Government Ownership and Control of China's "Private" Steel Producers

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The Chinese government continues to exert substantial ownership and control over the Chinese steel industry, including the purportedly private steel producers. As demonstrated in *Money for Metal: A Detailed Examination of Chinese Government Subsidies to Its Steel Industry*, 19 of the top 20 Chinese steel groups are majority owned or controlled by the government, with 91 percent of the production of the top 20 steel groups state-owned or controlled.[1]

In response to *Money for Metal*, however, some have argued that the Chinese steel industry is becoming increasingly private and that the government's influence on the industry has been overstated. For example, the Chairman of China's Chamber of Commerce of Metals, Minerals and Chemicals Importers & Exporters recently stated that claims of substantial government direction and control over the steel industry is a "very, very big misunderstanding" and that China's "steel industry has developed over the last several decades along the path of [a] market economy."[2] He stressed that "China has been making great efforts in developing the non-state-owned sector" and that "almost 40% of total production [in China's steel industry] is contributed by the private sector."[3] Indeed, numerous steel producers in China claim to be privately owned. A recent industry report claims that production from the top ten "privately-owned" mills reached 50 million metric tons in 2006.[4]

However, a closer examination of the so-called top ten private steel producers in China reveals that many of these producers are substantially owned and controlled by the Chinese government and/or are subject to substantial government intervention. The attached ownership chart demonstrates that the state maintains a significant ownership share in at least seven of the top ten private firms. These so-called private producers with government ownership stakes include the Shagang Group; Fushun Xinfugang Co., Ltd., a subsidiary of Jianlong Iron and Steel; Nanjing

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1 *See Money for Metal: A Detailed Examination of Chinese Government Subsidies to Its Steel Industry*, at 8-11, available at http://www.wileyrein.com/docs/publications/13202.pdf.

2 *Marketization Process of China's Steel Industry and Trade*, Chan Horan, Chairman of China's Chamber of Commerce of Metals, Minerals and Chemicals Importers & Exporters, September 18, 2007, AMM China Summit Conference, Arlington, Virginia.

3 *Id.*

4 *China's Top Ten Private Mills*, Steel Business Briefing Analytics, China, September 11, 2007, at 3.

Iron & Steel Company United Co., Ltd.; Rizhao Iron & Steel Group Co. Ltd.; Jiangsu Yonggang Group Co., Ltd.; and Sichuan Chuanwei Group Co., Ltd. Other private producers appear to be substantially influenced by government policies, subsidies, and other forms of manipulation.

For example, the Chinese government owns 40 percent of **Nanjing Iron & Steel United Co., Ltd.** ("NISCO United"). According to the Chinese Iron and Steel Association, NISCO United was founded in August 2003 as a joint venture on the basis of investments by Nanjing Iron & Steel Group Co., Ltd. (40 percent), Shanghai Fosun High-tech Co., Ltd. (30 percent), Shanghai Fosun Industrial & Investment Co., Ltd. (20 percent), and Shanghai Guangxing Sci-tech Development Co., Ltd. (10 percent).[5] The Fosun Group is a large privately-owned conglomerate, giving the illusion that NISCO United has been privatized. However, Nanjing Iron and Steel Group Co. Ltd. is a 100 percent state-owned enterprise ("SOE") owned by the Jiangsu Province State Asset Supervision and Administration Commission ("SASAC").[6] At the time of the merger, all the steel making assets and subsidiaries of Nanjing Iron and Steel Group were merged into the new subsidiary, NISCO United.

As a result, while the state-owned Nanjing Iron and Steel Group Co. Ltd. has no steel making assets of its own, it retains a 40 percent share of NISCO United. Thus, even though the majority share of NISCO United is owned by a private company, the Chinese government has a substantial ownership share and is able to exercise considerable management and control. This is but one example of how substantial government ownership and control has been obscured by the creation of intermediate owners.

Significant Chinese government ownership is also present in **Jiangsu Shagang Group**, which is billed as the largest private steel enterprise in China and the country's fourth largest steel producer.[7] The firm was formed in 1975 as a village enterprise,[8] and changed its name to Jiangsu Shagang Group in 1995. The firm's ownership status changed in 2001, during a period of asset stripping management buyouts in the Chinese steel industry. Approximately 17 percent of the firm was purchased by the plant general manager and 25 percent of the firm was sold to the Jiangsu SASAC. An additional 23 percent went to the company's labor union, which is controlled by the Chinese Communist Party,[9] and almost 35 percent went to the "employees of

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5 *See* http://www.steelhome.cn/english/introduction.html.

