SECTION 2: THE CONTROL OF CHINA'S ECONOMY BY ITS GOVERNMENT, AND THE EFFECT ON THE UNITED STATES

"The Commission shall investigate and report on—

"WORLD TRADE ORGANIZATION COMPLIANCE—The compliance of the People's Republic of China with its accession agreement to the World Trade Organization.

"ECONOMIC TRANSFERS—The qualitative and quantitative nature of the transfer of United States production activities to the People's Republic of China, including the relocation of high technology, manufacturing, and research and development facilities, the impact of such transfers on United States national security, the adequacy of United States export control laws, and the effect of such transfers on United States economic security and employment."

China's Industrial Policies

The decisions by Presidents Bill Clinton and George W. Bush and by Congress to support the entry of China into the World Trade Organization (WTO) were predicated on expectations that membership would commit China to a path toward free-market capitalism. Six years after joining that body, China is still trudging along the path of economic liberalization, with a mixed record of meeting its many WTO accession commitments. Although China has had some notable successes, concerns are now growing over the pace and direction of China's economic reforms.

Certainly the current version of China's economy bears little resemblance to the one that existed three decades ago. China has made extensive market reforms that contributed to the impressive economic growth rates it has seen over the last thirty years. China's industrial output in 2000 was ten times what it was in 1978 when Deng Xiaoping initiated his economic reform program and opened China to the outside world.[63] Also, Chinese poverty has declined significantly; between 1981 and 2001 the proportion of China's population living on an income below the level the World Bank defines as China's poverty line[64] dropped from 53 percent to just eight percent.[65] Economic liberalization has benefited China enormously.

The Chinese Communist Party's (CCP) ultimate goals for economic liberalization may not match the expectations of many in the West, however. Recent CCP actions and announcements indicate that Beijing has no intention of giving up control over significant elements of the economy or relinquishing its outright ownership of key industrial and high technology sectors. This dynamic is particularly apparent in the efforts of China's government to retain control of a large number of state-owned enterprises.

It now is becoming evident that Beijing plans to reform its economy only partially, embracing elements of both free-market capitalism and centralized planning. While the Chinese prefer to call this system "capitalism with Chinese characteristics," economists testifying before the Commission used such terms as "a partially marketized economy," [66] "an economy with private elements," [67] "state-guided capitalism," [68] and "a politicized and government-distorted market economy." [69]

Chinese State-Owned Enterprises

The Congressional Research Service defines state-owned enterprises (SOEs) as those firms in which a central or local government holds an equity stake, either directly or through a holding company, sufficiently large to give it control over the firm.[70] Because China's regulatory systems are opaque, it can be difficult to trace the ownership of any enterprise in China. Beijing has been able to shroud its stake in a variety of firms by listing a portion of each such enterprise on public exchanges while maintaining ownership of the remaining equity, usually through a parent company.

While China's state-owned business sector is greatly diminished from its pre-1978 reform period, it still is a major factor in China's economy.[71] The current number of SOEs is thought to be roughly 127,000.[72] Even more important, China has indicated it intends to revitalize significant numbers of its failing state-owned companies with a wide variety of subsidies that would violate free market principles and China's WTO commitments. This would represent a large step backward from the expectations of the American proponents of China's entry into the WTO. The result would be a unique hybrid economy with a scale that could create serious challenges and potential harm for the world economy.

The reduction in size of China's state-owned sector has resulted from efforts to consolidate the strongest state-owned enterprises and to allow the weakest to "fade away." [73] SOEs made up 38 percent of industrial output in 2004, down from 49.5 percent in 1998, a reduction of 23 percent.[74] SOE employment numbers also have fallen. In the early 1990s, SOEs employed an estimated 70 million workers. By 2003 that number had declined to 40 million.[75]

