10-2019

Building a market economy through WTO-inspired reform of state-owned enterprises in China

Weihuan ZHOU

Henry S. GAO
Singapore Management University, henrygao@smu.edu.sg

Xue BAI

CHINA'S SOE REFORM: USING WTO RULES TO BUILD A MARKET ECONOMY

Weihuan Zhou, Henry Gao & Xue Bai

(forthcoming in International and Comparative Law Quarterly, 2019, Vol 68, Issue 2)

ABSTRACT

This paper responds to the widespread view that existing WTO rules are insufficient in dealing with China's state capitalism, which has been further emboldened by its latest rounds of state-owned enterprise ("SOE") reforms. Through a careful review of WTO agreements and jurisprudence, the paper argues that, we do not necessarily need new rules, because the unique challenges created by China's state capitalism can be sufficiently dealt with by the WTO's existing rules on subsidies coupled with the China-specific obligations. Thus, a more realistic approach would be to push China back to the path of market-oriented reforms through WTO litigation based on existing rules, rather than trying to negotiate new rules.

I. INTRODUCTION

State-owned enterprises ("SOEs") is now a looming challenge to the international economic legal order. In December 2016, an OECD report called for governments to "identify and remedy gaps in the coverage of multilateral rules regarding trade distorting government and enterprises behaviour."[1] At the 11th WTO Ministerial Conference in December 2017, the US, the EU and Japan expressed serious concerns about the impacts of SOEs' activities on "the proper functioning of international trade" and called for new rules to ensure a global level playing field.[2]

While state sectors remain significant in many countries,[3] China has been at the center of academic and policy debates given its growing clout in global economy and the size and complexities of its state sector. Many of the contemporary challenges in international trade regulation have much to do with China's state capitalism. These include, for example, the EU's amendments of anti-dumping regulation to specifically address market distortions caused by state intervention,[4] the US's refusal to recognize China as a market economy,[5] and the escalating US-China trade conflicts and tit-for-tat protectionist moves through retaliatory tariffs.[6]

---

[1] See OECD, STATE-OWNED ENTERPRISES AS GLOBAL COMPETITORS: A CHALLENGE OR AN OPPORTUNITY? 15 (2016).

[2] See OFF. OF U.S. TRADE REPRESENTATIVE, JOINT STATEMENT BY THE UNITED STATES, EUROPEAN UNION AND JAPAN AT MC11 (Dec. 2017), *available at* https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/december/joint-statement-united-states (last visited Nov. 30, 2018).

[3] See Sean Miner, *Commitments on State-Owned Enterprises*, *in* TRANS-PACIFIC PARTNERSHIP: AN ASSESSMENT 335, 338 (Cathleen Cimino-Isaacs & Jeffrey J. Schott eds., 2016).

[4] Regulation (EU) 2017/2321 of the European Parliament and of the Council of 12 December 2017 Amending Regulation (EU) 2016/1036 on Protection against Dumped Imports from Countries not Members of the European Union and Regulation (EU) 2016/1037 on Protection against Subsidised Imports from Countries not Members of the European Union, Official Journal of the European Union, L338, 19 December 2017.

[5] U.S. DEP'T OF COM., CHINA'S STATUS AS A NON-MARKET ECONOMY, (A-570-053 Investigation, Public Document E&C VI: MJH/TB, 2017), *available at* https://enforcement.trade.gov/download/prc-nme-status/prc-nme-review-final-103017.pdf (last visited Nov. 30, 2018).

[6] See Proclamation No. 9705, 83 Fed. Reg. 11,625 (Mar. 8, 2018); Proclamation No. 9704, 83 Fed. Reg. 11,619 (Mar. 15, 2018); OFF. OF U.S. TRADE REPRESENTATIVE, USTR ISSUES TARIFFS ON

In this debate, the key question is whether the existing WTO rules are adequate to address the effects of the Chinese government's intervention in the domestic market on trade and competition. In a speech on US trade policy priorities, US Trade Representative Robert Lighthizer called China's state capitalism "[an unprecedented] threat to the world trading system" and criticized the inadequacies of the WTO rules in ensuring "that a market-based economy prevails."[7] This view was repeated by US Ambassador to the WTO Dennis Shea, who argued at the General Council meeting on 26 July 2018 that "change is necessary if the WTO is to remain relevant to the international trading system", but "the WTO itself does not currently provide the tools needed to bring about that change".[8] This view is becoming increasingly popular in the international trade community, which not only regards the current set of multilateral rules as insufficient in dealing with China, but also deems it as a systemic failure of the WTO.[9]

Are WTO rules indeed premised on market economy principles? Does WTO Membership really presume the existence of a market economy? These are important questions on both the letter and spirit of WTO rules and may only be adequately addressed by a separate article. Here, we would only note that while we do not entirely agree with either proposition, we do concede that certain WTO rules are more aligned with market economy principles and if used well, could help "build" a market economy, if we were to paraphrase the critics.

Against this background, this article provides fresh insights into the current debate by exploring the challenges that China's SOE reform may pose to the world trading system and how the WTO rules may be utilised to overcome these challenges. Section II provides a detailed review of China's current SOE reform commenced in 2013. It argues that the reform seems to have been designed (and implemented) to create national champions and to ensure that the market-based transformation of SOEs does not undermine the effective control of the government. While market liberalisation and market-oriented economic reforms continue to progress in China, the resurrection of state capitalism also presents new challenges for the multilateral trading system.

Section III discusses the limitations of using GATT/WTO[10] rules to tackle the various issues relating to SOEs especially in the context of China's current SOE reform. Being

---

CHINESE PRODUCTS IN RESPONSE TO UNFAIR TRADE PRACTICES (June 15, 2018), *available at* https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/june/ustr-issues-tariffs-chinese-products; MINISTRY COM. P.R.C., NOTICE ON THE IMPOSITION OF TARIFFS ON CERTAIN GOODS FROM THE US, (June 16, 2016), *available at* http://www.mofcom.gov.cn/article/ae/ai/201806/20180602756389.shtml (China) (last visited Nov. 30, 2018).

[7] CENT. FOR STRATEGIC & INT'L STUD., U.S. TRADE POLICY PRIORITIES: ROBERT LIGHTHIZER, USTR, at 4, (Sep. 18, 2017), *available at* https://csis-prod.s3.amazonaws.com/s3fs-public/publication/170918_U.S._Trade_Policy_Priorities_Robert_Lighthizer_transcript.pdf?kYkVT9pyKE.PK.utw_u0QVoewnVi2j5L (last visited Nov. 30, 2018).

[8] U.S. AMBASSADOR DENNIS SHEA, CHINA'S TRADE-DISRUPTIVE ECONOMIC MODEL AND IMPLICATIONS FOR THE WTO (WTO General Council Meeting, July 26, 2018), *available at* https://geneva.usmission.gov/2018/07/27/55299/ (last visited Nov. 30, 2018).

[9] See *How to Rescue the WTO?,* THE ECON. July 19, 2018, *available at* https://www.economist.com/leaders/2018/07/19/how-to-rescue-the-wto?fsrc=scn/tw/te/bl/ed/howtorescuethewtoworldtrade (last visited Nov. 30, 2018); Philip I. Levy, *The Treatment of Chinese SOEs in China's WTO Protocol of Accession* 16 WORLD TRADE REV. 635 (2017).

[10] General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194. This became one of the multilateral agreements under the WTO. See General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187 (1994).

cognizant of the limitations of the market economy hypothesis, we argue that the WTO does not provide a comprehensive code of conduct to govern the anti-competitive behaviour of SOEs or even *enterprises* in general,[11] but only restrains Member *governments* from using certain policy instruments to undermine the expected conditions of competition. Through an analysis of the GATT rules on (1) honouring tariff concessions by import monopolies, (2) non-discrimination requirement on state trading enterprises ("STEs"), (3) trade restrictions by STEs, (4) transparency, and (5) anti-dumping measures, we argue that the first three rules are limited in terms of the types of policy instruments and the scope of obligations. Furthermore, the transparency mechanisms have been ineffective in ensuring adequate notifications by WTO Members in general and in inducing China to provide sufficient information on SOEs. Finally, the WTO jurisprudence has developed in a way that gradually removes the flexibility in using anti-dumping to address market distortions caused by state intervention.

Recognising the limitations of general WTO rules, WTO Members negotiated China-specific rules to tackle China's state capitalism. These are discussed in Section IV, which explores China's WTO-plus obligations on subsidies, pricing, and commercial behaviours of SOEs. We argue that the WTO rules on subsidies and countervailing measures, coupled with these China-specific commitments, have provided sufficient tools for Members to use in dealing with China. Therefore, instead of trying to negotiate new rules, WTO Members should make more active use of these existing rules.

II. CHINA'S CURRENT SOE REFORM

SOE reform has been one of the central elements of China's landmark economic reforms launched in 1978-79.[12] Prior to the commencement of the current round of reform in 2013, China's SOE reform had undergone several phases with many significant accomplishments. These phases of reform, which have been well documented, witnessed the devolution of corporate power through increasing the operational autonomy of SOEs (1978-1986)[13] and the managerial authority of SOEs (1987-1992), [14] the privatisation, corporatisation and

[11] Aaditya Mattoo, *Dealing with Monopolies and State Enterprises: WTO Rules for Goods and Services*, 1 (WTO Staff Working Paper, No. TISD9801, 1997).

[12] Gregory Chow, *Economic Reform and Growth in China,* 5 ANNALS ECON. & FIN. 127 (2004).

[13] For a discussion of the achievements and issues in this stage of reform, see Yiping Huang, *State-Owned Enterprises Reform, in* CHINA: TWENTY YEARS OF ECONOMIC REFORM 95, 99-101 (Ross Garnaut & Ligang Song eds., 2012); Qunhui Huang, *How 'New SOEs' Come of Age: Four Decades of China's SOE Reform*, 13 CHINA ECON. 58, 60-66 (2018); WU JINGLIAN & MA GUOCHUAN, WHITHER CHINA?: RESTARTING THE REFORM AGENDA 120–134 (Xiaofeng Hua & Nancy Hearst trans., Oxford Univ. Press. 2016); Xiao Geng, Xiuke Yang & Anna Janus, *State-Owned Enterprises in China: Reform Dynamics and Impacts, in* CHINA'S NEW PLACE IN A WORLD IN CRISIS: ECONOMIC, GEOPOLITICAL AND ENVIRONMENTAL DIMENSIONS 155, 157 (Ross Garnaut, Ligang Song & Wing Thye Woo eds., 2009); Xin Li & Kjeld Erik Brodsgaard, *SOE Reform in China: Past, Present and Future*, 31 COPENHAGEN J. ASIAN STUD. 54, 56-57 (2013).

[14] For a discussion of the achievements and issues in this stage of reform, see JINGLIAN WU, DANGDAI ZHONGGUO JINGJI GAIGE JIAOCHENG (当代中国经济改革教程) [UNDERSTANDING CHINA'S ECONOMIC REFORM] 152–53, (Shanghai Far East Publishers, 2d ed., 2016); Huang, *Four Decades of China's SOE Reform*, *supra* note 13, at 64-66; Huang, *State-Owned Enterprises Reform*, *supra* note 13, at 101–04; Daniel Ho & Angus Young, *China's Experience in Reforming Its State-Owned Enterprises: Something new, Something old and Something Chinese?*, 2 INT'L J. ECON., MGMT. & SOC. SCI. 84, 85 (2013); NICHOLAS R. LARDY, CHINA'S UNFINISHED ECONOMIC REVOLUTION 23-24 (Brookings Inst. 1998).

modernization of SOEs (1993-2002),[15] and finally, with the establishment of the State-Owned Assets Supervision and Administration Commission ("SASAC") in March 2003, a significant shift to the preservation and expansion of state assets and the creation of "national champions" of large SOEs especially in strategic sectors.[16]

Before the launch of the current SOE reform, SOEs have shrunk in the numbers of firms and employees, and the market shares in many sectors.[17] However, they became even more significant and influential in the economy. For example, in 2013, the 110 central SOEs (under the supervision of the SASAC) held 38,423 subsidiaries (compared with 16,290 subsidiaries in 2005) and controlled a total of RMB 9.3 trillion state assets (compared with RMB 3.7 trillion in 2005).[18] The efforts to create "national champions" made remarkable achievements with 85 mainland Chinese companies (the majority are SOEs) made to the Fortune Global 500 list of the world's largest corporations in 2013, rising from six in 2003.[19] Notably, all of the 11 Chinese companies on the top 100 list in 2013 were central SOEs. Furthermore, the assignment of multiple roles to the SASAC and its local branches further enhanced the role of government in the management and operation of SOEs and hence increased the likelihood of government intervention in their business activities.[20] In addition, the Party played an

[15] For a discussion of the achievements and issues in this stage of reform, see Yingyi Qian & Jinglian Wu, *China's Transition to a Market Economy: How Far Across the River?*, *in* HOW FAR ACROSS THE RIVER?: CHINESE POLICY REFORM AT THE MILLENNIUM 31, 35–8 (Nicholas C. Hope, Dennis Tao Yang & Mu Yang Li eds., 2003); Huang, *Four Decades of China's SOE Reform*, *supra* note 13, at 66-70; NICHOLAS LARDY, MARKETS OVER MAO: THE RISE OF PRIVATE BUSINESS IN CHINA 45-48 (Peterson Inst. for Int'l Econ., 2014); OECD, *State Owned Enterprises in China: Reviewing the Evidence*, at 4-5, (OECD Working Group on Privatisation and Corporate Governance of State Owned Assets, Jan. 26, 2009), *available at* https://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/42095493.pdf (last visited Nov. 30, 2018); OECD, OECD REVIEWS OF REGULATORY REFORM – CHINA: DEFINING THE BOUNDARY BETWEEN THE MARKET AND THE STATE 42–43 (2009), *available at* https://www.oecd.org/gov/regulatory-policy/42390089.pdf (last visited Nov. 30, 2018); WU & MA, *supra* note 13, 158–63.

[16] See Lardy, *The Rise of Private Business in China*, *supra* note 15, at 48–58; Li & Brodsgaard, *supra* note 13, at 57-58; Dong Zhang & Owen Freestone, *China's Unfinished State-Owned Enterprise Reforms*, 2 ECON. ROUNDUP 77, 83-93 (2013); Geng et al, *supra* note 13, at 158–61; US–China Econ. & Security Rev. Commission, *2012 Report to Congress*, at 48-51 (Nov. 2012), *available at* https://www.uscc.gov/sites/default/files/annual_reports/2012-Report-to-Congress.pdf (last visited Aug. 1, 2018).

[17] Barry Naughton, *The Current Wave of State Enterprise Reform in China: A Preliminary Appraisal*, 12 ASIAN ECON. POL'Y REV. 282 (2017).

[18] For 2013 data, see ZHONGGUO GUOYOU ZICHAN JIANDU GUANLI NIANJIAN (中国国有资产监督管理年鉴) [CHINA'S STATE-OWNED ASSETS SUPERVISION AND ADMINISTRATION YEARBOOK] 687 (China Econ. Publishing House, 2014). For 2005 data, see ZHONGGUO GUOYOU ZICHAN JIANDU GUANLI NIANJIAN (中国国有资产监督管理年鉴) [CHINA'S STATE-OWNED ASSETS SUPERVISION AND ADMINISTRATION YEARBOOK] 597 (China Economic Publishing House, 2006). See also Naughton, *supra* note18, at 285–86.

[19] See THE FULL LIST OF FORTUNE 500 COMPANY 2003, *available at* http://archive.fortune.com/magazines/fortune/fortune500_archive/full/2003/ (last visited Nov. 30, 2018); See THE FULL LIST OF 95 CHINESE COMPANY THAT MADE TO THE FORTUNE 500 2013, *available at* http://www.fortunechina.com/fortune500/c/2013-07/08/content_164367.htm (in Chinese) (last visited Nov. 30, 2018).

