating and nurturing national champions designed to compete globally. In addition, there are very real concerns that other countries, seeing the apparent success of the Chinese approach, may seek to copy this model.

The growth of foreign SOE investment represents a new and growing threat to fair competition and the ability of privately owned steel producers to compete around the globe. Subsidized and otherwise advantaged by their home governments, these SOEs often do not operate based on market principles and therefore introduce market-distorting behavior and other trade and investment imbalances. In addition, SOE investment at home and abroad forces companies to compete directly against foreign governments in markets around the world, creating significant imbalances that harm workers and private companies competing in those markets. These distortions impact the North American and global steel markets, as well as related upstream and downstream markets.

The steel industries in the NAFTA countries and elsewhere include companies that have significant levels of private foreign capital and investment. Governments in these countries should continue to welcome foreign investment (as long as it is on a commercial basis and

---

[1] This paper was prepared by Alan H. Price, Timothy C. Brightbill, Christopher B. Weld, and Laura El-Sabaawi, attorneys with the international trade practice of Wiley Rein, LLP in Washington, D.C.

[2] Adrian Wooldridge, *The visible hand*, The Economist (Jan. 21, 2012) ("*The visible hand*") at 5.

[3] As used in this paper, the term "state-owned enterprises" includes "state-supported enterprises" and other government-backed entities.

otherwise consistent with international trade rules) and support an open investment regime. However, the expanding involvement of SOEs in markets around the world presents unique challenges that could harm North American and global competitiveness if left unaddressed. As a result, governments committed to the free market system should increase efforts to address the potential market-distorting effects of SOE investment in global markets.

II. "STATE CAPITALISM" AND THE RESURGENCE OF STATE-OWNED ENTERPRISES

A. The Rise of State Capitalism

While the presence of SOEs in the marketplace is not a new phenomenon, the degree of state involvement in economic activity is growing in certain sectors, as a number of governments are increasingly pursuing ownership, control, and direction of key industries and companies. In fact, SOEs now dominate key segments of the global economy. For example, the world's 13 largest oil companies are state-owned or -supported, controlling more than three-quarters of the global oil supply.[4] The world's largest bank, largest natural gas company, largest insurance company, and fastest growing airline are all SOEs.[5] Moreover, the degree to which SOEs are investing abroad – often financed and otherwise supported by their governments – also appears to be growing.[6]

Nowhere is the rise of state capitalism more evident than in the case of China, where the government continues to control the "commanding heights" of the Chinese economy, including through ownership of major sectors such as banking, insurance, raw materials, and steel. China's strategic plan for these and other "pillar" industries is to create massive state-owned and -controlled national champions that are capable of competing on the international stage. Pursuant to government-issued industrial policies, these SOEs are now expanding overseas, with the full support of the Chinese government, to pursue government objectives.

SOEs now constitute 80 percent of the value of the Chinese stock market, and the Chinese government is the biggest shareholder in China's 150 largest companies.[7] In addition, many companies which are not wholly-owned by the government are nonetheless subject to state control. As the U.S.-China Economic and Security Review Commission has recognized, "[t]he state's influence over China's economy takes many forms and covers a whole spectrum of companies from fully state owned to those that are nonstate but maintain close ties to the government."[8]

---

4 *The visible hand* at 4.

5 Sean Heather and Alan Wolff, *Establishing Rules of the Road: Commercial SOEs & Private Actors*, SOE Presentation, Melbourne, Australia (Mar. 4, 2012) at 3.

6 *See e.g.*, *The visible hand* at 6, 15.

7 *The visible hand* at 4. *See also* U.S.-China Economic and Security Review Commission, *2011 Report to Congress* (Nov. 2011) ("Commission's 2011 Report to Congress") at 40 ("there are more than 100,000 smaller companies [in China] that are owned or operated by provincial and local governments").

8 Commission's 2011 Report to Congress at 40.

Other countries are pursuing a similar model of state intervention in the economy. *The Economist* reports that Russia has "reasserted direct state control over 'strategic' industries," including oil, gas, and transportation,[9] which are important to the steel industry. SOEs account for approximately 40-50 percent of Russia's GDP, more than 60 percent of stock market capitalization, and more than 30 percent of employment.[10] SOEs in India and Indonesia account for 20 percent and 30 percent, respectively, of the value of the stock market in those countries and are pervasive in mining, energy, steel, logistics, and other sectors critical to manufacturing and raw materials.[11] In Indonesia, SOEs account for 40 percent of GDP.[12] SOEs in Brazil account for 38 percent of stock market capitalization and are dominant in the mining, energy, and financial sectors.[13] The economies of Vietnam, Malaysia, and Singapore also have significant participation from state-owned companies. For example, Vietnamese SOEs account for 40 percent of GDP,[14] while in Malaysia, one SOE, Petroliam Nasional Berhad ("Petronas"), supplies more than 40 percent of government revenue.[15] As one observer has noted:

> Vietnam, Malaysia, and Singapore manage their economies through a state-capitalist model in which the government directly or indirectly controls many of the economy's productive assets, formal financial systems, and activities. . . . They benefit from preferred access to bank capital, below-market-rate financing, favorable tax treatment, capital injections, and other advantages that distort the playing field and put American firms and workers at a competitive disadvantage.[16]

B. <u>Government Ownership and Control of the Steel Industry</u>

Because of the market imbalances that result from state interference, the U.S., Canadian, and Mexican governments have worked for years with other governments to remove subsidies and other government interference from the steel industry and to seek fair competition for all

---

9 *The visible hand* at 5. *See also OECD Progress Report, State-Owned Enterprises: Trade Effects and Policy Implications*, OECD Trade and Agriculture, Working Party of the Trade Committee (Mar. 2012) ("*OECD Progress Report, State-Owned Enterprises: Trade Effects and Policy Implications*") at 6.

10 *The visible hand* at 2. *See also OECD Progress Report, State-Owned Enterprises: Trade Effects and Policy Implications* at 6.

11 *OECD Progress Report, State-Owned Enterprises: Trade Effects and Policy Implications* at 6.

12 *See State of Indonesian State Owned Enterprises*, Sovereign Wealth Fund Institute (Aug. 10, 2011).

13 *The visible hand* at 2. *See also OECD Progress Report, State-Owned Enterprises: Trade Effects and Policy Implications* at 6.

14 Central Intelligence Agency, *The World Factbook – Vietnam Economy* (last updated May 1, 2012).

15 Central Intelligence Agency, *The World Factbook – Malaysia Economy* (last updated May 1, 2012); *Malaysian Petrochemical Inspection Co. of CCIC Singapore Co., Ltd Put on Qualified Inspectors List By Petronas*, China Certification and Inspection Group (Feb. 27, 2009).

16 Sabina Dewan, *Getting State-Owned Enterprises Right in the Trans-Pacific Partnership: The Obama Administration Must Negotiate a Robust Set of Rules on State-Owned Enterprises*, Center for American Progress (Feb. 23, 2012).

enterprises, including SOEs. Despite these efforts, which achieved some success, governments around the globe are asserting increasing levels of ownership and control over their steel industries. While this is especially true with respect to China, other countries are also following suit.

Like all pillar industries, China's steel industry remains predominately state-owned, with the government owning the vast majority of shares in almost all of China's major steel producers.[17] As of 2009, more than 95 percent of the production of the top 20 steel groups in China was subject to some government ownership, and 16 of the top 20 steel groups were 100 percent-owned and -controlled by the government.[18] In addition, the Chinese government continues to exercise control over the development of the Chinese steel industry through policy directives and industrial plans,[19] including the recently issued 12th Five-Year Plan for the Iron and Steel Industry.[20] These plans provide for government management and control of almost every aspect of the industry's development, including resource and equipment utilization, regional output levels, product development (including which companies should produce which products), quality improvements, technological innovation, and consolidation of the industry. To further consolidate control over the steel industry, the Chinese government also heavily regulates foreign investment in the industry and imposes a number of investment restrictions, such as *de facto* technology transfer requirements.[21]

This significant degree of state ownership and control enables the Chinese government to direct steel producers to act in ways that further governmental aims, such as maximizing tax revenue and employment, rather than responding to market aims. Government ownership and control also facilitate the provision of a broad array of subsidies and other financial support to steel producers. Indeed, the Chinese government provides substantial direct and indirect benefits to its steel industry, including cash grants, land grants, transfers of ownership interests, conversions of debt to equity, debt forgiveness, preferential loans, and tax incentives.[22]

---

17 The Chinese Government's 10th Five-Year Plan for National Economic and Social Development established the framework for state ownership of the steel industry by requiring that the "state must hold a controlling stake in strategic enterprises that concern the national economy." *Government of the People's Republic of China's Report on the Outline of the Tenth Five-Year Plan for National Economic and Social Development* (2001) (delivered at the Fourth Session of the Ninth National People's Congress on Mar. 5, 2001).