Local governments, rather than the central government in Beijing, own and direct the majority of the smaller SOEs. In 2002, local governments' share of total employment in the state-owned sector stood at 76.3 percent.[76] Most of these smaller, local SOEs operate at a loss and rely on government subsidies to remain viable. Many of these firms once had been operated by the central government but have been transferred to local authorities in the hope they might be "turned around" to profitability, privatized, or closed. Many of them remain open to maintain local employment levels and, in some cases, to provide illicit income for corrupt local politicians. But as the smaller, local SOEs have been shrinking in number and importance, the larger but fewer centrally-owned SOEs have been gaining in importance.[77] "The local sector [SOEs] ... seem to be steadily ... privatized and transformed [with] the local government officials act[ing] more like entrepreneurs," says Dr. Barry Naughton of the University of California/San Diego.[78]

The central government plays a small role in the activities of the local SOEs and instead focuses on several hundred larger firms that Beijing sees as critical to China's future. While local SOEs do employ the majority of the state-owned sector's workforce, the central government controls a disproportionately large share—48.3 percent—of the state-owned sector's assets.[79] The firms that fall in this category are the principal beneficiaries of much of China's industrial policy.[80]

Dr. Naughton quoted a senior Chinese official as saying, "state ownership is appropriate in four sectors: national security, natural monopoly, important public goods or services, and important national resources. In addition, a few key enterprises in 'pillar' (priority) industries and high-tech sectors should be maintained under state ownership."[81] Dr. Naughton testified that "the five sectors of oil, metallurgy, electricity, telecommunications, and military industries represent two-thirds of the labor force and three-quarters of the capital in [the] state sector core."[82]

The largest state-owned firms fall under the Chinese version of a holding company: the State-Owned Assets Supervision and Administration Commission (SASAC). SASAC was created to "manage the [CCP's] efforts to control more effectively China's SOEs, while increasing the SOEs' economic returns and maintaining the political returns to the government."[83] SASAC has jurisdiction over China's best SOEs and has been given explicit instructions to advance a number of the CCP's economic goals.

SASAC's mandate directs it to consolidate its control over larger SOEs and dispose of smaller ones. To accomplish this goal, SASAC divided tens of thousands of SOEs into two groups: those from strategic industries to be owned by the central government and the remainder to be run by provincial and local governments with help from the Ministry of Finance. The smallest and weakest were, in many cases, given to local authorities to shut down or merge. Through restructuring and consolidation, SASAC appears to have pared its list from the original 198 companies to 155 companies.[84]

SASAC has been candid in revealing its plans for China's state-owned enterprises. These include its intentions to provide government subsidies to the "national champions" it intends to create. The "goal of reforming is to reorient state capital away from poorly performing companies in non-crucial areas to priority sectors,"[85] explained Shao Ning, Vice Minister of SASAC.

In December 2006, SASAC and China's State Council jointly announced the "Guiding Opinion on Promoting the Adjustment of State-Owned Capital and the Reorganization of State-Owned Enterprises." The Guiding Opinion identifies seven "strategic industries" in which the state must maintain "absolute control through dominant state-owned enterprises," and five "heavyweight" industries in which the state will remain heavily involved. (See the box below.) *China Daily* and the *Asia Times* estimate that between 40 and 50 of the 155 SASAC-controlled SOEs are engaged in the seven "absolute control" sectors, accounting for 75 percent of SASAC's total assets[86] and as much as 79 percent of SASAC's total profits.[87] They include such highly profitable companies as China Mobile, PetroChina, and Air China. A complete list of these SOEs is included as Appendix VII-C.[88]

INDUSTRIES THE PEOPLE'S REPUBLIC OF CHINA HAS IDENTIFIED AS "STRATEGIC" AND "HEAVYWEIGHT"

Strategic Industries:	**Heavyweight Industries:**
1) Armaments	1) Machinery
2) Power Generation and Distribution	2) Automobiles
3) Oil and Petrochemicals	3) Information Technology
4) Telecommunications	4) Construction
5) Coal	5) Iron, Steel, and Non-Ferrous metals
6) Civil Aviation	
7) Shipping	

According to China's official news agency *Xinhua*, the "Guiding Opinion proposes 10 actions to promote the reorganization of state-owned enterprises, including stock exchange listing for sound companies and the addition of foreign investors."[89] Other proposed actions include shutting down money-losing companies, reorganizing management in other firms, linking manufacturers to state research institutes, and tightening budget controls.