[20] For a detailed discussion of SASAC's multiple roles, see Barry Naughton, *Top-Down Control: SASAC and the Persistence of State Ownership in China*, 1–21 (paper presented at the "China and the World Economy" conf., Leverhulme Cent. for Res. on Globalisation and Econ. Pol'y, Univ. of Nottingham, June 23, 2006), *available at*

important role in SASAC-controlled entities, maintaining a high level of influence on their operation.[21] These issues provoked robust debates, both internationally and domestically, over the needs and approaches to push forward the SOE reform.[22]

The current phase of SOE reform was launched by the Third Plenum of the 18th Party Congress in November 2013, which adopted the *Decision on Matters on Comprehensively Deepening Reform*.[23] The Decision outlined the missions for furthering comprehensive economic reforms with an emphasis on the crucial importance of enabling the market to play a decisive role in allocation of resources, and of managing government intervention in a way that enhances fair competition. It reiterated the significance of pursuing a "modern enterprise system" through further severing regulatory and business functions, improving corporate management and governance, and exposing SOEs to market competition. The Decision contemplated several important initiatives including the classification of SOEs, the creation of state assets management entities, and the introduction of private ownership in industries or projects that were previously reserved for SOEs. At the same time, however, the Decision envisaged that the economic reforms will be carried out under the Party's leadership which shall be strengthened and improved. To implement the Decision, the Central Committee of the Party and the State Council jointly issued the *Guiding Opinions on Deepening the Reform of State-Owned Enterprises*[24] ("Guiding Opinions") in August 2015, which was followed by the release of over 110 implementing regulatory instruments at the central level, and over 830 at the local level.[25] Since the implementation of the reform started only after the release of the Guiding Opinions, the actual outcomes and prospects of the reform are far from clear. The numerous policy documents complicated rather than clarified the tasks and process of the reform. The implementation has been fragmented due to inconsistent interpretation of the Guiding Opinions at different levels of government and by different responsible authorities. Overall, the reform seems to have proceeded in a way that seeks to ensure that the market-based transformation of SOEs serves to create more powerful and competitive SOEs and does not undermine the effective control of the government. In this sense, the current reform is more likely to be an extension of the previous round which concentrated on protection of state assets and creation of national champions than one which pursues fundamental changes.

A. Classification of SOEs

---

https://www.nottingham.ac.uk/gep/documents/conferences/2006/june2006conf/naughton-june2006.pdf (last visited Nov. 30, 2018).

[21] See Lardy, *The Rise of Private Business in China*, *supra* note 15, at 51.

[22] See Zhang & Freestone, *supra* note 16, at 93. WORLD BANK & DEV. RES. CTR. OF THE ST. COUNCIL OF CHINA, P.R.C., CHINA 2030: BUILDING A MODERN, HARMONIOUS, AND CREATIVE SOCIETY 109–15 (2013).

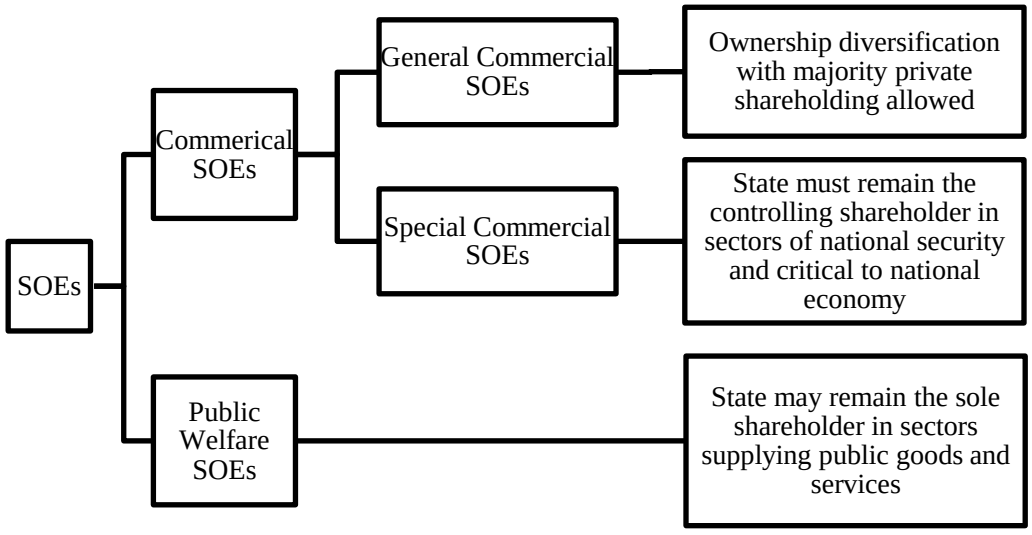
[23] ZHONGGONG ZHONGYANG GUANYU QUANMIAN SHENHUA GAIGE RUOGAN ZHONGDA WENTI DE JUEDING (中共中央关于全面深化改革若干重大问题的决定) (Nov. 12, 2013), *available at* http://www.gov.cn/jrzg/2013-11/15/content_2528179.htm (last visited Nov. 30, 2018).

[24] ZHONGGONG ZHONGYANG, GUOWUYUAN GUANYU SHENHUA GUOYOU QIYE GAIGE DE ZHIDAO YIJIAN (中共中央、国务院关于深化国有企业改革的指导意见) (promulgated by Cent. Comm. of CPC & St. Council, (Zhong Fa [2015] No. 22) Aug. 24, 2015, effective Aug. 24, 2015) (Chinalawinfo) [hereinafter Guiding Opinions].

[25] Liu Qingshan (刘青山), *Guoqi Guozi Wunian Gaige Lueying (国企国资5年改革掠影) [A Glimpse of the Five years Reform of State-owned Enterprises]* 9 GUOZI BAOGAO (国资报告) [STATE-OWNED ASSETS REPORT] 10, 11 (2017).

The first element of the current reform concerns the classification of SOEs into "Commercial SOEs" and "Public Welfare SOEs".[26] This classification is aimed at further integrating SOEs into market-based economic reforms and promoting both the commercial and social functions of SOEs. In general, Commercial SOEs are expected to operate independently in the market and continue to pursue corporatization and ownership diversification with majority private shareholding allowed ("General Commercial SOEs"). Their performance is evaluated against three key criteria including general financial indicators (e.g. revenue and profits), return on state assets investment, and the market competitiveness of these entities. A sub-category of Commercial SOEs involves those whose core business falls within industries or fields concerning national security and the lifeline of the national economy, or those which undertake projects or tasks designated by the State ("Special Commercial SOEs"). While these SOEs are also open to private capital and mixed ownership, the State must remain the controlling shareholder. In addition to the performance criteria applicable to General Commercial SOEs, Special Commercial SOEs are also required to contribute to implementation of national strategies, protection of national security, and development of strategic industries. Public Welfare SOEs, which exercise social functions and provide public goods and services, may remain wholly state-owned and may decide whether to pursue ownership diversification according to their individual circumstances. The performance evaluation of these SOEs hinges on factors that reflect their capacity to make social contributions such as cost control, quality of services, and efficiency. The classifications of SOEs are summarized in Diagram 1 below.

Diagram 1: SOE Classifications



According to the classifications, one may observe that General Commercial SOEs are most likely to operate as privately-owned enterprises ("POEs"). In contrast, Special Commercial SOEs and Public Welfare SOEs will largely remain under the control of the State and are likely to be shielded from market competition. In practice, the classification has been

[26] See Guiding Opinions, *supra* note 24, Section 2. The implementing regulation for the SOE classification is the GUANYU GUOYOU QIYE GONGNENG JIEDING YU FENLEI DE ZHIDAO YIJIAN (关于国有企业功能界定与分类的指导意见) [GUIDING OPINIONS ON THE FUNCTIONAL DEFINITION AND CLASSIFICATION OF STATE-OWNED ENTERPRISES] (promulgated by State-Owned Assets Supervision Commission & Ministry of Fin. of the P.R.C & Nat'l Dev. Reform Commission, (Guozifayanjiu [2015] No. 170) Dec. 30, 2015, effective Dec. 30, 2015) (Chinalawinfo).

implemented by the SASAC and its local branches. Due to the large number of local SASAC departments,[27] the reform has resulted in mixed results with uncertain and fragmented classifications.[28] For instance, Shanghai SASAC, Chongqing SASAC, Shanxi SASAC have classified their SOEs into three groups, namely, competitive, functional, and public service.[29] In contrast, Sichuan SASAC has defined all its SOEs as commercial SOEs.[30] These inconsistent practices suggest that the categorization of SOEs, by itself, may not provide a clear guidance on whether an SOE is more market-oriented or policy-oriented or whether it operates and competes according to market forces. Accordingly, it is necessary to consider other elements of the reform or other features of SOEs in assessing the function and conduct of SOEs.

B. Corporate Governance

The second element focuses on furthering the corporatization and modernization of SOEs.[31] The reform seeks to promote the restructuring of SOEs and group companies for public listing, ownership diversification, and regulation of shareholders' conducts, as well as to enhance the decision-making role of boards of directors and the autonomy of management. Accordingly, this element can be further broken up into three key components, including corporate governance (which is discussed below), mixed ownership (which is discussed in sub-section C), and restructuring and reorganisation (which is discussed in sub-section D).

The implementation regulation on corporate governance reform, released in April 2017, set the deadline for the corporatization of central SOEs by the end of 2017.[32] It requires clarifications of the rights and responsibilities of all organs and individuals central to the corporate governance system of SOEs, including shareholders, boards of directors, management, boards of supervisors, the Party, and representatives of employees (Section 2). According to the OECD, over 80% of central SOEs have finalized the process of establishing

---

[27] There are more than 300 local SASAC departments at provincial, municipal, county, and town levels. See Liy Qingshan (刘青山), *Naxie Yijing Xiaoshi de Difang Guoziwei (那些已经"消失"的地方国资委) [The 'Disappeared' Local State-owned Assets Supervision and Administration Commission]* 8 GUOZI BAOGAO (国资报告) [STATE-OWNED ASSETS REPORT] 44, 44 (2016).

[28] Paul Hubbard, *'Fragmented Authoritarianism' and State Ownership*, EAST ASIA FORUM Q. (Jan. 23, 2017), *available at* http://www.eastasiaforum.org/2017/01/23/fragmented-authoritarianism-and-state-ownership/ (last visited Nov. 30, 2018).

[29] Yuan Shimeng (原诗萌), *Difang Guoqi Fenlei Gaige Fenxi Baogao (地方国企分类改革分析报告) [An Analysis of the Classification of Local State-Owned Enterprises]* 12 GUOZI BAOGAO (国资报告) [STATE-OWNED ASSETS REPORT] 71 (2016).

[30] GUANYU YINFA GUANYU SHENGSHU QIYE GONGNENG JIEDING YU FEILEI JIANGUAN DE ZHIDAO YIJIAN (SHIXING)> DE TONGZHI) (关于印发《关于省属企业功能界定与分类监管的指导意见（试行）》的通知) [NOTICE ON THE PRINTING AND DISTRIBUTING THE GUIDING OPINIONS ON THE CLASSIFICATIONS OF PROVINCIAL SOES (TRIAL IMPLEMENTATION)], promulgated by Sichuan State-Owned Assets Supervision Commission (No. 115) June 7, 2016, effective June 7, 2016), *available at* www.scgz.gov.cn/10000/10004/10201/2016/06/12/10006366.shtml (last visited Nov. 30, 2018).

[31] See Guiding Opinions, *supra* note 24, Section 3.

[32] See GUOWUYUAN BANGONGTING GUANYU JINYIBU WANSHAN GUOYOU QIYE FAREN ZHILI JIEGOU DE ZHIDAO YIJIAN (国务院办公厅关于进一步完善国有企业法人治理结构的指导意见) [GUIDING OPINIONS ON FURTHER IMPROVING THE CORPORATE GOVERNANCE STRUCTURE OF STATE-OWNED ENTERPRISES] (promulgated by Gen. Off. of the St. Council (Guo Ban Fa [2017] No. 36), Apr. 24, 2017, effective Apr. 24, 2017), at Section 1.3 (Lawinfochina).

a board of directors, although "this is mainly happening at the lowest tiers of enterprise groups, not at the group level."[33] However, there is limited information on the progress of the other elements of the corporatization. The most significant is the uncertainty relating to how government intervention in business decision-making is to be effectively managed or avoided. Despite the broad coverage of the reform, the Guiding Opinions stresses that the Party will play a leadership role in SOEs by creating a representative committee in the enterprises ("Party Committee").[34] The constitutions of SOEs shall specify the functions of Party Committee and the process for its senior members to undertake executive roles in the entities and for executives of the entities to undertake senior positions in the committee. In principle, the Party secretary of the committee shall also serve as the chairman of the board. In the past, the involvement of the Party in the corporate governance of SOEs was typically linked to the appointment of senior executives, which had already generated concerns about state intervention in the management and decision-making of SOEs. As Lin observed,

> In 53 central enterprises, the occupants of top positions, including the board chairman, CEOs, and party secretaries, are appointed and evaluated by the Central Organization Department of the Chinese Communist Party. This appointment practice predates the establishment of SASAC and persists until today.[35]

Under the current reform, the role of the Party is enhanced through an explicit power to directly participate in the decision-making of the board beyond personnel appointments.[36] In practice, the implementation of the Guiding Opinions has led to amendments to the articles of association of SOEs. By 2017, all 98 central SOEs have incorporated provisions on Party Committee into their articles of association.[37] Over 30 HK-listed SOEs have established Party Committees through amendments of articles of association.[38] For example, the amended Articles of Association of Datang International Power Generation Co., Ltd, a HK-listed central SOE, includes the following clauses:

> Article 10 In accordance with the requirements of the Constitution of the Communist Party of China, an organisation of the Communist Party of China shall be established and play the core leadership role, functioning as the political core of the Company, providing direction, managing the overall situation and ensuring implementation…
>
> Article 139 (Item 20) The opinions of the Party Committee shall be heard before the board of directors decides on material issues of the Company.[39]

---

[33] See OECD, OECD ECONOMIC SURVEYS: CHINA 2017 44 (2017), *available at* https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-china-2017_eco_surveys-chn-2017-en (last visited Aug. 1, 2018).

[34] See Guiding Opinions, *supra* note 24, Section 7.

[35] Li-Wen Lin, *A Network Anatomy of Chinese State-Owned Enterprises*, 16 WORLD TRADE REV. 583, 588 (2017).

[36] Jennifer Hughes, *Communist Party Control Written into Law at China's Big Companies,* FIN. TIMES (Aug. 15, 2017), *available at* https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247afd (last visited Nov. 30, 2018); Naughton, *supra* note 17, at 292.

[37] Wang Qianqian (王倩倩), *Guowuyuan Guoziwei Dangwei Tuijin Zhongyang Qiye Dangjian Gongzuo Jishi (国务院国资委党委推进中央企业党建工作纪实) [SASAC Promotes the Establishment of Party Committee in Central SOEs]* (Oct. 10, 2017), *available at* www.sasac.gov.cn/n2588030/n2588919/c7979758/content.html (last visited Nov. 30, 2018).

[38] Hughes, *supra* note 36; Naughton, *supra* note 17, at 292.

[39] See PROPOSED AMENDMENTS TO ARTICLES OF ASSOCIATION AND NOTICE OF EGM, DATANG INTERNATIONAL POWER GENERATION CO., LTD, (June 29, 2017), *available at* www.hkexnews.hk/listedco/listconews/SEHK/2017/0630/LTN201706301016.pdf (last visited Nov. 30, 2018).

Such clauses leave considerable room and flexibility for the Party to exert influence over the boards of directors, thereby creating a clear tension with the pursuit of corporatization and modern corporate governance. Thus, despite the classifications of SOEs, there remains the possibility that the commercial decisions of all types of SOEs will be affected by the Party. The possibility tends to be higher in Special Commercial SOEs and Public Welfare SOEs than in General Commercial SOEs which are expected to optimise commercial performance and competitiveness.

C. Ownership Diversification

The second component of corporatization and modernization is ownership diversification.[40] On the one hand, it allows the injection of private capital in SOEs in various ways and the involvement of private investors in the restructuring and management of SOEs, and provides full protection of the property rights and interests of all shareholders. In sensitive sectors such as oil, natural gas, electricity, railway, telecommunications, resources, and public utilities, non-state capitals are only allowed limited access upon completing security reviews in accordance with relevant laws and regulations. In theory, the introduction of non-state interest in SOEs would contribute to the corporate governance reform as it introduces additional checks and balances and improves transparency in the decision-making of SOEs.[41] In practice, the reform has led to the sale of either a majority (i.e. General Commercial SOEs) or minority interest (e.g. Special Commercial SOEs) in SOEs to private investors. A typical example of the former is the diversification of ownership in Yunnan Baiyao Holdings, a provincial SOE initially 100% owned by the Yunnan SASAC. The state interest was diluted to 50% with the injection of private capital by New Huadu Industrial Group in 2016, and then to 45% with the introduction of another private investor Yuyue Technology Development Co., Ltd. in 2017.[42]

With respect to Special Commercial SOEs, the mixed ownership reform is restricted in a list of industries specified in the *Opinions of the State Council on the Development of Mixed Ownership Economy by State-Owned Enterprises*[43] ("Mixed Ownership Reform Opinions"). These industries include, for example, important communication infrastructure, water supply and conservation, oil and gas, power, forest and strategic mineral resources, key public technology. In these industries, private capital participation is limited to certain activities while the State remains the sole or controlling shareholder. Thus, the State will own or effectively control the SOEs in those sectors. The mixed ownership reform of China United Network Communications Group Co., Ltd. ("China Unicom"), a central SOE, offers a good

---

[40] See Guiding Opinions, *supra* note 24, Section 5.