18 *The Reform Myth: How China is Using State Power to Create the World's Dominant Steel Industry*, Wiley Rein LLP (Oct. 2010) ("*The Reform Myth*") at 3, 6-8.

19 The plans include the 2005 Steel and Iron Industry Development Policy, the 2009 Steel Adjustment and Revitalization Plan, and the June 2010 State Council Policy.

20 *12th Five-Year Plan for the Iron and Steel Industry*, China's Ministry of Industry and Information Technology (Oct. 24, 2011).

21 *See The Reform Myth* at 17-19.

22 In fact, a recent study documented more than $50 billion in Chinese government subsidies to its steel producers as part of the government's drive to create large, state-owned, and internationally-competitive national champions. Alan H. Price, Timothy C. Brightbill, Christopher B. Weld, and D. Scott Nance, *Money for Metal: A Detailed Examination of Chinese Government Subsidies to its Steel Industry* (July 2007) ("*Money for Metal*") at 2 and iii-iv.

Other governments are pursuing a similar agenda of ownership and control of their steel industries. For example, in India, the government owns up to 85 percent of Steel Authority of India ("SAIL"), the country's largest steel producer,[23] while the Vietnamese government owns 65 percent of the country's largest steel producer, Vietnam Steel.[24] In addition, the following governments own significant shares of the large (if not the largest) steel companies in their countries: Indonesia (PT Krakatau Steel), Libya (Libyan Iron and Steel Company), Venezuela (Siderúrgica del Orinoco and Siderúrgica del Turbio SA), Pakistan (Pakistan Steel Mills Corporation), Saudi Arabia (Saudi Basic Industries Corporation), and the United Arab Emirates (Emirate Steel Industries PJSC). In fact, the Organization for Economic Cooperation and Development ("OECD") estimates that 25 of the 50 largest steel companies in the world have some level of state ownership.[25] As additional countries pursue the state capitalist model, state ownership and control in the global steel industry is likely to become even more pervasive.

C. The Increase in SOE Investment Abroad

SOE investment abroad also appears to be on the rise,[26] increasing the likelihood that market-based steel producers will be adversely impacted in global markets. China in particular is deploying its massive state-owned national champions overseas pursuant to its "Going Abroad" strategy. First announced by the government in 1999, "Going Abroad" is a government-mandated policy intended to strengthen the presence of Chinese companies abroad. Chinese industrial policies identify which entities are to go abroad, and call for government support to enable these entities to do so.[27]

China's "Going Abroad" policy has been successful to date. In 2005, Chinese outward foreign direct investment ("FDI") totaled $10.2 billion; in 2011, it rose to nearly $73 billion.[28] Overall, Chinese companies have made foreign investments totaling approximately $443.2 billion.[29] Moreover, at least 80 percent of all Chinese outward FDI has been funded by SOEs.[30] The actual figure is likely much higher, as Chinese government statistics demonstrate that private

---

23 *See SAIL Defers Follow-on Offer Due to Volatile Stock Markets*, Economic Times (Jun. 1, 2011).

24 *CORRECTED - Vietnam PM approves VNSteel privatization plan*, Reuters (Apr. 21, 2011).

25 *State Ownership in the Steel Industry: Issues for Consideration*, OECD, Directorate for Science, Technology and Industry, Steel Committee, DSTI/SU/SC (2012)6 at 6-7. Even this estimate is conservative, as the OECD limits its definition of an SOE to an entity with state ownership that exceeds 50 percent. This definition, therefore, does not take into account entities that are otherwise owned, controlled, or effectively influenced by the government (through, for example, controlling minority shares, golden shares, the ability to appoint board members, or the ability to otherwise influence the management or operations of the entity).

26 *See e.g.*, *The visible hand* at 6, 15.

27 For example, the *2009 Steel Adjustment and Revitalization Plan* encourages Chinese steel producers to "make exclusive investments or set up joint ventures abroad" and encourages "qualified backbone enterprises . . . to carry out resource exploration, development, technical cooperation and mergers and acquisitions . . . overseas."

28 Derek Scissors, Ph.D., *Chinese Outward Investment: Slower Growth in 2011*, The Heritage Foundation (Jan. 9, 2012) at Chart 1.

29 *See* Heritage Foundation, *China Global Investment Tracker Interactive Map*, available at http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map.

30 *The visible hand* at 15.

enterprises accounted for only 0.6 percent of all outward FDI from China in 2009.[31] The energy, power, and metals sectors continue to draw the largest investments from China.[32]

Chinese SOEs have made several large investments in North America in recent years, and have begun to target the steel industry. In January 2009, Chinese state-owned Tianjin Pipe Group Corp. ("TPCO") announced its plans to invest in the construction of a steel pipe plant near Corpus Christi, Texas – its first U.S. production operation.[33] In 2010, the fourth-largest Chinese steel producer, Anshan Iron and Steel ("Anshan"), announced that it was forming a joint venture with Steel Development Company to build up to five new steel plants in the United States.[34] Anshan is 100 percent owned and controlled by the central Chinese government, and several Chinese government industrial plans explicitly identify Anshan as a recipient of extensive government support in order to strengthen its international competitiveness and to assist it in establishing operations abroad.[35] In fact, Anshan itself made clear that its U.S. investment was part of the government's "Going Abroad" strategy.[36]

While Chinese SOEs are the largest and most aggressive in terms of overseas investments, other countries are beginning to follow suit with significant SOE investments abroad. In fact, four-fifths of FDI has come from state companies around the globe,[37] and North America has been a primary target. For example, as of March 2010, the United States was the destination for 36 percent of investments by Singapore's largest sovereign wealth fund.[38] Several large Singaporean investments in the United States grabbed headlines in the last decade, including SOE Singapore Technologies Telemedia's acquisition of bankrupt telecom operator Global Crossing and government-linked k1 Ventures Ltd.'s energy-related U.S. investments.[39]

In addition, state-owned Indian coal company Coal India Ltd. attempted to make a major investment in the U.S. coal sector in 2010, with a $1 billion bid to purchase a complex of eight U.S. underground coal mines from Massey Energy Company.[40] While negotiations fell through,

---

31 *See* Nargiza Salidjanova, Policy Analyst for Economic and Trade Issues, *Going Out: An Overview of China's Outward Foreign Direct Investment*, USCC Staff Research Report (Mar. 30, 2011) at 6.

32 Derek Scissors, Ph.D., *Chinese Outward Investment: Slower Growth in 2011*, The Heritage Foundation (Jan. 9, 2012) at 3-4.

33 *China's TPCO plans build of $1B pipe mill in Texas*, MetalBulletin.com (Jan. 2, 2009). This investment was made possible by massive Chinese government subsidies. *See* Wiley Rein LLP, *Facing the Challenges of SOE Investment Abroad* (June 2011) at 9.

34 *See* Wiley Rein LLP, *Facing the Challenges of SOE Investment Abroad* (June 2011) at 9-11.

35 *See id.*

36 *See id.*

37 *The visible hand* at 15.

38 *2011 Investment Climate Statement – Singapore*, U.S. Department of State, Bureau of Economic, Energy and Business Affairs (Mar. 2011).

39 *Singapore Investment Developments, Second and Third Quarter, 2003,* Embassy of the United States – Singapore.

40 Nesil Staney, *Coal India places $1-bn bid for US coal co*, The Economic Times (Dec. 17, 2010).

Coal India Ltd. has reportedly accelerated its search for overseas assets.[41] In Canada's mining sector, Brazilian iron ore producer Vale SA (in which the Brazilian government retains an ownership stake)[42] announced plans in 2010 to invest more than $9.8 billion in Canada over five years to increase metals and fertilizer output.[43]

To the extent that additional countries pursue the state capitalist model, SOE investment in North America and global markets will only increase, as will the potential negative impacts of such investment.

III. STATE-OWNED ENTERPRISES POSE CHALLENGES TO THE GLOBAL STEEL INDUSTRY AND RELATED UPSTREAM AND DOWNSTREAM INDUSTRIES

The rise of state capitalism and the resurgence of market-distorting behavior by SOEs pose significant challenges to the global steel industry. SOE investment and operations present potential market-distorting impacts in the SOE's home country, as well as in third countries. In addition to the steel industry, these potential adverse impacts affect the upstream raw materials trade and downstream steel-consuming industries.

