Chinese State-Owned and State-Controlled Enterprises:
Policy Options for Addressing Chinese State-Owned Enterprises

Testimony before the U.S. – China Economic and Security Review Commission

Elizabeth J. Drake
Partner, Law Offices of Stewart and Stewart

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I. Introduction

State-owned and state-controlled enterprises ("SOEs" collectively) in China present a number of policy challenges. The Government of China's aggressive support policies create an unfair advantage for Chinese SOEs in the Chinese home market, in the U.S. market, and in third country markets. The scope of the problem requires a comprehensive U.S. response, one that combines elements of trade policy, investment policy, and domestic competition policy.

While reducing or eliminating state ownership and control in some sectors of China's economy may be a desirable goal, it will likely be very difficult to achieve in the near future, especially in those pillar and strategic sectors where the Government of China has announced its intention to maintain or increase the role of SOEs. These sectors include, at a minimum, defense, electric power, telecommunications, oil and coal, civil aviation, shipping, equipment manufacturing, automobiles, information technology, construction, iron and steel, non-ferrous metals, and chemicals. In its *12th Five-Year Plan*, China identified many of these as "Strategic and Emerging Industries" in which the government plans to invest $1.5 trillion over the next five years.

This testimony seeks to identify policies that would help to neutralize the competitive advantage that Chinese SOEs enjoy in these sectors. The U.S. and other major market economies have endorsed this principle of competitive neutrality at the OECD and elsewhere, and the policies discussed herein seek to meet that goal. The sections below are organized into three major areas in which Chinese government policies and practices regarding SOEs distort markets.

1. Government subsidies to SOEs, including subsidized loans, export credits, debt forgiveness, grants, equity infusions, and preferential access to key inputs such as land, utilities, and raw materials.

2. Chinese SOEs' use of purchasing and joint venture agreements to favor domestic suppliers, goods, and services over foreign suppliers, goods, and services or to leverage technology transfers and other concessions from U.S. firms.

3. The failure to adequately address anti-competitive and unfair trade practices by SOEs, including under China's own competition policies as well as the policies of countries that are increasingly targeted for overseas expansion by SOEs.

Fortunately, there are many tools that already exist for confronting the competitive challenges posed by Chinese SOEs. However, there are a number of areas in which the current set of rules does not adequately address the problem. These comments highlight those areas in which current rules can be more effectively enforced, and they also seek to identify gaps in the current system and propose possible approaches to filling those gaps.

II. Government Subsidies to SOEs

SOEs in China enjoy significant advantages due to their preferential access to credit and debt forgiveness from state-owned banks, to government-owned land, and to electricity, water, and raw materials from other SOEs. Other subsidies include equity infusions and an exemption from paying full dividends to state shareholders. These subsidies permit SOEs to add capacity, produce more and better products, and sell at lower prices than would otherwise be possible.

One area in which SOEs have received tens of billions of dollars of government support is through concessional export credits and export credit guarantees. The U.S. Ex-Im Bank estimates that China Ex-Im and the China Development Bank provide as much as $100 billion in export credits each year, making China by far the largest export financier in the world.[1] China's annual export credit financing is thus the same as the total cumulative exposure limit for U.S. Ex-Im.[2] Indeed, in 2010, China Ex-Im issued more than three times as many new medium- and long-term export credits as U.S. Ex-Im.[3] While the terms of China's export financing are far from transparent, the People's Bank of China publishes rates for certain Ex-Im credits that are typically about two percentage points below the Bank's already depressed "market" benchmark rate, and other sources indicate Ex-Im financing is available at rates as low as two, one, or even zero percent.[4]

Chinese SOEs routinely benefit from these export credits and guarantees. Infrastructure and power projects have been a major focus of support, and both sectors are dominated by SOEs. Sinohydro, for example, a state-owned hydropower firm that has benefitted from significant Ex-Im support, is involved in more than half of all hydropower projects underway around the world.[5] In the telecommunications arena, ZTE, a major state-owned firm, and Huawei, a firm widely believed to have ties to the state, have received more than $50 billion in export financing from the China Development Bank and China Ex-Im; the companies have also signed strategic cooperation agreements with Sinosure to expand their use of export credit guarantees.[6]

Export credits and guarantees are just one example of massive government subsidies to Chinese SOEs. Fortunately, rules already exist to discipline these subsidies and remedy the harm that they cause.

