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Subsidies in China as a Challenge to International Trade Law

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ABSTRACT

International trade is necessary in the modern world with all of the demands and expectations for a better economic situation in a nation. Fair competition is necessary to boost economy of a country. Such fairness is brought about by the implementation of subsidies by domestic country while competing in the international trading scenario. But biased nature of subsidies towards a domestic market implemented by a country such as China has proved to create problems and disputes, in addition to causing disruption of fairness in international trade. Chinese state-owned companies pose significant problems to the global trading system due to their size and importance. One question is whether a state-owned enterprise falls within the World Trade Organization anti-subsidy system as a "public body" and whether such public bodies are involved in "financial contribution" to the domestic market. The Chinese government instructs state-owned enterprises and state-owned banks to provide loans and raw resources to support the growth of important sectors. Such contributions fulfil all the conditions to be called subsidies. Even if the government refuses to release any relevant information, state-owned enterprises can be deemed to be public bodies under the governmental authority standard and the facts-available process. This research work contends that the countervailing measures statute is a workable instrument to combat the subsidies that China indirectly provide through its State-Owned Enterprises. Further, we will look at how the subsidies are implemented by China in its domestic market through State Owned Enterprises and the effect that the subsidies have with respect to General Agreement on Trade and Tariff 1994 and Subsidies and Countervailing Measures agreement. The current state of the economy will be discussed, including the way China views subsidies, their effects, and the apparent failure of the World Trade Organization's Agreement on Subsidies and Countervailing Measures to address them.

Keywords: *General Agreement on Trade and Tariff, 1994, Subsidies and Countervailing Measures Agreement, State-owned enterprises, Financial contribution, Public enterprises.*

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I. INTRODUCTION

(A) Evolution of subsidies

The concept of subsidies plays an important role as an international trade instrument. Such international trade instruments are always governed by legal provisions instituted by the WTO and GATT. The General Agreement on Tariffs and Trade (1994) and the Marrakesh Declaration, also known as the Uruguay Round, are the two documents that, in general, define the subsidies in the WTO/GATT regulations. The Uruguay Round of negotiations resulted in the SCM agreement. The SCM agreement defines a subsidy as "measures that involve a 'financial contribution' from a 'government or public entity' that impart a 'benefit' on the recipient firm" and is applicable to all WTO members as part of the single endeavour. The "Subsidy Code" from the Tokyo Round, which is then improved upon by the WTO Agreement on Subsidy Countervailing Measures, is the next significant step. The Subsidies Code established a requirement that countries intending to file for CVDs had to first establish that their domestic industry was harmed by the subsidised imports. It said that subsidies contained measures making export subsidies a per se violation of the rules.

(B) Definition of subsidies and CVD

According to Article 16 of the GATT, if a contracting party maintains or grants any form of income or price support that operates directly or indirectly to boost exports of any product from, or to decrease imports of any product into, its territory, it shall notify the contracting parties in writing of the extent and nature of the subsidisation, as well as the estimated effect of the subsidisation on the quantity of the affected product or products. The contracting party granting the subsidy shall, upon request, discuss the possibility of limiting the subsidisation with the other contracting party or parties concerned, or with the contracting parties, in any case where it is determined that any such subsidisation threatens or causes serious prejudice to the interests of any other contracting party. The main purpose of regulating countervailing measures, according to Article 6 of the GATT 1994, is to balance out the adverse effects of the application of subsidies for both goods and services in the production of goods, manufacturing, and subsidies on the transportation aspect, either directly or indirectly. The provisions of **Article 10 of the SCM Agreement** discusses the methods that must be taken to be able to apply **Article 6 GATT 1994**.²

The forms and types of subsidies provided by the government, either directly or indirectly, in

² WTO Analytical Index, https://www.wto.org/english/res_e/publications_e/ai17_e/gatt1994_art16_jur.pdf (last visited 16 Nov, 2022)

accordance with the provisions of **Article 1.1. The SCM Agreement**, which benefits both the country's development and certain recipient parties. This subsidy is being implemented in accordance with the provisions of **Article 14 of the SCM Agreement**. As a result, the restrictions on the application of subsidies are quite specific, which becomes a problem when competitors, particularly foreign business actors, face subsidy provisions, and countervailing measures are used to resolve these problems.³

II. ABOUT CHINESE SOE

The core of the Chinese economy and significant players on the international scene are state-owned Chinese corporations. The Chinese government has two approaches to affect the country's manufacturing processes through SOEs. The Chinese government may effectively control the production of raw materials in the upstream industries and, as a result, have an impact on non-SOEs' business decisions in the downstream industries. Second, by offering credits, the Chinese government can promote the growth of particular businesses. Loans to those designated businesses may be easily steered because state-owned commercial banks ("SOCBs") and policy banks are heavily regulated by the government. There are significant ramifications to the employment of SOEs and SOCBs as public policy tools. The Chinese government's creation of artificial supply is a key cause of worry for foreign trade. It resulted in price decreases for several goods, particularly steel. The United States has also emphasised how excess capacity in China's manufacturing industry, particularly in the production of steel and aluminium, distorts international markets and harms American firms and employees.