[41] See OECD, *OECD Economic Surveys*, *supra* note 33, at 36.

[42] See YUNNAN BAIYAO: 2016 NIAN NIANDU BAOGAO (云南白药：2016 年年度报告) [YUNNAN BAIYAO GROUP CO LTD ANNUAL REPORT 2016] at 56 (Apr. 2017), *available at* www.yunnanbaiyao.com.cn/upload/files/1704/%E4%BA%91%E5%8D%97%E7%99%BD%E8%8D%AF%EF%BC%9A2016%E5%B9%B4%E5%B9%B4%E5%BA%A6%E6%8A%A5%E5%91%8A.PDF (last visited Nov. 30, 2018); YUNNAN BAIYAO: 2017 NIAN BANNIANDU BAOGAO ZHAIYAO (云南白药：2017 年半年度报告摘要) [Yunnan Baiyao Group Co., Ltd. First Half Year 2017 Report Summary] at 3 (Aug. 24, 2017), *available at* www.yunnanbaiyao.com.cn/upload/files/1708/%E4%BA%91%E5%8D%97%E7%99%BD%E8%8D%AF%EF%BC%9A2017%E5%B9%B4%E5%8D%8A%E5%B9%B4%E5%BA%A6%E6%8A%A5%E5%91%8A%E6%91%98%E8%A6%81.PDF (last visited Nov. 30, 2018).

[43] GUOWUYUAN GUANYU GUOYOU QIYE FAZHAN HUNHE SUOYOUZHI JINGJI DE YIJIAN (国务院关于国有企业发展混合所有制经济的意见) (promulgated by St. Council, (Guo Fa [2015] No. 54), Sep. 23, 2015, effective Sep. 23, 2015) (Lawinfochina).

illustration of how the reform of Special Commercial SOEs may proceed. As one of the six candidates selected for pilot mixed ownership reform in 2016,[44] China Unicom reduced its shareholding in China United Network Communications Co., Ltd. – a Shanghai-listed subsidiary company – from 62.74% to 36.67% in 2017.[45] The other major shareholders include state-owned China Life Insurance Company (10.22%) and China Structural Reform Fund Co., Ltd. (6.11%), and private investors Tencent (5.18%), Baidu (3.30%), JD.com (2.36%), Alibaba (2.04%), Suning Commerce Group (1.88%), Kuang-Chi Group (1.88%), and Shenzhen Huaihai Ark Information Fund (1.88%). Thus, the reform maintained the majority state ownership (i.e. 53%) in the subsidiary SOE so as not to affect the State's control over the entity.

As far as Public Welfare SOEs are concerned, the Mixed Ownership Reform Opinions largely reproduces the relevant section of the Guiding Opinions and merely adds several examples of the industries and fields supplying public goods and services which include utilities (i.e. water, electricity, natural gas, heat), public transportation and infrastructure. In these sectors, ownership diversification is to be *guided* ~~(e.g. not encouraged)~~ according to the conditions of SOEs.

The other important aspect of the mixed ownership reform pertains to the encouragement of investment of state capital in POEs with a focus on public services, advanced technology, ecological and environmental protection, and other strategic industries. Article 4(13) of the Mixed Ownership Reform Opinions further clarified that State-owned capital investment and operating companies (which are discussed in sub-section E below) should play a major role in such investment. While how the reform is to proceed on this front remains to be seen, it creates the potential for the State to influence the private sectors. As Naughton has observed, the reform "may actually encourage the extension of SOEs into competitive markets where they do not currently have a presence…[by] encouraging state capital to expand its investment in, and control of, private firms."[46]

D. Restructuring and Reorganisation

The third component of corportisation and modernization involves the restructuring and reorganization of SOEs. The *Guiding Opinions on Promoting the Restructuring and Reorganisation of Central SOEs*[47] ("Restructuring Opinions"), released by the State Council in 2016, set out three key objectives of the reform. The first is to enhance the capability of central SOEs in protecting and stabilizing sectors of national security, their control in sectors of critical importance to national economy, and their influence and leadership in strategic and

---

[44] GUOJIA FAZHAN GAIGEWEI ZHAOKAI GUOYOU QIYE HUNHE SUOYOUZHI GAIGE SHIDIAN ZHUANTIHUI SOEs (国家发展改革委召开国有企业混合所有制改革试点专题会) [NATIONAL DEVELOPMENT AND REFORM COMMISSION PRESS CONFERENCE ON PILOT PROGRAMS OF MIXED-OWNERSHIP REFORM] (Sep. 28, 2016), *available at* www.ndrc.gov.cn/xwzx/xwfb/201609/t20160930_821881.html (last visited Nov. 30, 2018).

[45] See ANNUAL REPORT OF CHINA UNICOM (HONG KONG) LIMITED (2016), at 20, *available at* www.chinaunicom.com.hk/en/ir/reports/2016_20f.pdf (last visited Aug. 2, 2018).

[46] Barry Naughton, *Restructuring and Reform: China 2016 in* STRUCTURAL CHANGE IN CHINA: IMPLICATIONS FOR AUSTRALIA AND THE WORLD 69 (Reserve Bank of Australia eds., 2016), *available at* www.rba.gov.au/publications/confs/2016/pdf/rba-conference-volume-2016.pdf (last visited Nov. 30, 2018).

[47] GUOWUYUAN BANGONGTING GUANYU TUIDONG ZHONGYANG QIYE JIEGOU TIAOZHENG YU CHONGZHU DE ZHIDAO YIJIAN (国务院办公厅关于推动中央企业结构调整与重组的指导意见) (promulgated by Gen. Off. of the St. Council (Guo Ban Fa [2016] No.56), Jul. 17, 2016, effective Jul. 17, 2016) (Westlaw China).

priority sectors such as high-end equipment manufacturing, information technology, biotechnology, aviation and aerospace, new energy, new materials, energy conservation and environment protection, etc. The strategic and priority sectors are consistent with those identified in China's overarching guiding policies such as the 12th Five Year Plan (2010-2015), the Made in China 2025 Action Plan, and the 13th Five Year Plan (2016-2020).[48] The second goal is to improve efficiency and allocation of resources through mergers and acquisitions, institutional innovation and cooperation, reduction of overcapacity, and disposal of inefficient and non-performing assets. The third is to boost the growth and internationalization of the central SOEs. Overall, the reform is expected to establish a group of world-class multinational companies with innovative capacity and international competitiveness by 2020. Between January 2013 and 31 January 2018, 37 central SOEs have undergone restructuring through 19 horizontal or vertical mergers, as summarised in Table 1 below. Typical examples of horizontal mergers include the mergers of two rival companies in selected industries, such as the railway equipment industry (i.e. the two largest railway equipment groups – China CNR Corporation Limited ("CNR") and CSR Corporation Limited ("CSR")) in 2015, the shipping industry (i.e. the two largest shipping groups – China Ocean Shipping (Group) Company and China Shipping Group) in 2016, and the nuclear energy industry (i.e. China Nuclear Engineering and Construction Corp. ("CNEC") and China National Nuclear Corp. ("CNNC")) in 2018. This last merger reduced the number of central SOEs to 97 and created "a new nuclear powerhouse with assets worth more than 600 billion yuan ($95.4 billion)."[49] With respect to vertical mergers, one remarkable example is the merger between electricity producer China Guodian Corporation ("Guodian") and coal producer Shenhua Group Corporation Limited ("Shenhua") in 2017 to create "the world's largest power company by capacity, with combined assets of 1.8 trillion yuan."[50] While restructuring of SOEs has also been carried out at the local level, the reform seems to have prioritized mergers of central SOEs so far.[51] Overall, the restructuring and reorganization of SOEs, at least at the central level, has clearly carried forward the efforts of the previous round of reform to create "national champions" in strategic industries.[52] As the reform continues to

[48] For the full text of these policy instruments, see GUOMIN JINGJI HE SHEHUI FAZHAN DI SHIERGE WUNIAN GUIHUA GANGYAO (国民经济和社会发展第十二个五年规划纲要) [THE 12TH FIVE-YEAR PLAN FOR ECONOMIC AND SOCIAL DEVELOPMENT OF THE PEOPLE'S REPUBLIC OF CHINA] (Mar. 6 2011), *available at* http://www.gov.cn/2011lh/content_1825838.htm (last visited Nov. 30, 2018); GUOMIN JINGJI HE SHEHUI FAZHAN DI SHISANGE WUNIAN GUIHUA GANGYAO (国民经济和社会发展第十三个五年规划纲要) [The 13th Five-Year Plan for Economic and Social Development of the People's Republic of China] (Mar. 17, 2016), *available at* http://www.gov.cn/xinwen/2016-03/17/content_5054992.htm (last visited Nov. 30, 2018); ST. COUNCIL OF THE P.R.C, MADE IN CHINA 2025 (May 8, 2015), *available at* http://www.gov.cn/zhengce/content/2015-05/19/content_9784.htm (last visited Nov. 30, 2018).

[49] See Huang Kaixi, Deng Yucong & Denise, *China Combines Two State-Owned Nuclear Firms Into Powerhouse*, CAIXIN NEWS AGENCY (ONLINE) (Feb. 1, 2018), *available at* www.caixinglobal.com/2018-02-01/china-combines-two-state-owned-nuclear-firms-into-powerhouse-101205786.html (last visited Nov. 30, 2018).

[50] *Id.*

[51] Wendy Leutert, *State-Owned Enterprise Mergers: Will Less be More?,* EUR. COUNCIL ON FOREIGN REL. (Nov. 30, 2016), *available at* www.ecfr.eu/publications/summary/china_state_owned_enterprise_mergers_under_xi_jinping7196 (last visited Nov. 30, 2018).

[52] François Godement, *Introduction*, EUR. COUNCIL ON FOREIGN REL. (Nov. 30, 2016), *available at* www.ecfr.eu/publications/summary/china_state_owned_enterprise_mergers_under_xi_jinping7196 (last visited Nov. 30, 2018).

proceed in that direction, the tension between the growing concentration and influence of SOEs in pillar industries and the market-oriented reform of SOEs will intensify.

Table 1: List of Central SOEs Mergers between January 2013 and January 2018[53]

NO.	Year	Central SOEs	Outcome
1	2018	CNNC & CNEC	CNEC merged into CNNC as a subsidiary
2	2017	Guodian & Shenhua	Establishing a new company, China Energy Investment Corporation
3	2017	Sinolight Corporation (Sinolight) & China National Arts and Crafts (Group) Corporation (CNACGC) & China Poly Group Corporation (Poly Group)	Sinolight and CNACGC merged into Poly Group as a subsidiary
4	2017	China National Machinery Industry Corporation (Sinomach) & China Hi-Tech Group Corporation Limited (China Hi-Tech)	China Hi-Tech merged into Sinomach as a subsidiary
5	2016	China Grain Reserves Corporation (Sinograin) & China National Cotton Reserves Corporation (National Cotton)	National Cotton merged into Sinograin as a subsidiary
6	2016	Baosteel Group Corporation (Baosteel) & Wuhan Iron and Steel (Group) Corporation (WISCO)	Establishing a new company, China BaoWu Steel Group Corporation Limited
7	2016	China National Building Materials Group Corporation (CNBM) & China National Materials Group Corporation Limited (Sinoma)	Sinoma merged into CNBM as a subsidiary
8	2016	China National Cereals, Oils and Foodstuffs Corporation (COFCO) & Chinatex Corporation Limited (Chinatex)	Chinatex merged into COFCO as a subsidiary
9	2016	China Travel Service (HK) Group Corporation (HKCTS) & China International Travel Service Group Corporation (CITS)	CITS merged into HKCTS as a subsidiary
10	2015	China Merchants Group Company Limited & Sinotrans and CSC Holdings, Corporation Limited (Sinotrans Group)	Sinotrans Group merged into China Merchants Group as a subsidiary
11	2015	China Ocean Shipping (Group) Company (COSCO) & China Shipping (Group) Company (China Shipping)	Establishing a new company, China COSCO Shipping Corporation Limited
12	2015	China Minmetals Corporation (Minmetals) & China Metallurgical Group Corporation (MCC)	MCC merged into Minmetals as a subsidiary
13	2015	Nam Kwong (Group) Company Limited (Nam Kwong) & Zhuhai Zhen Rong Company (Zhen Rong)	Zhen Rong merged into Nam Kwong as a subsidiary
14	2015	CNR & CSR	Establishing a new company, China Railway Rolling Stock Corporation Limited
15	2015	China Power Investment Corporation (CPI) & State Nuclear Power Technology Corporation Limited (SNPTC)	Establishing a new company, State Power Investment Corporation Limited

[53] All mergers are reported and updated on the official website of the SASAC, *available at* www.sasac.gov.cn/n2588035/n2641579/n2641660/index.html (last visited Nov. 30, 2018).

16	2014	China Huafu Trade and Development Corporation (Huafu) & COFCO	Huafu merged into COFCO as a subsidiary
17	2013	China National Erzhong Group Corporation (Erzhong) & China National Machinery Industry Corporation (Sinomach)	Erzhong merged into Sinomach as a subsidiary
18	2013	China Grain and Logistics Corporation (China Grain) & COFCO	China Grain merged into COFCO as a subsidiary
19	2013	Caihong Group Corporation (Caihong) & China Electronics Technology Group Corporation (CETC)	Caihong merged into CETC as a subsidiary

E. State Asset Management System

The fifth and final element concerns the improvement of the state-owned assets management system.[54] This reform aims to transform the functions of state assets regulatory bodies (i.e. SASAC and its local branches) by shifting the focus of the supervision from enterprise to capital, defining the boundaries of the supervision, and clarifying their rights and responsibilities. The reform has resulted in the creation of two types of companies, namely, State Capital Investment Companies ("SCICs") and State Capital Operation Companies ("SCOCs"), or collectively State Capital Investment and Operation Companies ("SCIOs"). They specialize in the management of state assets and operate within the authorities granted by the SASAC or its local branches. While the management of state assets will be guided by the market, it is also required to serve national strategies, industrial policies, and the capital needs of the most competitive SOEs. Thus, SCIOs are essentially subordinates of central or local SASACs and are expected to support national or provincial industrial policies and the development of strategic and emerging industries.[55] By the end of 2017, there were 89 SCIOs established at the central and local levels.[56]

The differences between SCICs and SCOCs are not clearly defined in the existing regulatory documents. However, the practice suggests that they may serve different functions. For example, China Chengtong Holdings Group Ltd. ("Chengtong"), a SCOC created in 2016, initiated the China Structural Reform Fund to participate in the reorganization of SOEs,[57] including the mixed ownership reform of China United Network Communications Limited as discussed above. In contrast, the China Reform Holdings Corp., a SCIC established around the same time as Chengtong, partnered with two banks and one investment fund to inject RMB200 billion into innovative technology and industrial upgrading projects.[58] Accordingly,

[54] See Guiding Opinions, *supra* note 24, Section 4.

[55] See Naughton, *supra* note 17, at 291–2.

[56] See Wang Lu (王璐), *Guozi Touzi Yunying Gongsi Shidian Gengduo Kuowei zhi Chongfen Jingzheng Hangye (国资投资、运营公司试点 更多扩围至充分竞争行业) [The Pilots for State Capital Investment and Operations Companies Expanded to Fully Competitive Industries]*, ECON. INFO. DAILY (ONLINE) (Mar. 15, 2018), *available at* http://www.sasac.gov.cn/n2588025/n2588139/c8734772/content.html (last visited Nov. 30, 2018).

[57] Chang Lyu, *Massive fund to help reform giant SOEs*, CHINA DAILY (ONLINE) (Sep. 27, 2016), *available at* www.chinadaily.com.cn/business/2016-09/27/content_26904633.htm (last visited Nov. 30, 2018).

[58] Matthew Miller, *China to reform SOEs using investment firms, asset managers: Xinhua*, THOMSON REUTERS (ONLINE) (Feb. 25, 2016), *available at* www.reuters.com/article/us-china-soe-reform/china-to-reform-soes-using-investment-firms-asset-managers-xinhua-idUSKCN0VY15O (last

the future reform may witness the division of labour between SCOCs and SCICs, with the former focusing on the restructuring of SOEs and the latter on the investment in priority industries.[59] More significant than the possible functional difference between SCOCs and SCICs is the common goal that SCIOs serve and their far-reaching impacts on the SOE reform. As indicated in Table 1 above, SCIOs have been established through mergers of large SOEs to create massive fund to finance SOEs' reorganization or investment in strategic industries. These reforms will considerably strengthen and expand the influence of SOEs or the State in these industries and generate growing concerns on China's state capitalism.