A. Enforcing Existing Subsidy Rules

Where government benefits are conditioned on export performance or domestic content, they are prohibited by the WTO Agreement on Subsidies and Countervailing Measures ("SCMA").[7] The export credits and export credit guarantees discussed above are prohibited export subsidies, because they are granted by the government, conditioned on export performance, and provided at below-

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[1] Export-Import Bank of the United States, *Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States* (June 2011) at 113.
[2] "White House Explores Export Financing Options, But Faces Obstacles," *Inside U.S. Trade* (Feb. 2, 2012).
[3] Export-Import Bank of the United States, *Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States* (June 2011) at 11.
[4] Terence P. Stewart, et al., *China's Support Programs for Automobiles and Auto Parts under the 12th Five-Year Plan* (Jan. 2012) at 60.
[5] Yang Wanli, "Sinohydro: top hydropower engineering firm," *China Daily* (Oct. 20, 2009).
[6] Terence P. Stewart, et al., *China's Support Programs for High-Technology Industries under the 12th Five-Year Plan* (June 2011) at 136 – 137.
[7] WTO Agreement on Subsidies and Countervailing Measures ("SCMA"), art. 3.

market rates. While the SCMA provides a safe haven for export credits that conform to the terms of the *OECD Arrangement on Export Credits*, China has refused to sign on to the OECD rules. In addition, as noted by U.S. Ex-Im, most of the terms and conditions of China Ex-Im's financing "*did* not and *do* not fit within the OECD guidelines."[8] The SCMA also lists export credit guarantees that are provided at a loss as an example of a prohibited export subsidy – Sinosure has operated at a cumulative loss since its founding in 2002.[9] Given the scale of these export subsidies, a WTO case challenging these practices could have major benefits for U.S. firms. The evidence supporting a case is strong, and China would bear the burden of demonstrating that its programs are consistent with OECD rules to defend its practices. In addition, it is not necessary to show that these support programs have any harmful effects to prevail in a WTO challenge; as export subsidies, they are *per se* prohibited.

WTO rules also discipline subsidies that are not contingent on exports or domestic content. These so-called domestic subsidies are actionable under the SCMA where they are limited to a group of industries (such as SOEs), provide a benefit, and cause serious prejudice.[10] Serious prejudice exists if the subsidies: 1) displace or impede U.S. exports to China or third country markets; 2) cause significant price undercutting, suppression, or depression or lost sales in any market (China, the U.S., or third country); or 3) increase China's share of the world market in a primary product or commodity.[11] A successful WTO challenge would require China to withdraw the subsidies in question, eliminate their harmful effects, or face the retaliation.

While the evidence of concessional lending and other domestic subsidies to Chinese SOEs is overwhelming, a successful WTO challenge would also require showing serious prejudice, which would likely require industry support and increased USTR enforcement resources to build the necessary factual record. Where the will exists to present such evidence, the WTO system has proven itself capable of disciplining domestic subsidies as it recently did in the Airbus and Boeing cases. In addition, the WTO Appellate Body recently affirmed that one of the primary forms of government support to Chinese SOEs, loans from Chinese state-owned banks at below market rates, are indeed subsidies under SCMA rules and that market interest rates from outside of China may be used to measure the benefit conferred by such loans.[12] While challenges to actionable subsidies may be ambitious, they offer the only hope of confronting the severe competitive disadvantage that vast government support for Chinese SOEs poses to the U.S. firms seeking to compete in China and third country markets.

The SCMA only disciplines subsidies that distort trade in goods. Fortunately, China agreed to additional provisions disciplining certain subsidies that disadvantage U.S. service providers and investors. Section 3 of China's Protocol of Accession, for example, requires China to accord foreign enterprises treatment national treatment in respect of the prices and availability of goods and services supplied by government authorities and state enterprises in areas including energy, utilities, and other factors of production. Thus, to the extent that SOEs are able to access these inputs at

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[8] Export-Import Bank of the United States, *Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States* (June 2010) at 99 (emphasis in original).
[9] Terence P. Stewart, et al., *China's Support Programs for Automobiles and Auto Parts under the 12th Five-Year Plan* (Jan. 2012) at 64 – 65.
[10] SCMA, arts. 1, 2, and 5.
[11] SCMA, art. 6.
[12] *United States – Definitive Anti-Dumping and Countervailing Duties On Certain Products From China*, WT/DS379/AB/R (March 11, 2011).

quantities and rates not available to foreign firms in China, the U.S. could challenge the practices as a direct violation of China's Protocol. China also agreed to ensure all SOEs "make … sales based solely on commercial considerations, *e.g.*, price, quality, marketability and availability," and foreign enterprises must also "have an adequate opportunity to compete for … purchases from these enterprises on non-discriminatory terms and conditions."[13] The rule thus explicitly prohibits the provision of key inputs by SOEs at below-market rates. A successful case under either of these provisions would not require an injury showing.