A. The Impact of SOEs on the Global Steel Industry

SOE investment and operations in world markets may result in unfair behavior and other distortions that adversely impact North American and global steel companies and workers.[44] Many SOEs receive substantial subsidies from their government, including cash grants, below-market financing, and other support. As a result, these entities do not need to make a profit and have little incentive to make production, pricing, or other business decisions based on market principles, giving them a significant advantage over their private sector competitors. Moreover, SOEs often operate at the direction of the government and for the purpose of advancing government aims, rather than in accordance with commercial principles.

The potential adverse economic impact of SOE participation in the marketplace and investment abroad has been well documented. For example, the OECD has released a number of reports detailing the rise of SOE investment abroad and the related anti-competitive effects and market distortions that may result, both in the SOE's home market and in markets around the world. The OECD has concluded that:

---

41 Rajesh Kumar Singh, *Coal India to Quicken Search for Overseas Mines as Domestic Output Drops*, Bloomberg (Nov. 2, 2011).

42 *See* Juan Pablo Spinetto, *Vale Names Former Canada Head Ferreira CEO After Brazil Government Concern*, Bloomberg Businessweek (Apr. 5, 2011).

43 *See* Heather Walsh and Bill Koenig, *Vale Sees C$10 Billion Investment in Canada in 5 Years*, Bloomberg Businessweek (Nov. 17, 2010); Peter Koven, *Vale approves $2B clean air project in Sudbury*, World Financial Post (Feb. 16, 2012).

44 SOE investment and operations also raise national security and other strategic concerns that are not addressed in this paper.

> In most instances, SOEs enjoy privileges and immunities that are not available to their privately-owned competitors. These privileges give SOEs a competitive advantage over their rivals. Such advantages are not necessarily based on better performance, superior efficiency, better technology, or superior management skills but are merely government-created and can distort competition in the market.[45]

The various distortions caused by SOE investment and operations in global markets are discussed in further detail below.

1. Government Subsidies and Other Benefits Provide SOEs with Unfair and Market-Distorting Competitive Advantages

SOEs often receive massive subsidies and other benefits from their government, which bestow an unfair competitive advantage on SOEs in their worldwide operations.[46] While the Chinese government is well known for providing massive subsidies and other assistance to its steel producers, other governments around the globe also provide direct and indirect benefits to their steel producers.[47] Some of the most significant ways in which governments benefit their SOEs and distort the global marketplace are described below.

- Direct subsidies: Governments often provide direct subsidies to their SOEs in the form of cash grants and/or capital infusions.[48] Chinese steel companies, for example, have reported receiving more than $280 million in cash grants and equity infusions in recent years.[49] Baosteel, Maanshan Iron & Steel, Jinan, JISCO, Baotou, Wuhan, and Shougang, each of which are state-owned, have all reported receiving direct subsidies from the Chinese government.[50]

- Preferential loans and access to finance: State policy banks and state-owned commercial banks often make loans based on political directives, rather than creditworthiness or other

---

45 *Competitive Neutrality and State Owned Enterprises: Challenges and Policy Options*, OECD Corporate Governance Working Papers, No. 1 (May 2011) ("May 2011 OECD Paper on Competitive Neutrality and SOEs") at 5.

46 In addition to the anti-competitive effects in global markets, SOEs often fail to benefit the local economies in which they invest. For example, Chinese SOEs often import Chinese labor and equipment to use in their operations abroad, rather than employing local workers or using locally-manufactured equipment. *See, e.g.*, Martyn Davies, *How China Is Influencing Africa's Development*, OECD Development Centre (Apr. 2010) at 21 (noting the "widespread usage of expatriate Chinese labour where local labour could often be utilised").

47 *See, e.g.*, Commission's 2011 Report to Congress at 40 (China's state-owned and state-controlled companies "receive massive government subsidies and are protected from foreign competition").

48 *See* Andrew Szamosszegi and Cole Kyle, *An Analysis of State-owned Enterprises and State Capitalism in China*, prepared for the U.S. China Economic and Security Review Commission (Oct. 26, 2011) ("Analysis of Chinese SOEs and State Capitalism") at 20.

49 *Money for Metal* at 25-31.

50 *Id.* at 30-31.

market-based factors.[51] Government-owned banks also frequently make loans to SOEs on preferential terms. For example, as reported by *The Economist*, Chinese SOEs enjoy favorable interest rates on loans from state-owned banks, paying only 1.6 percent interest on such loans, while private companies are charged 4.7 percent interest – if they can access credit at all.[52] In fact, approximately 85 percent of China's $1.4 trillion in bank loans went to state-owned companies in 2009.[53] Such concessionary funding is often used to finance an active foreign acquisition strategy for SOEs.[54]

- <u>Tax reductions and exemptions</u>: Many SOEs benefit from preferential tax rates and exemptions from both central and/or provincial governments. U.S. regulatory filings for firms owned by foreign SOEs demonstrate that "many SOEs and subsidiaries were beneficiaries of preferential tax rates."[55] In China, in particular, the "government has long used lower tax rates to reward firms for undertaking investments, procuring goods and services, and performing other activities that market incentives alone would not support."[56]

- <u>Preferential access to raw materials and other inputs</u>: As discussed in detail below, governments also support their SOEs and other domestic manufacturers by ensuring them adequate supplies of low-priced raw materials, often at below market prices. In addition, certain governments have imposed various export restrictions on steel-making raw materials and rare earth elements; China has done so, even though it is the largest source of many of these materials. This can cause supply crises for manufacturers around the world, while providing domestic companies with an unfair competitive advantage. The World Trade Organization's ("WTO") Appellate Body recently upheld a dispute settlement panel's finding that China had violated several of its commitments by imposing WTO-inconsistent export restrictions on raw materials, including bauxite, coke, and zinc.[57]

- <u>Preferential regulatory treatment</u>: SOEs are often not subject to the same costly regulatory regimes as private companies, resulting in lower operating costs than their

---

51 *See* Stephen Lacey, *How China Dominates SolarPower*, The Guardian (Sept. 12, 2011) ("The [China Development Bank ('CDB')] was originally set up as a 'policy bank,' to operate as an arm of the Chinese central government. ... Now it … reports to China's national cabinet on certain policy issues … [allowing] the Chinese government to get involved in CDB activities and direct loans…").

52 *The visible hand* at 15. The World Trade Organization ("WTO") recognized in 2010 that domestic private enterprises in China, as opposed to SOEs, were finding it more difficult to access credit from banks. *See* WTO, Trade Policy Review of China, Report of the Secretariat, WT/TPR/S/230 (Apr. 26, 2010) at 54.

53 *The visible hand* at 7.

54 *See Competitive Neutrality in the Presence of State Owned Enterprises*, OECD, DAF/CA/PRIV(2010)I, (Apr. 2, 2010) ("OECD Paper on Competitive Neutrality") at 7; *The Corporate Governance of SOEs Operating Abroad*, OECD, DAF/CA/PRIV(2009)8 (Oct. 8, 2009) ("*Corporate Governance of SOEs Operating Abroad*") at 10.

55 Analysis of Chinese SOEs and State Capitalism at 45.

56 *See id.* at 45.