The announcement indicates that Beijing may be looking to foreign, or "strategic," investors to help China create what economic planners like to call "market socialism." This phenomenon already can be seen at work in the information technology sector to which SASAC attached such great importance. Dr. Zhi Wang, an economist at the U.S. International Trade Commission, recently said that 90 percent of China's high technology exports to the United States are from Foreign Invested Enterprises (FIE), many of which involve joint ventures with Chinese firms.[90] American venture partner companies may be helping a SASAC-targeted industry climb the technology ladder.

Beijing goes to great lengths to hide the fact that many Chinese firms thought to be private are, in fact, SOEs. Many companies in China whose stocks are traded on China's exchanges are in reality SOEs in which the government keeps as much as a 75 percent stake, says Mr. Frederick Jiang, manager of the Ivy Pacific Opportunities Fund. By only listing part of an SOE on domestic exchanges, the Chinese government is able to maintain control of the firm. This association with China's government "often means the companies are assured of maintaining their dominant position,"[91] said Mr. Jiang. Studies have shown that when foreign investment capital is attracted to SOEs through this opaque process, there typically is an increase in their competitiveness. "Foreign capital participation in an SOE is associated with higher innovative activity. . . . There is a positive effect of FDI on SOEs that export, invest in human capital or R&D, or have prior innovation experience."[92]

Of course, at the same time, Beijing isn't anxious to see control of its strongest SOEs pass to foreigners. The State Council reportedly is planning to establish an interdepartmental committee to "scrutinize large-scale mergers or acquisitions of state-owned enterprises by foreign companies." [93]

Another way for Beijing to support companies in SASAC's favored industries is to use government subsidies. SASAC public pronouncements confirm what external studies have already observed: China already is deeply involved in such activity. University of New Haven professor George Haley testified before the Commission that these subsidies are most frequently provided at the provincial and municipal levels in China. They are listed in the box below:

Forms of Provincial and Municipal Government Support for SOEs [94]

1) *Low Cost Loans.* Provincial governments use their influence over the state banks to ensure that SOEs receive low-cost and sometimes free loans that amount to an outright transfer of capital.

2) *Asset Injections.* Provincial and municipal governments transfer assets, such as toll roads and toll bridges, to their SOEs at prices far below market value or replacement costs.

3) *Subsidized Inputs.* Provincial and municipal governments subsidize purchases of equipment, component parts, raw materials, and supplies for SOEs by requiring other SOEs or pressuring their own suppliers to provide these inputs at below-market or even below-cost prices.

4) *Tax Breaks.* Provincial and municipal governments provide tax breaks of various types to their own SOEs. Tax breaks include reduced utility costs, reduced income-based taxes, and reduced general taxes.

5) *Energy Subsidies.* Provincial and municipal governments sell energy and other utilities to their SOEs at below-market prices.

6) *Land Subsidies.* Provincial and municipal governments consolidate land parcels and sell them to their SOEs at below-market prices.

7) *Purchasing SOE Products.* Provincial and municipal governments purchase goods and services from their SOEs at above-market prices, often higher than less well-connected companies' lower bids.