Finally, the U.S. must ensure it can remedy the harm that subsidies cause in the U.S market. Unfortunately, that ability has been thrown into doubt by a recent decision from the U.S. Court of Appeals for the Federal Circuit, *GPX International Tire Corp. v. United States*, Nos. 2011–1107, –1108, –1109, slip op. (Fed. Cir. Dec. 19, 2011). The *GPX* court ruled the U.S. may not apply the countervailing duty law to subsidized imports from China, because China is treated as a non-market economy under the antidumping law. The decision puts 23 countervailing duty orders on imports from China at risk, as well as five on-going investigations. While it is possible that the decision may be corrected on appeal, the surest way to restore the integrity of the countervailing duty law is for Congress to enact a targeted legislative fix that corrects the decision as quickly as possible.

B. Strengthening Anti-Subsidy Rules

When legal certainty regarding U.S. countervailing duty law is restored, there are a number of steps that could make that law more effective at combatting subsidies to SOEs. The Department of Commerce has rightly recognized that subsidies which are limited to SOEs as a group are "specific," and thus countervailable. Commerce, however, unnecessarily weakens the effectiveness of the law through various methodologies, such as the adjustments it applies to reduce the duties applied to offset subsidized loans. In addition, the Administration should explore making greater use of its power to self-initiate countervailing duty cases, particularly in sectors where domestic industries are being injured but are too fragmented, under-resourced, or intimidated by threats of retaliation to invoke their legal rights and petition for relief.

The U.S can take additional actions to protect U.S. industries from competition with subsidized imports even where no countervailing duty orders apply. For example, Buy America laws permit agencies to purchase foreign products where the foreign good is significantly less expensive than competing American goods. These rules could be revised to eliminate this flexibility where the foreign good in question is produced or exported by an SOE or other enterprise that receives foreign government support. Such a change would likely be permitted under WTO rules unless and until China becomes a member of the Government Procurement Agreement.

Additional rules to address the harm that subsidies to SOEs can cause U.S. firms would likely require new negotiations with China, whether at the WTO or bilaterally. The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* offer guidance in this area. For example, Chapter I of the *Guidelines* states that governments should ensure a "level playing field" in markets where SOEs and private companies compete "in order to avoid market distortions."[14] Thus, "SOEs should face competitive conditions regarding access to finance," and SOEs' relationships with state-

[13] *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (Nov. 10, 2011) at paras. 46, 342; *Accession of the People's Republic of China*, WT/L/432 (Nov. 23, 2011) at Sec. 1(2).
[14] *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, Ch. I, chapeau.

owned banks and other SOEs "should be based on purely commercial grounds."[15] Notably, the principle does not contain an injury test – it is a *per se* rule that requires SOEs to be subjected to the same competitive conditions that private firms face.

On-going negotiations over competition rules in the Trans-Pacific Partnership ("TPP") Agreement also offer an opportunity to establish a high standard that would set the baseline for new rules to discipline subsidies to Chinese SOEs. Proposals to include a commitment to operate SOEs in accordance with *OECD Guidelines* would be a step in the right direction. In addition, the TPP could limit the extent of government assistance to SOEs (with possible carve-outs for SOEs' non-commercial operations, national emergencies, and other negotiated exceptions), and, at a minimum, require transparency and regular reporting regarding the extent of such assistance.

A more robust regime would require parties to submit comprehensive annual notifications listing all SOEs in which they have an ownership or control interest, identifying the markets in which such SOEs operate and their market shares, detailing all forms of government support to such SOEs, and disclosing the terms of major procurement and supply contracts entered into by such SOEs. Such notifications should be subject to review by a standing working group and questions from the parties concerned. The format could be similar to notification regimes at the WTO for subsidies, state trading enterprises, technical barriers to trade, and other trade-related matters.