57 *China – Measures Related to the Exportation of Various Raw Materials*, Reports of the Appellate Body, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (Jan. 30, 2012).

private competitors. Such preferential treatment includes: exemption from regulatory regimes such as antitrust enforcement, zoning regulations, or disclosure regulations; preferences in government procurement; and preferential tax treatment, including tax exemptions, reductions, or other tax-related concessions.[58]

All of these subsidies and other benefits artificially lower SOEs' costs and enhance their ability to sell at lower prices than their private sector competitors. Thus, the potential repercussions of government subsidies to SOEs include predatory pricing and raising rivals' costs.[59] In addition to lowering profits for private companies and potentially threatening their survival, "[p]redation or raising rivals' cost takes away the ability for [private] competitors to invest in increased research and development and limits their ability to roll out new products and services and processes that increase dynamic gains from innovation."[60] Beyond unfair cost advantages, some unprofitable SOEs, which in a free market would be driven out of business, "may enjoy outright exemptions from bankruptcy rules."[61] Indeed, the ability to sustain losses for longer periods of time and not having to earn a commercial rate of return provide SOEs with a significant competitive advantage over their private sector counterparts. The OECD also notes the possibility for "cross-subsidization" of SOEs, which can occur where SOEs "charg[e] excessive revenues in certain 'lucrative' areas in order to be able to fund the public service obligations elsewhere."[62]

A number of additional market-distorting effects result from the fact that control of an SOE cannot be transferred as easily as in privately-owned firms. These advantages include: some SOEs are not required to pay dividends or any return to shareholders; SOEs will be more inclined to engage in anti-competitive (and rarely profitable) exclusionary pricing strategies without fear of falling stock prices when losses are incurred due to the below-cost pricing; and SOEs' management will have less incentive to operate the enterprise efficiently as it is not subject to the threat of takeovers and is generally impervious to the disciplining effects of capital markets.[63]

Moreover, the asymmetric availability of information and lack of transparency that characterize state-dominated economies can create market distortions. If SOEs have access to government information, including classified or market intelligence, while their private competitors do not, then these entities trade at what could be an unfair advantage, distorting and undermining confidence in the market.[64]

---

[58] *See OECD Paper on Competitive Neutrality* at 6-7 and 20.

[59] May 2011 OECD Paper on Competitive Neutrality and SOEs at 6; *Corporate Governance of SOEs Operating Abroad* at 9-10.

[60] May 2011 OECD Paper on Competitive Neutrality and SOEs at 19.

[61] *Id.* at 6.

[62] *Id.* at 8.

[63] *Id.* at 7-8.

[64] *Corporate Governance of SOEs Operating Abroad* at 10-11.

Most of the above-noted distortions created by SOE involvement in the marketplace adversely impact the competitive environment in the SOE's home country market as well, making it more difficult for North American and other companies to compete on a level playing field in China and other countries in which the state plays a dominant role in the market. Indeed, the provision of subsidies and other benefits, access to concessionary financing, preferential regulatory treatment, and other privileges and immunities granted to SOEs provide these entities a competitive advantage in their own home market over their private sector competitors. These privileges and immunities are often reinforced with discriminatory market access and government procurement policies that serve to protect favored industries and national champions.[65] Indeed, China has implemented policies that discriminate against certain imported goods, in derogation of its obligation to provide treatment no less favorable than that accorded to domestic like products. As noted above, China also restricts foreign investment in certain industries, including the steel industry.[66] Finally, the same subsidies and other benefits granted to SOEs allow them to export dumped and subsidized products around the world, causing further market distortions, as discussed in the case study below.

These distortive effects essentially cause market-based steel companies to compete in global markets against foreign governments (with all of their resources and power), rather than against similarly-situated foreign companies. The resulting effects create unfair conditions experienced by companies in markets around the globe. Not surprisingly, in many cases, FDI through SOEs into global markets has pushed out local companies, who are unable to compete with heavily subsidized SOEs.[67] As steel-making SOEs increasingly invest abroad, the potential for adverse impacts in the North American and global steel markets will grow.

2. Case Study: The Chinese Steel Industry

The Chinese steel industry demonstrates the market-distorting effects of state capitalism and government subsidies. Over the past decade, China's steel industry has expanded at a phenomenal rate, capturing virtually all of the world's growth in steel production. From 2000 to 2011, Chinese steel production increased by more than 430 percent, growing from 128.5 million metric tons to 683.3 million metric tons, even though steel production in the rest of the world increased by less than 12 percent.[68] As these figures indicate, China's growth has come at the expense of the rest of the global steel industry – China's share of world production jumped from 15 percent in 2000 to 46 percent in 2011.[69]

This unprecedented growth is inconsistent with commercial considerations, and is largely a result of massive government intervention, including ownership, control, and subsidization – at

---

65 Robert D. Hormats, *Ensuring a Sound Basis for Global Competition: Competitive Neutrality*, DipNote: U.S. Department of State Official Blog (May 6, 2011).

66 *See The Reform Myth* at 17-19.

67 *See, e.g.*, Stanley Kwenda, *Zimbabwe: Chinese become unwelcome guests*, TradeMark Southern Africa (Jan. 9, 2012).

68 *Steel Statistical Yearbook 2011*, World Steel Association (2011) at 5. *See also* Steel Production Archive, World Steel Association.

69 *Id.*

the expense of market-oriented steel producers around the globe. Indeed, China's dramatic increase in steel production has occurred despite financial returns in the Chinese steel industry that are well below those achieved by other steel industries. According to World Steel Dynamics, the Chinese steel industry's average earnings before interest, taxes, depreciation, and amortization ("EBITDA") over the last decade has been much lower than that of the rest of the world.[70] Even compared to China's other industries, the steel industry's profits are low.[71] In fact, as *Reuters* recently reported, the Chinese steel sector "has seen margins plummet and has racked up a mountain of debt as it tries to serve the twin masters of the state and the market."[72] The industry is estimated to have $400 billion in debt, caused primarily by losses incurred by China's largest SOEs.[73] For example, state-owned Baosteel, one of the largest steel producers in China, experienced a 43 percent drop in net income in 2011, while state-owned Anshan posted a loss of more than $340 million.[74]

The fact that the Chinese steel industry continues to lose money while at the same time adding massive new capacity is the result of China's state capitalist model. As one Chinese policy analyst has noted: "The big state-owned steel mills are motivated not so much to seek profits but to seek government support. There is actually no mechanism to put them out of business, no sense of the survival of the fittest, and that is probably the biggest problem facing the sector."[75] Indeed, Chinese state-owned steel companies "serve[] the needs of local governments, hiring hundreds of thousands of workers and providing cradle-to-grave welfare services."[76]

As a result, Chinese SOEs continue to produce steel and add new capacity without regard for market forces (such as the need to earn a commercial rate of return). The impact, as noted above, is a decrease in world market share for the remainder of the global steel industry. Moreover, as production and capacity have skyrocketed, Chinese steel-producing SOEs have increasingly exported dumped and subsidized steel products to markets around the world, injuring steel industries and distorting the entire global market for steel. For example, Chinese exports of finished and semi-finished steel products – much of them unfairly subsidized and dumped – increased by nearly 275 percent from 2000 to 2010,[77] prompting numerous countries

---

70 *Global Steel Finance #14*, World Steel Dynamics (July 2, 2010) at 26. On average, from 2005-2010(e), China's steel industry was approximately half as profitable as the rest of the world. *Id.* at 22, 24.

71 CRU reports that the Chinese steel industry's profit margin is about half of the average profit margin for industry overall in China. *Official Steel Policy in China to Remain Stable, Despite Low Profit Margins*, CRU Steel News Daily (Sept. 16, 2010).

72 *In China's Floundering Steel Sector, the Burden of Politics*, Reuters (May 3, 2012).

73 *Id.*

74 *Id.*

75 *Id.*

76 *Id.*

77 *Steel Statistical Yearbook 2010*, World Steel Association (2010) at 63; *Steel Statistical Yearbook 2011*, World Steel Association (2011) at 63.

around the world to impose trade remedies.[78] Chinese government subsidies and other state support have also caused harm to market-based producers in the rest of the world in the form of reduced capacity expansion, production, sales, and profits. As Chinese and other steel-producing SOEs continue to invest and operate abroad, the potential adverse impacts will only become more severe.

B. The Impact of SOEs on the Trade in Raw Materials

SOE investment and operations may also result in distortions to the global raw materials market. The market for raw materials, including those for steel-making, has grown more competitive in recent years, as strong economic growth and increased manufacturing in developing countries over the past decade have caused the world's appetite for raw materials to grow significantly.[79] Increased consumption has fueled a race to secure access to raw materials worldwide – a race in which SOEs are increasingly participating.[80]

The result has been cost increases for an array of commodities, from iron ore and steel scrap to crude oil and natural gas, as well as concerns about raw material shortages.[81] However, the raw materials trade is not being driven purely by market-based factors like supply and demand. Rather, many governments across the globe are increasingly intervening in commodity markets to acquire raw materials, protect their domestic industries, and sustain economic growth, often through the use of their SOEs. In fact, Ernst and Young notes that "[p]erhaps the most significant trend [in mergers, acquisitions, and capital raising in mining and metals in 2011], but the hardest to track, was the indirect funding by state-owned Asian enterprises in early stage projects in return for off-take agreements."[82] The increasing involvement of governments and SOEs in the procurement and trade of raw materials may cause distortions in the raw materials market, as described below.

