

# CHASING THE GHOST OF TRANSATLANTIC COOPERATION TO LEVEL THE PLAYING FIELD WITH CHINA: TIME FOR ACTION

François Chimits



## KEY FINDINGS

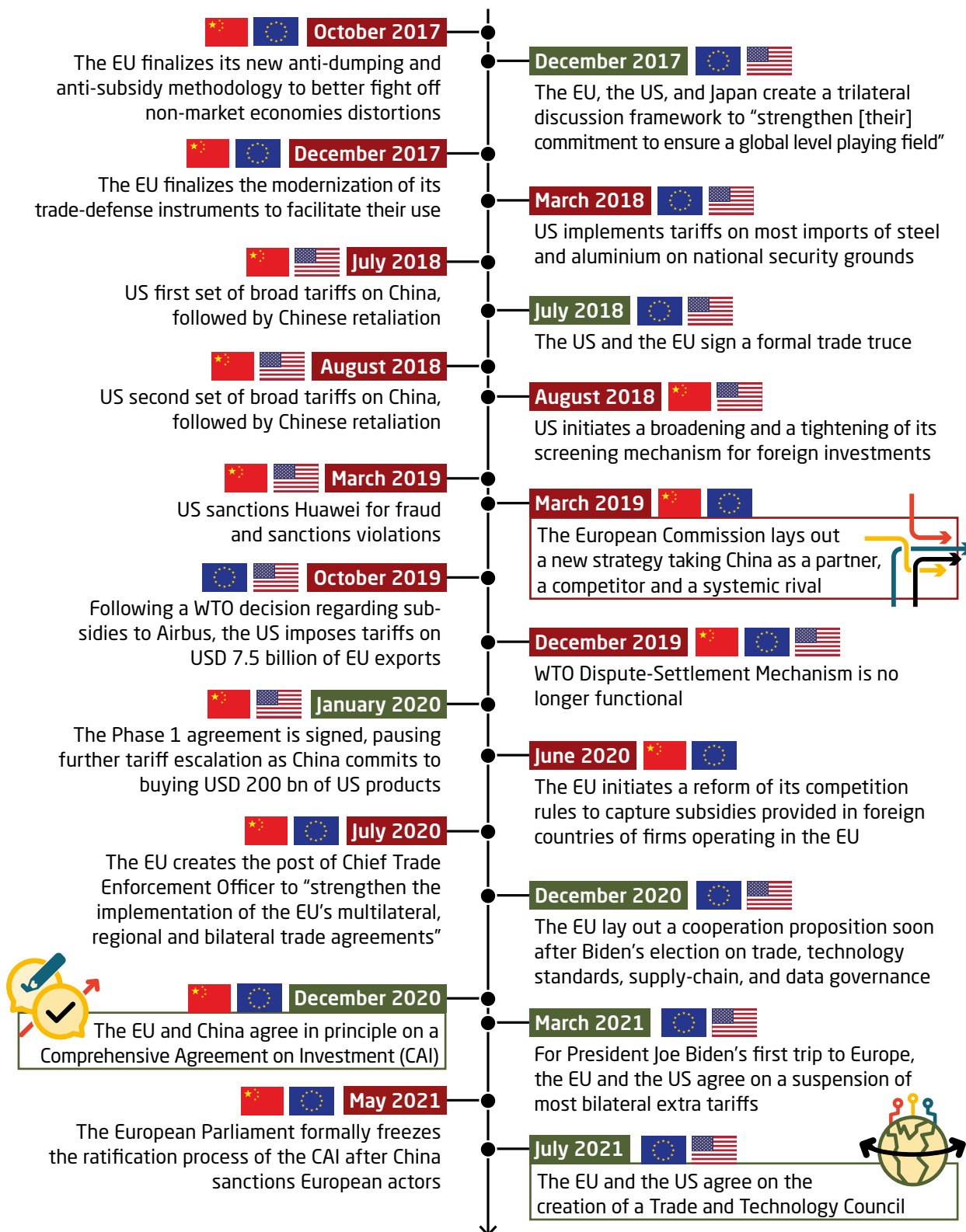
- **In recent years, the EU has beefed up its awareness, toolbox, and administrative ability to deal with Chinese economic competition distortions.** Tough actions, and costly Chinese retaliation, are still ahead.
- **There is a growing bipartisan consensus in the United States on the need for more assertive reactions to Chinese economic distortions.** The Biden administration has done away with the more controversial rhetoric and positions of the Trump administration, without repudiating the vast majority of the latter's economic measures. A clear position and approach on how to handle Chinese distortions is still pending.
- **China aims for a new development model focused on innovation and technological independence,** under the overarching strong guidance of the party state. This is likely to worsen its economic distortions, especially in relation to more innovation-intensive advanced economies.
- **With an increasingly distortive China and the transatlantic alignment of views in this regard,** a unique window of opportunity to act to fix the liberal economic order has opened. Especially as the EU-China Comprehensive Agreement on Investment and the US-China Phase 1 Agreement appear unlikely to become functional.
- **An update of the multilateral rulebook would need EU resoluteness against retaliation by Beijing and accepting the possibility of pursuing a complementary plurilateral system if negotiations stall.** The United States would need to clarify its position regarding enforceable multilateral rules. However, geopolitical and technical complexities make concrete outcomes a long-term game.
- **The EU and United States would need to make concessions on bilateral divergences,** such as how to have serious negotiations on a WTO reform and how to get developing economies on board for more disciplines on industrial policies.
- **Parallel actions through their respective unilateral tools to level the playing field with China could be quick wins for the EU and the United States and contribute to transatlantic cooperation.** Sectors prioritized in China's industrial plans are good targets, being of strategic importance and subject to Chinese innovative distortive channels improperly covered in the current rulebook.
- **The working group on global trade challenges of the EU-US Trade and Technology Council offers a good venue to kick-start serious discussions on common actions against Chinese distortions as well as multilateral disciplines.**
- **Considering the magnitude of the joint effort needed to fight back against Chinese distortions,** the EU and the United States should set aside, at least temporarily, the irritants in their trade relationship and the areas where their views do not converge.

## A complicated relationship triangle

Major events increasing economic tensions between the US, EU and China since 2017



Confrontational ■ Cooperative ■



Source: MERICS

© MERICS

## 1. INTRODUCTION: TRANSATLANTIC COOPERATION IS NEEDED TO DEAL WITH ECONOMIC CHALLENGES POSED BY CHINA'S NEW DEVELOPMENT MODEL

Fighting for a level playing field with China has been an increasingly common priority for Europe and the United States. The Biden administration has put China and alliance building at the heart of its foreign policy narrative. The analytical framework it has laid out for its relations with Beijing as simultaneously a partner, a competitor, and a systemic rival, is very similar to the EU's.

The EU met the new US administration with an ambitious cooperation proposition for a renewed rules-based liberal order.<sup>1</sup> This led to the creation of the EU-US Trade and Technology Council intended to “coordinate approaches to key global trade, economic, and technology issues” in order to “better protect our businesses and workers from unfair trade practices.” A working group of the council is dedicated to “global trade challenges,” largely to tackle Chinese distortions.

Fighting distortions is a top priority of EU and US trade policy plans.<sup>2</sup> According to a definition of the World Trade Organization (WTO), the term ‘distortion’ describes a situation when “prices and production are higher or lower than levels that would usually exist in a competitive market.”

Transatlantic cooperation is even more pressing as China develops an economic system aiming for state-led technological leadership and grows more assertive in redesigning the rules of globalization.<sup>3</sup> This “new development model” intends to innovatively use market forces for the allocation of resources under the strong guiding hand of the party-state, incorporating new types of distortions channels (see Exhibit 2).<sup>4</sup> This has led to an often-misread mix of improving China's legal and regulatory framework, circumscribed liberalization and targeted opening-up, and tech-centered industrial policies.

This monitor assesses the feasibility and specific modalities of cooperation between the EU and the United States to level the economic playing field with China.<sup>5</sup> It does not cover challenges related to the Chinese economy but less directly to the issue of a level playing field e.g., economic competition, security and trust (for instance, on industrial standards, export control, investment screening, supply dependencies, or data transfers), or values and politics (forced labor, dual-use technologies, industrial standards, or economic coercion). Nor does it touch upon the discussion on the virtues and flaws of industrial policy and distortions in general.

The first section reviews the possibility of cooperation towards an update of the international rulebook, especially at the WTO, with consideration for a second-best option of a liberal and rule-based plurilateral order. The second section looks at EU and US unilateral tools that could be used in parallel. The analysis describes recent evolutions of domestic stances, as well as efforts to cooperate, before assessing the prospects for greater cooperation (see Exhibit 3).