III. SOE Procurement and Contracting Practices

A. Discriminatory and Distortionary Purchasing and Contracting Practices

Chinese SOEs expand their influence in the market by discriminating against U.S. suppliers, goods, and services in their procurement decisions and by using their leverage in supply and joint venture negotiations to force technology transfers and other concessions.

In the telecommunications sector, for example, China's big three state-owned operators reportedly purchase under a government directive to buy domestic components and equipment.[16] The government also encourages the use of domestic over imported telecommunications equipment by directing telecom operators to support indigenous innovation.[17] In 2009, for example, service licenses granted to China Telecom, the largest mobile service provider in China, mandated the use of the TD-SCDMA standard, an indigenous standard developed with support from Government of China.[18] The government's policy is also reflected in the telecom operators' own purchasing arrangements. China Unicom, for example, purchases equipment through contracts with its state-owned parent, and it warns investors that the arrangement may not be in the best interests of

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[15] *Id*. at Ch. I, Sec. F.

[16] United States Trade Representative, *2011 National Trade Estimate Report on Foreign Trade Barriers* (March 2011) at 64.

[17] In 2008, when the Chinese government consolidated its telecom operators into the three state-owned entities, it encouraged all "relevant departments, enterprises, and institutions to give priority to indigenously innovated products," and it stated that "state-owned assets management departments shall use indigenous innovation as a key criterion in assessing telecom operators." Ministry of Industry and Information Technology, National Development and Reform Commission, Ministry of Finance, *Notice on Deepening the Telecom Reform* (May 24, 2008) at Sec. III.

[18] Xudong Gao, *Understanding Key Features of the TD-SCDMA Adoption Process in China* (2009) at 19; Jenn-hwan Wang and Ching-jung Tsai, *How Does China Restructure Global Production Networks?* Paper presented at 2010 Industry Studies Conference (ISA), University of Illinois at Chicago, May 6-7, 2010; "Datang receives another CNY 20 billion line of Credit," *ChinaTechNews.com* (July 27, 2007).

shareholders.[19] Under the arrangement, the state-owned parent gets three percent of the contract cost for purchases of domestic equipment but only one percent of the contract cost for imported equipment,[20] creating an incentive for the parent company to procure equipment from domestic producers even if it is more expensive than imported equipment. As a result of these policies, domestic manufacturers dominate important segments of China's telecommunications market, supplying at least two-thirds of the 3G market and over 80 percent of the TD-SCDMA market.[21]

Discrimination also appears in the form of domestic content provisions in Chinese SOEs' sourcing and joint venture contracts. In the wind-energy sector, for example, the state-owned producer Sinovel contracted to purchase wind turbine components from American Superconductor for delivery from 2009 to 2011. The contract set out a "localization schedule" under which converters which American Superconductor had produced with imported material would instead be produced with domestic materials.[22] By 2010, American Superconductor reported that it had successfully localized the supply of components for its converters to China.[23] More recently, as part of an agreement to establish a joint-venture with a Chinese SOE to produce trucks in China, Daimler similarly agreed to "localize" the production of the truck engines to China.[24]

SOEs in China also use their market position to negotiate technology transfer provisions in joint venture agreements with foreign partners. State-owned firms in the natural gas, coal, automotive, and solar industries, among others, have obtained technology transfer concessions from U.S. investors in a range of joint venture agreements.[25] Chinese SOEs have also obtained concessions to gain access to foreign partners' global supply chains as part of joint venture agreements.[26] These concessions are often facilitated by government rules that limit the extent of foreign equity participation in the market or grant preferential treatment to SOEs.[27]

B. Enforcing Existing Rules

Fortunately, China has already agreed to relatively robust rules prohibiting these types of discriminatory and distortionary purchasing and contracting policies by SOEs. Article III:4 of the GATT prohibits discriminatory treatment of imported goods – while there is a limited carve-out to this obligation for government purchases of goods for governmental purposes, the exception does