A 2006 European Union report noted these advantages: "China has channeled significant subsidies to favored national industries, in particular companies destined to become national or regional champions. These companies also have benefited from preferential policies such as privileged access to the banking sector. In some cases, such as the automotive and steel sectors, whole sectors benefit from an integrated industrial policy intended to support domestic production and boost exports. China also has developed a taxation system granting tax preferences contingent on the use of local content or export performance."[95] An article in the *China Business Review's* November-December 2006 edition listed auto, steel, energy, financial services, telecommunications, and information technology sectors as strategic sectors "where barriers to access are already being erected."[96] During a recent fact-finding trip to China, Commissioners learned how industrial planners in Liaoning province are using these tactics to develop the local economy:

Case Study of a Chinese Province's Economic Development Efforts, Partially Dependent on the Role of SOEs and the Application of Various Government Subsidies: Liaoning Province

In April 2007, members of the Commission traveled to China to directly assess Sino-American economic and security relations and other issues related to the Commission's mandate. During the trip the delegation visited the cities of Dalian, Anshan, and Shenyang in China's northeastern province of Liaoning. While in Liaoning the Commission toured private manufacturing facilities and state-owned enterprises, and discussed the region's economic development plans with local officials and business executives.

The Commission learned that businesses in the area have modified their practices and growth strategies to take advantage of Dalian's port location and new trade promotion policies. For example, the delegation visited Brilliance (Huachen) Auto Company in Shenyang, a majority state-owned firm that once manufactured solely for domestic markets but now produces high-end sedans for export to Europe. Upon final assembly these sedans are transported from the factory to Dalian's newly constructed Auto Terminal where they are loaded onto ships at a government owned facility with a capacity of 750,000 automobiles per year. Access to this facility has expanded the ability of firms like Brilliance to export their products.

The Commission learned that other incentives in addition to the auto loading facility are offered by the government to promote the growth of exporting companies. For instance, the Dalian Free Trade Zone manages a new bonded port area that will become fully operational by the end of 2007. The central government has identified three of the new container terminals and their surrounding areas as bonded ports that are outside the administration of Chinese customs officials. Once domestic cargo enters one of these areas, it instantly will be considered exported and domestic producers will be able to claim a tax rebate for their exported goods.

Case Study of a Chinese Province's Economic Development Efforts, Partially Dependent on the Role of SOEs and the Application of Various Government Subsidies: Liaoning Province—Continued

The delegation also toured the facilities of two state-owned enterprises in the region: an iron and steel factory and an oil refinery. The Anshan Iron and Steel Group Corporation is the second largest steel producer in China and produces pipes, rails, containers, and automobile frames. PetroChina Fushun Petrochemical Company (PFPC) produces gasoline, industrial chemicals, and waxes for export. Both firms fall within sectors considered strategic by the Chinese government and both are heavily influenced by Beijing's industrial policies. In fact, in PetroChina's English language brochure, the firm proudly boasts that "PFPC will fulfill the target of '1145' during 'the eleventh Five-Year Plan,' i.e. 11.5 million t/a[97] refining capabilities, 1 million t/a ethylene production capacity and four world level petrochemical raw material production bases . . . and reach a goal of more than 50 billion renminbi in sales income."[98]

Dalian is seeking to acquire a reputation as a center for high-technology development and is establishing software parks to attract businesses. While preparing for its visit, the Commission learned that Dalian was offering various financial incentives as part of its strategy to attract foreign and domestic investment. This policy was well received by U.S. firms in Silicon Valley that may be interested in doing business in China. Just before the Commission left for China, the Intel Corporation announced it had signed a deal with Dalian to build a massive $2.5 billion chip fabrication facility there, a big win for Dalian and for a nation committed to advancing its economy's high-tech, knowledge-intensive industries. It is estimated that Intel negotiated nearly $1 billion in financial incentives from the Chinese government.[99] Had the new facility been built in the United States, new jobs and increased high-tech production capacity would have been created domestically.

