Typology of Chinese Market Economy and Trade Rules: A Case of Competitive Neutrality of State-Owned Enterprises

WATANABE Mariko

Professor, Faculty of Economics, Gakushuin University

Summary

How to engage China is more important than ever as global society is forging international rules. However, it is not straightforward to understand the characteristics of China's market economy, given the wide diversity across industries, regions and firms. In order to present a practical view on Chinese economies, this paper first categorizes the types of market economies in China. Then, it examines cases that present challenges on trade rules. Specifically, in a mixed market such as the steel industry, the existence of state-owned enterprises distorts competitive neutrality through subsidies: The use of such subsidies should be disciplined.

Keywords: State-owned enterprises, competitive neutrality, subsidies
JEL Classification: G34 L61 L68 L88 P52

I. Introduction

Countries around the world are currently being forced to respond to a drastic change of trade rules initiated by the US Trump administration. Friction between the US and China, ongoing for over almost three years as of the date of writing, has led to a battle to raise tariffs, embargos and the barring of Huawei and Tiktok's transaction with the US firms or into the US market and its allies' markets. Furthermore, the US's withdrawal from the Trans-Pacific Partnership Agreement (TPP), and denial of appointments of senior members of the World Trade Organization (WTO), may fundamentally disrupt various goals of the WTO system.

Nonetheless, China's economic policy has its defects and is conducted inappropriately from the perspective of global economic rules. As the US claims, China has traditionally prioritized securing its own interests over behaving in line with fair rules. State-owned enterprises are given preferential policies, subsidies and or financial assistance. At the same time, cutting-edge innovation has emerged in some fields mostly implemented by private enterprise. China's industries and economy are highly diversified. It needs a careful approach to understand them accurately.

Along with the rise of the Chinese economy, rule-making regarding international trade needs to take into account the special characteristics of China. Both the WTO, which China has already rejoined, and the Trans-Pacific Partnership Agreement (TPP), are discussing provisions which are implicitly intended to discipline the potential non-conventional conduct of China. Furthermore, the US-Mexico-Canada Free Trade Agreement (UMCFTA), which the US under the Trump administration revised with Mexico and Canada from the NAFTA trade agreement, included a provision that restricts the negotiation of free trade agreements with economies which are not yet recognized as market economies by the WTO, that is, China.

However, if new rules and restrictions are rashly imposed, they will not work appropriately to discipline the problem in question, or worse, it will bring about undesirable situation. Examination on rationality of the rules, or consistency between the international trade rules and the characteristics of the domestic market economy of China, is necessary.

In order to elucidate the consistency of the international trade rules and the characteristics of the domestic market economy of China, this paper first categorizes the types of Chinese market economies. The Chinese market system consists of contrasting features: One is a world of excessive intervention and control of political power, where state-owned enterprises (SOEs) and private, foreign enterprises are competing each other, and allegedly distortion is created. The other is freely competing in innovation, where mainly private companies dominate the competition. Both types of markets compose the Chinese economy like a chimera, which consists of a variety of different cells.

This paper takes the issue as a case to elucidate the consistency between the international trade rules and domestic market economy: an SOE's competitive neutrality and trade-rule competitive distortion of state-owned enterprises and data trading issues. This will allow us to gain a basic understanding of the current state and system of Chinese markets, as well as the corresponding international rules that deal with it, or that will seek to deal with it in the future.

II. Types of Chinese Market Economies

One of the most salient and unique elements of China's market economy is the distinction system based on ownership. The second element is the degree of competition.

II-1. Differentiated and Institutionalized Corporate Identities by Ownership System

In China's market economy, public enterprises have priority over other proprietary enterprises. There are formal systems in China that determine this sort of distinction by ownership. Constitution of Communist Party of China and the Constitution of China respectively state the following:

As mentioned in Tables 1 and 2, the Constitution of Communist Party of China and Constitution stipulate that the existence of public enterprises is the backbone of the economy, and that the state must preserve their status. This means that competitive conditions of public enterprises and other companies are not equal, and private companies and foreign-affili-

Table 1. Position of firm by Ownership Types, as Stipulated by the Constitution of Communist Party of China

	Constitution of Communist Party of China (revised November 14, 2012)
Item 14	The Communist Party of China leads the people in developing the socialist market economy. It unwaveringly consolidates and develops the public sector of the economy and unswervingly encourages, supports and guides the development of the non-public sector. It gives play to the basic role of market forces in allocating resources and works to set up a sound system of macroeconomic regulation. The Party works to balance urban and rural development, development among regions, economic and social development, relations between man and nature, and domestic development and opening to the outside world; adjust the economic structure, and transform the growth model. It is dedicated to promoting harmonized development of industrialization, IT application, urbanization and agricultural modernization, building a new socialist countryside, taking a new path of industrialization with Chinese characteristics, and making China an innovative country.