F. China's State Capitalism as a Challenge for the World Trading System

In essence, "state capitalism" concerns the magnitude of government involvement in business activities depending on "state ownership stake in or significant influence over" the business sector.[60] While it takes different forms in different economies,[61] one of the common features pertains to the extensive role that SOEs have been playing in consolidating and expanding state capitalism.

China's current SOE reform has been dedicated to bolstering the state sector and reinforcing the role of the State/Party in pursuing various policy objectives. As such, the reform is heading in a direction which strengthens rather than weakens state capitalism. In 2017, the number of mainland Chinese companies on the Fortune Global 500 list of the world's largest corporations increased to 109 (from 85 in 2013) including 48 central SOEs and 18 local SOEs.[62] The restructuring of central SOEs has made some of the world's largest companies even more powerful. For example, China BaoWu Steel Group Corporation Limited, the new company created through the merger between Baosteel and WISCO in September 2016, was ranked 204th in 2017, up from Baosteel's ranking of 275th in 2016.[63]

---

visited Nov. 30, 2018); Engen Tham & David Stanway, *China launches $30 bln state-controlled venture capital fund*, TOMSON REUTERS (ONLINE) (Aug. 18 2016) *available at* www.reuters.com/article/china-funds/china-launches-30-bln-state-controlled-venture-capital-fund-idUSL3N1AZ1SX (last visited Nov. 30, 2018).

[59] GUOYOU ZICHAN JIANGUAN HE GUOYOU QIYE GAIGE YANJIU BAOGAO (2014-2015) (国有资产监管和国有企业改革研究报告 (2014-2015)) [REPORTS ON THE SUPERVISION OF STATED-OWNED ASSETS AND THE REFORM OF STATED-OWNED ENTERPRISES (2014-2015)] 65 (China Economic Publishing House, 2017); Deloitte, *Key Points on the Reorganization/Establishment of State-owned Capital Investment Companies and State-owned Capital Operating Companies* (2016), *available at* www2.deloitte.com/cn/en/pages/operations/articles/soe-transformation-whitepaper-issue5.html (last visited Nov. 30, 2018).

[60] JOSHUA KURLANTZICK, STATE CAPITALISM: HOW THE RETURN OF STATISM IS TRANSFORMING THE WORLD 13–14 (Oxford Univ. Press, 2016); Aldo Musacchio & Sergio G. Lazzarini, *Leviathan in Business: Varieties of State Capitalism and their Implications for Economic Performance*, 3–4 (Harv. Bus. Sch. Working Paper, Paper No.12–108, 2012), *available at* https://ssrn.com/abstract=2070942 (last visited Nov. 30, 2018).

[61] See Kurlantzick, *supra* note 60, at 29–47.

[62] See FULL LIST OF FORTUNE 500 COMPANY 2017, *available at* http://fortune.com/fortune500/list/ (last visited Nov. 30, 2018); THE LIST OF ALL THE CHINESE COMPANIES THAT MADE INTO FORTUNE 500 COMPANY 2017, *available at* http://www.fortunechina.com/fortune500/c/2017-07/20/content_286799.htm (last visited Nov. 30, 2018).

[63] See FULL LIST OF FORTUNE 500 COMPANY 2016, *available at* http://fortune.com/global500/2016/ (last visited Nov. 30, 2018); LIST OF ALL THE CHINESE COMPANIES THAT MADE INTO FORTUNE 500 COMPANY 2016, *available at*

Similarly, Minmetals' ranking rose from 323th in 2016 to 120th in 2017 after the reorganization with MCC in December 2015. In short, despite the rapid growth of the private sector and the progressive liberalisation in China, SOEs will remain one of the principal mechanisms of Chinese state capitalism for the foreseeable future.[64]

The control of SOEs by the State/Party is not necessarily problematic, at least not under the rules of the WTO, as we argue below. However, combined with other factors, such control could and often did result in anti-competitive effects. As noted by a recent OECD report, the main concern is that SOEs "may not behave like private firms" and "decisions may not be driven by business objectives and the underlying creation of economic value" but "by political or public policy goals."[65] The report identifies a range of unfair competitive advantages to SOEs, spanning from subsidies and preferential financing to privileged access to information, regulatory advantages, protected monopolistic position, and other forms of government support.[66] These problems are further exacerbated by China's unique economic model whereby SOEs are regarded as the primary economic agents of the State and the main instrument for implementing industrial and other national policies.[67] Frequently, large SOEs which are already market leaders individually are merged by the State to create behemoth national champions, in total disregard of antitrust concerns.[68] While such mergers are often motivated by national pride rather than the desire for market dominance, the other firms in the same sectors often become collateral damages in such ambitious campaigns. In addition to squeezing competitors out of the relevant Chinese market, SOEs have also been used as a vehicle to restrict market access to China by foreign competitors[69] and expand foreign markets through aggressive bids and other means, often with the financial backing of the Chinese government.[70] Moreover, State/Party controls not only create such anti-competitive effects, but tend to sustain such effects by preventing markets from self-correction through the confluence of several factors such as vertical policy actions, administrative monopoly, and preferential support for SOEs.[71] Accordingly, these practices not only raise competition concerns in general, but also pose mounting challenges for the multilateral trading system as they undermine the conditions of competition that the WTO is designed to maintain.

---

http://www.fortunechina.com/fortune500/c/2016-07/20/content_266975.htm (last visited Nov. 30, 2018).

[64] Benjamin Liebman & Curtis Milhaupt, *Introduction: The Institutional Implications of China's Economic Development*, *in* REGULATING THE VISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM xiii, xv (Benjamin Liebman & Curtis Milhaupt eds., 2016).

[65] See OECD, *State-Owned Enterprises as Global Competitors*, *supra* note **Error! Bookmark not defined.**, at 27.

[66] *Id.*, at 28–30.

[67] William E. Kovacic, *Competition Policy and State-Owned Enterprises in China*, 16 World Trade Rev., 693–711, 704 (2017).

[68] See Lin, *A Network Anatomy of Chinese State-Owned Enterprises*, *supra* note 35, at 587.

[69] See Peter Harrell, Elizabeth Rosenberg & Edoardo Saravalle, *China's Use of Coercive Economic Measures*, Ctr. New Am. Sec. (June 2018), at 22, *available at* https://s3.amazonaws.com/files.cnas.org/documents/China_Use_FINAL-1.pdf?mtime=20180604161240 (last visited Nov. 30, 2018).

[70] See e.g. Kanupriya Kapoor & Hidayat Setiaji, *Indonesia favouring China over Japan in railway bid - govt sources*, Thomson Reuters (online) (Aug 31, 2015), *available at* https://www.reuters.com/article/indonesia-infrastructure-idUSL4N1162WK20150831 (last visited Nov. 30, 2018). Also see Angela Huyue Zhang, *The Antitrust Paradox of China, Inc.*, 50 N.Y.U. J. Int'l L. & Pol. 159, 166 (2017).

[71] See Kovacic, Competition Policy and State-Owned Enterprises in China, *supra* note 67, at 705.

Therefore, they put to the test the adequacy and efficacy of WTO rules in coping with Chinese state capitalism.

III. THE LIMITATIONS OF GATT/WTO RULES IN CHALLENGING STATE CAPITALISM

The postwar effort to construct a multilateral system of world trade culminated in the conclusion of the GATT in October 1947 which subsequently operated as a *de facto* international institution for the negotiations of trade liberalization and the settlement of trade disputes over the decades before the birth of the WTO in 1994.[72] Many GATT rules were designed to control and reduce the degree of governmental interference with commercial transactions so as to achieve a better allocation of international resources and increase the economic welfare worldwide.[73] More specifically, these rules impose a series of general disciplines to limit the governments' use of various policy instruments such as tariffs, quantitative restrictions, certain customs rules and formalities, internal taxes and regulations, and subsidies. However, these rules are ill-equipped to deal with SOEs, as noted by Jackson, Davey and Sykes below:

> Many GATT rules … restrict the types of regulations which governments can impose on international traders, but do not purport to regulate the traders themselves. If the government is the trader or controls the trader, the rules may be ineffective since decisions ostensibly made independently by the trader may in fact reflect actions of the government.[74]

Indeed, GATT draftsmen realized that governments may act through firms or enterprises to influence trade indirectly.[75] Thus, several GATT provisions seek to regulate such conduct by prohibiting the imposition of import mark-ups by import monopolies (Article II:4) and import or export restrictions through state trading operations (the interpretative note to Articles XI, XII, XIII, XIV and XVIII), and discriminatory conduct of STEs.

Furthermore, subsidies, as a typical form of state intervention, may be used to enhance the international trading position of domestic firms in the pursuit of certain policy goals such as discouraging imports or promoting exports.[76] The GATT treats subsidies as trade-distortive instruments, regulates the provision of subsidies, and allows the use of countervailing measures to offset the effect of subsidies. Subsidies are regulated under the WTO Agreement on Subsidies and Countervailing Measures[77] ("SCM Agreement"), which elaborates on the relevant rules under GATT Articles VI (i.e. countervailing measures) and XVI (i.e. subsidies). In addition, GATT Article VI and the WTO Anti-Dumping Agreement[78] ("AD Agreement") allow WTO Members to take actions against 'dumping', the practice of companies selling goods in a foreign market at a price (i.e. export price) lower than what the goods are sold in the market of exportation (i.e. normal value). Anti-dumping ("AD"), typically in the form of

---

[72] The negotiation of the GATT was intertwined with the negotiation of a Charter for an International Trade Organisation (ITO) which failed to eventuate. For the drafting history of the ITO Charter and the GATT, see JOHN H. JACKSON, WORLD TRADE AND THE LAW OF THE GATT 35–46 (1969).

[73] *Id.*, at 329.

[74] JOHN H. JACKSON, WILLIAM J. DAVEY & ALAN O. SYKES, LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS – CASES, MATERIALS AND TEXT 402 (4th ed., 2002).

[75] Jackson, *World Trade and the Law of the GATT*, *supra* note 72, at 331.

[76] *Id.*, at 365.

[77] Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 UNTS 14.

[78] Agreement on the Implementation of Article VI of GATT 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 UNTS 201.

import tariffs, has become one of the most popular instruments for countries to tackle the so-called "unfair trade practice" which is made possible sometimes by state intervention in the market.

Another reason for the limitations of the GATT rules in addressing state intervention in commercial activities has to do with the fact that the GATT was negotiated predominantly among market oriented economies without much contemplation of rules that apply to the so-called non-market economies ("NMEs").[79] Therefore, in economies where SOEs play a significant role or state intervention is pervasive in economic activities, the GATT rules tend to be insufficient to ensure that such economies operate in a way that does not nullify and impair the benefits of these rules.[80] In 1950s-60s, the accession of certain NMEs (e.g. Poland, Romania, and Hungary) to the GATT led to the creation of a special AD rule to address certain extreme situations in which markets were dominated by state monopolies (which will be discussed in Section III.E).[81] However, as these NMEs were "relatively small in terms of their impact on trade",[82] the limits of the GATT rules in addressing NME-related problems did not escalate into a systemic issue until the negotiations of China's accession to the GATT/WTO. During the accession negotiations between 1986 and 2001, the Chinese economy underwent unprecedented and far-reaching market-oriented reforms and liberalization.[83] The fact that China was no longer a purely centrally-controlled economy[84] largely rendered the above-mentioned special AD rule inapplicable. However, as China remained in the process of transitioning into a market economy at the time of the accession negotiations, GATT/WTO Members were concerned about the ineffectiveness of the general rules in dealing with China.[85] Consequently, China agreed to undertake a range of WTO-plus obligations under its accession instruments – the Protocol on the Accession of China[86] ("AP") and the Report of the Working Party on the Accession of China[87] ("WPR").

The reminder of the article discusses the extent to which the general WTO rules and the China-specific WTO-plus obligations may be applied to Chinese state capitalism, particularly

---

[79] See John Jackson, State Trading and Non-Market Economies 23 INT'L LAW. 891, 891–93 (1989).

[80] See Eliza Patterson, *Improving GATT Rules for Nonmarket Economies*, 20 J. WORLD TRADE 185, 186 (1986); William Davey, *Article XVII GATT: An Overview*, *in* STATE TRADING IN THE TWENTY–FIRST CENTURY 17, 32 (Thomas Cottier & Petros Mavroidis eds., 1998).

[81] GATT Analytical Index, Article VI Anti-Dumping and Countervailing Duties, at 228, *available at* www.wto.org/english/res_e/booksp_e/gatt_ai_e/art6_e.pdf (last visited Nov. 30, 2018).

[82] Jackson, *State Trading and Non-market Economies*, *supra* note 79, at 894.

[83] See NICHOLAS LARDY, INTEGRATING CHINA INTO THE GLOBAL ECONOMY 65–105 (Brookings Inst. Press, 2002).

[84] This was acknowledged by the GATT Secretariat and the founding Director General of the WTO. See *e.g.*, GATT Secretariat, *Working Party on China's Status as A Contracting Party: China's Foreign Trade Regime*, GATT Doc. Spec(88)13/Add.13 (Sep. 7, 1993); GATT, *Global Multilateral Trading System: The Role of the PRC, Address by Peter D. Sutherland*, GATT Doc. GATT/1633 (May 10, 1994).

[85] See *e.g.*, GATT, *Working Party on China*, GATT Doc. GATT/AIR/2392 (Mar. 11 1987); GATT, *Working Party on China Status as a Contracting Party*, GATT Doc. L/6191/Rev.1 (Feb. 25 1988); GATT Secretariat, *Working Party on China's Status as A Contracting Party: Annotated Checklist of Issues*, GATT Doc. Spec(88)13/Add.5 (June 9, 1989); WTO, *Communication from China*, WTO Doc. WT/ACC/CHN/15 (Jul. 13, 1998); WTO, *Communication from China*, WTO Doc. WT/ACC/CHN/30 (July 18, 2000).

[86] *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001). [hereinafter AP]

[87] *Report of the Working Party on the Accession of China*, WT/ACC/CHN/49 (1 October 2001). [hereinafter WPR]

in the context of China's current SOE reform. Due to space constraints, our discussions will focus on the rules relating to trade in goods as opposed to trade in services.[88]

A. Non-Discrimination and STEs

The non-discrimination principle, enshrined in the most-favoured-nation ("MFN") rule (GATT Article I:1) and the national treatment ("NT") rule (GATT Article III), is one of the fundamental pillars of the WTO edifice. Activities of government-related enterprises may undermine the operation of these rules through business decisions which discriminate among imports or between imported and domestic goods based on origin. Accordingly, one of the key proposals during the negotiations of the GATT was the imposition of an obligation on governments to ensure that STEs "operate on a non-discriminatory basis, allowing their sales and purchases to be governed only by commercial considerations."[89] This obligation was eventually codified in GATT Article XVII:1 which reads in the substantive parts:

> (a) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.
> (b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

Two major elements may affect the scope of Article XVII:1 in dealing with SOEs, including the enterprises covered and the obligations imposed.

Article XVII:1 deals with "STEs" which is defined under Article 1 of the Understanding on the Interpretation of Article XVII ("Understanding") as follows:

> Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports.

This definition leaves two major issues unclarified: (1) the scope of "exclusive or special rights or privileges", and (2) the degree of influence required to become an STE. These two issues are arguably at the core of determining whether an enterprise is subject to the obligations under Article XVII:1. Since it is impossible to envisage all trade-distorting activities of STEs, Article XVII:1 seeks to tackle the underlying sources of such trade distortions, namely, the use of special rights and privileges by an enterprise to influence trade.[90] Without limiting the scope of "exclusive or special rights or privileges"[91] or requiring

[88] For a discussion of the adequacy of WTO rules on trade in services in dealing with state enterprises and monopolies, see Mattoo, *supra* note 11.

[89] Jackson, *World Trade and the Law of the GATT*, *supra* note 72, at 331.

[90] See Ernst-Ulrich Petersmann, *GATT Law on State Trading Enterprises: Critical Evaluation of Article XVII and Proposals for Reform*, *in* STATE TRADING IN THE TWENTY-FIRST CENTURY 71, 72 (Thomas Cottier & Petros Mavroidis eds., 1988).