The Impact on American Firms

SOEs have distinct advantages when competing internationally and within their home market. In addition to the several varieties of subsidies that SOEs enjoy, indigenous companies benefit from sympathetic government regulators. The competitive challenge SOEs pose for U.S. companies in those sectors singled out by SASAC soon may intensify, particularly in third country markets worldwide. Beijing has announced that its ultimate goal is eventually to create "80 to 100 globally-competitive (state-owned) corporations."[100]

According to the official *People's Daily Online,* in 2003 14 Chinese SOEs nudged their way into the Fortune Global 500, compared to just three in 1998.[101] In 2005 that number rose to 19.[102] One expert testified before the Committee on Ways and Means of the U.S. House of Representative that SASAC hopes China will have 30 to 50 globally competitive firms by 2010.[103]

Case Study: Steel

China's steel policy shows how state ownership and control combined with extensive government subsidies can threaten a U.S. industry—in this case, one that is vital to both civilian and military manufacturing. Beijing has adopted an explicit industrial policy to support steel production using a wide variety of subsidies. The consequence has been a dramatic increase in steel output in China, so far exceeding even China's skyrocketing domestic steel consumption that huge overcapacity has resulted.

In just four years, China transformed itself from a large steel importer to a large steel exporter by adding capacity at a record rate. In 2002, imports of iron and steel in China exceeded exports by 450 percent; by 2006, exports of iron and steel from China exceeded imports by 230 percent.[104] As a result, China now produces 35 percent of the world's steel. According to the American Iron and Steel Institute (AISI), "Chinese crude steel production more than quadrupled in the last ten years, growing from an estimated 100 million metric tons in [1996] to approximately 420 million metric tons in 2006 . . . [,which is] the rough equivalent of building three entire American steel industries in one decade." [105]

China's steel industry remains largely state-owned and controlled. Nine of the 10 largest producers in China are state-owned, accounting for 57 percent of total Chinese production.[106] China is now a larger steel producer than the next three producers combined: the United States, Japan, and Russia.

When the Chinese government decides how much of a good to produce, and subsidizes the production, the discipline of the marketplace no longer holds. Government-run industries continue to produce despite the rise in supply and the fall in price, which in a market-driven economy would signal producers to cut back on shifts or hours in order to minimize financial losses. But in a government command sector of the economy such as China's steel industry, prices can keep falling because a glut on the market is not rectified by natural economic forces. Those falling prices can harm workers and industry sectors in nations that do not provide huge government subsidies.

The U.S. steel industry is imperiled. AISI figures show that in 2006, China shipped over five million net tons of steel products to the United States, more than double the level of imports from China in 2005.[107] Although steel exports from China have declined somewhat from their peaks in 2006, the long-run threat from China's overcapacity remains. "On level terms, [the U.S. steel industry] can compete with steel industries anywhere, but we simply cannot compete against the . . . government of China," [108] according to Barry Solarz, AISI Vice President.

China's Foreign Exchange Reserves

Over the last several decades the Chinese have accumulated an enormous stockpile of foreign exchange reserves. A fixed exchange rate and an ever-growing export sector have worked in tandem to accumulate excess foreign currency valued by the People's Bank of China at $1.43 trillion as of October 2007. In 2006 China's reserves of $1.2 trillion surpassed Japan's to become the world's largest. These numbers are likely to continue to grow at a rate of $300 to $400 billion a year[109] if Beijing persists in refusing to ease its capital controls and allow market forces to determine its currency's value or reverse its export-oriented growth strategy.

To date, the vast majority of these reserves have been managed by China's State Administration of Foreign Exchange (SAFE). This agency has tended to invest the currency in low-risk, low-yield debt investments. Most estimates show 70 percent of the reserves are invested in U.S. corporate bonds, government backed securities, and treasury bills[110]—meaning that China has roughly $1 trillion invested in U.S. securities, mainly bonds. China currently is the largest purchaser of U.S. Treasury securities.

Until recently, Beijing seems to have been satisfied with concentrating its dollar investments overwhelmingly in U.S. debt instruments. China announced in March 2007 that it intends to diversify some of its reserves by moving them out of U.S. debt securities and into higher yielding investments—presumably equities—through a new investment institution. Many of the details surrounding the new institution—the China Investment Corporation (CIC)—remain unclear. The new fund initially was allotted $200 billion dollars,[111] but details surrounding its eventual size, what its processes will be for determining where it will invest, and what its investment criteria and priorities will be remain unclear. The Chinese official chosen to run the fund, former Deputy Minister of Finance Lou Jiwei, has said little about the structure of the fund or its future investment plans.

