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China Economy

US demands level playing field in China, but can Beijing rein in state subsidies to end trade war?

United States trade representative Robert Lighthizer has been a long-term critic of advantages given to domestic companies that make it difficult for foreign firms

China has long been accused of favouring domestic companies, resulting in an unfair competitive advantage at home and abroad

Topic | China economy

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US President Donald Trump has delayed the application of additional tariffs on Chinese imports, citing "substantial progress" in addressing the US demands for structural reform in the Chinese economy. This is the fourth article in a five-part series looking into these demands, which are the conditions for ending the trade war.

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Curbing China's massive subsidies offered to domestic firms has long been a priority of United States trade representative (USTR) Robert Lighthizer in the trade talks with Beijing.

Even before the tariff battle kicked off last year, the China critic had made it clear in 2017 that the US objective should be eliminating unfair subsidies and "non-economic" industrial policy, all of which he described as an "unprecedented" threat to the world trading system.

In a joint report issued last month, the American Chamber of Commerce in China (AmCham China) and the US Chamber of Commerce also called on Washington to push Beijing to remove subsidies that arti½cially support domestic industries to ensure a level playing ½eld for all companies operating in China.

Since joining the World Trade Organisation (WTO) in 2001, China has often been accused by the US and its allies of a lack of transparency in granting numerous subsidies that favour domestic companies, giving them a competitive advantage in both domestic and global markets.

Those subsidies came into sharp focus during the trade war, with Washington expressing particular concern with their use in Beijing's "Made in China 2025" industrial policy initiative that seeks to create global leaders in a range of cutting-edge hi-tech industries at the expense of the US and other developed countries.

In 2017 alone, the country o ºered hundreds of billions of yuan in subsidies to Chinese companies in a range of industries, with "Made in China 2025" only a small part.

Most of the money ¾owed to China's state-owned enterprises (SOEs), which also enjoy easy, low-cost access to loans. The subsidies and loans enhance their dominant position in multiple sectors including banking, insurance, energy, and transport.

This irked both foreign companies and domestic private ½rms, which complain that the advantages that SOEs enjoy let them crowd out competition and restrict market access.

Beijing had a plan to dominate tech. Then the US trade war happened

[1]

The subsidies have also allowed Chinese companies in certain industries to expand capacity rapidly and ship ever more goods to the rest of the world at lower prices.

The US claims this has led to a “non-market driven” global oversupply in a range of products, including steel, aluminium and solar panels, that is harming US businesses and destroying American jobs.

WTO rules require member countries to disclose all subsidies that are provided to a speci½c enterprise or industry, including production subsidies.

But Washington claims China has failed to disclose many of its subsidies, noting it took Beijing 15 years after joining the WTO to ½ll out its ½rst report on local government subsidies.

“China never took it seriously that they really have to do this,” said Craig Allen, president of the US-China Business Council (USCBC). “What are the subsidies, that is very unclear.”

The US also complains that China, the world’s largest exporter of goods, had taken advantage of the WTO’s vague de½nition of what constitutes a subsidy, allowing Beijing to adopt alternative channels – such as government-backed investment funds for the “Made in China 2025" initiative – to support favoured industries while avoiding scrutiny by fellow WTO members.

“China is too big to allow subsidies to go unaddressed,” said Lester Ross, chairman of the policy committee at AmCham China.

China introduced the “Made in China 2025” initiative in 2015, aiming to make itself the world’s dominant player in 10 strategic hi-tech industries and so reduce reliance on foreign technology.

In 2017, the Chinese government offered more than 5.16 billion yuan (US$770 million) in subsidies to local governments to support the “Made in China 2025” programme, according to data from the Ministry of Finance.

Local authorities no longer required to work on ‘Made in China 2025’

[2]

Last year, “Made in China 2025” subsidies were 9.29 billion yuan.

In comparison, Germany allocated just

“They use government money but run in a private-sector manner,” USCBC president Allen noted. “The US is concerned that massive sums of capital is being invested in hi-tech industries to allow Chinese national champions to dominate those industries in the future.

“This is state-driven, not market-driven, so it violates the WTO.”

The foreign business community also argues that Chinese state-owned banks provide “inappropriate” subsidies, such as loans on non-commercial terms, to selected Chinese companies in “Made in China 2025” industries.

The subsidies and other help for “Made in China 2025” are also largely granted by provincial and municipal governments, further reducing transparency as there are no aggregated ½gures for local government support and data on provincial subsidies is fragmented.