1. SOEs and the Race for Raw Materials

With increasing frequency and intensity, SOEs have been acquiring sources of raw materials around the world, as part of a government-led effort to give their domestic industries, and especially steel industries, preferential access to essential inputs at low prices. Many

---

78 According to WTO data, from 1995 through 2011, 147 antidumping duty orders and 18 countervailing duty orders have been imposed on unfairly-traded Chinese exports of "base metals and articles of base metal," the harmonized system category which includes steel and steel products. *Antidumping*, World Trade Organization, http://www.wto.org/english/tratop_e/adp_e/adp_e.htm.

79 For example, "China/Asia has dramatically increased its share of world consumption of key metals and minerals over the past two decades. The drivers of this trend remain intact." *Asia's Importance for African and Global Mining*, The Beijing Axis (Feb. 7, 2012) at 12.

80 *Metals Deals Forging Ahead: 2012 outlook and 2011 review*, PricewaterhouseCoopers (2012) at 7 ("The quest for security of supply and reduced dependence on the contract pricing strategies of the large mining companies remains a main deal driver that will continue into 2012").

81 *See Minerals and metals scarcity in manufacturing: the ticking time bomb,* PricewaterhouseCoopers Accountants N.V. (Dec. 2011).

82 *Mergers, acquisitions and capital raising in mining and metals: 2011 trends 2012 outlook,* Ernst & Young (2012) at 25.

governments are mobilizing public resources, often through their SOEs, to target overseas markets and tilt global raw materials trade in their favor. China, for example, uses SOEs, state-owned banks, and its sovereign wealth fund to subsidize the acquisition of raw materials abroad.[83] Indian SOEs have also stepped up government-supported overseas acquisitions of raw materials, such as iron ore and coal, in recent years.[84] Other countries are beginning to follow this lead, so as not to let their domestic industries fall behind in the raw materials race.

China, in particular, has undertaken significant efforts to secure access to raw materials around the globe, and is using its numerous SOEs to do so.[85] As the world's largest consumer of iron ore and many other steel-making raw materials,[86] China relies heavily on imports to satisfy its growing demand.[87] In 2011, China imported 686 million metric tons of iron ore, an increase of 11 percent over 2010 levels,[88] and China's iron ore imports are expected to reach a staggering 1 billion tons by 2015.[89] To ensure readily available and cheap iron ore and other raw materials for its domestic industries, the Chinese government has mobilized its SOEs to target mineral-rich countries, and is actively assisting in acquisitions abroad.[90]

Since 2005, Chinese companies, including many SOEs, have invested over $85 billion in metals sectors worldwide.[91] China has pumped billions of dollars into investments around the world to secure large supplies of low-priced raw materials for its domestic manufacturers, and its overseas acquisitions are not slowing. For example, in September 2011, China Niobium Investment Holding Company, a consortium of five Chinese SOEs, paid $1.95 billion for a 15 percent stake in Brazilian niobium producer Cia Brasileira de Metalurgia e Mineracao ("CBMM").[92] Moreover, a $2 billion agreement by China National Bluestar Group to purchase

---

83 *See* Wiley Rein LLP, *Raw Deal: How Governmental Trade Barriers and Subsidies Are Distorting Global Trade in Raw Materials* (Nov. 2008) ("*Raw Deal*") at 1.

84 *See, e.g.*, Priyadarshi Siddhanta, *NMDC goes all out on global acquisitions*, Indian Express (May 8, 2012).

85 "The past five years represented an international resource acquisition spree for China. Deals in the resource sector have consistently constituted a large portion of its international acquisitions… State-owned enterprises are the main players in China's overseas investment." Kobus van der Wath, *The Global Context: How will China/Asia affect demand and will investment in South Africa continue?*, The Beijing Axis (Sept. 15, 2011) at 33, 41.

86 *See China's 2011 Iron Ore Imports Gain 11% as Steel Output Rises*, Bloomberg (Jan. 10, 2012).

87 Kobus van der Wath, *The Global Context: How will China/Asia affect demand and will investment in South Africa continue?*, The Beijing Axis (Sept. 15, 2011) at 12-16.

88 *See China's 2011 Iron Ore Imports Gain 11% as Steel Output Rises*, Bloomberg (Jan. 10, 2012).

89 *WRAPUP 1-China's iron ore imports seen soaring to 1 bln T*, Reuters (Sept. 28, 2011).

90 *See Raw Deal* at 14-20.

91 *China Global Investment Tracker Interactive Map*, The Heritage Foundation, available at http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map.

92 China Niobium is an investor group comprising Chinese state-owned investment company CITIC Group and Chinese steelmakers Baosteel Group, Anshan Iron & Steel Group, Shougang Corporation, and Taiyuan Iron & Steel Group Company. *See* Ruby Lian and Denny Thomas, *China Baosteel group buys $1.95 bln stake in Brazil CBMM*, Reuters (Sept. 2, 2011); *Forging ahead: Third-quarter 2011 global metals industry mergers and acquisitions analysis,* PricewaterhouseCoopers LLP (2011) at 6.

Norway-based Elkem was announced in early 2011, under which Bluestar gained ownership of Elkem Silicon Materials, Elkem Foundry Products, Elkem Carbon, and Elkem Solar.[93] As yet another example, early this year, China's Minmetals Resources succeeded with a $1.3 billion bid for Africa-focused copper miner Anvil Mining.[94]

Notably, in 2011, Beijing announced a policy encouraging companies to seek overseas investments in iron ore, with an ultimate goal of 50 percent of China's iron ore imports coming from Chinese-invested mines. SOEs are following through on this policy.[95] Last year, Wuhan Iron and Steel, China's state-owned and third-largest steelmaker, invested $240 million in Canada's Consolidated Thompson Iron Mines.[96] Also in 2011, the Shandong Iron & Steel Group acquired a 25 percent stake in an African Minerals iron ore project in Sierra Leone for $1.5 billion.[97] In addition, Hebei Iron & Steel Group, an SOE and China's largest steel producer, recently announced that it will invest about $195 million for a stake in Canadian iron ore developer Alderon Iron Ore Corp.[98]

India has also been at the forefront of government-led raw materials acquisitions. For example, NMDC, a state-run mineral producer in India, recently engaged in a spree of mine purchases worldwide. The company bought a $150 million majority stake in Brazilian iron ore company Amplus, which reportedly has iron ore reserves of 1.5 billion metric tons,[99] and it has announced plans to acquire three mines in Russia.[100] India's state-owned SAIL is reported to have purchased rights to develop a major iron deposit in Afghanistan in late 2011.[101] Moreover, in March 2012, International Coal Ventures Ltd. ("ICVL"), a five-member consortium formed to explore coal assets overseas and whose lead partner is SAIL, announced that it is in the final stages of acquiring a coking coal mine in Australia.[102] ICVL is also in advanced negotiations to

---

93 *Forging ahead: First-quarter 2011 global metals industry mergers and acquisitions analysis,* PricewaterhouseCoopers LLP (2011) ("Forging Ahead Q1 2011") at 8.

94 Minmetals, which is 72 percent owned by China's biggest SOE metals trader, wanted Anvil for its Congo copper project. Sonali Paul, *UPDATE 3-China's Minmetals wins $1.3 bln Anvil bid, eyes more*, Reuters (Feb. 17, 2012). Minmetals' CEO has stated that the company will continue looking for copper, zinc, and nickel sulphide assets in Africa, North and South America, parts of Asia, and Australia.

95 *See* Leslie Hook, *China steel consortium takes Brazil stake*, Financial Times (Sept. 2, 2011).

96 Wuhan acquired a 19.9 percent stake in Thompson and a 25 percent stake in a mine. Robert Gibbens, *World buyers boost iron-ore mining*, Montreal Gazette (Apr. 27, 2011).

97 *See* Esmarie Swanepoel, *Shandong completes $1.5bn Tonkolili investment*, miningweekly.com (Apr. 3, 2012); Christopher Thompson, *African Minerals seals $1.5bn China deal*, Financial Times (Aug. 1, 2011).

98 *China's Hebei to invest $195 mln in Canada iron ore miner*, Reuters (Apr. 13, 2012).