[91] The only limits on the scope of 'exclusive or special rights or privileges' are set out in the interpretative note to Article XVII:1(a) which excludes governmental measures "imposed to insure

any specific degree of influence, Article XVII:1 provides the flexibility to cover a broad range of enterprises including SOEs and private firms which utilise special rights or privileges bestowed by governments to influence trade through "purchases or sales" activities. In this connection, the Working Party on STEs, established under Article 5 of the Understanding, produced an illustrative list on notifiable STEs.[92] While the list did not define STEs, it contemplated a wide spectrum of government-entity relationships and activities of enterprises, showing the willingness of WTO Members to maintain a flexible definition of STEs.[93] Accordingly, in the context of China's SOE reform, Public Welfare SOEs and Special Commercial SOEs would fall within the definition of STEs as they undertake governmental functions or carry out government-mandated policies either explicitly or implicitly. Article XVII:1 could also be applied to General Commercial SOEs or private enterprises insofar as special rights or privileges are conferred on these entities, enabling them to influence trade through "purchases or sales" or associated activities.[94]

In contrast with the potentially broad coverage of STEs, the substantive obligations imposed by Article XVII:1(a) and (b) are limited. According to Professor Jackson, these provisions were intended to impose an MFN obligation only.[95] However, the issue whether Article XVII:1(a) also covers an NT obligation remains unsettled to date.[96] In *Canada – FIRA*, the GATT panel concurred with Canada's submission that only the MFN and not the NT obligations fall within the scope of Article XVII:1(a).[97] In contrast, the WTO panel, subsequently in *Korea – Beef*, observed that the general principle of non-discrimination under

---

standards of quality and efficiency in the operation of external trade, or privileges granted for the exploitation of national natural resources but which do not empower the government to exercise control over the trading activities of the enterprise in question." These limits were compromises reached in the original negotiations of the GATT. See Jackson, *World Trade and the Law of the GATT*, *supra* note 72, at 341–42.

[92] WTO, Working Party on State Trading Enterprises, Illustrative List of Relationships between Governments and State Trading Enterprises and the Kinds of Activities Engaged in by These Enterprises, WTO Doc. G/STR/4 (July 30, 1999).

[93] Andrea Mastromatteo, *WTO and SOEs: Article XVII and Related Provisions of the GATT 1994*, 16 WORLD TRADE REV. 601, 607 (2017).

[94] With respect to the activities of enterprises, while Article XVII:1(a) refers to "purchases or sales involving either imports or exports", there is no requirement that the enterprises concerned undertake import or export activities; rather, it would suffice if their purchases or sales affect trade. Moreover, the Working Party on STEs provided a non-exhaustive list of activities ranging from direct involvement in importation or exportation (e.g. imports control, quota administration, licensing) to those relating to domestic sales or purchases (e.g. production, distribution, credit guarantees, storage, promotion, packaging, transportation). This suggests that the covered activities are not limited to 'purchases or sales' per se but include related activities. See GATT, Panel on Subsidies and State Trading, Final Report on State Trading, at 5, GATT Doc. L/1146 (11 March 1960); Working Party on State Trading Enterprises, *supra* note 92.

[95] Jackson, *World Trade and the Law of the GATT*, *supra* note 72, at 345-47.

[96] For a review of the relevant GATT/WTO panels' decisions, see Petersmann, *supra* note 90, at 80–84; Mastromatteo, *supra* note 93, at 608–09.

[97] GATT Panel Report, Canada—Administration of the Foreign Investment Review Act, para. 5.16, GATT Doc. L/5504–30s/140 (adopted Feb. 7, 1984) [hereinafter Canada—FIRA]. Canada's submission relied on two major arguments: (1) the reason why the word 'principle' is used in the plural is that the GATT contains a number of MFN-type obligations; and (2) by referring to 'imports or exports', Article XVII:1(a) does not concern "the treatment by the state-trading enterprise of imported or domestic products in its domestic market." The validity of these arguments has not been examined by WTO tribunals.

Article XVII:1(a) "includes at least the provisions of Articles I and III of GATT."[98] In *Canada – Wheat*, the Appellate Body ("AB") was requested to consider the relationship between paragraphs (a) and (b) of Article XVII:1 and did not clarify the exact scope of the non-discrimination principles under Article XVII:1(a).[99]

Another important issue is whether Article XVII:1(b) establishes a stand-alone obligation beyond non-discrimination, that is, requiring STEs to "make … purchases or sales solely in accordance with commercial considerations" ("Commercial Considerations Requirement") and "afford the enterprises of the other contracting parties adequate opportunity … to compete for participation in such purchases or sales" ("Adequate Opportunity Requirement"). In *Canada – Wheat*, one of the US's major claims was that the Commercial Considerations Requirement is additional to non-discrimination so that STEs must "make sales solely in accordance with commercial considerations".[100] The AB disagreed, holding that the opening phrase of Article XVII:1(b) shows "abundantly clear" that the remainder of that provision merely defines and clarifies the requirement in Article XVII:1(a) and does not create obligations separate or independent from non-discrimination.[101] The AB concluded that "Article XVII:1 was intended to impose disciplines on one particular type of STE behaviour, namely discriminatory behaviour, rather than to constitute a comprehensive code of conduct for STEs" or impose "comprehensive competition-law-type obligations on STEs".[102] Regarding the Adequate Opportunity Requirement, the AB rejected the US's allegation that this requirement means that "the CWB must offer the requisite opportunity to any enterprise that is … selling wheat in the same market as the CWB."[103] The reason was that the Adequate Opportunity Requirement "must refer to the opportunity to become the STE's counterpart in the transaction, *not* to an opportunity to replace the STE as a participant in the transaction."[104]

In light of the above, while Article XVII:1 is sufficiently broad to capture SOEs, it is limited to anti-discrimination and does not address other trade-distorting conduct of SOEs. Other than discrimination, Article XVII:1 does not prohibit anti-competitive behaviour of SOEs and does not require SOEs to act as private entities, thereby leaving the flexibility for WTO Members to use SOEs for various regulatory purposes.[105] Finally, the application of Article XVII:1 may be qualified by the availability of other WTO rules applicable to trade-distorting conduct of SOEs. As the AB observed in *Canada – Wheat*, "Article XVII:1 was never intended to be the sole source of the disciplines imposed on STEs" and "a number of

---

[98] Panel Report, Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef, paras. 753, 769, WTO Doc. WT/DS161/R, WT/DS169/R (adopted Jan. 10, 2001) [hereinafter Korea—Beef]. Amongst others, the panel found that the practice of Korea's Livestock Products Marketing Organisation, in delaying "its sales of imported beef into the Korean market while having important stocks", violated the non-discrimination principles contemplated in Article XVII:1(a). This finding suggests a NT-type violation whereby imported beef was treated less favourably than domestic beef in terms of distribution in the Korean market.

[99] Appellate Body Report, Canada—Measures Relating to Exports of Wheat and Treatment of Imported Grain, para. 88, WTO Doc. WT/DS276/AB/R (adopted Sep. 27, 2004) [hereinafter Canada—Wheat]

[100] *Id.*, paras. 82–83.

[101] *Id.*, paras. 89–91.

[102] *Id.*, paras. 97–98, 145.

[103] *Id.*, para. 152. CWB refers to Canadian Wheat Board the monopoly and STE at issue conferred with a range of "exclusive and special privileges" over the purchase and sale of wheat in certain areas.

[104] *Id.*, para. 157 (original emphasis).

[105] Bernard Hoekman & Joel Trachtman, *Canada-Wheat: Discrimination, Non-Commercial Considerations, and the Right to Regulate Through State Trading Enterprises* 7 World Trade Rev. 45, 58, 62, 64 (2008).

additional obligations, under different covered agreements, operate to further constrain the behaviour of STEs."[106] These obligations include, *inter alia*, GATT Article II:4, the *Ad* Note to Articles XI, XII, XIII, XIV and XVIII, and GATT Article VI as implemented by the SCM Agreement and the AD Agreement.[107] In practice, GATT/WTO tribunals have relied on the other disciplines, in preference to Article XVII:1, in condemning the conduct of STEs.[108]

B. Tariffs and Import Monopoly

Another fundamental GATT/WTO rule, as codified in GATT Article II:1, serves to protect the value of tariff concessions by preventing a WTO Member from increasing import tariffs beyond the 'bound' levels recorded in its WTO 'Schedules of Concessions on Goods' ("Goods Schedule"). While this rule limits the permissible conduct of governments, it is not directly applicable to the activities of companies. Thus, if a trading company acquires a monopoly position in the importation of certain goods, it may simply make a business decision to increase their resale price in the domestic market, which would effectively offset the benefits of tariff concessions. To deal with such a situation, GATT Article II:4 stipulates:

> If any contracting party establishes, maintains or authorizes, formally or in effect, a monopoly of the importation of any product described in the appropriate Schedule annexed to this Agreement, such monopoly shall not, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule...

Thus, Article II:4 limits the level of protection an import monopoly may provide for a 'bound' product by requiring that the maximum permissible monopoly protection must not, on the average, exceed the amount of protection specified in Goods Schedules.[109] The *Ad* Note to Article II:4 suggests that the relevant provisions of Article 31 of the Havana Charter would assist in the interpretation of this obligation. Article 31(4) of the Havana Charter relevantly provides that a 'bound' import duty

> shall represent the maximum margin by which the price charged by the import monopoly for the imported product (exclusive of internal taxes conforming to the provisions of Article 18 [i.e. GATT Article III], transportation, distribution and other expenses incident to the purchase, sale or further processing, and a reasonable margin of profit) may exceed the landed cost...[110]

Accordingly, several GATT panels interpreted Article II:4 as allowing only for protection that has been included in Goods Schedules. In *Canada – Provincial Liquor Boards (EEC)*, since all imported alcoholic beverages are bound under Canada's Goods Schedule, the panel ruled that the application of a higher profit margin on imported alcoholic beverages than that on like domestic ones ran afoul of Article II:4.[111] The panel held that an import monopoly may charge, beyond an import duty, costs associated with importation and a "reasonable

---

[106] Appellate Body Report, *Canada—Wheat*, *supra* note 99, para. 98.

[107] *Id.*, para. 98 & FN 102–05.

[108] See Mastromatteo, *supra* note 93, at 609.

[109] Jackson, *World Trade and the Law of the GATT*, *supra* note 72, at 356-57.

[110] GATT Analytical Index, Article II Schedules of Concessions, at 91–92, *available at* https://www.wto.org/english/res_e/publications_e/ai17_e/gatt1994_art2_gatt47.pdf (last visited Nov. 30, 2018).

[111] GATT Panel Report, Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies, paras. 4.3–19, GATT Doc. L/6304-35S/37, (adopted 22 Mar. 22, 1988) [hereinafter Canada – Provincial Liquor Boards (EEC)].

amount of profit".[112] However, a profit margin obtained from a monopoly position – i.e. not under normal conditions of competition – is not 'reasonable' and would constitute a 'mark-up' prohibited by Article II:4.[113] Regarding the costs associated with importation, the panel in *Canada – Provincial Liquor Boards (US)* clarified that they must reflect the variable costs directly associated with the importation of the goods or the "charges for fixed assets employed that were calculated in proportion to the use of these assets by the imported product."[114] Accordingly, the panel found that the cost-of-service differential between imported and domestic products, which was equivalent to the differential profit margin applied previously in *Canada – Provincial Liquor Boards (EEC)*, did not represent "additional costs necessarily associated with the marketing of imported products".[115] To date, Article II:4 has not been considered by WTO tribunals, which suggests that import monopolies "are less of an issue nowadays" than they were during the GATT era.[116]

The scope of Article II:4 in dealing with SOEs is limited in at least three aspects. Firstly, Article II:4 concerns whether an entity maintains a monopoly position in the importation of goods. Thus, SOEs that do not have such a monopoly position would fall outside the ambit of Article II:4. Secondly, Article II:4 regulates import tariffs only and does not deal with other types of policy instruments which may or may not be covered by other GATT/WTO rules. For example, Article II:4 does not apply to quantitative restrictions which are governed by GATT Article XI:1. Nor does Article II:4 apply to export tariffs which are generally excluded from GATT disciplines. Thirdly, Article II:4 applies to 'bound' goods only and does not apply to goods which are 'unbound' (i.e. not included in Goods Schedules), although the current coverage of bound tariff lines is broad.[117]

C. Quantitative Restrictions and STEs

Import or export quantitative restrictions (i.e. quotas), which are generally prohibited under GATT Article XI:1, may also be applied via STEs. Thus, the *Ad* Note to Articles XI, XII, XIII, XIV and XVIII stipulates that

---

[112] *Id*, paras. 4.16, 4.19. The panel ruled that "'a reasonable margin of profit' was a margin of profit that would be obtained under normal conditions of competition (in the absence of the monopoly). The margin of profit would have on the average to be the same on both domestic and the like imported products so as not to undermine the value of tariff concessions under Article II." With respect to costs associated with importation, the panel held that "the mark-ups which were higher on imported than on like domestic alcoholic beverages (differential mark-ups) could only be justified under Article II:4, to the extent that they represented additional costs necessarily associated with marketing of the imported products, and that calculations could be made on the basis of average costs over recent periods."

[113] This finding was confirmed by the GATT panel in *Korea – Beef (Australia)*. See GATT Panel Report, Republic of Korea—Restrictions on Imports of Beef—Complaint by Australia, para. 106, GATT Doc. L/6504 – 36S/202, (adopted Nov. 7, 1989).

[114] GATT Panel Report, Canada—Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, paras. 5.19, GATT Doc. DS17/R-39S/27, (adopted 18 Feb. 18, 1992) [hereinafter Canada—Provincial Liquor Boards (US)].

[115] *Id.*, paras. 5.18, 5.21.

[116] 1 PETROS C. MAVROIDIS, THE REGULATION OF INTERNATIONAL TRADE: GATT 172 (MIT Press. 2016).

[117] WTO, *Six Decades of Multilateral Trade Cooperation: What Have We Learnt? in* WORLD TRADE REPORT 2007 SIXTY YEARS OF THE MULTILATERAL TRADING SYSTEM: ACHIEVEMENTS AND CHALLENGES, 33, 221 (2007).

> Throughout Articles XI, XII, XIII, XIV and XVIII, the terms "import restrictions" or "export restrictions" include restrictions made effective through state-trading operations.[118]

This *Ad* Note has been applied in a number of disputes to successfully challenge the conduct of STEs. For example, in *Canada – Provincial Liquor Boards (EEC)*, the GATT panel found that "the practices concerning listing/delisting requirements and the availability of points of sale [as maintained by the Canadian import and distribution monopoly of alcoholic beverages] which discriminate against imported alcoholic beverages were restrictions made effective through state-trading operations contrary to Article XI:1."[119] The panel observed that such "systematic discriminatory practices" were "restrictions made effective through 'other measures' within the meaning of Article XI:1".[120] In *Korea – Beef*, the WTO panel clarified that in cases where an STE exercises effective controls over both importation and distribution channels, "the imposition of any restrictive measure, including internal measures, will have an adverse effect on the importation of the products concerned"; and this will trigger the application of the *Ad* Note.[121] Consequently, the panel found that as the Livestock Products Marketing Organisation (Korea's state trading agency for beef) had an exclusive import right over 30% of imported beef, its refusal to distribute imported beef in the domestic market constituted import restrictions on foreign beef contrary to Article XI:1 through the application of the *Ad* Note, amongst other WTO rules.[122]

Given the definition of STEs, the scope of the *Ad* Note is not confined to import or export monopolies or STEs with exclusive rights over importation or exportation. However, like Articles XVII:1 and II:4, the *Ad* Note merely deals with one type of trade-restrictive policy instrument. The combined scope of these provisions is therefore limited as they leave other forms of trade-distorting measures unregulated. Finally, it must be noted that the *Ad* Note does not prohibit Members from using STEs for importation or exportation *per se*. As ruled by the WTO panel in *India – Quantitative Restrictions*,

> the mere fact that imports are effected through state trading enterprises would not in itself constitute a restriction. Rather, for a restriction to be found to exist, it should be shown that the operation of this state trading entity is such as to result in a restriction.[123]

This suggests that to establish a violation of the *Ad* Note, the facts that 'trading rights' (i.e. the right to import or/and export) are granted to an entity with exclusive or special privileges (i.e. an STE) and that there are no imports of the subject goods during certain periods are not, in themselves, sufficient.[124] One must further prove that the absence of imports is caused by the STE.

---

[118] While Articles XII, XIV and XVIII provide for certain exceptions to the general principle above for balance of payments and economic development reasons, Article XIII requires that any permitted import or export quotas are allocated on a non-discriminatory basis. The latter means that administration of quotas through STEs in a discriminatory manner is also prohibited.

[119] GATT Panel Report, *Canada—Provincial Liquor Boards (EEC)*, *supra* note 111, para. 4.25.

[120] *Id.*, para. 4.24.