The methods and goals China will employ to diversify its unprecedented hoard of dollars have prompted great interest on Wall Street and in other international financial capitals for a number of reasons, including the fact that movement of such sums in and out of investments can roil financial markets. Concern in the United States focuses on the fact that China's government is the single largest actor in the foreign exchange market and the single largest buyer of U.S. debt instruments. Many financial companies will be interested in capturing the transaction fees associated with these new trades.

The CIC could be modeled after similar sovereign wealth funds (SWF) run by the governments of Singapore and Norway. These institutions invest a portion of their nations' foreign exchange holdings in foreign equities and domestic investments with higher yields than the government bonds in which SAFE has invested. Singapore's Government Investment Corporation manages roughly $100 billion while Norway's State Pension Fund manages roughly $300 billion. In Singapore, the institution also acts as a holding company, housing many of that nation's SOEs. It is unclear whether China will make similar arrangements and transfer certain

SASAC assets to CIC, but Singapore's success may encourage such a move.

China's pool of dollars is growing ever larger. Dr. Brad Setser, senior economist at Roubini Global Economics, estimated that by 2010, on the current trajectory, the various state entities that manage China's external assets will hold $3 trillion.[112] Dr. Setser argues that the immense growth of China's foreign exchange reserves makes it inevitable that China increasingly will diversify its portfolio into equities and warns that the switch will generate friction. "I think it is quite possible that, as a result of those frictions, [for] what so far has been a very stable and not terribly volatile process for financing the U.S. external deficit, the level of volatility and friction will rise, and that could at some point generate less benign outcomes associated with our large deficit than we've seen to date."[113]

Not only is the investment strategy of great interest to the markets, but also there is great interest in what China's goals will be for such investment. Thus far, the best known CIC investment is the $3 billion stake it took in the New York-based private equity firm The Blackstone Group. Some worry that the new fund may be used to capture more than China's fair share of natural resources, to bolster the international competitiveness of Chinese SOEs, or to capture advanced technology by acquiring foreign IT or other technology companies outright. Regardless of China's intentions, its activities will be closely watched as "China could be in the top four outward investors in the next five years . . . just behind the United States, the [United Kingdom], and Japan. . . ."[114] Indeed, with the world's largest pool of foreign currency holdings, China could purchase nearly eight percent of all the 2,249 U.S. companies listed on the New York Stock Exchange, worth a cumulative $15.5 trillion.

The China Model, the WTO, and American Responses

The world is no stranger to centrally-planned economies. In East Asia, in particular, several nations have used government industrial policies since the end of World War II in an attempt to accelerate their economic development. These have included, most notably, Japan, Taiwan, and South Korea. The key differences between what those nations did and what China currently is doing are the sheer size and scope of the Chinese model and the nature of the Chinese government.[115] For these reasons, China's policies will have a much larger impact on the international community.

The general theme of China's 11th Five-Year Plan[116] is to further strengthen China's industrial sectors and foster the growth of a more highly-developed, knowledge-based economy. According to Dr. Naughton, the plan states that "the Chinese government is now going to substantially step up the amount of money . . . it invests in research and development, [and] it's going to substantially step up the activity of the government in using procurement to foster a high-technology sector in China and . . . the flow of resources from the government to subsidize credit through the policy bank system[117] in particular."[118]

While the WTO says nothing specifically about the legality of SOEs and state-directed development, it does have strict rules on the use of subsidies intended to influence trade. China still uses illegal export subsidies and import substitution to further its industrial policies.[119] China's own 2006 report to the WTO on its remaining subsidies, and the subsequent U.S. complaint to the WTO in 2007 on those subsidies, provide a detailed record.[120]