Fighting distortions is a top priority of EU and US trade policy plans



**Chinese distortions have been moving from traditional channels towards more innovative ones**

Assessment of the magnitude and trend of distortions in China from the various ways the Chinese state supports production

Distortion: by channel

Type of support production		Below market equity	Below market debt	Below market prices of inputs	State-owned enterprises	Direct subsidies and specific tax breaks	Coercive Tech. Transfers & Intelec. Property infringements	Manipulated exchange rate	Export credit and insurance	Dominant domestic position	Social dumping	Environmental dumping
Magnitude in China	Level	High	High	Medium	Medium	Medium low	Medium	Low	High	Medium	-	-
	Trend to GDP	Increasing	Stable	Decreasing	Decreasing	Stable	Stable	Increasing	Increasing	Increasing	-	-

Distortion: by destination

Type of support production		Discriminated access to public procurement	Upstream subsidies (or trickling down subsidies)	Transnational subsidies	Service subsidies
Magnitude in China	Level	High	Medium	Low	Low
	Trend to GDP	Stable	Stable	Increasing	Increasing

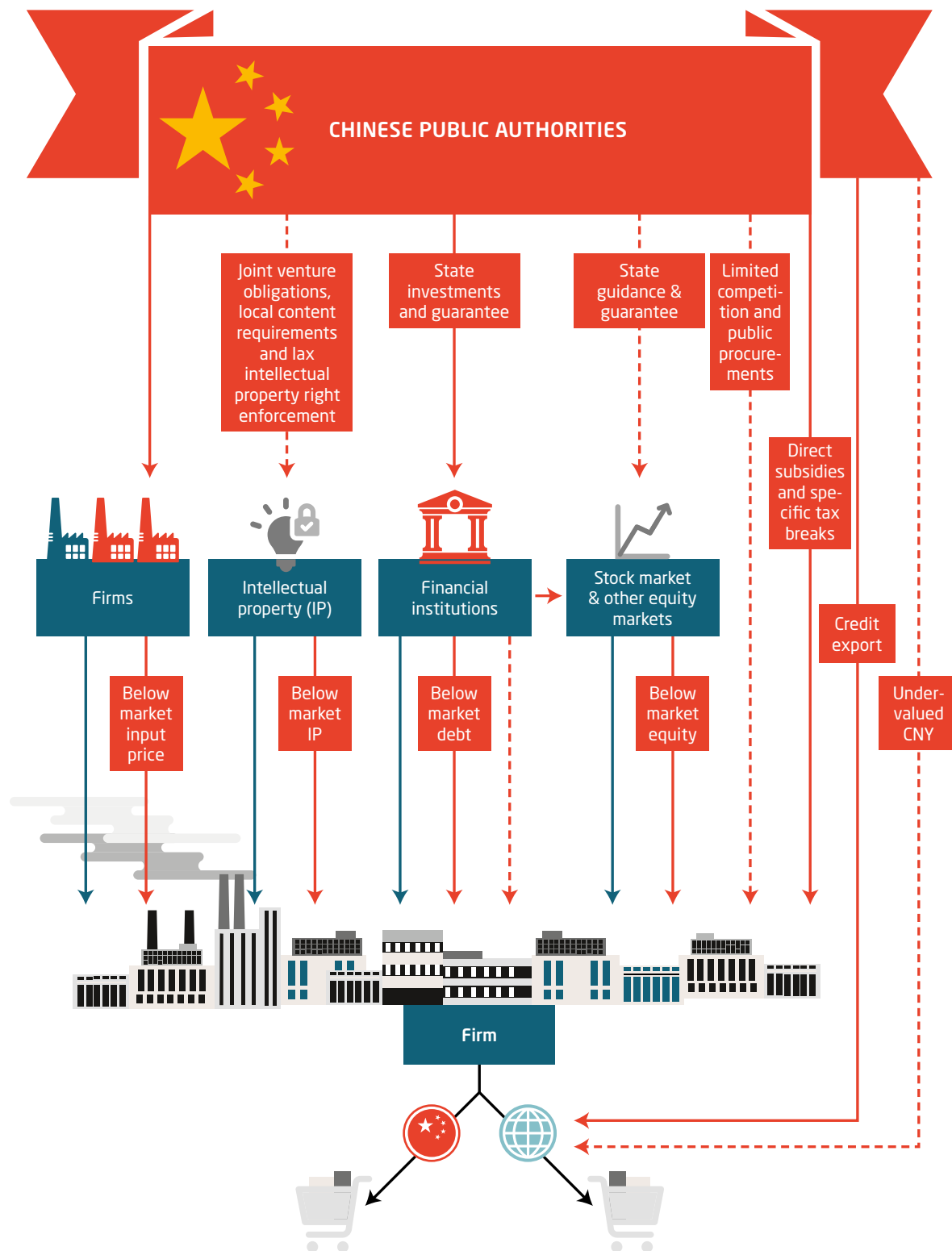
Note: See Annex 2 for details on what analysis those assessments are built on.

Source: Author's own assesment based on sources provided in the Annex.

**Distortive support to production can happen in many ways**  
 The many channels the Chinese state uses to support production



Direct state support → Indirect state support - - - - - Regular market transfer →



Source: MERICS

© MERICS

## 2. THE EU AND THE US HAVE A SHARED INTEREST IN UPDATING INTERNATIONAL RULES ON DISTORTIONS BUT DIVERGE IN THEIR APPROACH

The EU and the United States have grown dissatisfied with the WTO rule book that, with China in mind, they deem unsuited for dealing with distortions (see Annex 1). The WTO rule book, approved in 1994, sets a high burden of proof before countries are allowed to put tariffs on subsidized goods. What's more, the WTO transparency obligations on subsidies are toothless and poorly respected. Subsidization through below-market financing – in the form of cheap loans or cheap equity – or through below-market inputs is also hard to demonstrate at the WTO.<sup>6</sup> The WTO rules does not properly cover subsidies for production sites in third countries or those channeled through a state-guided entity. On top of this, the rules do not cover the service sector at all.

The EU and the United States have over the years aired similar demands for a change in the WTO on allowing countries to self attribute the status of “developing country”, which China benefits from. The treatment of non-market economies, intellectual-property infringement, exchange rates, and environmental issues all have also been occasionally referred to in Brussels and Washington for greater disciplines.

### **The multilateral rule book on economic interactions - a long effort to prevent beggar-thy-neighbor policies**

Most non-financial international economic interactions are subject to multilateral rules created in order to disincentivize countries to pursue beggar-thy-neighbor economic policies.<sup>7</sup> Originally a coordinated lowering of trade barriers after the Second World War, firstly tariffs, the General Agreement on Tariffs and Trade (GATT) and the WTO developed a rule book to forbid the most predatory behaviors, such as export subsidies, discriminations against foreign firms or products, and blunt intellectual-property infringements.<sup>8</sup> The WTO allows members to increase tariffs on goods for which prices have been proved to be distorted and thus hurt their commercial interests. The WTO's dispute-settlement mechanism can allow a party to proportionally raise barriers against a member breaching its commitments.

### **2.1 A transatlantic vision for how to achieve an update of the WTO rule book is a necessary first step**

A serious discussion among all WTO members regarding such transatlantic concerns has yet to be initiated. Since the organization functions purely on unanimity, the agreement of all is necessary to initiate such a discussion and to conclude it. Citing the lack of consideration at the WTO for reforms long demanded, the Trump administration decided to block the dispute-settlement mechanism (DSM) by vetoing new members for its Appellate Body. Due to the resulting insufficient number of members, the DSM has been inactive since late 2019.

The United States blockage is aimed at forcing a discussion on the rulebook as well as on the DSM itself. There is bipartisan criticism in Washington of the DSM's autonomous development of the rule book through its binding interpretations of the WTO rules when explaining its final decision on disputes. The United States considers the lack of political oversight by member states over this quasi-case law as a breach of the sovereignty of its citizens. On this matter, the EU diverges from the United States. It is eager to have a DSM independent

**The United States blockage is aimed at forcing a discussion on the rulebook as well as on the DSM itself**

from political pressure and only shares some technical issues the United States has with the mechanism (duration of procedures, duration of members' mandates, etc.).

The United States and the EU have so far failed to move forward with a common approach to get negotiations going because of their divergences on the ultimate purpose of the institution as well as a lack of mutual trust. The Trump administration repeatedly claimed the EU refused to engage on the reasons for what it perceived as the WTO's flaws.

For example, its trade representative saw the WTO as having been created so that all members would become market economies,<sup>9</sup> a view European countries reject. Moreover, the EU was reluctant to engage with the administration because of concerns it was hampering the organization only to facilitate its own protectionism.<sup>10</sup>

European countries went as far as contributing to an interim mechanism to circumvent the US blockage of the DSM with 15 other WTO members (including China), which is designed to mirror the DSM. Still, the EU also supported a proposal to reform the DSM, including by restraining its interpretative power through ex post oversight by members.

The Biden administration has not retained its predecessor's radical ideological position on the WTO, but it has not changed the US stance on the DSM blockage and kept the tariffs on China initially put to incentivize a reform. What is more, it has yet to lay out its vision for the WTO, an issue that is not among its declared priorities.