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[19] China Unicom 2008 Form 20-F at 10.
[20] China Unicom 2009 Form 20-F at 83.
[21] DBS Vickers Securities, *Hong Kong / China Industry Focus: China Telecom Sector* (Feb. 24, 2010).
[22] American Superconductor Corp. Form 8-K (June 5, 2008) at Ex. 10.1.
[23] American Superconductor Corp. Form 10-Q (Aug. 5, 2010) at 18.
[24] "Germany's Daimler to Make Trucks in China," *Agence France Presse* (Spet. 26, 2011); "Final Approval Issued by Chinese Authorities: Way Clear for Daimler's Truck Joint Venture with Foton," Daimler.com (Sept. 26, 2011).
[25] *See*, *e.g.*, IMPCO Technologies Inc. Form 10-K (2002) at 4-5, 8, Ex. 10.64; Evergreen Solar, Inc. Form 8-K (July 30, 2009) at item 1.01, Ex. 99.2; Evergreen Solar, Inc. Form 10-Q (Nov. 10, 2009) at 28-30, Ex. 10.1-10.7; Equity Joint Venture Contract for the Establishment of BMW Brilliance Automotive Ltd. by and between BMW Holding BV and Shenyang JinBei Automotive Industry Holding Co., Ltd. (2003) at arts. 1.47, 4, 12; Valence Technology Inc. Form 10-Q (2003) at 12-13, JV Contract at art. 9; Synthesis Energy Systems Inc. Form 8-K (2009) at item 1.01, Exs. 10.1 & 99.1.
[26] *See*, *e.g.*, General Motors, *2010 Annual Report* at 62.
[27] In the automotive sector, for example, foreign investors in complete automobile production are required to enter into a joint venture in which the Chinese partner owns at least 50 percent. *Automotive Industry Development Policy*, State Council Document Guo Han [2004] No. 30 (May 21, 2004) at Art. 48. In other sectors such as energy and infrastructure, SOE dominance is so widespread that foreign investors face few options to enter the market aside from joint ventures with SOE control.

not apply when SOEs procure goods for commercial purposes. Nor is there any exemption for SOEs outside of the purchasing context, such as in their negotiation of joint venture agreements. National treatment obligations in the GATS have a similar scope, though they only apply to sectors in which members have made positive commitments.

China has made additional, specific commitments to respect the principle of non-discrimination in SOE purchasing decisions. In its Protocol of Accession and accompanying Working Party Report, China agreed that SOEs shall make purchases based solely on commercial considerations, that foreign enterprises will have an adequate opportunity to compete for such contracts on a non-discriminatory basis, that China will not influence, directly or indirectly, the purchasing decisions of SOEs, and that SOEs' commercial purchases will not be subject to government procurement exceptions.[28] These commitments apply to purchases of both goods and services, and they appear to require non-discrimination not only for imports but also for foreign-invested firms in China.

China has also agreed not to implement domestic content or technology transfer requirements as a condition of investment approvals.

> China shall eliminate and cease to enforce … local content and export or performance requirements made effective through laws, regulations or other measures. Moreover, China will not enforce provisions of contracts imposing such requirements …. China shall ensure that … any other means of approval for … the right of … investment by national and sub-national authorities, is not conditioned on … performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or the conduct of research and development in China.[29]

It appears that China is directly violating these commitments in its telecommunications, energy, and automotive sectors at a minimum, and likely in many other SOE-dominated sectors as well. These obligations should be rigorously enforced. While some cases may be fact-intensive and require information on specific contracts and transactions, other violations appear to be a matter of formal policy that could be more easily challenged at the WTO.

IV. Anti-Competitive and Unfair Trade Practices

A. China's Domestic Competition Regime

Under the Anti-Monopoly Law adopted by China in 2007, the state shall "protect the lawful business activities" of SOEs in industries that implicate national economic vitality and national security, and the state shall regulate such SOEs' business operations not only to safeguard consumer interests but also to "promote technological progress."[30] While the law also notes that SOEs should not abuse their market dominance to the detriment of consumers, it has been unclear in practice how this provision would be enforced against SOEs, if at all.

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[28] *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (Nov. 10, 2011) at paras. 46, 47, 342; *Accession of the People's Republic of China*, WT/L/432 (Nov. 23, 2011) at Sec. 1(2).
[29] *Accession of the People's Republic of China*, WT/L/432 (Nov. 23, 2011) at Sec. 7(3).
[30] *Anti-Monopoly Law of the People's Republic of China* (Aug. 30, 2007) at art. 7.