6 All provincial SASAC's report to the central government SASAC.

7 *See SBB Analytics China* (September 11, 2007) at 7; "Shagang in talks to buy rival producer," *China Daily* (September 20, 2007) at http://www.china.org.cn/english/business/225157.htm.

8 Liu Weiling and Diao Ying, "Man of Steel," *China Daily* (August 13, 2007).

9 *See Money for Metal* at 8-9 ("Labor Unions in China Labor unions in China are not independent, but rather controlled by the Chinese Communist Party ("CCP") and are therefore treated as government-controlled entities for purposes of this chart. According to the U.S. State Dep't: "[I]n practice workers were not free to organize or join unions of their own choosing. The All-China Federation of Trade Unions (ACFTU), which was controlled by the CCP and chaired by a member of the Politburo, was the sole legal workers' organization. The trade union law gives the ACFTU control over all union organizations and activities, including enterprise-level unions, and requires the ACFTU to 'uphold the leadership of the Communist Party.' Independent unions are illegal. In some cases the ACFTU and its constituent unions influenced and implemented government policies on behalf of workers; however,

Shagang." That same year, the firm doubled its capacity by acquiring a German mill and reassembling it in China. In 2006, it acquired Huaigang, a specialty steel producer whose ownership has at various times included the municipal government of Huai'an, the provincial government of Jiangsu, and the Nanjing Iron & Steel Group, which is owned by the Jiangsu Province SASAC.[10] In short, even China's largest privately owned producer is substantially state-owned, and appears to have received capital inflows from the state in the same year it doubled its capacity.

Jiangsu Yonggang was China's 48th largest steel producer in 2005 and is considered the ninth largest private steel mill in China.[11] Its website indicates that its main steel producing entity is Jiangsu Lianfeng Industrial Stock Co., a joint stock company.[12] However, it appears that a significant portion of the company's ownership remains in the hands of state-controlled entities. Jiangsu Yonggang was formed in 1984 by the local village enterprise and the Nanfeng County Supply and Marketing Corporation, which is owned by the Jiangsu Province SASAC.[13] It later jointly invested in a new rolling line with the China Shipbreaker Co., another firm wholly owned by the provincial SASAC. As a result, despite its disparate first line of ownership, ultimate ownership of the group continued to rest with the Jiangsu SASAC and the village, as shown in the attached chart. As part of a restructuring in 1998, Jiangsu Yonggang established Jiangsu Lianfeng Industrial Stock Co., with a portion of its shares ultimately transferring to management.[14] However, even after this restructuring, state-owned entities continue to have a majority ownership in Jiangsu Yonggang Group and the Group, in turn, continues to maintain majority ownership in Jiangsu Lianfeng Industrial Stock Co.

The Chinese government exerts considerable control and direction even over those companies that appear to be truly controlled by private investors. From 2001-2003, the state-owned **Hebei Jinxi Iron & Steel Corporation** underwent a restructuring that included a management buyout and an investment by the Pioneer Iron & Steel Group of Hong Kong.[15] In December 2003, Hebei Jinxi announced its intentions to sell shares in Hong Kong.[16] Despite the IPO, Hebei Jinxi is almost entirely owned by the China Oriental Group, a firm owned primarily by Wellbeing

the CCP used the ACFTU to communicate with and control workers." U.S. State Dep't, *Country Report on Human Rights Practices 2006, China* Section 6(a) (2007), *available at* http://www.state.gov/g/drl/rls/hrrpt/2006/78771.htm.")

10 *See* http://www.huaigang.com/about1.asp.

11 *See SBB Analytics China* (September 11, 2007) at 3,8.

12 *See* http://www.yong-gang.com/english/fazanlicheng.htm; and http://www.yong-gang.com/english/zhidu.htm.

13 *See* http://www.yong-gang.com/english/fazanlicheng.htm.

14 *See* http://www.yong-gang.com/english/fazanlicheng.htm; and http://www.yong-gang.com/english/zhidu.htm.

15 *See* http://www.chinaorientalgroup.com/english/gsjj.asp.

16 *See* "Jinxi Iron & Steel Plans Hong Kong IPO; Hires Bankers (Update5)," *Bloomberg.com* (December 16, 2003) at http://quote.bloomberg.com/apps/news?pid=10000080&sid=a3Q9DY1txZUY&refer=asia#.