The EU long stated that unblocking the DSM must come before any common actions on WTO reform, but has refused to consider anything but peer pressure to drive reform forward. It has, though, recently signaled receptivity to some US concerns about the members' monitoring of the de facto case law of the DSM.<sup>11</sup> However, without the EU providing a serious alternative leverage to start a reform discussion at the WTO, it seems hardly conceivable for the United States to let go of its blocking approach, especially as many in Washington doubt the resoluteness of European countries to confront Chinese distortive practices.<sup>12</sup>

The US and the EU have so far failed to move forward with a common approach

With the recently created EU-US Trade and Technology Council (TTC) the pair have committed to "work together to advance the proper functioning of the WTO's negotiating function and dispute settlement system, which requires addressing long-standing issues" (the latter referring to the case-law concern).<sup>13</sup> The fact that neither the related EU factsheet nor the communiqué of the first meeting in September mentioned addressing long-standing issues likely indicates there is still work to do. Leaders on both sides have also yet to signal any moves towards addressing the constraint on leverage. The communiqué following the G7 summit in June omitted the DSM when calling for WTO reform. This indicates the need for a common EU-US position first.

The greater the number of supportive members of a reform proposal, the greater the pressure on China. It also makes more credible the possibility of setting up a new and deeper plurilateral order in case discussions for a WTO reform stall; a potential leverage to get discussion going. The United States and the EU need to clearly acknowledge the possibility of such an outcome, given that unanimity would be needed for any WTO reform.



## 2.2 A transatlantic view on updated WTO rules appears within reach

The discussions on the WTO rules launched in 2017 between the EU, the United States, and Japan made progress, but seemingly stopped in January 2020. This trilateral framework was created to strengthen their “commitment to ensure a global level playing field.” The discussions were structured around transparency, subsidy, and state-owned-enterprises (SOEs).<sup>14</sup> These have led to joint communiqués and formal propositions.

At the time the trilateral discussions ceased, the United States and China agreed on their Phase 1 bilateral deal and new US tariffs hit European products. Meanwhile, the EU-China dialogue on WTO reform created in 2018 has not shown any sign of life, likely because of the concurrent discussions on the EU-China Comprehensive Agreement on Investment (CAI). Since the agreement was announced in December 2020, China has not signaled any interest in a reform of the WTO rulebook, which likely conflicts with key characteristics of its model.

After agreeing “to construct direct or indirect incentives for WTO Members to fully comply with their notification obligations,” at the WTO in 2018, the EU, the United States, and Japan submitted a proposal on transparency at the WTO, with the aim to obtain timely and correctly notified subsidies.<sup>15</sup> The idea is to raise the cost on non-compliance to notify subsidies— a poorly observed obligation that lacks any serious enforcement.

For example, China did not notify any subsidies by its local governments until 2016, though they are responsible for most spending, and it still communicates only a few. Under the CAI, China has agreed to publicize subsidies in services as well as to a mechanism for the EU to obtain information on subsidies for any company.

Common concerns have led the three sides to agree on a proposition regarding subsidies in January 2020,<sup>16</sup> of which the details have not been made public as trilateral cooperation apparently stopped. The update includes a broader scope for the most harmful – and thus prohibited – subsidies, a softening of the burden of proof of the complaining party and more enforceable rules on subsidies through preferential prices, credit, or equity.<sup>17</sup>

Transnational subsidies (when support from one state is provided for production in another) are not explicitly mentioned but could be effectively covered when considering lowering the burden of proof. An extension of WTO disciplines to services was not mentioned, possibly because the Trump administration focused on industrial sectors.

The EU, the United States, and Japan failed to translate common concerns about SOEs into an agreement. They had stated there is a “need to better address market-distorting behavior of public bodies,” which are originators and beneficiaries of distortions, through a broader legal definition of what an SOE is and additional transparency obligations.

The lack of a breakthrough on this between the three sides over more than three years likely reveals difficulties between a Republican administration that took a strict view of SOEs and an EU more focused on the behavior of firms than their ownership.

Imposing WTO disciplines on SOEs has been a sensitive topic for China. SOEs are a crucial feature of the model pushed by the CCP, and this issue fits in the Chinese narrative of developed economies forcing their model onto others. The ambitious definition and disciplines contained in the CAI could however indicate a way forward.<sup>18</sup>

Imposing WTO disciplines on SOEs has been a sensitive topic for China

The Biden administration has shown a willingness to collaborate with the EU

The Biden administration has yet to show an interest in joint efforts at the WTO, it has supported a domestic industrial policy and focused on creating more US jobs and reducing trade dependencies. The EU-US TTC and the June G7 communiqué stress the need to update the WTO rulebook on subsidies, SOEs, and transparency. However, neither endorses the work of the EU-US-Japan trilateral, despite the EU's offer to do so.<sup>19</sup> This could signal a lack of consensus within the Biden administration as well as divergences with the EU are a low priority for the US government compared to economic recovery and re-industrialization.

Nonetheless, Democrats usually have a less aggressive stance against SOEs, a position shared by some nominees to the US Trade Representative staff and potentially hinted at in recent official documents.<sup>20</sup> Besides, the Biden administration has shown a willingness to collaborate with the EU by setting aside most of the transatlantic trade confrontations that had developed under Trump.

### 2.3 The EU and United States need to gather support from developing countries

The usual divide between advanced and developing economies would likely be fatal to any attempt at WTO reform. It would also make an alternative plurilateral rules-based order less viable. Outreach to other members has seen almost exclusively advanced economies voicing support for the work of the EU-US-Japan trilateral.<sup>21</sup> This is a reminder that those concerns are the usual ones of advanced economies.

The split between these and the developing countries has been the key roadblock for WTO negotiations for decades, and this could repeat itself with this reform effort. This might even more so be the case since China has repeatedly positioned itself as the herald of emerging countries<sup>22</sup> – a positioning in line with its developing-country status in the WTO (See box). The EU and the United States ended up with two separate proposals to narrow the scope of flexibilities for developing countries at the WTO, with China mostly in mind, despite initial hopes in the trilateral. Neither has received much support.<sup>23</sup>

The United States focused on conditionality to access the benefits of developing-country status, which would effectively exclude China from these, rather than from the status itself. The EU supports an agreement-by-agreement approach for new carve-out, along with a more targeted scope of flexibilities that exclude China too.<sup>24</sup>

#### **Special and differentiated treatment (SDT) at the WTO, a largely self-attributed status that has hampered negotiations**

Special and differentiated treatment at the WTO matches status with some carve-outs and support. In the current framework, those are limited, but for the more targeted least developed countries.

Nevertheless, with about two-thirds of members – from Singapore, to China, and Equatorial Guinea – categorizing themselves as developing countries, discussion on SDT – a principle of the WTO – has burdened all negotiations on setting new rules. This is partly why no serious new agreement has been reached at the WTO since 1995.

Offering developing countries better targeted but more generous space for industrial policies would incentivize them to support tighter disciplines for regular members.<sup>25</sup> Developing countries have consistently demanded more access at the WTO to advanced economies' markets for agricultural goods and more industrial policy space.

With political momentum in the United States and Europe against more foreign competition for domestic farmers, proposing less stringent disciplines for “genuine” developing countries to conduct industrial policy appears to be their only bargaining chip left.<sup>26</sup> Besides, an offer on industrial policy space could drive a wedge between China and many of its long-term allies in the WTO.

The Biden administration has yet to formulate a stance on special and differentiated treatment, but it has agreed to “continue to cooperate on” that matter in the TTC. Its focus on developing alliances, domestic industrial policy, and fostering development in poor countries could lead to it taking a more accommodating line.<sup>27</sup>

#### **2.4 Transatlantic cooperation on international rules and actions on export credit could have a visible impact**

While the conversation on the international economic framework and distortions often focuses on the WTO and trade, other fora also set rules and standards to level the international playing field.<sup>28</sup>

The international rule book on export credit is set by the Organisation for Economic Co-operation and Development’s Arrangement on Officially Supported Export Credits dedicated to “fostering a level playing field” for such support. The agreement disciplines interest rates and volume of such financing while providing quasi-real-time transparency. It has been enshrined in the WTO, making use of export credit that conforms to the OECD’s disciplines automatically in line with WTO rules.<sup>29</sup>

However, neither the WTO nor the OECD provides an effective dispute-settlement mechanism on this issue. The latter does not have one, while the former suffers from the burden of proof and the delay of procedures.<sup>30</sup> Albeit having provided as much export credit than all other G7 countries combined over the past five years, plans to provide even more, China is not part of an arrangement. Besides, Chinese export credits stand out as particularly opaque.<sup>31</sup>

Neither the WTO nor the OECD provides an effective dispute-settlement mechanism

The EU and the United States have long pressed China to join the OECD arrangement. US efforts led to China participating in the creation of the International Working Group on Export Credits, which was set up in 2012 “to make concrete progress towards a set of international guidelines on the provision of Official Export Financing ... by 2014.” The group’s negotiations ended in November 2020, with most members pointing to the lack of efforts by China.<sup>32</sup>

The EU-US-Japan trilateral’s intentions to pursue this topic have not led to any outcome, likely because the United States was struggling through a domestic discussion on export credits, that ended in 2020 when its export-credit bank returned to regular operations after years of suspension.