In the fall of 2011, reports indicated the National Development and Reform Commission was investigating anti-competitive behavior by two major telecom SOEs, China Unicom and China Mobile.[31] The two providers were allegedly charging prices for access to their broadband backbone networks that were higher for competitors in the broadband access business than for internet operators.[32] It is too early to determine whether the cases signal a willingness to subject SOEs to competition disciplines in an even-handed manner. As a preliminary matter, the case may be more about competition among SOEs rather than between state and private firms, as many of the broadband access network operators harmed by the anti-competitive conduct are themselves state-owned.[33] In addition, it appears that there has been little progress in the case since the NDRC submitted its investigation to the People's Supreme Court, the Ministry of Industry and Information Technology (which oversees the telecom industry), and the Legal Affairs Office of the State Council in November of last year.[34] Conflict among these agencies is what reportedly led the NDRC to reveal its investigation to the news media in China.[35] Shortly thereafter, the two SOEs involved pledged to increase access, reduce rates, and correct improper charges, and the decision whether or not to continue with the investigations remains pending.

Current trade and investment rules are likely inadequate to address preferential treatment that China's SOEs may receive under China's antitrust laws. The *OECD Guidelines* again provide a useful starting point: "SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated."[36] In the specific area of competition policy, the U.S.-Singapore FTA also provides a possible model. It requires the Government of Singapore to ensure that its SOEs refrain from certain anti-competitive conduct such as agreements to restrain price or output or allocate customers and exclusionary practices that substantially lessen competition to the detriment of consumers.[37] While application of such rules to the Chinese marketplace would require agreement with the Government of China, the TPP Agreement again offers an important opportunity to develop model rules that could form the starting point for any such negotiations.

B. Competition with Chinese SOEs as Investors in the U.S. and Abroad

U.S. firms also face competition from Chinese SOEs that establish a commercial presence in the United States or third countries. The Government of China actively encourages SOEs to expand their presence abroad as part of the "Going Global" strategy.[38] Since China joined the WTO in 2001, its annual foreign direct investment flows to the rest of the world have increased ten-fold, and SOEs account for the majority of China's outbound investment.[39] While foreign investment can support job creation and economic growth, such investors should not be permitted to take advantage of their state backing to distort foreign markets and undermine competition.

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[31] "Anti-Monopoly Investigations Should be Conducted Openly and Independently," *New China Magazine* (Jan. 2012).
[32] "Chinese Antitrust Enforcement Agencies Ready to Show Teeth to Large State-Owned Enterprises?" *China Law Insight* (Sept. 26, 2011).
[33] *Id*.
[34] "Anti-Monopoly Investigations Should be Conducted Openly and Independently," *New China Magazine* (Jan. 2012).
[35] *Id*.
[36] *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, Ch. I, Sec. D.
[37] U.S.-Singapore FTA, art. 12.3(2)(d)(ii).
[38] Wayne M. Morrison, *China's Economic Conditions*, Congressional Research Service (June 24, 2011) at 20.
[39] *Id*. *See also* United Nations Conference on Trade and Development, "Inward and Outward Foreign Direct Investment Flows, Annual," *UNCTADStat Database*.

Rising overseas investment by Chinese SOEs poses a number of policy challenges. First, government support for Chinese SOEs may give them an unfair advantage as investors in overseas markets. As noted in section II, above, current rules primarily discipline government subsidies to the extent they affect trade in goods – subsidies that distort international investment flows in the U.S. and third countries are not the subject of binding rules. Such rules would require negotiation with China, and could draw upon principles of competitive neutrality enshrined in the *OECD Guidelines* and proposed for the TPP Agreement.

Absent such rules, there are other steps that the U.S. can take to address the advantages Chinese SOEs may enjoy as overseas investors. In the U.S. market, the U.S. should undertake a review of the screening rules employed by the Committee on Foreign Investment in the United States ("CFIUS"), U.S. antitrust laws, SEC reporting requirements, and unfair trade statutes to ensure they adequately address the challenges posed by a growing SOE presence in the U.S.

U.S. antitrust laws merit particular attention. On predatory pricing, for example, the OECD notes that the U.S. recoupment test, under which pricing is only deemed anti-competitive if the predator is likely to eventually collect enough profits to make up for the losses caused by the predatory behavior, may fail to account for competition from SOEs.[40] SOEs do not face the same market discipline or incentives as private firms. They can rely on state support to maintain losses that may never be recouped in order to meet political or industrial policy goals, or secure access to key suppliers, leading technologies, brand names, and other assets. Alternative predatory pricing rules, such as those based on cost benchmarks, may provide better safeguards for competition in such cases. Government support for SOEs and their central role in carrying out Chinese industrial policies should also be taken into account when the Department of Justice reviews proposed mergers and acquisitions for competition concerns.