[121] WTO Panel Report, *Korea—Beef*, *supra* note 98, para. 751. The panel also observed that "when dealing with measures relating to agricultural products" (i.e. beef in this case), a violation of the *Ad* Note "would necessarily constitute a violation of" Article 4.2 of the WTO Agreement on Agriculture and Footnote 1 to that provision which prevent Members from maintaining quantitative import restrictions through STEs. (paras. 759-62)

[122] *Id.*, paras. 767–68.

[123] WTO Panel Report, *India—Quantitative Restrictions on Imports of Agricultural Textile and Industrial Products*, para. 5.134, WTO Doc. WT/DS90/R (adopted on Sep. 22, 1999).

[124] *Id.*, para. 5.135.

D. Transparency

As an underlying WTO principle, transparency serves to reduce "information asymmetries among governments, and between the State, economic actors, and citizens" and is essential for the systemic stability of the trading system.[125] In general, the GATT/WTO rules on transparency comprise three key elements: (1) publication of trade-related laws, regulations and other governmental measures (e.g. GATT Article X), (2) notification of such regulatory measures under various WTO agreements through the relevant WTO committees, and (3) periodic review of trade policies and regulations pursuant to the Trade Policy Review Mechanism ("TPRM"). For various reasons, however, the implementation of these rules in practice has been uneven under the different notification mechanisms.[126]

Transparency becomes more crucial for the operation of the trading system when dealing with NMEs or SOEs the impact of whose conducts on trade is often difficult to observe.[127] During the 1954-55 Review Session, GATT Article XVII:4 was added with an aim to ensuring adequate disclosure of the activities of STEs so as to bring STEs under closer international scrutiny.[128] Sub-paragraphs (a)-(c) of Article XVII:4, respectively, require Members to notify the products traded by STEs, the import mark-up applied by import monopolies, and the operations of STEs that have adversely impacted the interests of other Members. Sub-paragraph (d) excludes confidential information from the disclosure obligations. Subsequently, the GATT Contracting Parties adopted standard questionnaire and procedures for STE notifications in 1960 and 1962, which however did not facilitate adequate notifications.[129] The Understanding on Article XVII was then designed to improve the notifications by (1) requiring Members to review their policies regarding submission of STE notifications to the Council for Trade in Goods, (2) encouraging Members to maximize transparency on the notification of STE operations and the effect on trade, and (3) allowing other Members to make counter-notifications against inadequate notifications. The Working Party on STEs was tasked to review notifications and counter-notifications. In 2003, the Working Party produced a revised questionnaire requesting for a wide range of information on STEs, their activities, and impact on trade.[130] Despite these efforts, notifications have remained strikingly inadequate with a decreasing number of notifications over the notification periods despite the expansion of the WTO membership.[131] In the latest notification period in 2016, only 45 new and full notifications were submitted, while 91 Members including China did not submit a notification.[132]

Under the TPRM, China's Trade Policy Review ("TPR") documents in 2016 did contain information on SOEs. However, the information provided by China was too sparse to satisfy

---

[125] See generally Petros Mavroidis & Robert Wolfe, *From Sunshine to a Common Agent: The Evolving Understanding of Transparency in the WTO*, 21 BROWN J. WORLD AFF. 118 (2015); Robert Wolfe, *Letting the Sunshine in at the WTO: How Transparency Brings the Trading System to Life*, 1–44 (WTO, Staff Working Paper ERSD-2013-03, 2013).

[126] See Wolfe, *Letting the Sunshine in at the WTO*, *supra* note 125, at 16–19.

[127] See Patterson, *supra* note 80, at 199–200.

[128] Jackson, *World Trade and the Law of the GATT*, *supra* note 72, at 349-50.

[129] See GATT Analytical Index, *Article VI Anti-Dumping and Countervailing Duties*, *supra* note 81, at 481–82; Jackson, *World Trade and the Law of the GATT*, *supra* note 72, at 350–54.

[130] WTO Working Party on State Trading Enterprises, *Questionnaire on State Trading*, WTO Doc. G/STR/3/Rev.1 (Nov. 14, 2013).

[131] WTO Working Party on State Trading Enterprises, *Status of Notifications Submitted by WTO Members under Article XVII:4(A) of the GATT 1994 and Paragraph 1 of the Understanding on the Interpretation of Article XVII of the GATT 1994*, WTO Doc. G/STR/17 (Nov. 6, 2017).

[132] WTO, *Report (2017) of the Working Party on State Trading Enterprises*, at 2, WTO Doc. G/L/1196, G/STR/18 (Nov. 9, 2017).

the purpose of STE notifications.[133] This contrasted with the WTO Secretariat's Report on China's TPR which contained much more detailed information on the operation of Chinese SOEs and identified certain areas where more information is required.[134] Many WTO Members raised questions on Chinese SOEs and requested concrete details of the SOE reform, showing a significant shortage of transparency in China's submissions and a lack of knowledge on the (potential) impact of SOEs on trade and competition.[135] In the latest TPR of China in July 2018, China provided almost no further information on issues relating to SOEs including the SOE reform,[136] while these issues remained a major matter of concern.[137]

In addition, the records of notification of subsidies granted to or through SOEs have also been poor in general.[138] Collectively, the inadequacy of notifications under the different WTO transparency mechanisms reveals the limitations or ineffectiveness of the relevant WTO rules in ensuring transparency. The underlying causes of the ineffectiveness have to do with, amongst others, the ambiguities in the definition and coverage of STEs, the exclusion of confidential information from notifications, and the lack of capacity or incentives of Members to collect and provide the required information.[139] These causes apply to WTO Members in general and do not make China a unique case. Nevertheless, given the role of SOEs in the Chinese economy and the complexities in the SOE reform, the lack of transparency in the operation, activities, and impact of Chinese SOEs would create more acute challenges for the WTO.

E. Anti-Dumping

AD is the most frequently invoked policy instrument in dealing with NMEs. When an NME is involved in an AD investigation, investigating authorities ("IAs") may decide to replace the price of the subject goods sold in the NME market with a surrogate price of 'like goods' in a market economy third country for the determination of dumping margins. The justification for the use of surrogate prices typically relates to alleged state intervention and resultant distortions in the NME market. As the NME price is regarded as having been artificially lowered by the government, the surrogate price selected is generally higher than the NME price, thereby leading to higher dumping margins and AD duties. By doing so, AD duties are used to counteract the injurious effect of state intervention in an NME exporting country on the relevant domestic industry of the importing country.

China has been treated as an NME in many jurisdictions and suffers hefty and often inflated AD duties.[140] The extent to which the WTO AD rules allow the use of surrogate

---

[133] WTO Trade Policy Review Body, *Trade Policy Review Report by China*, at 12–13, WTO Doc. WT/TRP/G/342 (June 15, 2016).

[134] WTO Trade Policy Review Body, *Trade Policy Review Report by the Secretariat*, WTO Doc. WT/TRP/S/342 (June 15, 2016).

[135] WTO Trade Policy Review Body, *Trade Policy Review - China, Minutes of the Meeting*, paras. 3.19, 4.211, 4.348, WTO Doc. WT/TRP/M/342 (Sep. 26, 2016). See also Robert Wolfe, *Sunshine over Shanghai: Can the WTO Illuminate the Murky World of Chinese SOEs?*, 16 WORLD TRADE REV. 713, 721–24 (2017).

[136] WTO Trade Policy Review Body, *Trade Policy Review Report by China*, WTO Doc. WT/TRP/G/375 (June 6, 2018).

[137] WTO Trade Policy Review Body, *Trade Policy Review Report by the Secretariat*, WTO Doc. WT/TRP/S/375 (June 6, 2018).

[138] Wolfe, *Sunshine over Shanghai*, *supra* note 135, at 720.

[139] *Id.*, at 720, 724.

[140] According to China's Ministry of Commerce, China has been the primary target in AD actions worldwide for the past 20+ years. Sun Shaohua (孙韶华), *Shangwubu: Woguo Lianxu Shiernian Chengwei Fanqingxiao Zuida Mubiaoguo (商务部：我国连续 21 年成为反倾销最大目标*

prices has been vigorously debated and remains contentious.[141] Instead of fully engaging in the debate, our analysis below focuses on the major constraints on the use of AD to tackle NME-related issues under the WTO AD rules.

Like the other WTO rules, GATT Article VI and the AD Agreement are not designed to specifically deal with NMEs. Arguably, the only AD rule that does so is set out in the second Supplementary Provision to paragraph 1 of GATT Article VI which reads:

> It is recognized that, in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.[142]

In *EC – Fasteners*, the AB confirmed that the *Ad* Note "allows investigating authorities to disregard domestic prices and costs of … an NME in the determination of normal value and to resort to prices and costs in a market economy third country."[143] However, the AB also ruled that surrogate prices and costs may be invoked only when both of the prescribed conditions are found to exist in an economy, that is, "the complete or substantially complete monopoly of trade and the fixing of all prices by the State".[144] Thus, the *Ad* Note applies to an extreme type of NMEs only and does not apply to other types of NMEs where state intervention exists in a lesser degree.[145] Given the level of liberalization and competition in the Chinese market, any claim that China remains such an extreme type of NME must be rejected.[146] Commentators have repeatedly and correctly pointed out that the current Chinese

---

国) *[MOFCOM: China has been the primary target of anti-dumping for 21 years]*, ECON. INFOR. DAILY (July 6, 2016), *available at* http://finance.people.com.cn/n1/2016/0706/c1004-28527586.html (last visited Aug. 2, 2018). For a comprehensive volume on the evolvement of the so-called NME anti-dumping methodology under the WTO rules and the laws and practices in various major jurisdictions using China as a case study, see James Nedumpara and Weihuan Zhou (eds), *Non-Market Economies in the Global Trading System: The Special Case of China* (Singapore: Springer, 2018).

[141] See *e.g.*, Weihuan Zhou, *Appellate Body Report on EU-Biodiesel: The Future of China's State Capitalism under the WTO Anti-Dumping Agreement* 17 WORLD TRADE REV. 609 (2018); Jochem de Kok, *The Future of EU Trade Defence Investigations against Imports from China,* 19 J. INT'L ECON. L. 515 (2016); Ilaria Espa & Philip Levy, *The Analogue Method Comes Unfastened – The Awkward Space between Market and Non-Market Economies in EC-Fasteners (Article 21.5)* 17 WORLD TRADE REV. 313 (2018).

[142] As shown earlier, this special AD rule was added to the GATT during the Review Session of 1954-55 to deal with certain NMEs. Article 2.7 of the AD Agreement provides that Article 2 of the agreement is 'without prejudice to' this *Ad* Note. The wording 'without prejudice to' suggests that the interpretation of the other provisions of Article 2 must not 'detrimentally affect, encroach upon, or impair' the right of WTO Members under the *Ad* Note. See Appellate Body Report, China—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products, para. 219, WTO Doc. WT/DS363/AB/R (adopted Jan. 19, 2010).

[143] Appellate Body Report, European Communities—Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China, para. 285, WTO Doc. WT/DS397/AB/R (adopted Jul. 28, 2011) [hereinafter EC—Fasteners].

[144] *Id.*, FN 460.

[145] *Id.*

[146] See *e.g.*, David Palmeter, *The WTO Antidumping Agreement and the Economies in Transition, in* STATE TRADING IN THE TWENTY-FIRST CENTURY 115, 117 (Thomas Cottier & Petros Mavroidis eds., 1998).

economy is at least comparable to many other WTO Members so that the application of the *Ad* Note to China cannot be justified.[147]

The remaining question is 'to what extent the AD Agreement allows the use of surrogate prices and costs in dealing with exports from NMEs?' Under Article 2.2 of the AD Agreement, a normal value is generally established by reference to the price of the subject goods in the market of the exporting country. However, a surrogate price based on sales in a third country or a constructed normal value ("CNV") may be employed where (1) there is 'no domestic sales of like products in the ordinary course of trade'; or (2) a 'particular market situation' ("PMS") exists in the domestic market; or (3) there is 'low volume of sales in the country of exportation'. The third circumstance concerns the technical issue of whether there are sufficient sales in the domestic market for the determination of normal values and ~~hence~~ is not concerned about state interventions in an NME. The first two circumstances may be relevant to the consideration of NME-related issues in AD actions. However, according to the AB's rulings in *US – Hot-Rolled Steel*, it is submitted that the 'ordinary course of trade' ("OCT") test concerns the terms and conditions of sales transactions between *enterprises* and does not concern market distortions caused by state intervention *per se*.[148] In other words, the test focuses on distortions arising from commercial activities and not on governmental or regulatory activities. For example, the OCT test would apply to the sale of goods by a Chinese SOE to a related entity at a price lower than the market value of the goods or on terms and conditions more favorable than the sale of the goods to unrelated entities. However, whether the sale of the SOE has benefited from subsidies for the production of the goods or has been influenced by other government policies may not be relevant to the OCT test. As long as the sale is concluded on normal terms and conditions, the existence of state interventions in the market would not prevent the sale from satisfying the OCT test. In this sense, the OCT test would be of limited use in dealing with market distortions caused by government interventions, although the scope of the test is to be further elucidated by the WTO adjudicators.[149]

Comparing with the OCT test, the PMS test tends to provide more flexibility for consideration of state-caused market distortions in AD actions. Due to the absence of a definition of PMS under the AD Agreement and the lack of WTO jurisprudence on how the term should be interpreted and applied, there is currently little constraint on the discretion of IAs to treat state intervention in a market as creating a PMS. However, it is submitted that the application of the PMS test to addressing state interventions in NMEs may be limited as Article 2.2 does not concern an alleged market situation *per se* but concerns whether the

[147] See *e.g.*, William Watson, *Will Nonmarket Economy Methodology Go Quietly into the Night?*, 1, 8 (Cato Inst. Pol'y Analysis No. 763, 2014); Matthew R. Nicely, *Time to Eliminate Outdated Non-Market Economy Methodologies*, 9 GLOBAL TRADE & CUSTOMS J. 160, 160–61 (2014); Lisa Toohey & Jonathan Crowe, *The Illusory Reference of the Transitional State and Non-Market Economy Status*, 2 CHINESE J. COMP. L. 314, 333–34 (2014) (arguing that the distinction between market economy and NME is fundamentally flawed given "the diversity of regulatory regimes and market mechanisms around the world").

[148] Appellate Body Report, United States—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan, paras. 141-148, WTO Doc. WT/DS184/AB/R (adopted Aug. 23, 2001). For an analysis of this ruling, see Zhou, *supra* note 141, at 19-21.

[149] It should be noted that the scope of the OCT test has not been settled, and the WTO tribunals have not closed the door for the application of the test to address imports sold at distorted prices. WTO Members such as the EU have relied on the test for that purpose. See *e.g.*, Stephanie Noel & Weihuan Zhou, *Replacing the Non-Market Economy Methodology: Is the European Union's Alternative Approach Justified Under the World Trade Organization Anti-Dumping Agreement?* 11 Global Trade and Customs Journal 559 (2016).

existence of the situation has precluded a 'proper comparison' between export prices and domestic prices of the subject goods.[150] Thus, an alleged state intervention or market situation would not in itself be sufficient to constitute a PMS; rather, a PMS would exist only if the situation has affected the comparability of domestic prices *vis-à-vis* export prices. This would require the situation to have affected the two prices asymmetrically or un-evenhandedly.

Furthermore, a finding that a PMS exists merely provides a pathway to the application of the alternative methodology based on the use of CNV for comparison with export price. The level of the CNV (and ultimate dumping margins) would depend on the production cost, the administrative, selling and general costs, and profits in relation to the manufacture and sale of the subject goods. In practice, WTO Members have predominantly relied on the use of surrogate production costs to address state intervention in raw materials markets (e.g. steel and aluminum) in NMEs. However, in *EU – Biodiesel*, the AB has reduced substantially the flexibility in applying surrogate production costs for the construction of normal values, holding that the existence of governmental regulation and resultant distortions in a raw material market does not justify a deviation from the use of the costs actually incurred and recorded by the producers/exporters under investigations.[151] Thus, producers' costs must still be employed for the calculation of a CNV when state intervention or a PMS is found to exist in the raw material market. Towards this end, the only flexibility left in the AB's rulings (for the application of surrogate costs) will need to be based on the OCT test.[152] This was confirmed lately by the WTO panel in the *US – OCTG (Korea)* dispute.[153] However, as discussed above, the OCT test may not leave sufficient flexibility for consideration of government-caused market distortions.