Cooperation on actions against Chinese export-credit behavior could be one of the first outcomes of an update of international rules to level the playing field with China. The Biden administration has identified “export financing” as one of the Chinese distortions to go after.<sup>33</sup> Similarly, the EU 2021 trade policy review mentions a need for an “EU strategy on export credit.” Recent EU anti-subsidy investigations on Chinese products have targeted non-market-based export-credit insurance.<sup>34</sup>

Renewed EU-US cooperation in this field could materialize in various ways. An update of the WTO rules could facilitate an effective challenge against export subsidies but this would only be in a long-term perspective. Common actions or guidelines could be developed for trade-defense instruments against below-market export credit. An agreement on systematic matching of Chinese financial conditions, which is permitted by the OECD agreement and was mandated to the Export-Import Bank of the United States in 2019, would be quick to materialize, but potentially costly.<sup>35</sup>

## 2.5 The EU and the US should acknowledge that they are less eager to converge on other multilateral topics

A country being labeled a non-market economy (NME) at the WTO facilitates the imposition of larger penalties by its trade partners. China was in that category until 2016 and for a long time the highly contentious point was whether it would then let the label go, as it claimed, or a new decision would be needed. The issue has been left pending and considered less of priority as the United States and China entered a trade war. The EU has dealt with this issue unilaterally and efficiently.<sup>36</sup> It went with its own country and sector-specific assessments, whereas the United States just kept treating China as an NME.

The EU's approach, which was recognized as WTO-compliant, could inspire the United States but there has been no sign to follow its example.<sup>37</sup> China in the meantime has started labelling the US as an NME in some of its own trade defense investigations, which could generate momentum for transatlantic cooperation.<sup>38</sup>

The EU seems to have acknowledged the United States preference to address coercive transfers of technology outside of the WTO, while it lacks a clear way forward in that regard with the CAI in limbo.<sup>39</sup> To the United States, such coercive transfers materialized in China "through oral instructions and behind closed doors" making a WTO challenge difficult.<sup>40</sup> After initial talks in the trilateral, the Trump administration went for unilateral tariffs on USD 200 billion of Chinese goods, which eventually led to its Phase 1 deal with China. The deal forbids conditioning market access on technology transfers, while aiming to strengthen intellectual property in China.<sup>41</sup>

For its part, the EU first initiated a WTO case against such Chinese practices in 2018, which has been on pause for quite some time, likely because of the CAI negotiations. Eventually, the CAI included equivalent disciplines on coercive transfer as in the Phase 1 deal.<sup>42</sup> The EU's recent cooperation proposition to the United States separated WTO reform and technology transfers.

There have been no signs of transatlantic cooperation intentions on exchange rates, a matter entirely absent from the WTO rulebook and on which the EU has displayed no appetite. The United States, which has long complained about undervaluation of the Chinese currency, has implemented unilateral pressure to better discipline exchange-rate distortions. The Phase 1 deal contains non-intervention commitments with, for the first time, some form of enforcement on that matter. The United States also listed in late 2020 an undervalued Renminbi as a source of subsidization for some Chinese goods, in a case confirmed in 2021 under Biden.

Still, the Biden administration has shifted its attention from the valuation of the Renminbi to transparency and suspected stealth foreign-exchanges interventions through state-owned banks.<sup>43</sup> The lack of international rules, mirrors the case in China of the 1985 Plaza

There have been no signs of transatlantic cooperation intentions on exchange rates

Accord in which the United States and its European allies got Japan to agree on an appreciation of the Yen, which points to tougher push back by China. Besides, while China's exchange-rate management is still opaque, the International Monetary Fund has assessed the Renminbi to be "broadly in line with its [economic] fundamentals" for a decade.<sup>44</sup>

The Trump administration produced a late effort to weaponize divergences in the ambition of environmental regulations, with a level-playing-field angle, to go after China.<sup>45</sup> No other country has voiced support for this approach. Still, the House of Representatives and the Senate have pressed the Biden administration to act, so far without a clear response.

The EU has been extremely reluctant to mix the environmental questions with the issue of a level playing field. It has made a considerable effort to shield the conversation on its proposed carbon border adjustment mechanism from those considerations.



**Transatlantic alignment on the approach to tackle Chinese distortions convergences vary greatly**

Assessment of the transatlantic alignment of approach to tackle the various ways the Chinese State supports production

Distortion: by channel

Type of support production	Below market equity	Below market debt	Below market prices of inputs	State-owned enterprises	Direct subsidies and specific tax breaks	Coercive Tech. Transfers & Intelec. Property infringements	Manipulated exchange rate	Export credit and insurance	Dominant domestic position	Social dumping	Environmental dumping
Transatlantic convergence	Medium high	Medium high	Medium	Medium	High	Medium	Low	Medium high	Unclear	Medium high	Very low

Distortion: by destination

Type of support production	Access to public procurement	Upstream subsidies (or trickling down subsidies)	Transnational subsidies	Service subsidies
Transatlantic convergence	Low	Medium high	Low	Low

Source: Author's own assessment.

### 3. SELECTIVE EU-US COORDINATION ON THEIR UNILATERAL ACTIONS COULD PAVE THE WAY FOR MULTILATERAL EFFORTS

While US actions on China during the Trump administration have attracted attention, the EU has for some years strengthened its unilateral toolbox to shield its market from distortions. Those efforts have in many respects put the EU ahead of the United States (see Annex 1).

#### 3.1 Joint sanctions on sectors most subsidized by China would help build trust

The EU has beefed up its legal and administrative ability to put tariffs on distorted imports, with China in mind. The 2013 - 2017 modernization of its trade-defense instruments (TDIs)<sup>46</sup> was in response to both failure to act on some Chinese goods and to end the NME status of China.<sup>47</sup> The first EU report to provide sector- and country- NME categorizations mentioned China. The reform facilitated and amplified TDI tariffs, in a WTO-compliant way.

In addition to its legal capacities, the EU strengthened its administrative ability by creating the position of a Chief Trade Enforcer Officer in 2020, with a mandate to enforce international trade rules and dedicated human resources.

The European Commission has recently displayed a willingness to act forcefully and innovatively on Chinese distortions. Since 2018, EU TDIs have targeted new distortions, such as the lack of labor-union diversity, political influence through CCP cells in firms, subsidized inputs, restrictions on exports of raw materials, and subsidies provided abroad under the BRI.<sup>48</sup> The use of TDIs has risen from 13 investigations per year between 2013 and 2017 to 18 in 2019 and in 2020. The share of China-related cases rose to two-thirds of initiated procedures in 2020.<sup>49</sup>

The United States has also used its TDIs more but without any similar efforts to fix loopholes. The number of anti-dumping and countervailing duties under implementation against China rose from 131 in 2014 to 208 in January 2021, amounting to a third of all cases.<sup>50</sup> But, in spite of the momentum against Chinese distortions, US trade remedies do not cover transnational subsidies and do not attempt to tackle labor-market distortions.<sup>51</sup> In her recent presentation of the Biden administration's approach to China, US Trade Representative Katherine Tai acknowledged the need for new tools against "massive subsidies" from China, as well as the perspective of cooperating with allies on that matter. One minor innovation was the strengthening in 2020 of the possibility to counter the undervaluation of foreign currencies, which led to the tariffs in the aforementioned case.

Cooperation between the EU and the United States on their respective tools has been limited to jointly pushing the OECD to inform on support for production brought by public authorities worldwide. This has led to reports which have found China to be the provider of 80 percent of the world's subsidies in sectors such as aluminum and semiconductors.<sup>52</sup> A recent report scoping below-market financing through main companies in 13 industrial sectors also finds China standing out, with an average of support through below-market equity price of two percent of firms' revenues from 2005 to 2019, versus zero percent in OECD countries.<sup>53</sup>

Common actions on key topics and sectors could set new standards to tackle Chinese distortions, while building trust and clarifying the need for the WTO reform.<sup>54</sup> The EU's innovative use of trade remedies against Chinese distortions often tests the current WTO framework on the very points where an update is deemed needed. The strong priority given by the Biden administration to labor rights creates cooperation potential on this often-overlooked topic, as pointed to in the communiqué of the first TTC meeting in September.<sup>55</sup>

The strong priority given by the Biden administration to labor rights creates cooperation potential

China's reaction is likely to be fierce in this eventuality as this touches a core characteristic of the CCP regime. A less sensitive option would be to build on the work of the OECD on the channels and sectors for Chinese distortions, such as semiconductors, rail stock vehicles, steel, aluminum, or telecommunications cables.<sup>56</sup>

Such common action on that front could possibly be shared with other G7 partners, that clearly signaled interest to better confront Chinese distortions.<sup>57</sup> At the same time, efforts to better understand and assess distortive practices through the OECD could be amplified.