99 Shivom Seth, *India's NMDC to take majority stake in Brazilian iron ore miner plus others*, Mineweb (Mar. 14, 2012).

100 Priyadarshi Siddhanta, *NMDC goes all out on global acquisitions*, Indian Express (May 8, 2012).

101 Matthew Green and James Lamont, *Indian company wins Afghan iron ore deal*, Financial Times (Nov. 28, 2011).

102 *ICVL may buy coal mine in Australia soon*, The Economic Times (Mar. 13, 2012).

buy a 59 percent stake in Talbot Group's Mozambique mines and plans to acquire access to two coal mines in Indonesia.[103]

Other countries are pushing their SOEs into the global raw materials race as well. For example, a grouping of Japanese and South Korean companies, including government-funded Japan Oil, Gas & Metals National Corp. and South Korea's National Pension Service, bought a combined 15 percent stake in Brazilian niobium producer CBMM for $1.8 billion in March 2011.[104] "The rationale behind this deal was to gain long-term access to columbium, an alloy additive needed for certain types of steel production."[105] In addition, New Zealand SOE Solid Energy purchased Pike River Coal mine in that country in March 2012.[106]

2. <u>SOE Participation in the Raw Materials Market Causes Major Distortions</u>

The involvement of government-supported SOEs in raw materials procurement puts private companies at a significant disadvantage in accessing raw materials and may result in anti-competitive effects throughout the market.[107] Manufacturing industries located in countries that are interfering in raw materials markets obtain a significant unfair competitive advantage through their access to guaranteed and low-priced inputs, while manufacturers in North America and elsewhere may face limited supplies and higher prices for strategic raw materials.[108]

The same market-distorting impacts caused by SOE participation in the global steel industry, discussed in Section III.A above, occur in raw materials markets when SOEs receive subsidies and other government benefits to acquire raw materials. In particular, such benefits artificially lower SOEs' costs of production, allowing them to sell at lower prices than their private sector competitors. The provision of other inputs, such as energy, at subsidized prices by governments in countries like China and Russia[109] similarly lowers SOEs' cost of production

---

[103] Meera Mohanty, *International Coal Venture Ltd likely to go slow on buyouts*, The Economic Times (July 16, 2011).

[104] *See* Ruby Lian and Denny Thomas, *China Baosteel group buys $1.95 bln stake in Brazil CBMM*, Reuters (Sept. 2, 2011). As noted above, a Chinese SOE also purchased a 15 percent stake in CBMM several months later.

[105] Forging Ahead Q1 2011 at 8.

[106] Alan Wood and Rachel Young, *Pike River mine sold to Solid Energy*, stuff.co.nz (Mar. 9, 2012).

[107] *See* A.S. Firoz, *Competitiveness and Competition Issues in the Context of the Steel Industry in India* (Oct. 1, 2008) at 25 ("[Difficulty arises w]hen the iron ore consumer, say, a steel producer[,] is provided with a iron ore or coal mining lease grant, at a price/cost that has no relevance to the value of the asset and this happens especially when other producers who are dependent on the same raw material are not blessed with the same conditions. It is like providing land or capital goods to one free of cost and to another at market prices to do the same business.").

[108] "For industrial consumers, access to raw materials under non-discriminatory and market-based conditions is crucial for their competitiveness." Adrian van den Hoven and Anka Schild, *Trade in natural resources and the business community: what is at stake?*, WTO (May 18, 2010).

[109] "The European Union and the United States have raised concerns about Russian energy pricing policies which allow natural gas, oil, and electricity to be sold domestically far below world prices providing, they argue, a subsidy to domestic producers of fertilizers, steel, and other energy-intensive goods." William H. Cooper, *Russia's Accession to the WTO*, CRS Report to Congress (Jan. 7, 2008). *See also*, Alan Grimmond, *Energy Subsidies in the Steel Industry* (May 13, 2011) at 37.

relative to their private competitors. Government-guaranteed access to critical raw materials and other inputs bestows a significant unfair competitive advantage on SOEs in their competition with private companies which must procure raw materials in the open market.

In addition, large-scale acquisitions of raw materials by SOEs lead to a reduction in the global supply of raw materials, many of which are already scarce, and may cause shortages in some essential materials.[110] Such uncertainties cause increased price volatility and higher international prices.[111] This also raises concerns that, in times of supply shortages, raw materials owned and controlled by SOEs will be used to supply domestic consumers (such as steel manufacturers) rather than customers in North America and other countries, despite the willingness of the latter to pay market prices.[112] This would give manufacturers in countries with raw material-rich SOEs a decided, and unfair, advantage in international competition.

Moreover, policies encouraging overseas raw materials acquisitions by SOEs often appear in conjunction with other government practices designed to secure preferential raw materials access, such as export restrictions, compounding these distortive impacts. China is well-known for imposing such restrictions, and the WTO's Appellate Body recently affirmed a finding that Chinese export restraints on materials such as bauxite, coke, and zinc violated WTO rules.[113] Other countries with active state-owned sectors also impose such restrictive measures. India, for example, requires that exports of high grade iron ore pass through state trading enterprises, with the state-owned Minerals and Metals Trading Company as a clearinghouse. As USTR has noted, "it appears the Indian government is using these measures to improve supply and lower prices of inputs used by India's rapidly growing steel industry."[114] While the Russian steel industry is largely privately owned, Russia discourages scrap exports by restricting the ports from which scrap may be exported, in part to assist a Russian state-owned steel producer.[115]

---

110 For example, global demand for iron ore – the target of many SOE raw material acquisitions abroad – is expected to exceed supply over the next three years. Matt Pieterse, *China's Impact on Global Commodity Markets and Increasing International Investment*, The Beijing Axis (Apr. 13, 2011) at 23.

111 *See* Adrian van den Hoven and Anka Schild, *Trade in natural resources and the business community: what is at stake?*, WTO (May 18, 2010); *Dutch Government Policy Document on Raw Materials,* The Netherlands Ministry of Foreign Affairs (Sept. 5, 2011) at 3 ("There are also signs that the transparency of trade and the regulating power of the market are diminishing… [T]here is increasing state intervention in the security of raw material supplies throughout the world. Such distortions cause supply to fall behind demand, which in turn leads to stronger price fluctuations and concern among businesses about the availability of raw materials for their production processes").

112 "Raw materials are also being politicised to achieve foreign and economic objectives, for example, by excluding deliveries in the event of conflicts, as political small change in international forums or to obtain investment, loans and trade preferences." *Dutch Government Policy Document on Raw Materials* (Sept. 5, 2011) at 6.

113 *See China - Measures Related to the Exportation of Various Raw Materials,* Reports of the Appellate Body, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (Jan. 30, 2012) at 4.

114 *2011 National Trade Estimate Report on Foreign Trade Barriers,* Office of the U.S. Trade Representative (2011) at 182.

115 Reports indicate that Russia has closed many ports in its Far East, including Vladivostok, to exports of steel scrap and has proposed prohibiting the export of scrap from two of its important ports, Rostov-on-Don and its largest port in St. Petersburg, in order to assist Russian state-owned steel producer Amurmetal. *Access to Raw*

Indonesia, for its part, has just instituted a complete ban on exports of all unprocessed minerals, including nickel, bauxite, and iron.[116] Thus, where SOEs are active, many governments also appear to be using other measures, such as export restrictions, to assist their SOEs and ensure preferential access to raw materials for their domestic industries, thereby distorting the global market for these materials.

Government efforts to provide steel industries with preferential access to raw materials run directly counter to the principles underlying the international trading system – namely, that trade should be based on commercial and market principles rather than political interests and government funds. If this continues, global steel companies could find it increasingly difficult to procure raw materials globally. The trend further risks responses by other countries committed to the free and market-based flow of goods internationally.

In sum, the government-subsidized acquisition of raw materials by SOEs gives those countries' manufacturing industries an unfair competitive advantage, making them more cost-competitive and profitable than they would otherwise be in an open global market, and distorts prices and supply in the entire world market for raw materials.

C. The Impact of SOEs on Downstream Steel-Consuming Industries

When state-owned steel manufacturers receive preferential treatment, including low-cost raw materials, from their governments, the resulting imbalances can also be seen in the market for downstream goods. The effect of many government benefits, such as the provision of cheap raw materials, is to make larger quantities of primary and intermediate products in a particular sector available domestically at lower prices than in the rest of the world. This gives the country's downstream producers of finished products, which use the subsidized primary and intermediate products as inputs, an unfair competitive advantage over foreign downstream producers.[117] For example, subsidies to steel manufacturers allow them to sell steel products at unfairly low prices, and the effects of the government benefits thus trickle down to their customers in downstream steel-consuming industries. Governments may also direct the provision of raw materials and intermediate steel inputs at less than adequate remuneration to certain favored industries or companies pursuant to policies to promote the production of key steel products, thereby conferring an unfair advantage even more directly.