3. What is China doing to address this?

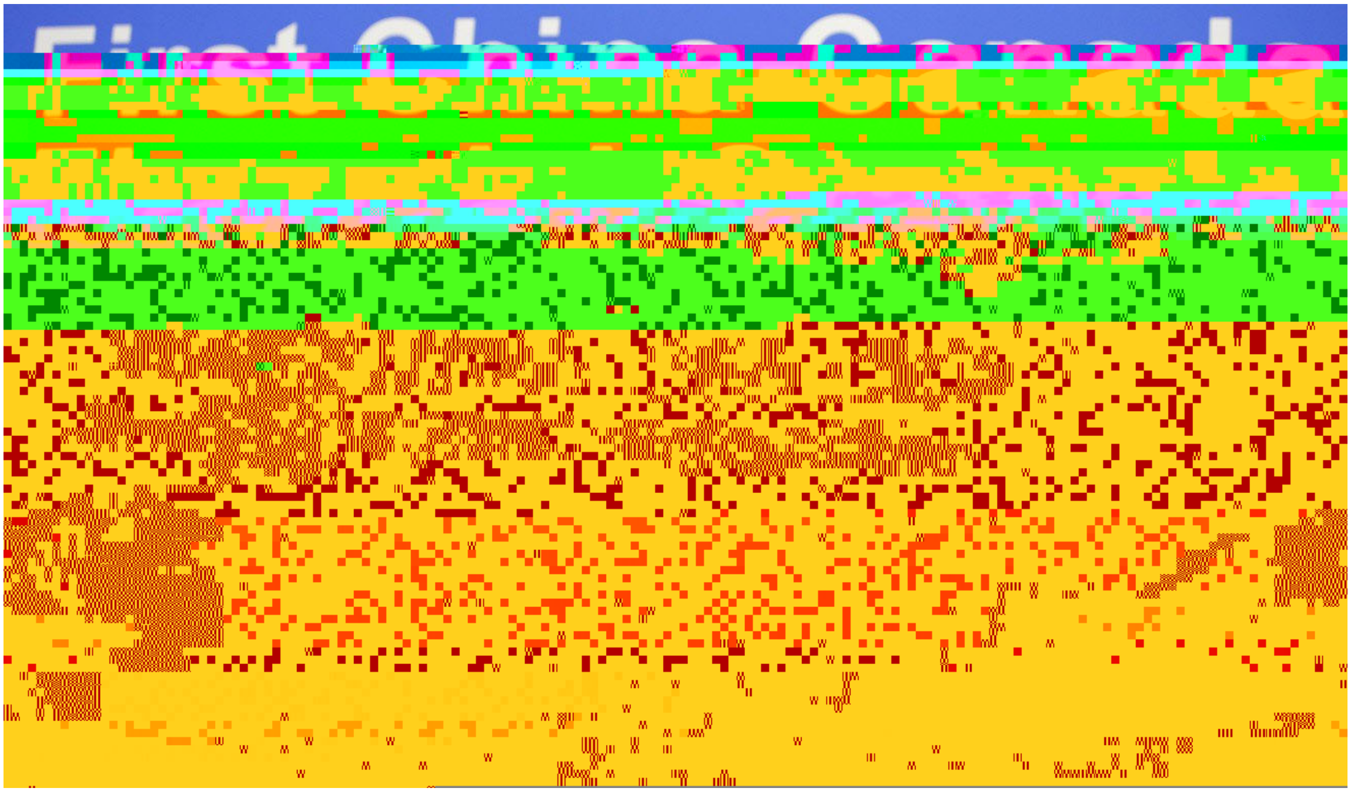
After four days of trade negotiations in Beijing in February, Channel NewsAsia reported that China has pledged to end market-distorting subsidies to Chinese industries and promised to bring all subsidy programmes into compliance with WTO agreements.

The Wall Street Journal also reported that Chinese representatives had oºered to eliminate subsidies given to Chinese consumers for purchasing new-energy and fuel e»cient cars. China began to gradually cut subsidies for new-energy cars in 2016 and halted funding for solar panel industries in May 2018.

China also stopped requiring local governments to work speci½cally on "Made in China 2025" projects, although local support for certain hi-tech industries continues.

Finance vice-minister Zou Jiayi argued that China's use of subsidies did not violate WTO rules, noting that Beijing had "fully abolished" subsidies that boost export performance or promote the use of domestic over imported goods.

She also said China had submitted over one thousand subsidy noti½cations to the WTO, including one covering all the provincial level subsidy policies between 2015 and 2016.



Finance vice-minister Zou Jiayi said that China's use of subsidies do not violate World Trade Organisation rules. Photo: AFP

USCBC president Allen said that merely meeting the WTO requirements was not enough.

"What we really want is the removal of subsidies when they distort the market," he said.

4. Chances of meeting US demands

It would be very di » cult for China to end all subsidies that a º ect trade, especially given politically powerful SOEs receive most of the bene½t.

President Xi Jinping has made clear that SOEs are a primary pillar of the "market economy with Chinese characteristics", pledging that China would "make no change where there should not and cannot be any reform".

This has led most foreign observers to expect little if any change in China's