### **3.2 Where EU and US approaches and priorities diverge, transatlantic cooperation could still foster information sharing**

The European Commission has innovatively proposed to mobilize competition rules to tackle the effect of foreign subsidies within the single market, including for public procurement, services, and foreign acquisition. The proposed foreign subsidy regulation of May 2021 would apply to distortions not covered by the WTO (first services, but potentially also transnational subsidies or below-market financing), distorted foreign investment, and subsidized foreign firms in public procurement. The proposal is then simultaneously a lever for, a complementary tool to, and a backup for WTO reform.<sup>58</sup>

The European Commission is optimistic that the adoption process will be fast, thanks to wide support, and hopes for its implementation as soon as 2022.<sup>59</sup> The only official Chinese reaction so far has pointed at the weakness of the proposal regarding EU law and WTO rules, and called for a carve-out for investments at the invitation of an EU member state.<sup>60</sup>

The EU has been working on an International Procurement Instrument (IPI) for almost a decade with the potential to make it a reality by 2022. The IPI was approved by the Council and passed to the European Parliament in June. It aims “to strengthen the position of the EU when negotiating access for EU businesses” to foreign public procurement.<sup>61</sup>

The EU has been working on an IPI for almost a decade

In practice, the IPI facilitates excluded bidders from countries without a commitment on a sufficient openness of their own in public procurement for EU firms. It would be thus defensive and offensive. Divergent views among member states hampered progress at the level of the EU Council; for instance, on the level of penalties for bidders from closed countries.<sup>62</sup>

While China has not officially reacted, the EU plan likely contributed to a fresh proposal by Beijing to join the WTO agreement on the topic in late 2020. It was followed shortly by a draft domestic regulation to clarify, standardize, and make public all domestic public procurement. Both do not appear to meet EU demands, which has a veto on China joining this plurilateral WTO agreement. The Government Procurement Agreement at the WTO (GPA) among the EU and 20 others members (including the United States) is a commitment on agreeing to a certain degree of public procurement access to other members of that deal, made by each participant.

The United States has extensively used national-security tools to block Chinese firms from its market, sometimes with level-playing-field motivations, reducing needs for tools akin of the ones the EU is proposing. The screening of foreign investment has been strengthened in recent years, especially with regard to Chinese firms, contributing to the quasi-disappearance of Chinese investments. Many Chinese firms have been banned because of alleged connections to the Chinese military. Public procurement, already only marginally open, has been de facto closed to Chinese firms.



EU-US cooperation perspectives in the near term appear limited to information sharing and damage control. The insistence of the Biden administration on international rules and proportionality suggests a narrower use of national-security tools by the United States. However, its first measures indicate that any narrowing will be marginal. The rather closed nature of US public procurement and the ambition to close it further to support domestic production limit the prospects for cooperation in the medium term.<sup>63</sup>

The recent announcement of cooperation on China between the EU commissioner for competition and the US trade representative indicates some prospects for cooperation on the new EU competition tools. Still, given the strong emphasis by the United States on national security when talking about China as well as the ongoing domestic discussions regarding a reform of competition rules for better tackling domestic growing clout of large companies, any perspective for cooperation in the medium term seems limited to information sharing.

#### 4. CONCLUSION

The divergence between the views of the EU and the United States on Chinese distortions during the Trump administration was largely exaggerated and the extent of transatlantic cooperation overlooked. Since the start of the Biden administration, broader commonalities feed into an already narrowing – but certainly remaining – gap.

However, a clear view on divergences is needed to make the most of the current window of opportunity to respond to this challenge for the international economic order. Parallel actions against China's most pervasive distortions offer a way to deepen transatlantic commonalities and build up trust. These are necessary preconditions for the more ambitious overhaul of the multilateral rules-based order.

The creation of the EU-US Trade and Technology Council, with its specific working group on global trade challenges, could help a lot in that respect. So could the separate working group on aircraft, which has a mandate to tackle the issue of distortion by non-market economies.

Sticking to a more demanding rules-based approach rather than ad hoc pushbacks would help demonstrate that, on level-playing-field issues, the EU and the United States are only standing up to safeguard rules-based principles they believe to be optimally efficient and not repressing any country's development. This would also be necessary to establish a complementary, more plurilateral, order in the likely enduring vacuum between the crippled old multilateral order and a new one that could only be agreed after a struggle with China.

## ENDNOTES

- 1 | It intends to “be the linchpin of a new global alliance of like-minded partners”, based on “common values of fairness, openness and competition” and “centered on areas where our interests converge, our collective leverage can best be used”. European Commission (2020). EU-US: A new transatlantic agenda for global change. European Commission. Accessed: September 2021.
- 2 | The “US Trade policy agenda” (United States Trade Representative, March 2021, hereafter USTR (2021)) lists “China’s Coercive and Unfair Economic Trade Practices Through a Comprehensive Strategy” and “Partnering with Friends and Allies” among priorities. The “Trade Policy Review” (European Commission, February 2021) identifies “the rapid rise of China, demonstrating global ambitions and pursuing a distinct state-capitalist model” among the main factors for the early review.
- 3 | Brown, Alexander & Gunter, Jacob & Zenglein, M. J. (2021). “Course Correction: China’s Shifting Approach to Economic Globalization”. MERICS. Berlin (Germany): MERICS.
- 4 | Blanchette, Jude (2021). “From “China Inc.” to “CCP Inc.”: A New Paradigm for Chinese State Capitalism”. China Leadership Monitor. Stanford (US): The Hoover Institution.
- 5 | A level playing field is a situation in which market participants “compete on an equal footing” (OECD). Discriminative state interventions such as specific subsidies, regulatory discrimination, and national preference are the usual culprit for tilting the playing field.
- 6 | Organisation for Economic Co-operation and Development (2019a). “Measuring distortions in international markets: the aluminium value chain”. OECD Trade Policy Papers. No. 218. Paris: OECD Publishing. Organisation for Economic Co-operation and Development (2019b). “Measuring distortions in international markets: The semiconductor value chain”, OECD Trade Policy Papers, No. 234. Paris: OECD Publishing.
- 7 | A simple quantity definition would define international unilateralism as the action of one party, bilateralism of two, and multilateralism of three or more. A more quality-based approach would define multilateralism as a combination of indivisibility, generalized organizing principles, and diffuse reciprocity. Bilateralism would be based on preferentialism and changes its goals and priorities on a case-by-case basis. Unilateralism describes a situation where a state acts autonomously with tools under its sole responsibility. Tago, A. (2017). “Multilateralism, Bilateralism, and Unilateralism in Foreign Policy”. Oxford Research Encyclopedia of Politics.
- 8 | Predatory behavior, also referred to as mercantilist, is when the creation of wealth for the acting party is realized by the puncture of someone else’s welfare, rather than a net value-added in terms of overall utility.
- 9 | The United States jointly proposed with Brazil in July 2020 that “market-oriented conditions are fundamental to a free, fair, and mutually advantageous world trading system.” They were joined later by Japan, but opposed by the EU in exchanges at the WTO.
- 10 | Trade Talks (2021). “The EU’s new trade policy, with S. Weyand of DG Trade”. Trade Talks 148. Peterson Institute for International Economics.
- 11 | The “Trade Policy Review” of the European Commission (published in February 2021) recognizes that “the US has raised a number of valid concerns” about the role of the Appellate Body, including the need for “judicial economy”, for new rules on SOEs, and for stricter timelines. The question of the leverage to get serious WTO reform regarding China’s state-led economy was the first asked to S. Weyand during her interview at one of the most famous American podcasts on trade matters (Trade Talks (2021)).
- 12 | In two articles in Foreign Affairs in 2020, US Trade Representative Robert Lighthizer justified the unilateral approach by referring to a lack of determination in Europe to confront China for its distortive actions. Scholar and former Obama official M. Bown shared similar concerns (Trade Talks (2021)).
- 13 | White House (2021). US-EU summit statement. Accessed: September 2021. Washington DC: White House.
- 14 | Office of the United States Representative (2017). Joint Statement by the United States, European Union and Japan at MC11. Accessed: October 2021.
- 15 | World Trade Organization (2019). Procedures To Enhance Transparency and Strengthen Notification Requirements Under WTO Agreements. JOB/CTG/14/Rev.2.
- 16 | Office of the United States Representative (2020). Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union. Accessed: July 2021.
- 17 | Office of the United States Representative (May 2018). Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union. Accessed: July 2021. Office of the United States Representative (September 2018). Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union. Accessed: July 2021.
- 18 | Under the CAI, SOEs – defined as all firms with a certain respect of state influence, including local SOEs – have an obligation to act according to commercial considerations and not discriminate against EU firms, as well as extra transparency obligations. Any subsidy to an SOE is considered “specific”, hence eligible for trade sanctions.
- 19 | S. Weyand, DG of the DG Trade at the webinar “The EU-China CAI: will it be a game changer?” organized by the Peterson Institute for International Economics (2021).
- 20 | At her various confirmation hearings this year, the incoming USTR K. Tai refrained from singling out SOEs when talking about the challenges relating to the “state-directed economics.” Besides, the US Trade Policy Agenda for 2021 only refers to subsidies and transparency under the objective of addressing China’s “unfair economic trade practices.”
- 21 | The Ottawa group is Australia, Brazil, Canada, Chile, EU, Japan, Kenya, South Korea, Mexico, New Zealand, Norway, Singapore, and Switzerland. European Commission (2021). “Joint Communiqué of the Ottawa Ministerial on WTO Reform”.