U.S. trade remedy laws may also need to be strengthened to ensure SOEs cannot use commercial presence to circumvent antidumping or countervailing duty orders. Under current law, for example, an order may be expanded to cover imported parts that are used to assemble merchandise in the U.S. that would otherwise be subject to unfair trade duties.[41] Relief is only available if the assembly is insignificant and the value of imported components is a significant portion of total value. Commerce also considers affiliation between the U.S. assembler and the component exporter and whether imports of components have increased, among other factors. These rules may need to be revisited to ensure they fully redress any instances in which SOEs invest in the U.S. to evade trade remedies, including where the SOE's operations in the U.S. are not insignificant and where the SOE is not affiliated with a Chinese exporter.

The CFIUS process is another tool that could help level the playing field with SOE investors. While CFIUS applies heightened scrutiny to transactions involving SOEs, it only reviews foreign investment for national security purposes, not for economic policy reasons. Some have suggested that CFIUS could incorporate an economic aspect to its screening process, similar to the net benefit test employed by Canada. Alternatively, CFIUS or a process similar to CFIUS could be used to

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[40] Antonio Capobianco and Hans Christiansen, "Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options," *OECD Corporate Governance Working Paper No. 1* (2011) at 21. The test is based on the theory that a predator who could not recoup its losses would either not engage in the predatory practices to begin with or will eventually exit the market, causing no long-term damage to competitors or consumers.
[41] 19 U.S.C. Sec. 1677j(a).

review SOE investments from a competitive neutrality standpoint, require disclosure of material information such as levels of government support and pricing practices, and regularly monitor investments for compliance with competitive neutrality principles.

In addition, many SOEs eager to access U.S. investment capital are now listed on U.S. stock exchanges. They are thus subject to the disclosure rules of the SEC, which can also provide a tool for leveling the playing field. The *OECD Guidelines*, for example, state that SOEs should disclose material information on all matters described in the *Guidelines*, including "[a]ny financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE," material transactions with related entities, and material risk factors.[42] As noted above, at least one Chinese SOE, China Unicom, felt the risk posed by discriminatory procurement policies was material enough to require disclosure – other SOEs should be held to the same standard. The terms of state assistance to SOEs should be disclosed in sufficient detail to permit investors to assess the risk countervailing duty liability or other trade action; the rates and terms of loans from state-owned banks, supply contracts with state-owned suppliers, land concessions, and similar information is all material to such an assessment.

Options for addressing competitive challenges posed by SOEs in third country markets may be more limited. If, however, competition rules in the TPP Agreement require governments to ensure that SOEs operate under conditions of competitive neutrality, it would be worthwhile to consider how those rules can be adapted to ensure that the same principle applies to all SOEs operating in the covered markets, not just those SOEs owned by the host country government.

V. Conclusion

Chinese SOEs pose a major challenge to U.S. firms and workers seeking to compete in China's market, in the U.S. market, and in third countries. Fortunately, many rules already exist which could be more energetically enforced to neutralize the unfair advantage Chinese SOEs enjoy. These include subsidy disciplines and non-discrimination rules at the WTO, as well as specific WTO commitments China has made to ensure its SOEs act consistently with commercial considerations and in a non-discriminatory manner when making purchasing and sales decisions, not to influence the commercial operations of SOEs, and not to require local content or technology transfers as a condition of investment approvals. The U.S. also needs to correct the *GPX* decision and ensure the countervailing duty law can be effectively used to remedy the injury caused by subsidized imports from China.

In some areas the unique challenges posed by Chinese SOEs may require new rules, whether at the WTO, in bilateral or regional agreements, or in domestic law. The *OECD Guidelines* set out competitive neutrality principles that could be incorporated into such rules, as do the competition provisions of FTAs with Korea and Singapore. In addition, the U.S. should review its antitrust rules, unfair trade laws, SEC reporting requirements, and CFIUS regime to determine if additional steps are required to more fully address the competitive challenges posed by China's growing state-owned sector.

[42] *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, Ch. V, Sec. E.