In short, the special AD rule under the *Ad* Note to GATT Article VI:1 would not be applicable to China. More significantly, the WTO jurisprudence has evolved in a way that gradually removes the flexibility for the use of AD to address state intervention and market distortions in NMEs. It is sensible to restrict the use of AD in dealing with NMEs as it has already resulted in abuses and tit-for-tat AD actions.[154]

IV. USING WTO RULES TO BUILD A MARKET ECONOMY

Given the limitations of the current rules framework, additional rules are needed to help build a market economy in China. Some attempts have been made in China's WTO accession package, where the existing WTO rules are either further refined by more specific rules or supplemented by additional obligations. Broadly speaking, they correspond to the general

[150] See Weihuan Zhou & Andrew Percival, *Debunking the Myth of 'Particular Market Situation' in WTO Antidumping Law* 19 J. Int'l Econ. L. 863 (2016); GATT Panel, EC—Imposition of Anti-Dumping Duties on Imports of Cotton Yarn from Brazil, para. 478, GATT Doc. ADP/137 (adopted Oct. 30, 1995).

[151] Appellate Body Report, European Union—Anti-Dumping Measures on Biodiesel from Argentina, WTO Doc. WT/DS473/AB/R (adopted Oct. 26, 2016) [hereinafter EU—Biodiesel]. For a detailed analysis of the Appellate Body Report, see Zhou, *supra* note 140.

[152] Appellate Body Report, *EU—Biodiesel*, *supra* note 151, paras. 6.24, 6.33. For further observations on the flexibility to use surrogate costs, see Meredith Crowley & Jennifer Hillman, *Slamming the Door on Trade Policy Discretion? The WTO Appellate Body's Ruling on Market Distortions and Production Costs in EU-Biodiesel (Argentina)*, 17 WORLD TRADE REV. 195, 208 (2018).

[153] Panel Report, United States—Anti-Dumping Measures on Certain Oil Country Tubular Goods from Korea, para. 7.184–7.200, WTO Doc. WT/DS488/R (adopted Jan. 12, 2018).

[154] See *e.g.*, Weihuan Zhou & Shu Zhang, *Anti-Dumping and China's Implementation of WTO Rulings*, 230 CHINA Q. 512 (2017).

WTO rules discussed in the last section including, *inter alia*, non-discrimination,[155] tariffs, taxes and other charges,[156] quantitative restrictions,[157] transparency,[158] and trade remedies.[159] However, many of these tailor-made rules remain general "market access" provisions designed to address certain trade barriers in China and hence do not specifically address trade distorting behavior of SOEs. Indeed, China's additional transparency obligations are typically broader in scope, more in-depth, and contain more specific and detailed rules; and the implementation of most of the transparency obligations did turn out to be satisfactory.[160] However, as discussed in Section III.D, China has not done a good job complying with the key obligation relating to SOEs.[161] In addition, China's commitment that Members may treat it as an NME in AD actions and apply the so-called NME Methodology in calculating normal values has arguably expired on 11 December 2016.[162] This removes the basis for the treatment of China as an NME in AD cases and the flexibility to deal with state intervention and market distortions in China through AD measures.

Despite the above, this section discusses China's specific commitments on subsidies and countervailing ("CV") measures, as well as certain competition-law-type obligations. We show how these rules may be interpreted and applied in addressing China's state capitalism.

A. "Market Economy" Commitments

A number of broad commitments on SOEs and price distortions under China's accession instruments have been overlooked and underutilized so far. Specifically, China's commitment under Section 6.1 of the AP goes beyond anti-discrimination by preventing China from influencing the commercial decisions of STEs. This commitment is elaborated by Paragraph 46 of the WPR which states:

> The representative of China further confirmed that China would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g. price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement. (emphasis added)

---

[155] See *e.g.*, AP, *supra* note 86, Sections 3(a), 5.2, 6.1, 9.2; WPR, *supra* note 87, paras. 18-19, 62, 84(b).

[156] See *e.g.*, AP, *supra* note 86, Sections 2(A), 2(B), 11.1-11.4; WPR, *supra* note 87, paras. 91-93, 107.

[157] See *e.g.*, AP, *supra* note 86, Annex 3; WPR, *supra* note 87, paras. 127, 129-130.

[158] See *e.g.*, AP, *supra* note 86, Section 2(C); WPR, *supra* note 87, paras. 324, 334.

[159] See *e.g.*, AP, *supra* note 86, Section 15; WPR, *supra* note 87, para. 152.

[160] Henry Gao, *The WTO Transparency Obligations and China*, 12 J. COMP. L., 12:2 (2018), 329, at 333–40.

[161] See JOINT REPORT OF THE OFF. OF U. S. TRADE REPRESENTATIVE & U. S. DEP'T OF COM., SUBSIDIES ENFORCEMENT ANNUAL REPORT TO THE CONGRESS, at 13–14 (Feb. 2018), *available at* https://esel.trade.gov/esel/groups/public/documents/web_resources/seo-annual-report-2018.pdf (last visited Nov. 30, 2018).

[162] See AP, *supra* note 86, Section 15(a)&(d). Weihuan Zhou, *China's Litigation on Non-Market Economy Treatment at the WTO: A Preliminary Assessment*, 5 Chinese J. Comp. L. 345 (2017); Weihuan Zhou & Delei Peng, *EU - Price Comparison Methodologies (DS516): Challenging the Non-Market Economy Methodology in Light of the Negotiating History of Article 15 of China's WTO Accession Protocol*, 52 J. World Trade 505 (2018).

Unlike GATT Article XVII:1 discussed in Section III.A, Paragraph 46 does not seem to be limited to a non-discrimination obligation but provides a more comprehensive restriction on the conduct of SOEs and state-invested enterprises ("SIEs"). Specifically, the underlined part of the first sentence makes no reference to non-discrimination and requires that the "purchases and sales" activities of these entities must be based solely on commercial considerations. In *Canada – Wheat*, the AB endorsed the panel's interpretation of the term "commercial considerations" as "encompassing a range of different considerations that are defined in any given case by the type of "business" involved (purchases or sales), and by the economic considerations that motivate actors engaged in business in the relevant market(s)."[163] Thus, Paragraph 46 may be interpreted in a way that imposes a general requirement of commercial behavior on the enterprises concerned[164] in a wide range of activities as broad as those covered under GATT Article XVII:1.[165] The second sentence of Paragraph 46 contains a similarly broad obligation, although the activities covered seem to be limited to purchases and sales relating to the quantity, value or country of origin of goods. However, an important distinction between the obligations set out in the underlined part and the second sentence of Paragraph 46 lies in that the latter refers to the WTO Agreement while the former does not. The lack of reference to the WTO Agreement may well mean that the exceptions under the GATT may not be invoked to justify any deviations from the former obligation.[166] Whether such an ambitious obligation was intended by China during the accession negotiations is questionable, as they would overly restrict the capacity of China in pursuing regulatory or policy goals via SOEs. It would also seem to be unfair that other WTO Members are not subject to such onerous obligations and enjoy "a great deal of regulatory freedom [in]… using STEs as instruments of economic policy."[167] These concerns may require an interpretation of Paragraph 46 (and Section 6.1 of the AP) in a cautious and restrictive manner so as to pay due deference to China's regulatory freedom. However, based on its text, Paragraph 46 seems to provide abundant flexibilities for WTO Members to challenge non-commercial activities of Chinese SOEs.

Another important commitment made by China is set out in Section 9.1 of the AP which reads:

> China shall, subject to paragraph 2 below, allow prices for traded goods and services in every sector to be determined by market forces, and multi-tier pricing practices for such goods and services shall be eliminated.

This commitment responds to WTO Members' concerns about China's extensive use of price controls in various sectors at the time of the accession negotiations.[168] Like Paragraph 46 of the WPR, this commitment expands far beyond an obligation of non-discrimination and applies to *all* governmental measures on *all* prices in *all* sectors other than a few exempted ones. The exemptions from this broad obligation are confined to a short list of goods and services which may be subject to government pricing or government guidance pricing as envisaged in Annex 4.[169] Notably, many of the strategic sectors contemplated in China's

---

[163] Appellate Body Report, *Canada—Wheat*, *supra* note 99, paras. 140, 144.

[164] See Hoekman & Trachtman, *supra* note 105, at 64.

[165] See *supra* note 94.

[166] See Appellate Body Report, China—Measures Related to the Exportation of Various Raw Materials, paras. 279–307, WTO Doc. WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (adopted Feb. 22, 2012).

[167] See Hoekman & Trachtman, *supra* note 105, at 64.

[168] See WPR, *supra* note 87, paras. 15-19.

[169] These exemptions include four categories of goods (i.e. tobacco, edible salt, natural gas, and certain pharmaceuticals) and four types of services (i.e. public utilities, and postal and

policy documents (as mentioned in Section II) and the currently controversial sectors such as the steel and aluminum industries are not exempted. Thus, it is arguable that in all of these covered sectors including goods and services, China must let the market determine prices and must not affect prices directly or indirectly through any measures or intervention. China is not allowed to expand the list of exempted sectors "[e]xcept in exceptional circumstances and subject to notification to the WTO."[170] This may be understood as strictly confining the application of this exception to an extraordinary circumstance which justifies the adoption of price controls.[171] In addition, since Section 9.1 makes no reference to the WTO Agreement, the exceptions permitted under the GATT may not apply. Collectively, the disciplines imposed under Section 9.1 and Paragraph 46 are strongly interrelated. While Section 9.1 prevents the Chinese government from intervening the market, Paragraph 46 requires the government to ensure that any such interventions would not be implemented through SOEs or SIEs. Given their broad scope, the two obligations may well operate together to provide sufficient restraints on state intervention (including via SOEs) so as to address the associated market distortions.

That said, the broad wording of the above provisions means that significant gap-filling exercises are required in their interpretation and application. For example, what factors should a WTO panel consider in determining whether Chinese prices are market prices or whether a decision of an SOE is made purely on commercial basis? How could a complaining Member collect sufficient evidence in these aspects since the determination of price and other business decisions of enterprises are often confidential? Paragraph 46 and Section 9.1 provide little guidance on these matters; and hence their exact scope of application would be subject to the development of WTO jurisprudence. A narrow interpretation of key terms such as "determined by market forces" and "commercial considerations" would limit the capacity of these rules in addressing SOE-related issues. Comparably, the SCM Agreement currently offers a more workable mechanism for WTO Members to challenge China's state capitalism, although the utility of Paragraph 46 and Section 9.1 should also be further explored.

B. Subsidy-countervailing Measures and China-Specific Rules

Before 11 December 2016, the NME Methodology permitted under Section 15(a) of the AP considerably facilitated AD investigations against China and the application of high duties, thereby making AD the preferred trade remedy tool.[172] However, this special methodology no longer applies. In any case, as argued in Section III.E, despite the convenience of using AD measures to deal with NMEs, the WTO AD rules are designed

---

telecommunication services, entrance fee for tour sites, and education services) subject to government price; and six categories of goods (i.e. grain, vegetable oil, processed oil, fertilizer, silkworm cocoons, cotton) and six types of services (i.e. transport services, professional services, commission agents' services, certain banking services, certain prices of residential apartments, and health-related services) subject to government guidance pricing.

[170] See AP, *supra* note 86, Section 9.2.

[171] See WPR, *supra* note 87, para. 51.

[172] Between 1995 and 2014, WTO Members brought 1,050 AD actions against China but merely 90 CV actions. More than 90% of the CV actions against China were brought by four WTO Members, i.e., the US, Canada, Australia, and the EU. Among them, the US has been the largest user with more than half of the CV cases during that period. QIAO XIAOYONG (乔小勇) & LI YIZE (李泽怡), *Shijie Zhuyao Guojia he Diqu Duihua Shishi Fanbutie Diaocha de Xingshi he Yingdui Jucuo (世界主要国家和地区对华实施反补贴调查的形势及应对举措) [Overview of the Countervailing Duty Investigations against China by Main Countries and Regions around the world and Possible Responses]*, 6 GUOJI SHANGWU YANJIU [INT'L BUS. REV.], 26, 26-9 (2017).

mainly to deal with practices of businesses or firms and should not be applied to addressing market distortions at the macro level due to state interventions.

There are other reasons why the US and the EU should resort to CV measures, rather than AD measures, if they wish to push for market economy reforms in China. Firstly, the provision of subsidies to SOEs or strategic industries remains one of the major obstacles in China's market economy reforms. Thus, CV measures target more specifically the source of the distortions created by government interventions.

Secondly, AD measures usually affect private Chinese firms more, while CV measures by definition tend to target SOEs or firms conferred with special rights or privileges. Thus, more frequent use of CV measures would place more restraints on SOEs or privileged firms while expanding the space for the growth of private firms, which are the main driving force in a market economy.

Thirdly, to address concerns over the large amounts of subsidies granted to SOEs, China agreed that subsidies would be regarded as "specific" if SOEs "are the predominant recipients of such subsidies or … receive disproportionately large amounts of such subsidies".[173] This expands the list of specific subsidies beyond the categories enumerated under Article 2 of the SCM Agreement and adds "ownership" as the key criterion for determining specificity. With such a tailor-made rule, it would be easier to target SOEs in CV investigations.

Fourthly, in CV actions, the investigating country has the right to replace Chinese prices with external benchmarks in determining the benefits conferred by subsidies under Section 15(b) of the AP. This provision states:

> In proceedings under Parts II, III and V of the SCM Agreement, when addressing subsidies described in Articles 14(a), 14(b), 14(c) and 14(d), relevant provisions of the SCM Agreement shall apply; however, *if there are special difficulties in that application, the importing WTO Member may then use methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks.* In applying such methodologies, where practicable, the importing WTO Member should adjust such prevailing terms and conditions before considering the use of terms and conditions prevailing outside China. (emphasis added)

Unlike the NME Methodology, this right is not subject to an expiration date. This important difference lends strong support to the view that CV actions were originally intended to be the preferred solution to address system-wide distortions in China due to its unique economic system. Arguably, it is precisely because of the lack of relevant rules on NMEs under the SCM Agreement that Section 15(b) was created to deal with the situation where no marketplace benchmarks are available or readily accessible in China.[174] As we will argue below, Section 15(b) and the new developments in China's SOE reform would make it easier to solve three major problems surrounding the use of CV rules against Chinese SOEs.

1. Availability of information

Practically speaking, China's commitment under Section 15(b) provides great convenience for WTO Members in CV investigations as it would facilitate the determination of benefits conferred by subsidies and hence the magnitude of the subsidies under Article 14 of the SCM Agreement. Being able to apply external benchmarks in determining whether an alleged subsidy confers benefits to the recipients of the subsidy, it would be much easier for IAs to

[173] AP, *supra* note 86, Section 10.2.

[174] See Julia Ya Qin, *WTO Regulation of Subsidies to State-Owned Enterprises (SOEs) – A Critical Appraisal of the China Accession Protocol* 7 J. INT'L ECON. L. 863, 870–71, 903 (2004).

find the existence of such benefits and a higher amount of subsidies. To begin with, there is almost no bar to the invocation of the right to use external benchmarks as the only condition seems to be that "special difficulties" exist in using Chinese prices. As the scope of "special difficulties" is not defined or circumscribed in any way, there is considerable latitude for IAs to decide that such difficulties exist. This latitude should be contrasted with the carefully-crafted conditions on the use of external benchmarks under the general rules of Article 14 of the SCM Agreement. In *US — Softwood Lumber IV*, the US authority applied external benchmark prices in determining adequacy of remuneration under Article 14(d) on the ground that Canadian prices of stumpage did not reflect competitive market prices.[175] The AB ruled that under Article 14(d), external benchmarks may be applied only if IAs have considered the suitability of private prices in the country of provision and have substantiated that such prices are distorted as the government plays a *predominant* role in providing the relevant goods.[176] In *US – Anti-Dumping and Countervailing Duties (China)*, the AB clarified that if the government is merely a significant (rather than predominant/dominant) supplier of the goods concerned, IAs must consider further evidence to "prove distortion of private prices".[177] The evidentiary burden on IAs under Article 14(d), therefore, is significantly heavier than that under Section 15(b). Accordingly, the AB repeatedly emphasized that "the possibility under Article 14(d) for investigating authorities to consider a benchmark other than private prices in the country of provision is very limited."[178] Such limitations do not seem to exist under Section 15(b) as the presence of "special difficulties" is not confined to the government being a predominant supplier. Rather, such "special difficulties" could arguably be either systemic difficulties resulted from the distortions created by government interventions in the whole market, or practical difficulties in obtaining or verifying the information on subsides. For example, it may exist in cases where it is hard for IAs to collect evidence on whether an SOE has received a benefit from subsidies or on the magnitude of such benefit. In other words, CV measures may be justified in cases of insufficient disclosure or lack of notification by China. This could solve a major problem in CV investigations, which have been plagued by the failure of the government of the exporting countries to provide information or reliable information. Indeed, what constitute "special difficulties" remains unsettled and may or may not be interpreted as broadly as suggested above. However, a reading of "special difficulties" as allowing more flexibility for IAs than Article 14(d) does is valid.