- 22 | In line with long-standing positions, the propositions of China on WTO reform (State Council of the People's Republic of China (2018). *China and the WTO*. Accessed: February 2021) focuses on market access in agriculture, fewer subsidies by developed economies in that sector, and more policy space for developing countries. China as the “champion of the developing world” is constitutive of the CCP narrative, explained by Wang Yi when detailing Xi Jinping’s thought on diplomacy (Qiushi (2021). 深入学习贯彻习近平外交思想 不断开创中国特色大国外交新局).
- 23 | World Trade Organization (2019). Communication from the USA. WT/GC/W/757. EU supported a proposition formally made by Norway (WT/GC/W/770). The United States got Brazil, Singapore, and Mexico to let go of the developing status for future negotiations.
- 24 | Both propositions have shied away from stripping China of that status, but only of the related benefits.
- 25 | The long proponent of extra industrial policy space for developing countries D. Rodrik (an idea expressed clearly as soon as 1997 in *Has globalization gone too far?*) has been joined by other respected scholars such as J. Bhagwati and P. Krugman. The IMF in 2018 acknowledged that no country had successfully caught up with advanced economies without strong industrial policies (Cherif, R. and Hasanov F., “The return of the policy that shall not be named”, IMF Working paper 19/74. Washington: International Monetary Fund).
- 26 | Demands from most developing countries, under the informal G90 group, has been trimmed down from 87 demands in 2002 to 10 propositions in 2017 (see WTO documents: JOB/DEV/48; JOB/TNC/60).
- 27 | In line with the long-standing position of the Democrats, the US Trade Policy Agenda for 2021 has “Promoting Equitable Economic Growth Around the World” among its ten priorities. The piece disregards mere market opening as a satisfying condition for common prosperity and poverty alleviation in third countries.
- 28 | Other subjects of international rules, such as sector-specific disciplines on overcapacities, development financing, corruption, economic coercion, and external debt could also benefit from extra disciplines against Chinese practices. Being less directly related to the level-playing-field issue, they are left out from this report.
- 29 | World Trade Organization (2000). Brazil - Export Financing Programme for Aircraft Recourse by Canada to Article 21.5 of the DSU - AB-2000-3 - Report of the Appellate Body. WT/DS46/AB/RW.
- 30 | Hopewell, Kristen (2019). “Power transitions and global trade governance: The impact of a rising China on the export credit regime”. *Regulation & Governance* 15 (3), 634-652.
- 31 | Export-Import Bank of the United States (2021). “EXIM 2020 Competitiveness Report”. Washington DC: Export-Import Bank of the United States. Multiple Chinese ministries published encouragement in September 2020 the use of export credit to support “core enterprises” supply chain (中国人民银行 工业和信息化部 司法部 商务部 国资委 市场监管总局 银保监会 外汇局关于规范发展供应链金融 支持供应链产业链稳定循环和优化升级的意见). In March 2021, the “Notice of the China Export Credit Insurance Corporation of the MofCom on Further Utilizing the Role of Export Credit Insurance” was issued by the Chinese ministry of Commerce (商务部中国出口信用保险公司关于进一步发挥出口信用保险作用加快商务高质量发展的通知).
- 32 | The EU, the United States, Australia, Brazil, Canada, Japan, Korea, New Zealand, Norway, Switzerland and Turkey jointly announced the suspension of their participation because of the lack of meaningful progress. China, India, and Russia are among the few participants missing from the statement.
- 33 | United States Trade Representative (2021). US Trade policy agenda. Accessed: July 2021.
- 34 | European Commission (2020). 38th Annual Report from the Commission to the Council and the European Parliament on the EU's Anti-Dumping, Anti-Subsidy and Safeguard activities and the Use of TDIs by Third Countries targeting the EU in 2019. 2020/776. See p.13 for electric bicycles.
- 35 | Hackenbroich, J. & Oertel, J. & Sandner, P. & Zerka, P. (2020). Defending Europe’s economic sovereignty: new ways to resist economic coercion. European Council on Foreign Relations. Ruhlig, T. (2020). Towards a more principle European China policy. Institut français des relations internationales. Huotari, M. & Weidenfeld, J. & Arcesati, R. (2020). Managing economic cooperation and competition with China - Towards a More Integrated European Trade Policy Approach. MERICS.
- 36 | Office of the United States Representative (May 2018). Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union. Accessed: July 2021. For the concrete outcomes of the non-market-economy status and the unilateral approach used by the US and the EU: Sandkamp, & Yalcin, K. (2020). Different Antidumping Legislations within the WTO. CESifo Working Paper No. 8398. CESifo GmbH.
- 37 | Since then, China has dropped the case it brought, most probably to prevent the decision and the explanatory report from being published. As acknowledged by Chinese scholar Tu Xinquan in an interview with CSIS in July 2019.
- 38 | Zhiguo Yu (2020). The US is now a “Non-Market Economy” – Anti-Dumping Ruling by China. *International Economic Law and Policy Blog*.
- 39 | Coercive technological transfer here refers to public actions coercing foreign firms to a technological transfer that would not have happened under a free competing market (OECD). Technological theft is not per se a level-playing-field issue as it is outside the realm of economic exchanges.
- 40 | Office of the United States Representative (2018). “Findings of the investigation into China’s acts, policies, and practices related to technology transfer, intellectual property, and innovation under section 301 of the trade act of 1974”. p.19.
- 41 | Wei, L. & Davies, B. (2020). “Negotiating a Truce, December 2019-January 2020”. In: *Superpower showdown – How the battle between Trump and Xi threatens a new cold war*. P359-386. New York, NY : Harper Business. Blustein, P. (2019) “*Might Unmakes Right*”. In: *Schism – China, America and the fracturing of the global trading system*. P253. Waterloo, ON, Canada : Centre for International Governance Innovation.

- 42 | Lester, S. (2021). Forced Technology Transfer Provisions in the CAI and the US-China Phase 1 Deal. International Economic Law and Policy Blog. Following the EU's sanctions on local officials responsible of human rights violation towards the Uighur minority, China retaliated by sanctioning European officials and civil society institutions. With some of its members being targeted, the European Parliament put the ratification process of the CAI on hold on April 2021.
- 43 | "The Biden Administration will examine how Treasury, Commerce and USTR can work together to put effective pressure on countries intervening in the FX market to gain a trade advantage" (Office of the United States Representative, US Trade policy agenda, 2021). United States Department of the Treasury (2021). Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States. Washington DC: United States Department of the Treasury.
- 44 | The latest annual report on China by the IMF still criticizes the opaqueness around the renminbi exchange rate.
- 45 | World Trade organization (2020). Advancing Sustainability Goals Through Trade Rules To Level The Playing Field. WT/GC/W/814.
- 46 | TDIs, as recognized by the WTO, are tools crafted to put some extra barriers to products entering the domestic market. They are anti-dumping, countervailing duties (in the case of subsidies) or safeguard.
- 47 | A point made by then EU Trade Commissioner M. De Gucht in a speech at the High-Level Conference: Modernisation of TDIs in 2012. Gstöhl, S. & De Bievre, D. (2018). Actors and Processes in EU Trade Policy. In: The trade policy of the European Union. P69–77. London: Palgrave. Pepermans, A. (2016). The Huawei case and what it reveals about Europe's trade policy. European Foreign Affairs Review. Pepermans, A. (2017). The Sino-European solar panel dispute. Journal of Contemporary European Research.
- 48 | See EU legal document: 2020/776; 2020/C 51/12; 2020/C 351/08; 2020/C 352 I/01; 2019 C 192/30, 2019/C 342/09 and 2020/776. Crochet, V. & Hedge, V. (2020). China's 'Going Global' Policy: Transnational Subsidies under the ASCM. Leuven Centre for Global Governance.
- 49 | Chimits, Francois (2021). The EU targets distortions in the Chinese aluminum value chain. MERICS, EU-China briefing. MERICS
- 50 | US Congressional Research Service (2021). Trade Remedies: Antidumping and Countervailing Duties.
- 51 | See the 1998 amendment incorporated Section 351.527 in the US Code of Federal Regulations (§ 351.527).
- 52 | OECD (2019a), "Measuring distortions in international markets: the aluminium value chain", OECD Trade Policy Papers, No. 218, OECD Publishing, Paris. OECD (2019b), "Measuring distortions in international markets: The semiconductor value chain", OECD Trade Policy Papers, No. 234
- 53 | The covered sectors are aerospace and defense; aluminum, automobiles, cement, chemicals, glass and ceramics, rolling stock, semiconductors, shipbuilding, solar photovoltaic panels, steel, telecom network equipment, and wind turbines. The sample cover in almost every sector more than two-thirds of the world production, along with a balanced geographical coverage. OECD (2021).
- 54 | Such key sectors could be derived from the sectors prioritized by Chinese industrial policies. To have an idea of such sectors, see "Evolving Made in China 2025: China's industrial policy in the quest for global tech leadership" by A. Holzmann and M. J. Zenglein (2019, MERICS).
- 55 | As part of its second priority of its trade policy agenda, called "Putting workers at the Center", the USTR stated that "Trading partners will not be allowed to gain a competitive advantage by violating workers' rights." The current USTR has long been a proponent of actions against labor-rights infringement abroad.
- 56 | The last three are referred to as likely Chinese distortions by both the USTR 2021 Trade policy agenda and recent EU TDIs investigations.
- 57 | The June 2021 G7 Communique mentions "the need for the world's leading democratic nations to unite behind a shared vision to ensure the multilateral trading system is reformed, with a modernised rulebook and a reformed WTO at its centre", with the following points to be advanced: modernization of the rulebook and protect against unfair practices (such as forced tech transfers, IP theft, lowering green and social standards to gain competitive advantages, market-distorting actions of SOEs and harmful subsidies).
- 58 | The WTO has an exclusivity clause barring domestic rules on distortions already effectively covered (Art 32.1).
- 59 | France and Germany reiterated in February 2021 their strong support to the mechanism as part of a joint proposal on reducing European dependencies.
- 60 | China Chamber of Commerce to the European Union (2020). CCCEU responds to EC white paper. Brussels: China Chamber of Commerce to the European Union.
- 61 | European Parliament (2020). EU international procurement instrument. Brussels: European Parliament.
- 62 | Federation of German Industries (BDI) (2020). International Public Procurement: New Opportunities for the EU?.
- 63 | In April 2021, the EU, the United Kingdom, Canada, Japan, Australia, Israel, and South Korea lodged a request for arbitration regarding a US effort to lower its opening commitments made under the WTO Government Procurement Agreement, initiated under Trump and confirmed under Biden (see: GPA/ARB/USA/1 - GPA/ARB/USA/1/Add. 7).