Separately, and in addition to the effects on the steel supply chain, governments have taken measures to increase their ownership and control over downstream steel-consuming

---

Materials: BIR and EFR Express Concern Regarding Russia's Intention to Limit Scrap Exports, Bureau of International Recycling (Feb. 24, 2011). *See also Russia Bans Scrap Exports From Far East From 13 February*, Steel Business Briefing (Jan. 18, 2012) ("The decision was made in order to assist Russia's only Far Eastern steel producer - working exclusively on scrap - Amurmetal. The mill is currently owned by the state controlled Vnesheconombank (VEB), following a bailout initiated by Putin in 2009").

[116] *Indonesia to ban bauxite exports?,* CRU: The Independent Authority; Yoga Rusmana, *Nickel-Ore, Bauxite Exports From Indonesia to Drop on Ban*, Bloomberg (Mar. 20, 2012).

[117] *2011 National Trade Estimate Report on Foreign Trade Barriers,* Office of the U.S. Trade Representative (2011) at 68.

industries, causing distortions in those markets and putting market-based downstream industries in other countries at a competitive disadvantage.

In China, for example, the government exerts significant ownership and control over the automotive and auto parts industries, which are major steel consumers. For decades, China's automotive industry has been designated as a "pillar industry," and "it continues to play a central role in the government's economic development policies today."[118] The Chinese government has intensified its control over the automobile and auto parts industries, naming the automotive industry as one of its ten industries for revitalization in 2009.[119] "New energy" automobiles and their parts are designated as one of seven "strategic and emerging industries" in China's 12th Five-Year Plan.[120] In addition to industrial policies, the Chinese government grants substantial subsidies to its automobile and auto parts manufacturers.[121] Such benefits include reduced corporate income tax rates, subsidized loans from state-owned banks, low-interest export credit financing, discounted export credit insurance,[122] and policies to discriminate against foreign auto parts.[123] By some estimates, the Chinese auto-parts industry received about $27.5 billion in government subsidies from 2001 to 2011.[124]

The Chinese government also exercises control over the industry through direct ownership. The government has always owned portions of China's automobile and auto parts industries,[125] and there have been recent signs that it intends to increase its ownership even further, urging SOEs to purchase private rivals.[126] Moreover, SOEs in the auto sector are working together to advance the government's industrial policy goals. In 2010, 16 Chinese SOEs formed the Electric Vehicle Industry Alliance, led by the State-owned Assets Supervision and Administration Commission ("SASAC"), to "promote the unification of electric car-related technologies, …master the core technology for electric vehicles and build internationally competitive Chinese electric car brands."[127]

---

118 Law Offices of Stewart and Stewart, *China's Support Programs for Automobiles and Auto Parts Under the 12th Five-Year Plan* (Jan. 2012) ("*China's Support Programs for Automobiles and Auto Parts*") at ii.

119 *See* Clarence Kwan, *The Changing Face of Competition – China's Plans for Industry Revitalization*, Deloitte (Apr. 2009).

120 *China's Support Programs for Automobiles and Auto Parts* at ii.

121 *See, e.g.*, Usha C.V. Haley, *Putting the pedal to the metal: Subsidies to China's auto-parts industry from 2001 to 2011*, EPI Briefing Paper #316 (Jan. 31, 2012) ("*Putting the pedal to the metal*").

122 *See China's Support Programs for Automobiles and Auto Parts* at iii.

123 *2011 National Trade Estimate Report on Foreign Trade Barriers*, Office of the U.S. Trade Representative (2011) at 62.

124 *Putting the pedal to the metal* at 1.

125 *See* Wan-Wen Chu, *How the Chinese government promoted a global automobile industry* (Apr. 5, 2011) at 5-10.

126 *See* Michael Forsythe, *China Inc.*, Bloomberg (Oct. 13, 2010).

127 *16 state-owned companies form electric auto alliance*, People's Daily Online (Aug. 18, 2010).

The Chinese government's ownership and control of downstream steel-consuming industries appears to be having its intended effect. In 2010, "China exported $48 billion of auto parts to the world, more than four and-a-half times the value of its auto parts exports in 2004... In the first eleven months of 2011, China's auto parts exports [grew] by 27 percent compared to the same period in 2010."[128] With about a quarter of China's auto parts exports going to the United States,[129] these production and export increases, spurred on by government subsidies, have negatively affected North American auto parts producers.[130] Moreover, there are signs that China's state-owned auto parts producers will increasingly invest abroad, including in North America, posing further competitive challenges for global producers.[131]

IV. POLICY OPTIONS FOR ADDRESSING THE MARKET-DISTORTING CHALLENGES POSED BY SOES

A. Confronting the Challenges Posed by SOEs

As discussed above, the growing involvement of SOEs in the global steel industry, the raw materials market, and downstream industries presents unique challenges that can harm competitiveness in global markets if left unaddressed. Indeed, the potential for distortive behavior and other imbalances will increase if state actors are allowed to operate in markets based on government directives rather than commercial principles.

A number of governments around the world have recognized the challenges to fair competition resulting from the expansion of SOEs in the commercial marketplace and have implemented mechanisms to address such challenges.[132] Canada, for example, has implemented a mechanism to review larger foreign investments for their "net benefit" to Canada. The legislation includes national security provisions and guidelines for SOE investments, in part to determine whether foreign SOEs will adhere to Canadian standards of corporate governance and whether the entity will continue to operate on a commercial basis after the SOE acquisition or investment.[133] The OECD has also been active in studying the effects of SOE involvement in the commercial sector and policy options available to counteract any negative effects. However, many other countries, including the United States, do not currently have adequate national

---

128 *China's Support Programs for Automobiles and Auto Parts* at 73.

129 *Id*. at 74.

130 *See* Doug Palmer, *Lawmakers press Obama on China auto parts*, Reuters (Jan. 31, 2012).

131 *See, e.g.*, David Sedgwick, *Govt. sends China's suppliers shopping for U.S. technology*, Automotive News (Jan. 16, 2012); Han Tianyang, *State-owned AVIC buys US-based Nexteer*, China Daily (Apr. 11, 2011); Joseph B. White and Norihiko Shirouzu, *In the Heart of the Rust Belt, Chinese Funds Provide the Grease*, The Wall Street Journal (Feb. 11, 2012).

132 For example, the Australian Government introduced a "competitive neutrality" policy in 1995, with the goal of removing market distortions caused by state-owned businesses. As defined by the Australian Government, "[c]ompetitive neutrality requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership." *Commonwealth Competitive Neutrality Policy Statement*, Australian Department of the Treasury (June 1996) at 4.

133 *See Guidelines — Investment by state-owned enterprises — Net benefit assessment, Investment Canada Act*, Industry Canada.

mechanisms or frameworks in place to address many of the major economic challenges posed by SOEs. Similarly, there are no clear international rules to ensure that private companies can compete on a level playing field with SOEs. While existing trade remedy laws and competition/antitrust laws may address some of the challenges posed by SOEs (and should be applied to SOE investments to the extent applicable), the absence of clear disciplines allows SOEs to obtain unfair competitive advantages over private competitors in the marketplace.

Various international trade-related frameworks currently exist or are being developed which could serve as a forum to address concerns related to the market-distorting effects of SOEs. For example, members of the business community have been working with the U.S. Government to address these issues in the context of the Trans-Pacific Partnership ("TPP") Agreement. The U.S. Trade Representative ("USTR") has introduced a proposal in the TPP negotiations to establish rules to ensure that SOEs compete fairly with private companies. The United States has also recently announced the resumption of Bilateral Investment Treaty negotiations with China. These negotiations, along with Canada's expected Foreign Investment Promotion and Protection Agreement with China, may provide an opportunity for both the United States and Canada to address issues related to Chinese SOE activity. Governments should address the involvement of other countries' SOEs in global markets through other bilateral and multilateral agreements, including free trade agreements.

In addition, governments committed to the free market system should continue to address the issue of SOEs through multilateral fora such as the OECD and the WTO, and continue to support the OECD's work on these issues. In particular, WTO dispute settlement should be considered with respect to China's failure to operate its SOEs on a commercial basis.[134]

Governments should be focused on how to effectively address SOE participation in the marketplace, through all possible avenues. No matter what the forum, any coherent SOE policy should include the principles identified below, in order to address the potential market-distorting affects of SOE participation in the North American and global markets.