Furthermore, under normal WTO rule, when an external benchmark is applied, adjustments of the benchmark, in relation to "price, quality, availability, marketability, transportation and other conditions of purchase or sale", are required under Article 14(d) to ensure that it reflects the prevailing market conditions in the country of provision.[179] In *US – Carbon Steel (India)*, an adjustment was required so as not to affect the comparability of the selected benchmark with the relevant Chinese prices.[180] In contrast, such an adjustment is not

---

[175] Appellate Body Report, United States—Final Countervailing Duty Determination with respect to Certain Softwood Lumber from Canada, para. 77, WTO Doc. WT/DS257/AB/R, (adopted Feb. 17, 2004) [hereinafter US—Softwood Lumber IV].

[176] *Id.*, para. 90.

[177] Appellate Body Report, United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, para. 479, WTO Doc. WT/DS379/AB/R (adopted 25 Mar. 25, 2011) [hereinafter US—Anti-Dumping and Countervailing Duties (China)].

[178] Appellate Body Report, *US—Softwood Lumber IV*, *supra* note 175, para. 102.

[179] *Id.*, para. 106.

[180] Appellate Body Report, United States—Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India, paras. 4.151, 4.211, WTO Doc. WT/DS436/AB/R (adopted Dec. 19, 2014).

mandatory under Section 15(b) as it merely uses best-endeavours language in *requesting* (as opposed to *requiring*) IAs to consider adjustments only when "practically possible", although what amounts to "practicable" may vary from case to case. Thus, the textual difference between Section 15(b) and Article 14(d) would at least lead to a less strict interpretation of the former on the requirement of adjustments. In sum, Section 15(b) provides additional rights and flexibilities for IAs in employing external benchmarks to determine the existence and magnitude of subsidies, making it easier for the application of CV measures. This is significant as it allows IAs to determine that the Chinese government has provided/purchased goods or services at a price less/higher than adequate remuneration as long as they encounter "special difficulties" in relying on the Chinese prices.

The same can be said of policy loans provided by state banks to SOEs or firms in strategic sectors. In *US – Anti-Dumping and Countervailing Duties (China)*, the AB ruled that in determining whether a benefit has been conferred by a government loan under Article 14(b), external benchmarks may be used only "in the absence of an actual comparable commercial loan that is available on the market" of the country of provision due to distortions in the interest rates on the loan resulted from government intervention.[181] When an external benchmark loan is applied, adjustments must be made to ensure that it "approximates the comparable commercial loan which the firm could actually obtain on the market."[182] These mandatory requirements do not seem to apply under Section 15(b) either. Thus, for anti-subsidy measures to be imposed, IAs do not have to determine whether the interest rates concerned are distorted by the Chinese government. Rather, they may simply rely on the lack of information or difficulties in collecting sufficient information, amongst other difficulties, to trigger the application of external benchmarks.

2. The "public body" issue

Anti-subsidy measures may be applied only when the subsidy is provided by a government or a public body or an entrusted private body under Article 1.1 of the SCM Agreement. In his influential article exploring China's unique economic structure and the efficacy of the existing WTO rules in tackling China's state capitalism, Mark Wu treated the determination of "which Chinese enterprises, banks, and entities" are "public bodies" as a primary challenge to the application of the SCM Agreement.[183] For Wu and many others, this challenge became particularly acute after the *US – Anti-Dumping and Countervailing Duties (China)* dispute[184] in which the AB ruled that a public body "must be an entity that possesses, exercises or is vested with governmental authority" and "the mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercises meaningful control over the conduct of that entity".[185] This ruling downplays the value of state ownership or interest in an entity as a criterion in a "public body" determination, and emphasizes on whether the entity has the authority to function as an extension of the government. Compared with the "ownership-based" approach, the "authority-based"

---

[181] Appellate Body Report, *US—Anti-Dumping and Countervailing Duties (China)*, *supra* note 177, para. 487.

[182] *Id*., para. 488.

[183] See Mark Wu, *The "China, Inc." Challenge to Global Trade Governance*, 57 HARV. INT'L L.J. 261, 301-05 (2016).

[184] *Id.* See also *e.g.*, Ru Ding, *'Public Body' or Not: Chinese State-Owned Enterprise*, 48 J. WORLD TRADE 167 (2014); Michel Cartland, Gerard Depayre & Jan Woznowski, *Is Something Going Wrong in the WTO Dispute Settlement?*, 46 J. WORLD TRADE 979, 1001–14 (2012).

[185] Appellate Body Report, *US—Anti-Dumping and Countervailing Duties (China)*, *supra* note 177, paras. 317-18.

approach apparently imposes a higher evidentiary burden on IAs to establish "public body". Critics of the AB's ruling concerned that the "authority-based" approach has erected a difficult barrier to the determination of "public body", thereby creating loopholes for subsidies granted through SOEs to circumvent the WTO disciplines.[186]

However, we believe that the "authority-based" approach leaves ample room for IAs to find a Chinese SOE or SIE as "public body", especially under China's current SOE reform. In *US – Anti-Dumping and Countervailing Duties (China)*, the AB has observed that "the absence of an express statutory delegation of authority [does not] necessarily preclude a determination that a particular entity is a public body."[187] The AB directed IAs, in applying the "authority-based" approach, to evaluate "core features of the entity" and "its relationship with government".[188] The AB elaborated:

> "In some instances, … where the evidence shows that the formal indicia of government control are manifold, and there is also evidence that such control has been exercised in a meaningful way, then such evidence may permit an inference that the entity concerned is exercising governmental authority."[189]

In applying its rulings, the AB accepted the US's finding of China's state-owned commercial banks as "public bodies" mainly based on evidence relating to (1) state ownership, (2) laws that mandate implementation or consideration of government policies, (3) influence of the government or the Party on the management and decision-making.[190]

China's current SOE reform has provided most of the evidence necessary for an affirmative finding of "public bodies". As discussed at length in Section II, the SOE classifications constitute an explicit designation of authority for Public Welfare SOEs to undertake government functions in the provision of public goods and services, and for Special Commercial SOEs to play a significant role in selected industries so that they contribute to the implementation of national strategies, the protection of national security, and the development of strategic industries. The government's *meaningful* influence on these entities may be readily inferred according to the limitations on private equity, the mandates on activities, the criteria for performance evaluation, the involvement of SASAC and the Party in management and decision-making, etc. While General Commercial SOEs are intended to operate as private entities, they may also undertake government functions in certain cases, particularly when they are involved in the investment in strategic sectors as SCIOs.

In this regard, it is worth reiterating that the role of the Party in the decision-making of SOEs have been explicitly recognized and strengthened in recent years. A measure issued by the SASAC Party Committee on 3rd January 2017 elaborated that the power of the Party Committee includes to:

1. deliberate and discuss major issues concerning the reform, development, stability of the company, and major operational and managerial issues. Before the Board of Directors decides major issues concerning the company, it shall first seek advice from the Party

[186] See Cartland, Depayre & Woznowski, *supra* note 184, at 1008, 1010–02; Wu, *supra* note 183, at 303–05. In our view, the AB's approach is reasonable as it attempts to avoid the over-reaching of "public body" to cover all SOEs or SIEs. If one accepts that SOEs or SIEs may operate as private entities, then the "ownership-based" approach is too broad to distinguish SOEs or SIEs acting on behalf of governments from those operating solely in their own interest.

[187] Appellate Body Report, *US—Anti-Dumping and Countervailing Duties (China)*, *supra* note 177, para. 318.

[188] *Id*., paras. 317, 345.

[189] *Id*., para. 318.

[190] *Id*., para. 350.

Committee of the company. More specifically, according to the principle of "Party assuming the responsibility for cardres' affairs", the Party Committee shall deliberate on the nominations by, and provide advices and suggestions, or make nominations to the Board or the CEO. It shall also valuate the proposed appointees along with the Board, and provide advices and suggestions; and

2. ensure the implementation of guidelines and polices of the Party and the State by the company, the implementation of major strategic decisions by the Party Central Committee and the State Council, and key working arrangements of the SASAC Party Committee and upper-level Party committees.[191]

While this measure only applies to Central SOEs, similar actions have been taken by SOEs at the provincial and municipal levels.[192] These documents confirm two things: first, the Party controls the SOEs; and second, the Party uses such control to ensure the achievement of various state policies by the SOEs. One might argue that the Party is not the same as the government or the State. However, any lingering doubts one might have on the separation between the Party and the State must be dispelled when China's Constitution was amended in early 2018 with the following addition in paragraph 2 of Article 1, "[t]he defining feature of socialism with Chinese characteristics is the leadership of the Communist Party of China." With the Party leading the State, the control of the Party is equivalent to the control of the State.

In summary, even under the "authority-based" approach, there is sufficient ground for a finding that SOEs are "public bodies" given the new developments in China's ongoing SOE reform.

3. Will CV measures provide sufficient remedy?

In the end, one might wonder whether the shift to CV measures would provide sufficient remedy to domestic industries. However, as noted in Bown's comparison of the rates in the US AD/CV cases involving China, the average CV duty rates tend to be higher than the average AD rates.[193] If we also factor in the fact that even such AD rates are somewhat inflated due to the application of the NME Methodology, the differences are likely to be much larger when the NME Methodology can no longer be applied. Another interesting fact is that the differentials of the average rates between Chinese and non-Chinese firms are much larger in CV cases than AD cases. While one may interpret this to mean that China is more

[191] GUANYU JIAKUAI TUIJIN ZHONGYING QIYE DANGJIAN GONGZUO ZONGTI YAOQIU NARU GONGSI ZHANGCHENG YOUGUAN SHIXIANG TONGZHI (关于加快推进中央企业党建工作总体要求纳入公司章程有关事项的通知) [*NOTICE ON RELEVANT ISSUES CONCERNING THE ACCELERATION OF THE ADVANCEMENT OF THE INCORPORATION OF THE OVERALL REQUIREMENTS OF CENTRAL SOES PARTY-BUILDING INTO COMPANY CONSTITUTIONS*] (PROMULGATED BY THE PARTY COMMITTEE ORGANIZATION DEPARTMENT OF SASAC (GUOZI DANGWEI DANGJIAN [2017] NO. 1), EFFECTIVE JAN. 1, 2017).

[192] See *e.g.*, STATE-OWNED ASSETS SUPERVISION & ADMIN. COMMISSION OF YINCHUAN CITY *at* http://gzw.yinchuan.gov.cn/tztg/201707/t20170711_267788.htm (last visited Nov. 30, 2018); STATE-OWNED ASSETS SUPERVISION & ADMIN. COMMISSION OF JILIN PROVINCE *at* http://gzw.jl.gov.cn/tzgg09/201712/t20171227_3576921.html (last visited Nov. 30, 2018); STATE-OWNED ASSETS SUPERVISION & ADMIN. COMMISSION OF FUJIAN PROVINCE *at* http://www.fj.chinanews.com/news/fj_zxmmt/2017/2017-08-16/387698.html (last visited Nov. 30, 2018).

[193] See Chad Bown, *Should the United States Recognize China as a Market Economy?*, at 6–8 (Peterson Inst. for Int'l Econ., Policy Brief 16–24, 2016), *available at* https://piie.com/system/files/documents/pb16-24.pdf (last visited Nov. 30, 2018).

likely to provide subsidies compared to other WTO Members, this could also be taken as support for a stronger role that CV actions may play in providing protection against unfair trade practices by China. A more aggressive use of CV measures will probably deter China from encouraging further expansion and entrenchment of SOEs.

V. CONCLUSION

Since the start of the economic reform in 1978, China's SOEs have gone a long way. While many were on the brink of bankruptcy at the beginning of the reform, nowadays the SOEs have become bigger, stronger, and more profitable. Many of them are now leading players in key sectors, and rank high in both domestic and international league tables. With such a remarkable turnaround, one cannot help but recall the prescient language in China's 1982 Constitution that SOE "is the leading force in the national economy".[194]

This article has conducted a detailed examination of the contours of China's current SOE reform. While we have yet to fully fathom the implications of the reform, it is safe to say that it aims at further advancement and enhancement of the SOEs in key strategic sectors. Domestically, this is very likely to lead to the corresponding retreat of private firms. As these SOEs rear their head at the international level, the future does not bode well for firms from the other parts of the world either.

How then, should we deal with the resurgence of state capitalism in China? Many suggestions have been made, but they all assumed that the existing WTO rules are insufficient. Some worries that the key players will start to look for alternatives, and this would lead to weakening of the multilateral trading system.[195] Policymakers have also started to take action. For example, on the sidelines of the eleventh WTO Ministerial Conference in Buenos Aires last year, the US, the EU, and Japan agreed in a joint statement to "enhance trilateral cooperation in the WTO and in other forums" to address the "critical concern" about the "severe excess capacity in key sectors exacerbated by government-financed and supported capacity expansion, unfair competitive conditions caused by large market-distorting subsidies and state owned enterprises". [196] On 31 May 2018, the three countries further issued a joint scoping paper to push for the development of stronger rules on industrial subsidies and SOEs.[197]

The problem with these approaches, however, is that there is no guarantee that China will agree to the new rules, at least not without being offered sufficient compensation. Moreover, what China resents the most is being singled out.[198] That is why China balked at the fateful July meeting in 2008 when the US requested it to provide additional concessions on special products in agriculture and sectoral negotiations on industrial goods, even though the same was not expected from other emerging economies such as India and Brazil.

Instead, as this article has argued, to tackle the problems created by China's SOEs, we do not necessarily need new rules. Rather, the WTO's existing rules on subsidies, coupled with

---

[194] ZHONGHUA RENMIN GONGHEGUO XIANFA [CONSTITUTION] Art. 7 (1988) (P.R.C.) (Westlaw).

[195] See Wu, *supra* note 183, at 323-24.

[196] See *supra* note 2.

[197] JOINT STATEMENT ON TRILATERAL MEETING OF THE TRADE MINISTERS OF THE UNITED STATES, JAPAN, AND THE EUROPEAN UNION, *available at* https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/may/joint-statement-trilateral-meeting (last visited Aug. 1, 2018).

[198] Henry Gao, *From the Doha Round to the China Round: China's Growing Role in WTO Negotiations, in* CHINA IN THE INTERNATIONAL ECONOMIC ORDER: NEW DIRECTIONS AND CHANGING PARADIGMS ,79 (Lisa Toohey, Colin B. Picker & Jonathan Greenacre eds., 2014).

the China-specific obligations, do provide sufficient defense against the encroachment of Chinese SOEs beyond its own shores. Unfortunately, China's additional commitments to restraining government intervention in the market and trade-distorting conducts of SOEs have never been used. Equally importantly, for too long, the rules on subsidies remain considerably underutilized due to three common misconceptions regarding the utility of these provisions. In this paper, we have set the record straight by addressing each of the three misconceptions. The first misconception is that CV actions are impossible without sufficient information about the subsidies programs in China. Our response is that the open-ended language of "special difficulties" in Section 15(b) of the AP does provide wide leeway to IAs in applying CV measures against China, especially in cases where the information is lacking, insufficient, or otherwise difficult to obtain. The second misconception is that the AB's narrow interpretation of "public body" as one with government authority has rendered it very difficult for IAs to find SOEs as "public bodies". We argue that this is no longer the case with China's designation of certain SOEs as exercising key governmental functions and its push to install Party Committees in SOEs and to enhance their roles in the decision-making of SOEs. These moves have made it much easier to find the exercise of government authority by these SOEs and the control of the government in these firms. The third misconception is that CV actions are ineffective in practice. However, we believe that CV measures tend to provide higher margins of protection compared to AD measures. Moreover, with the expiration of the NME Methodology, the current set of inflated AD rates can no longer sustain. This leaves CV measures the only meaningful option.

Thus, the real problem is not the lack of rules to tackle China's state capitalism, but the lack of utilization of existing rules. If WTO Members, especially the major players, can start bringing well-coordinated CV investigations domestically and "big, bold" cases [199] challenging China's subsidies and SOEs at the WTO, they will not only help to level the playing field for the firms from other countries, but also help China to steer its SOE reform back to the right course, as has originally been charted by the reform pioneers like Deng and Jiang more than thirty years ago.

[199] TESTIMONY OF JENNIFER HILLMAN BEFORE THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION HEARING ON US. TOOLS TO ADDRESS CHINESE MARKET DISTORTIONS (June 8, 2018), *available at* https://www.uscc.gov/sites/default/files/Hillman%20Testimony%20US%20China%20Comm%20w%20Appendix%20A.pdf (last visited Nov. 30, 2018).