## The EU and the US have built up their toolbox to tackle Chinese distortions, but loopholes remain



The coverage of frequently used ways of Chinese distortions by current mitigation instruments for the EU and the US

Category of distortions	Type of support production	WTO Coverage	EU				US		
			Trade Defense Instruments	Comprehensive Agreement on Investment	Foreign subsidy**	International Procurement Inst.**	Trade Defense Instruments	Phase 1	Section 301
By channel	Below market equity	Very low	Low*	Medium low	Medium high	Medium	Low*	Low	Good*
	Below market debt	Medium low	Medium low	Medium low	Medium high*	Medium	Medium low	Low	Good*
	Below market prices of inputs	Medium low	Medium low	Medium low	Good*	Medium	Medium low	Low	Good*
	State-owned enterprises	Medium	Medium	High	Low	–	Medium high	–	
	Direct subsidies and specific tax breaks	Good	Good	Very good	Good*	High	Good	Low	Good*
	Coercive Tech. Transfers & Intel. Property infringements	Medium	–	Good	–	Low	–	Good	Good*
	Manipulated exchange rate	Very low	Low	–	–	–	Good*	Medium high	Good*
	Export credit and insurance	Very low	Medium	–	Medium low	Medium	Medium	–	Good*
	Dominant domestic position	Very low	–	Low	Medium low	Low	–	–	Good*
	Social dumping	–	Medium	–	–	–	Low	–	Good*
	Environmental dumping	–	Medium low	–	–	–	Low	–	Good*
By destination	Discriminated access to public procurement	–	–	Medium low	Low	Very high	–	–	–
	Upstream subsidies (or trickling down subsidies)	Very low	Low	Low	Medium high	–	Low	–	Good*
	Transnational subsidies	Very low	Medium*	Low	Low	Low	Low*	–	Good*
	Service subsidies	–	–	High	Very high	–	–	–	–
Domain of intervention		World	Cross-border trade	China	Foreign firms in the EU	Domestic Public Procurement	Cross-border trade	China	Flexible

\*Likely in breach of the WTO current rulebook

\*\* Only at the proposition stage, without full text finalized

Source: Author's assessment



## Chinese distortions are difficult to precisely estimate, but existing research allows an assessment of their magnitude and trend

Estimates and sources to assess the magnitude and trend of distortions from the various ways the Chinese state supports production

Category of distortions	Type of support production	Magnitude in China		Estimates
		Level	Trend to GDP	
By channel	Below market equity	High	Increasing	<ul style="list-style-type: none"> <li>■ The OECD (2021) finds that below-market equity amounts to 2.5% of firms' revenues in China (vs. 0.1% in other non-OECD countries and 0% in OECD countries) and is growing.</li> <li>■ Naughton (2021) points that state-led investment funds went from RMB 0 to 11 trillion of announced capital between 2015 and 2020, based on Zero2IPO (2020) numbers, which find 1,741 of such funds by Q1 2020 with actual total assets of CNY 4.8 trillion.</li> <li>■ For a more qualitative analysis of those funds, see CSET (2021) or Fuller (2019).</li> <li>■ Rithmire and Hao Chen (2020) find that 90% of investment firms in China are state-controlled.</li> <li>■ The IMF (2017, 2019, 2021) finds a similar scale for "government-guided funds," operating "akin to public venture capital," which appeared in 2014 and amounted to 2.5 % of GDP by 2016, and since fueled annually with around 1 percent point of GDP. The perimeter defined by the IMF is broader than the industrial funds.</li> <li>■ The debt-to-equity swap program launched in 2016 likely also provided de facto below-market equity to SOEs, even though the opacity of operations make assessment difficult, but operations reached close to 2 trillion of debt by end 2017, before losing pace (Tresor 2018).</li> <li>■ The IMF (2019) estimates that retained profits by SOEs have remained very high at 95%.</li> </ul>
	Below market debt	High	Stable	<ul style="list-style-type: none"> <li>■ The OECD (2019a, 2019b) finds that below-market debt amounts to support of roughly 5% of revenue among the four Chinese semiconductor firms it covers and 10% in the ten aluminum firms (vs. close to 0% for non-Chinese firms in semiconductors and 5% for aluminum in OECD countries).</li> <li>■ Chinese central bank statistics show that a third of bank lending had a rate below the lending benchmark in 2019 (about 50% of GDP of credit), which is meant to represent the risk-free loans.</li> <li>■ Roughly 1% of GDP annually for SOEs from 2011 to 2019 and rising, according to the IMF (2019).</li> <li>■ Flurry of announcements by banks of credit tagged for sectors prioritized by industrial policies.</li> </ul>
	Below market prices of inputs	Medium	Decreasing	<ul style="list-style-type: none"> <li>■ Roughly 1.5% of GDP annually as support to SOEs in 2011-2018 according to the IMF (2017b, 2019), with cheaper land and rents (70%), cheaper commodities (15%), and cheaper inputs (15%), but decreasing because of dwindling cheap lands and rents.</li> </ul>
	State-owned enterprises	Medium	Decreasing	<ul style="list-style-type: none"> <li>■ SOEs enjoy roughly 3% of GDP of support annually, but decreasing according to the IMF (2017b, 2019).</li> <li>■ The very large majority of financial institutions are SOEs, making SOEs very large potential providers of support to production.</li> <li>■ SOEs are over-represented in upstream sectors, in line with the principle of dual-track liberalization applied in the 1990s.</li> </ul>
	Direct subsidies and specific tax breaks	Medium low	Stable	<ul style="list-style-type: none"> <li>■ Around 0.5% of GDP annually for SOEs according to various IMF studies.</li> <li>■ Formal subsidies registered by listed companies in China have stayed broadly stable (IMF 2019).</li> </ul>
	Coercive Tech. Transfers & Intelec. Property infringements	Medium	Stable	<ul style="list-style-type: none"> <li>■ A report produced by the US National Bureau of Asian Research (2017) estimated the harm to the United States from Chinese coercive intellectual-property practices (including theft) amounted to USD 225-600 billion annually, based on a 2014 study by PricewaterhouseCoopers LLP and the Center for Responsible Enterprise and Trade. Stolen trade secrets are thought to account for 80-90% of the total, the rest being counterfeit and pirated hardware and software.</li> <li>■ Anecdotal evidence in the media as well as in European or US Chamber of Commerce in China reports and surveys (see for instance EUCCC 2018, 2019 and 2020, AmCham 2019), and in some academic works by Prud'homme (2018).</li> <li>■ No serious general estimates of the benefits from coercive technology transfer in China.</li> </ul>