B. <u>Principles for State-Sponsored Actors in the Commercial Marketplace</u>

When SOEs operate in the commercial arena and compete with private sector companies, there is a high risk that such enterprises will not act purely as market-oriented players, causing market distortions and inefficiencies like those outlined above. The following principles address the potential anti-competitive and other market-distorting effects that may result from the participation of SOEs in the commercial marketplace. Adherence to these principles should help to reduce the likelihood that SOEs will gain an unfair competitive advantage by virtue of their government ownership and by ensuring a level playing field in markets where SOEs and private sector companies compete. If SOEs abide by the following principles, not only in theory, but in practice, the potential for market distortions could be reduced, if not eliminated.

---

[134] Among other things, China committed that it "would not influence, directly or indirectly, commercial decisions on the part of state-owned enterprises." *See* WTO Working Party Report on the Accession of China (Nov. 10, 2001) at ¶ 46.

SOEs should act in a manner consistent with commercial considerations.[135] In all investments, operations, and other activities in the commercial marketplace, SOEs should act solely on the basis of commercial, rather than governmental or political, objectives. SOEs should make business decisions based on market factors (*e.g.*, financial risk and return-related considerations) rather than governmental or other aims. Governments should not operate SOEs as a means to accomplish political or other non-commercial purposes. To that end, SOEs should be free from government influence, direct or indirect, with respect to the day-to-day management, operations, or investment decisions of the entity.

To ensure that SOEs act consistently with commercial considerations, they should not receive government subsidies, or other benefits not generally available on commercial terms, that provide an unfair advantage to the enterprise or its operations. Such government subsidies or other benefits to SOEs effectively force private sector companies to compete directly against foreign governments, rather than other companies. Subsidies and other benefits to be avoided include, but are not limited to, the following: equity infusions or debt-to-equity conversions from the government; financing at below-market interest rates;[136] government guarantees with respect to loans or other liabilities; preferential access to, and/or below market pricing for, raw materials and other inputs; preferential tax treatment, including tax exemptions, reductions, or other tax-related concessions; and preferential application of laws and regulations related to environmental, health, safety, labor, taxation, financial incentives, or other issues.

SOEs should not receive preferential legal or regulatory treatment that distorts commercial conditions. Moreover, laws and government regulations should be applied fairly and equitably to both SOEs and private sector companies. For example, an SOE should not receive exemptions from taxation, bankruptcy rules, building permit or zoning regulations, or other legal or regulatory benefits which are unavailable to its private sector competitors.

Neither companies nor the government should discriminate on the basis of SOE status. SOEs competing in the commercial marketplace should comply with applicable nondiscriminatory treatment obligations, treating other SOEs and private sector companies equally and fairly. Similarly, government procurement practices and bidding processes should be fair, competitive, and non-discriminatory, and not provide any special advantage to SOEs.[137] In the government procurement process, SOEs should not benefit from information asymmetries,

---

135 This principle mirrors the requirement in Art. XVII of the WTO's General Agreement on Tariffs and Trade ("GATT") 1994 that state enterprises operate "solely in accordance with commercial considerations."

136 This principle is reflected in Australia's principles on competitive neutrality: "Debt neutrality will be achieved by subjecting identified organisations to similar borrowing costs to those faced by private sector businesses." *Commonwealth Competitive Neutrality Policy Statement*, Australian Department of the Treasury (June 1996) at 17. A similar principle is also reflected in the OECD's Guidelines on Corporate Governance of State-owned Enterprises: "SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds." *OECD Guidelines on Corporate Governance of State-owned Enterprises*, OECD Publishing (2005) at 12 ("*OECD Guidelines on Corporate Governance of SOEs*").

137 As stated in the OECD Guidelines on Corporate Governance of State-owned Enterprises, "[g]eneral procurement rules should apply to SOEs as well as to any other companies. Legal as well as non[-]legal barriers to fair procurement should be removed." *OECD Guidelines on Corporate Governance of SOEs* at 19.

which occur when SOEs, due to their government relationships, have access to privileged government information or data that their private sector competitors do not.

SOEs should adhere to fair pricing practices. Government subsidies and other benefits provided to SOEs allow them to set prices below their marginal costs.[138] SOEs should ensure that pricing for the products or services they offer in the marketplace fully take into account their costs, and should not engage in predatory pricing practices. Conversely, governments should not use SOEs to monopolize certain sectors of the economy in order to charge prices in excess of market value and earn monopoly profits.

Fair dispute settlement mechanisms should be available to private sector companies. Private sector companies that compete with SOEs should have access to fairly adjudicated dispute settlement mechanisms and/or judicial processes to address any alleged violations of these principles or applicable laws and regulations.[139] This could involve the establishment of a formal complaints handling body, with responsibility for investigating allegations from private sector companies that an SOE is not complying with its obligations or is unfairly benefiting from its SOE status.[140]

SOEs should adhere to sound corporate governance standards. SOEs should be subject to sound governance structures in order to provide necessary operational control, risk management, and accountability. The OECD Guidelines on Corporate Governance of State-owned Enterprises provide one example of a comprehensive set of standards to improve SOE corporate governance.[141]

SOEs should observe a high degree of transparency. SOEs should act in a transparent manner with respect to their operations and governance. As an initial matter, SOEs within a given country should be clearly identified. The status of an SOE (including its relationship to the government) should be clearly set forth in the company's corporate charter or statutory authorization and made available for public inspection.[142]

In addition, SOEs should be subject to the same high quality accounting and auditing standards as publicly-listed companies and should disclose financial and non-financial information according to high quality internationally recognized standards. SOEs should also disclose material information related to corporate structure, finances, and other issues, including,

---

138 *See* Antonio Capobianco and Hans Christiansen, *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options*, OECD Corporate Governance Working Papers, No. 1, OECD Publishing (2011) ("*Competitive Neutrality and SOEs: Challenges and Policy Options*") at 17.

139 *See OECD Guidelines on Corporate Governance of SOEs* at 21 ("Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.").

140 *See Competitive Neutrality and SOEs: Challenges and Policy Options* at 13.

141 *See OECD Guidelines on Corporate Governance of SOEs*.

142 *See* OECD Directorate for Financial and Enterprise Affairs, Competition Committee, *Roundtable on the Application of Antitrust Law to State-Owned Enterprises: Discussion on Corporate Governance and the Principle of Competitive Neutrality for State-Owned Enterprises: United States*, DAF/COMP/WP3/WD(2009)40 (Oct. 20, 2009) at 2.

but not limited to, the following: the ownership and voting structure of the company; any material risk factors and measures taken to manage such risks; and any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE. Another beneficial practice is the European Commission directive on transparency regarding SOE financing, which requires state-owned companies with both commercial and non-commercial activities to separate their accounts in order to demonstrate how their budget is split between commercial and non-commercial activities.[143]

Exceptions to these principles due to exigent circumstances should be limited, temporary, and narrowly tailored. In particular, to the extent that governments take emergency measures that are contrary to the above principles, such measures should be temporary, reasonable, limited, and taken only in times of economic peril.[144]

These principles should be reflected in the outcome of any national, bilateral, or multilateral negotiations in order to develop a framework addressing the economic and competitive challenges caused by SOE participation in the commercial marketplace.

V. CONCLUSION

The increasing involvement of SOEs in markets around the globe threatens to undermine free-market principles and has significant implications for global steel producers, as well as the related upstream and downstream industries. The policies and actions of the Chinese government, as well as other governments that are actively intervening in commercial markets, continue to distort world trade and impose significant economic costs on other countries. By making its steel industry artificially competitive in world markets, the Chinese government has disadvantaged market-oriented producers around the globe, including those in North America. The deployment of steel-producing SOEs overseas to compete in private markets may further distort global steel markets and cause additional harm to market-based steel companies and their workers.

Governments committed to the free market system should not seek to restrict market-based foreign investment, but should increase efforts to address the potential market-distorting effects of SOEs worldwide. Such efforts will ensure that the global steel market remains free from government interference and that private companies are able to continue operating in accordance with free market principles.

---

143 Commission Directive 80/723/EEC, *On the Transparence of Financial Relations Between Member States and Public Undertakings*, 1980 O.J. (L 195) (EC).

144 *See* Stephen S. Kho and Sean Heather, *Checkers or Chess? Facing State Capitalism – Part II*, Law360 (Apr. 22, 2011) ("We must clearly delineate responsive actions taken by governments in times of crisis to prevent economic collapse from those actions designed to ensure the profitability, expansion and economic dominance of certain state-owned or state-assisted players in markets at home and abroad").