The multilateral trading rules of today remain neutral with regard to property ownership and do not prohibit members from keeping or establishing SOEs, even though the WTO Accords were established under the presumption that Members will have free-market economies. Even though it does not forbid governments from owning businesses, the WTO's anti-subsidy system limits government policies that grant SOEs financial benefits and laws that require SOEs to deliver comparable advantages to other producers. According to the WTO's SCM Agreement, members may impose countervailing duties like anti-dumping duties to make up for the benefits gained by producers from subsidies in the exporting nation. If a member discovers that a foreign nation is subsidising a particular product, it may impose an import duty on that product in an amount equal to the other country's subsidy margin.

³ Agreement on subsidies and countervailing measures, https://www.wto.org/english/docs_e/legal_e/24-scm.pdf, (lasted visited Nov 16, 2022)

(A) Issues involved

1. Whether CVD can be imposed, under the SCM agreement, on Chinese SOE?
 - a. Whether the Chinese government state owned enterprises fall under the category of public body?
 - b. Whether the Chinese state-owned enterprises meet the concept of financial contribution as a subsidy to the Chinese domestic market?
2. Whether the WTO remedies are ineffective to address China's subsidy problem?

III. LEGAL FRAMEWORK

Subsidies implemented by a country, being a member of WTO such as China, has to abide by GATT 1994 and SCM Agreement 1995 rules. Some of the relevant provisions of the mentioned agreements are mentioned in this paragraph. Starting with Article XVI of GATT provides general information on trade distorting nature of subsidies on other contracting parties and as per Article XI of GATT, contracting parties should extend no less favourable treatment to like products imported from any third contracting countries. Article XXIII talks about nullification of such distorting subsidies having adverse effect on international trade of contracting parties and revert the benefits enjoyed from such subsidies. Article 1 of SCM Agreement provides us the specific definition of a subsidy. As per Article 1.1(a)(1), subsidy should include financial contribution in form of direct fund transfer, loan guarantees or tax credits, by a government or any public body. Article 10 of SCM Agreement and in application to Article VI of GATT, members of agreement shall impose countervailing measures to prevent the effect of distorting subsidies. Article 17 of SCM Agreement allows members to impede investigation authority to investigate and collect evidences regarding illegal subsidies. Once the fact of financial contribution by public body is confirmed, investigation authority, under Article 14 of SCM Agreement, shall calculate the benefit to the recipient out of the amount of subsidy so that proper compensation can be provided to other contracting parties.⁴

IV. ANALYSIS**1. Whether CVD can be imposed, under the SCM agreement, on Chinese SOE?**

The SCM Agreement's Article 1.1(a)(1) discusses essential SOE concepts in relation to public bodies and financial contributions. The SCM Agreement states that countervailing measures may be used to address subsidies in the event that a "financial contribution" is made by a

⁴ Agreement on subsidies and countervailing measures, https://www.wto.org/english/docs_e/legal_e/24-scm.pdf, (lasted visited Nov 16, 2022)

"government or other public body within the territory of a member" from which a "benefit" is received. A brief on how Chinese SOEs function is that the central government routinely sends raw materials and electricity through upstream SOEs to downstream companies, and it distributes finances and loans through SOCB to producers in critical industries. As a result, if a Chinese SOE or SOCB is found to be a public body, the anti-subsidy regulations will investigate its activities with other companies and may see them as subsidies subject to CVD imposition if they are not conducted at market pricing⁵. The use of SOEs and SOCBs as instruments of public policy has drawbacks. A major concern in the domain of global commerce is the fact that the Chinese government artificially generates an excess supply, which has led to a decrease in prices for a range of items, particularly steel. In response to these consequences caused by Chinese SOEs, nations have increased their reliance on trade remedies, such as the imposition of anti-dumping and countervailing duties against goods imported from China.