The Chinese have a very different view than other members of what they are expected to do as a WTO member. They cite the examples of Korea, Taiwan, and Japan—all fellow WTO members. Says Mr. Clyde Prestowitz, President of the of the Economic Strategy Institute, who long has studied the efforts of governments to enhance their competitiveness through industrial policy: "We can argue that elements of this game are at variance with the rules of the WTO, and I believe they are, but we've never challenged that. We've never challenged [that] in the case of Japan or Korea or Taiwan or Israel or Ireland or any of the other guys who play this game. And so, [based on] precedent, the Chinese are in a position to argue . . . 'What are you talking about? . . . We're just doing what people do when they're trying to develop their economies.'"[121]

Nevertheless, the United States does have some tools with which to defend itself. The United States brought a case before the WTO's dispute panel in early 2007 charging that China employs illegal subsidies, although not directly linking the issue to China's SOEs. No decision has yet been reached in that case.

Another possible remedy is the use of countervailing duties (CVDs), rather than a lengthy WTO case, to counteract subsidies, according to Mr. Thomas Howell, an attorney at Dewey Ballantine."[122] In October 2007, the U.S. Department of Commerce cleared the way for such an approach by determining that it would be justified in applying antidumping and anti-subsidy CVDs on Chinese glossy paper exports to the United States. In doing so, the Department also ruled for the first time that it is able to determine the extent of subsidies from the Chinese government to a favored industry—in this case, paper production. This final ruling marked the first application of the CVD law against a non-market economy since the mid-1980s.[123] China has responded by formally requesting, through the WTO, consultations with the United States over the decision, which is the first step in bringing a formal complaint to be adjudicated by the organization.[124] China also has held open the possibility of bringing the issue before the U.S. courts.

As other U.S. industries have been preparing similar CVD cases against Chinese competitors, both houses of Congress began considering legislation that would allow CVD cases to be brought against non-market economies. The prospects for enactment of such legislation are unclear.

Conclusions

- The push for reform in China's economy in the 1980s and 1990s appears in some cases to have reversed with a renewed use of industrial policies combined with a new class of super state-owned enterprises.
- China's 11th Five-Year Plan emphasizes industrial policy planning for the state-owned sector. The plan heavily promotes the development of value-added industries of a technical nature. The

Chinese Communist Party employs a range of tools to accomplish these goals, including the use of subsidies and state-funded R&D centers, promoting foreign direct investment from Western high-tech firms, employing strategies to maximize technology transfers from more-developed economies, infant-industry protection, and directed use of China's state-owned enterprises.

- China's state-owned sector is evolving in a way that challenges American firms. The Chinese government provides state-owned enterprises a combination of subsidies, access to cheap capital, industrial coordination, and foreign policy support that U.S. firms do not have.
- China's consolidation of its state-owned enterprises (SOEs) is guided by a new policy announced in December 2006. The State-Owned Assets Supervision and Administration Commission (SASAC) and China's State Council identified seven strategic industries in which the state must maintain "absolute control through state-owned enterprises," and five heavyweight industries in which the state will remain heavily involved. The strategic industries are armaments, power generation and distribution, oil and petrochemicals, telecommunications, coal, civil aviation, and shipping. The heavyweights are machinery; automobiles; information technology; construction; and iron, steel, and non-ferrous metals. It is estimated that forty to fifty of SASAC's 155 central SOEs fall in the strategic category and account for 75 percent of SASAC's total assets.[125]
- China has created a new institution to invest part of its $1.43 trillion foreign exchange holdings. The new sovereign wealth fund, managed by the China Investment Corporation (CIC), initially has been allotted $200 billion to invest, according to some estimates.[126] It is expected that the fund will diversify by exchanging some investments in American debt securities for investments in international equity markets. Recently the CIC purchased a $3 billion stake in the private equity firm The Blackstone Group.
- China's economic policies violate the spirit and the letter of World Trade Organization membership requirements. The United States is not limited to countering China's industrial policy tactics through the WTO, however. It can use other WTO-sanctioned trade remedies to protect itself, such as Countervailing Duties (CVDs) and antidumping cases.