Source: See page 24



Category of distortions	Type of support production	Magnitude in China		Estimates
		Level	Trend to GDP	
By channel	Manipulated exchange rate	Low	Growing	<ul style="list-style-type: none"> <li>■ The IMF has stated since 2015 that the RMB exchange rate is in line with fundamentals.</li> <li>■ The US has assessed the RMB as not being undervalued in its annual report on foreign exchanges except in 2020, but keeps China on its “monitoring list” because of opacity in FX management</li> <li>■ The 2021 situation might signal a return to some undervaluation, because of the massive financial inflows and current account surplus in China (Chimits 2021).</li> </ul>
	Export credit and insurance	High	Growing	<ul style="list-style-type: none"> <li>■ The US EXIM Bank (2021) assessed Chinese export credits to represent 90% of all of such financing by G7 countries, at USD 76 billion for 2019.</li> <li>■ The OECD (2015) found that China increased its issuance of trade finance guarantees from USD 43 billion in 2008 to USD 327 billion in 2013.</li> <li>■ Chinese export credits are suspected to also differ from those of G7 members in terms of opacity, lower interest rates, and laxer constraints (OECD 2015; Hopewell 2019).</li> </ul>
	Dominant domestic position	Medium	Growing	<ul style="list-style-type: none"> <li>■ A recent report by Kratz (2021) describes the phenomenon as substantial, illustrating it through case studies of various sectors (solar, rail rolling stock, and telecom).</li> <li>■ No overall estimation of the benefits drawn by Chinese firms this way to the best of available knowledge.</li> </ul>
	Social dumping	–	–	<ul style="list-style-type: none"> <li>■ No known serious estimation of this debated phenomenon exists.</li> </ul>
	Environmental dumping	–	–	<ul style="list-style-type: none"> <li>■ No known serious estimation of this debated phenomenon exists.</li> </ul>
By destination	Discriminated access to public procurement	High	Stable	<ul style="list-style-type: none"> <li>■ The European Commission (2012) found China is the closest public procurement market out of twelve partners.</li> <li>■ Kratz's (2021) study of three sectors (solar photovoltaic panels, telecommunication, and rail rolling stock) finds that “some of the strongest barriers to foreign participation in China are erected through procurement.”</li> </ul>
	Upstream subsidies (or trickling down subsidies)	Medium	Stable	<ul style="list-style-type: none"> <li>■ Gourdon (2015) finds that those wide export restrictions relate to “official objectives pursued by the Chinese public authorities such as those related to the promotion of technology or protection of the environment but also other unstated motives pertaining to subsidization of downstream sectors and terms of trade.”</li> <li>■ Garred (2018) found that those export taxes have surged after China entered the WTO, and are closely negatively correlated to WTO-related tariff reduction for products downstream of the one affected by export taxes, hence pointing at a potential subsidization strategy for those downstream sectors previously protected by tariffs.</li> <li>■ The magnitude of the support through such channels is difficult to assess.</li> </ul>
	Transnational subsidies	Low	Growing	<ul style="list-style-type: none"> <li>■ The scale is extremely difficult to assess, but political intentions and anecdotal evidence converge.</li> <li>■ Li Keqiang (2014) stated that “[w]e encourage competitive Chinese producers of iron and steel, cement and plate, etc. to shift their operation to ASEAN countries to meet the local need of infrastructure development through investment, leasing and loan lending so as to achieve mutual benefit.”</li> <li>■ He Yafei (2014), then vice minister of the Overseas Chinese Affairs Office of the State Council, said that sectors with overcapacity should expand consumption and production in developing countries in need of such products.</li> <li>■ The head of a Chinese firm of fiberglass, that was later to become the first firm to be targeted by EU measures against transnational subsidy, explained to the China Daily (2016) that he was moving production to Egypt in part because “If you export fiberglass to Europe from China, you have to pay anti-dumping and anti-subsidy duties of 24.8 percent.”</li> <li>■ In a recent report, the European Commission talked about “the growing practice of state-owned Chinese companies receiving subsidies to export production capacity outside of China to special economic zones.”</li> </ul>
	Service subsidies	Low	Growing	<ul style="list-style-type: none"> <li>■ No known specific study on the service sector. But, if Chinese industrial policy has long focused on traditional industrial sectors, there is no reason to believe that service sectors are treated differently from the manufacturing one when it comes to state support as they become part of industrial priorities.</li> </ul>

Source: See page 24

## ANNEX - SOURCES

- American Chamber of Commerce in China (2019), 2018 China business climate survey report. Beijing (China): American Chamber of Commerce in China.
- Chimits, Francois (2021). China's 2020 external surplus - a wake-up call. Berlin (Germany): MERICS.
- China Daily (2016), "Chinese companies boost operations in Egypt". China Daily.
- China Development Bank (2021) announced in March to have earmarked 400 Bl RMB of annual loans to support strategic emerging industries and advanced manufacturing.
- Arnold, Z., Ngor Luong, B. Murphy (2021). Understanding Chinese Government Guidance Funds: An Analysis of Chinese-Language Sources. Washington (United States): Center for Security and Emerging Technology.
- Chimits, Francois (2018). Le programme d'échange de dettes contre actions (DES) semble pour le moment principalement assainir les bilans des entreprises d'Etat et des grandes banques. Paris (France): Direction Générale du Trésor (DG Trésor).
- EU Chamber of Commerce in China (2018). European business in China: Business confidence survey 2018. Beijing (China): European Chamber of Commerce in China.
- EU Chamber of Commerce in China (2019). European business in China: Business confidence survey 2019. Beijing (China): European Chamber of Commerce in China.
- European Commission (2012). Impact assessment working document (IAWD) of the Regulation establishing rules on the access of third countries' goods and services to the EU internal market in public procurement. Accessed: September 2021. See Annex 3 entitled "Problem analysis".
- European Commission (2021). 39th Annual report on EU's Trade Defence activity. Accessed: September 2021.
- Fuller, D. B. (2019). Paper Tigers, hidden dragons. Oxford (United Kingdom): Oxford University Press.
- Garred, Jason (2018). "The Persistence of Trade Policy in China After WTO Accession", *Journal of International Economics*, (114): 130-142.
- Gourdon, Julien, Hering Laura, Monjon Stéphanie, Poncet Sandra (2019). "Trade policy repercussions: the role of local product space - Evidence from China". Paris: Université Paris1 Panthéon-Sorbonne.
- He Yafei (2014). China's overcapacity crisis can spur growth through overseas expansion. Hong-Kong: South China Morning Post.
- Hopewell, Kristen (2019). "Power transitions and global trade governance: The impact of a rising China on the export credit regime". *Regulation & Governance* 15 (3), 634-652.
- IMF (2017a). Mano, R., Stokoe P. "Reassessing the Perimeter of Government Accounts in China". IMF Working Paper No. 17/272. Washington, DC: International Monetary Fund.
- IMF (2017b). Lam, W. R., Schipke, A. "Chapter 11. State-Owned Enterprise Reform". In: *Modernizing China*. Washington, DC: International Monetary Fund. See Figure 11.5.
- IMF (2019). "People's Republic of China: Selected issues". IMF Country Reports, No. 19/274. Washington, DC: International Monetary Fund. See graph on page 43.
- IMF (2021). "External sector report: Divergence recoveries and global imbalances". Washington, DC: International Monetary Fund.
- IMF (2021), "People's Republic of China: 2020 Article IV Staff Report", see Government-guided funds in Table 5 p59, under the hypothesis of a similar split between construction and government-guided funds identified in IMF (2017).
- Kratz, Agatha, J. Oertel (2021). Home advantage: How China's protected market threatens Europe's economic power. European Council on Foreign Relations and Rhodium Group.
- Li Keqiang (2014). "Remarks by H.E. Li Keqiang Premier of the State Council of the People's Republic of China At the 17th ASEAN-China Summit". Ministry of Foreign Affairs of the People's Republic of China. Accessed: September 2021.
- Naughton, Barry (2021). "The rise of China's industrial policy". In: *The rise of China's industrial policy, 1978 to 2020*. Buena Onda, S.A. de C.V. Mexico: Universidad Nacional Autonoma de Mexico;
- Organisation for Economic Co-operation and Development (2015). Skarp, Lennart. "Chinese Export Credit Policies and Programmes". Trade Committee Working document. Paris: OECD Publishing.
- Organisation for Economic Co-operation and Development (2019a). "Measuring distortions in international markets: the aluminium value chain". OECD Trade Policy Papers, No. 218. Paris: OECD Publishing.
- Organisation for Economic Co-operation and Development (2019b). "Measuring distortions in international markets: The semiconductor value chain", OECD Trade Policy Papers, No. 234. Paris: OECD Publishing.
- Organisation for Economic Co-operation and Development (2021). "Measuring distortions in international markets: Below-market finance". OECD Trade Policy Papers, No. 247. OECD Publishing. Paris: OECD Publishing.
- Prud'homme, Dan & von Zedtwitz, Max & Thraen, Joachim Jan & Bader, Martin, 2018. " 'Forced technology transfer' policies: Workings in China and strategic implications". *Technological Forecasting and Social Change*, Elsevier, vol. 134(C), pages 150-168.
- The National Bureau of Asian Research (2017) "Update to the Intellectual Property Commission report – The theft of American intellectual property". Washington DC: The National Bureau of Asian Research.
- Export-Import Bank of the United States (2021). "EXIM 2020 Competitiveness Report". Washington DC: Export-Import Bank of the United States.



United States Department of the Treasury (2021). “Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States“. Washington DC: United States Department of the Treasury.

Zero2IPO (2020). “Report on Performance Evaluation of Chinese Government Guidance Funds 2020” [年中国政府引导基金绩效评价研究报告, 情科研究中心]. Beijing (China): Zero2IPO.

## ACKNOWLEDGEMENTS

This study was supported by a Ford Foundation grant and is licensed to the public subject to the Creative Commons Attribution 4.0 International License.

### CONTACT

François Chimits  
*Analyst*, MERICS  
francois.chimits@merics.de

### EDITORIAL TEAM

Claudia Wessling  
*Director Communications  
and Publications*, MERICS  
claudia.wessling@merics.de

Nick Bouchet  
*Freelance Editor*

### GRAPHICS + LAYOUT

STOCKMAR+WALTER Kommunikationsdesign

### PUBLISHER

MERICS | Mercator Institute for China Studies  
Klosterstraße 64 | 10179 Berlin  
Tel.: +49 30 3440 999 0  
Mail: [info@merics.de](mailto:info@merics.de)  
[www.merics.org](http://www.merics.org)

ISSN: 2509-3843