1.1 Whether the Chinese government state owned enterprises fall under the category of public body?

The primary purpose is to determine whether a SOE is a public body, for which a sophisticated standard of investigation has been developed in United States Anti-Dumping and Countervailing Duties case dealing with Chinese subsidies. The problem faced in this case is Chinese government and SOE often are reluctant to provide information related to public body analysis. Despite their lack of cooperation, the investigating authorities are nonetheless able to determine that the in question SOEs are public bodies. This is due to the facts-available mechanism, which allows the investigating authorities to infer conclusions about public body from other data that is on the record.

Facts Available Mechanism includes delivering questionnaires to the exporting government and the SOEs under inquiry as the quickest way to learn whether there is government control. In particular, Article 12.7 of the SCM Agreement states that final decisions may be based on investigated information, which the Chinese government would not have otherwise offered that because it could reveal the entity as a public body. In order to reach the final decision, investigating authority has to evaluate and reason the facts available from other sources. Inference is to drawn from such facts and also consider other factors like any difficulties experienced by interested parties, including the nature and availability of the evidence being sought, the adequacy of protection accorded by an investigating authority to the confidentiality

⁵ Weihuan Zhou & Mandy Meng Fang, *Subsidizing Technology Competition: China's Evolving Practices and International Trade Regulation*, 30 Wash. INT'L L.J. 470 (2021).

of information, the time period provided in which to respond, and the extent or number of opportunities to respond.⁶

In the landmark case of US Anti-Dumping and Countervailing Duties (China), it was observed that Article 1.1 (a)(1), subparagraph (iv), states that it is important to consider whether an entity performs activities which would generally be vested in the government when considering whether the entity is a public body. It also relied on ownership and created a presumption that businesses having a majority state ownership are government entities that performs activities that otherwise would be carried out by the Chinese government. According to the appellate body, a public body is defined as an entity that "possesses, exercises, or is vested with governmental authority" serves as evidence that an entity is exercising systematic governmental functions, but the mere fact that a government is a majority shareholder of an entity may not be sufficient to establish that the entity is a public body. Therefore, it was decided that gathering further pertinent data was required in order to perform an assessment of the entity's status as a public body. For example, investigation authority relied on reports of Organisation for Economic Co-operation and Development and International Monetary Fund to reach to the conclusion that certain SOEs were public body.

1.2 Whether the Chinese state-owned enterprises meet the concept of financial contribution as a subsidy to the Chinese domestic market?

Once the investigation authority has established that the SOE under inquiry is a public body, the next step is to determine if any financial contributions is made by the public body in the domestic market of the country. The SCM Agreement states that a measure must be a financial contribution or any form of income or price support provided by the government, a public body, or a private body entrusted or directed, to perform relevant government functions, and it must confer a benefit on the target recipient in order to qualify as a covered subsidy.⁷

A government may transfer something of economic value through a variety of transactions, including financial contributions. The ASCM's Article 1.1(a)(1) covers three different kinds of monetary contributions:

- (1) a direct transfer of funds
- (2) foregoing or failing to collect taxes that would otherwise be payable

⁶ Tiny-Wei Chiang, Chinese State-Owned Enterprises and WTO's Anti-Subsidy Regime, 49 GEO. J. INT'L L. 845 (2018)

⁷ Chad P Bown, Jennifer A Hillman, WTO'ing a Resolution to the China Subsidy problem, Volume 22, *International Economic Law*, Pages 557–578, (2019)

(3) the provision of products or services (other than basic infrastructure); or the acquisition of goods.

Direct transfers of money also involve potential and actual direct transfers of assets or liabilities, such as loan guarantees, in addition to actions like grants, loans, and stock injections. resulting in the acquisition of assets that enhance the recipient's financial situation. India's claim that a loan to a government entity through an affiliated company was not a direct transfer of funds because there was an intermediary or intervening agency engaged was rejected by the appellate entity in the US-Carbon Steel (India) case. Forgoing financial contributions or failing to collect taxes that might otherwise generate cash for the government. The government effectively forfeits the right to "enjoy the cash available to it and earn interest on," and in that case, a monetary gift may be made. However, if the government did raise tax revenue, it would also amount to sacrificing revenue that would otherwise be due. Preferential tax treatment is a well-known source of government assistance in China's high-tech sector.

The third category of "financial contributions" refers to in-kind contributions, which can take one of two forms: either governments provide goods or services to a firm, or they acquire commodities from that enterprise. By giving inputs with a financial value, the former may reduce artificially the cost of making a product, whilst the latter may raise artificially the revenues received from selling the product. The grant could be used to provide products or services.