Holdings Limited (42.82 percent) and the Pioneer Iron & Steel Group (28.11 percent).[17] Wellbeing Limited and another minor shareholder are controlled by Mr. Han Jingyuan, the chairman of Hebei Jinxi prior to its restructuring. Ms. Chen Ningning, the 36-year old owner of the Pioneer Iron & Steel Group, is the grandchild of Mr. Lu Dong, who was China's metallurgy minister in the 1960s and 1970s.[18] Mr. Han and Ms. Chen are currently chairman and vice chairman of China Oriental Group, respectively.[19]

Though the government holds no ownership interest in the firm, it is clear from a recent proxy battle between Mr. Han and Ms. Chen that even private steel producers are significantly influenced by government policy mandates. According to company management, China Oriental has "focused, in line with PRC government policies, on improving its competitive edge by enhancing its product mix and production efficiency."[20] Management further noted that "China Oriental will continue to maintain its strategic position and diversify its product mix in line with PRC government policies."[21] And, assuming that these private steel companies toe the party line, the rewards are substantial. Proxy documents indicate that the privately-owned steel mill continues to benefit from government largesse, including an RMB 145 million loan from the local government at an interest rate equal to China's official deposit rate,[22] subsidy income,[23] a reduced effective tax rate due to the firm's status as a foreign invested firm,[24] and the provision of industrial facilities for less than market value.[25]

The Chinese government also exerts direction and control over private steel companies through its ties to company management. Numerous owners, directors and managers of privately-owned steel companies are Community Party officials. For example, Mr. Zhang Zhixiang, who owns the majority of Jianlong Iron & Steel Group, is a delegate to China's National People's Congress ("NPC").[26] Wang Shoudong, the chairman of Shandong Taishan Steel, another private steel

17 *See* "China Oriental Group Company Limited Response document in relation to the unsolicited voluntary conditional offers by Macquarie (Hong Kong) Limited on behalf of Smart Triumph Corporation," (August 17, 2007) (hereafter, "CNOG proxy response") at 157. The Jinxi company union owns 16 percent of Wellbeing. See CNOG proxy response at 29.

18 Robin Kwong, "Princeling Chen on track," *The Australian* (August 21, 2007).

19 It is unclear how these individuals acquired the capital to obtain their ownership shares. Nor is it clear whether state entities were involved in financing the acquisition of these shares.

20 *See* CNOG proxy response at 17.

21 *Id.* at 37.

22 *Id.* at 121. The deposit rate in Chin is several percentage points lower than the official borrowing rate.

23 *Id.* at 123.

24 *Id.* at 127 to 128. China's tax rate is 30 percent, while the local tax rate is three percent. The group's effective tax rate in 2006, due to the various tax preferences, was 17.1 percent (210,886 / 1,233,236 = 17.1 percent).

25 *Id.* at 152. For example, China Oriental leases a 62,016 square meter industrial complex in Tangshan, Heibei Province, for RMB 46,510 **per year** ($5,867 at the 2006 RMB-dollar exchange rate). The contract went into effect in 2003.

26 *See* http://www.hurun.net/detailen3.people38.aspx.

company, is described by the *China Daily* as an NPC deputy.[27] Guo Guangchang, an owner of Jianlong Iron & Steel Corp., Ltd., was a member of the 9th Chinese People's Political Consultative Conference ("CPPCC") National Committee and the 10th NPC.[28]

Finally, the fact that a steel company raises funds in Hong Kong or is based in Hong Kong does not necessarily support a finding of private ownership. Indeed, while certain private steel companies, such as China Oriental Group, raise funds in Hong Kong either through share offerings or through purchases by Hong Kong entities, it is well known that Chinese government capital has been frequently diverted through Hong Kong in order to access the preferential tax rates available to foreign-invested firms. Additionally, China Travel Service (Holdings), Ltd., a Hong Kong-based company, is the majority owner of **Tangshan Guofeng Iron & Steel Co., Ltd.** (considered the third largest private steel company in China). China Travel Service, however, is 100 percent owned by the central government SASAC.[29] Thus, the ultimate ownership and control of offshore (principally Hong Kong) private investment funds with stakes in Chinese steel firms may lie with the Chinese government.

In summary, the Chinese government exerts considerable ownership and control over the steel industry, including China's so-called private producers. The government owns substantial ownership shares in many of the private producers, exercising very visible control over these companies. In other instances, the government's role is less visible, though it nonetheless maintains considerable control and direction through ties to company management, subsidies, and other forms of manipulation and coercion.

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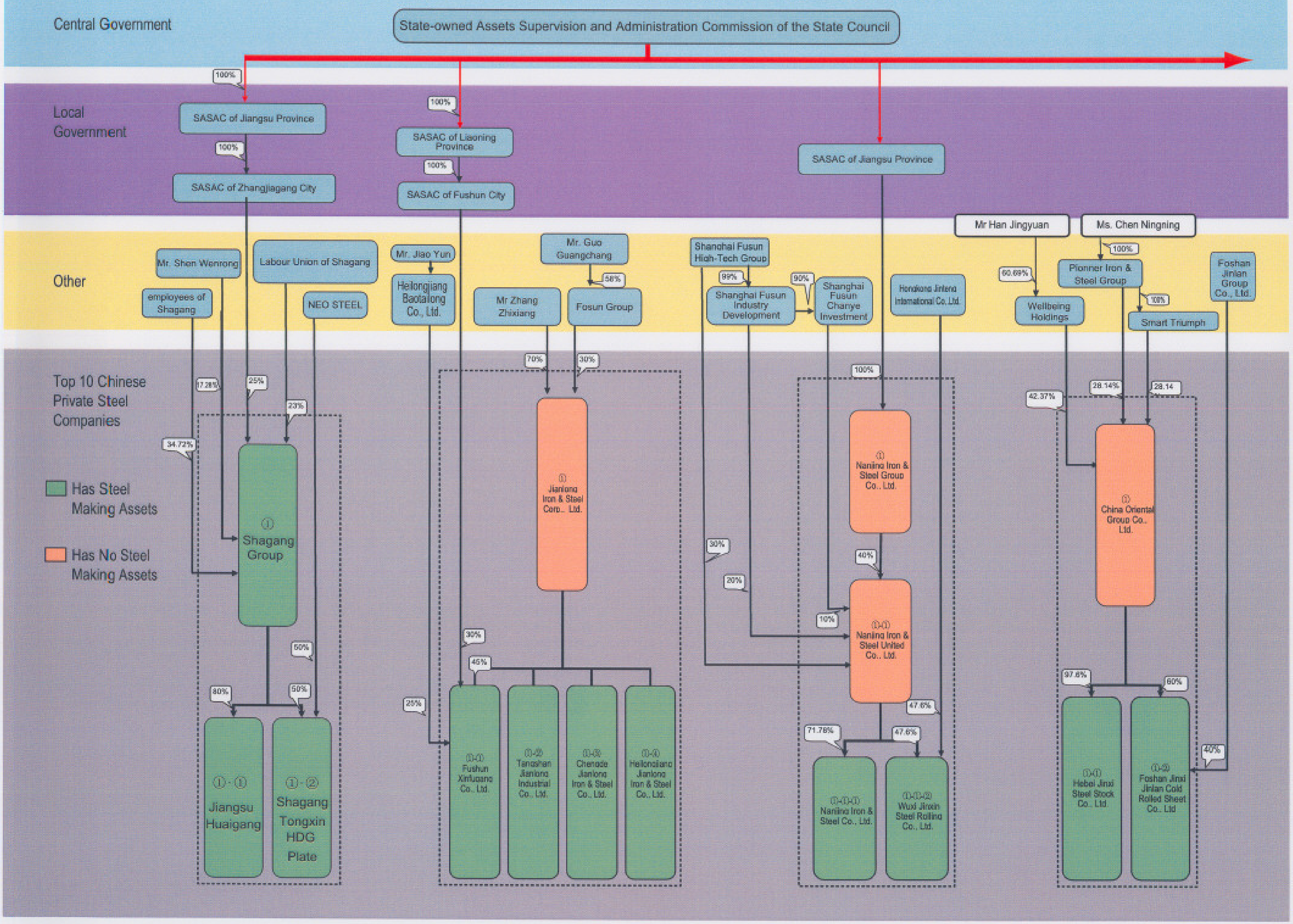
27 *See* http://www.chinadaily.com.cn/bw/2007-03/26/content_835905.htm.

28 *See* http://www.chinavitae.com/biography/Guo_Guangchang/full.

29 *See Money for Metal,* Appendix 2.

Ownership of China's Top Ten "Private" Steel Producers



Ownership of China's Top Ten "Private" Steel Producers (cont'd)