Ten crucial industries, including information technology, new energy vehicles, railway equipment, high-tech ships, medicines, and agricultural machinery, are the focus of a bold action plan named "Made in China 2025." Huge investment funds, advantageous taxes, loan guarantees, export promotion, and other substantial subsidies are all supporting policies for the growth of particular industries. Subsidies for export and those for local content are prohibited. Domestic subsidies are actionable, not outlawed, in order to reduce their negative impacts. Certain subsidies for R&D, environmental protection, and regional development that are excluded from CVD are considered non-actionable subsidies. ⁸

2. Whether the WTO remedies are ineffective to address China's subsidy problem?

A number of widely traded industrial products have seen China emerge as a prominent worldwide supplier. These include the industries of solar panels, steel, and aluminium, all of

⁸ Agus Supriyo1, Satria Unggul Wicaksana Prakasa, Subsidies and Countervailing Measures: Challenges in International Trade Law, 7, *Jurnal Komunikasi Hukum*, 10, (2021)

which have been alleged to be heavily subsidised by China. However, when China's economy slowed to below 7%, domestic demand for these goods decreased, and the country started to export a growing amount of metals to the global market at lesser rates. Traditional WTO remedies failed to fully address the issue with solar panels, steel, or aluminium. By 2017, the USA had put in place enough antidumping and CVDs to cover more than 90% of its imports from China in each industry. However, China continued to expand its exports into third markets, while the USA kept importing low-cost goods from these third markets. US tariff on China alone could lead to trade deflection and trade diversion. Chinese exports were more deflected towards third markets like Japan. So, then Japan would import from China at subsidized rates and process the Chinese imports into refined products for export.⁹ Here comes the concept of trade diversion, wherein USA will buy the same refined goods from Japan and as a result it will squeeze out close substitutes of the goods out of the Japanese market because of the Chinese imports. Furthermore, when Japan exports the refined goods, it will only boost subsidized imports from China. WTO remedies have so far been inadequate in addressing China's subsidy issue.

V. CONCLUSION AND SUGGESTIONS

The multilateral trading system made enormous contributions to ensuring peace and prosperity for the global community by fostering international collaboration on trade policymaking and dispute resolution. To allow a domestic market to prosper against tough competitive imports, countries tend to impose subsidies to boost production and supply of goods and services on a domestic and international level. The Chinese economy heavily relied on industrial policies and subsidies for its growth. Such reliance led China to export goods and services at cheaper rates and thus hampering international trade and cutting down presence of alternatives of goods or services in any importer market. In retaliation, importer countries have imposed anti-dumping and countervailing duties on Chinese exports. United States of America imposed the highest number of unilateral CVDs and strangled multilateral cooperation. The process of imposing CVDs is not so easy. The determination of a SOE or SOCB as public body that is financially contributing to the benefit of domestic players needs to be established with sufficient evidences in order to impose CVDs. The fact that United States of America placed the highest number of CVDs is concerning and can be biased because of current US – China trade war. China too has right to upgrade its economy which may be via imposition of subsidies. But every subsidy does not lead to adverse effect on international trade. The WTO tribunals should observe the nature

⁹ Chad P Bown, Jennifer A Hillman, WTO'ing a Resolution to the China Subsidy problem, Volume 22, *International Economic Law*, Pages 557–578, (2019)

of subsidies through detailed investigation and evidences rather than substantial allegations. A reform in WTO laws is invited to efficiently tackle the bad subsidies and also let countries promote their domestic market.

I would suggest to bring about some reform in the WTO laws. Some ideas of reform are stated in this paragraph. United States of America's unilateral imposition of CVDs upon the Chinese market is unreasonable. The WTO should encourage countries to take a multilateral approach through negotiations to curb the issue of biased subsidies of China. In order to regulate and prevent trade distortive subsidies and preserve policy space for the appropriate use of subsidies, a balance of both the implementation of the WTO's current rules on subsidies and the creation of additional rules in the future should be advocated. Another way of dealing with biased subsidies could be privatization and implementation of strict disciplines on an entity's behaviour to resolve the problems arising from SOEs and SOCBs. WTO members including China should enter into plurilateral agreements regarding the privatisation and regulation of Chinese domestic players so as to limit the benefits from its own subsidies and strive towards a solution that should be politically and economically palatable to all parties. Certain further measures can also be adopted. Stronger WTO regulations on market-distorting subsidies could be achieved by introducing insolvency and competition (antitrust) ideas. Retroactive remedies can be implemented that compel recipients who received benefit from subsidy to repay the amount of the subsidy. Lastly, WTO should also enlist measures to define problematic subsidies so that international community finds it easier to impose CVDs on the subsidy policies that show international market distorting character.

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