(Source) Constitution of Communist Party of China (China.org.cn http://www.china.org.cn/chinese/18da/2012-11/19/content_27156212_2.htm) Official English translation

Table 2. Position of Firm by Ownership Types in the Constitution of the People's Republic of China

	Constitution of the People's Republic of China (after amendment on , 2019)
Article 6	The foundation of the socialist economic system of the People's Republic of China is socialist public ownership of the means of production, that is, ownership by the whole people and collective ownership by the working people. The system of socialist public ownership has eradicated the system of exploitation of man by man, and practices the principle of "from each according to his ability, to each according to his work." In the primary stage of socialism, the state shall uphold a fundamental economic system under which public ownership is the mainstay and diverse forms of ownership develop together, and shall uphold an income distribution system under which distribution according to work is the mainstay, while multiple forms of distribution exist alongside it.
Article 7	The state sector of the economy, that is, the sector of the socialist economy under ownership by the whole people, shall be the leading force in the economy. The state shall ensure the consolidation and development of the state sector of the economy.
Article 11	Non-public economic sectors that are within the scope prescribed by law, such as individually owned and private businesses, are an important component of the socialist market economy. The state shall protect the lawful rights and interests of non-public economic sectors such as individually owned and private businesses. The state shall encourage, support and guide the development of non-public economic sectors and exercise oversight and regulation over non-public economic sectors in accordance with law.

(Source) Constitution of the People's Republic of China (China National People's Networkhttp://www.npc.gov.cn/englishnpc/constitution2019/201911/1f65146fb6104dd3a2793875d19b5b29.shtml) Official English translation ated companies operate in an environment that tends to be disadvantaged. For example, literally speaking, public enterprises may be given priority to be rescued when management problems occur. In addition, there are markets where private companies and foreign-affiliated companies are prohibited from entering based on ownership status (The Unirule Institute of Economics 2011).

II-2. Typology of Chinese Firms and Market by Ownership and Competition

In addition to ownership, the Chinese market can also be categorized by degree of competition. The author has organized the Chinese market economy into four categories for convenience. (1) Administrative monopoly market – A market where administrative monopoly is established by laws and regulations. (2) Mixed market #1 – A market where state-owned enterprises, private enterprises, and other owned enterprises compete under different conditions, and (3) mixed market #2 and (4) private enterprise-only market – These are markets where state-owned, private and foreign-affiliated companies compete under almost equal conditions.

It is easy to identify (1) administrative monopoly markets because there are laws and regulations prohibiting the entry of other businesses. This is the case for the railroad, postal, oil and broadcasting industries. Typical examples of (4) private-only markets are the service industries such as e-commerce and mobile payments service provided online.

However, (2) mixed-markets, where state-owned, private, and foreign-affiliated companies compete together, are harder to identify. Table 3 shows some representative examples of administrative monopolies, mixed markets, and private-only markets. There are not many indicators that allow us to understand whether the conditions of competition between state-owned, private, and foreign capital are different in these mixed markets. On the other hand, certain types of markets do give preferential treatment to state-owned enterprises for entry and/or exit. For example, in both the design and manufacturing markets, including foundries for fabless semiconductors, many companies have received investment from the government and government-affiliated funds. The steel industry is a market that has historically been centered on state-owned enterprises.

The following are the main characteristics of the four groups: First, in (1) administrative monopoly markets, harmful price increases and supply shortages tend to occur due to monopoly presence. In (2) mixed markets, where companies with different ownership systems (state-owned, private, and foreign capital) are under different competitive conditions, necessary selection and quality competition do not occur, and phenomena such as excessive price competition, excess production capacity, as well as poor working conditions and avoidance of environmental conservation costs for the purpose of cost reduction tend to occur. There are various examples of different competitive conditions within these markets, and in the next section we show that preferential treatment for state-owned enterprises has caused soft budget constraints. This point will be discussed later. There are also (3) mixed markets where state-owned, private, and foreign capital coexist, but there is no difference in compe-

Table 3. Ownership and Competition by Industry

Industry	Ownership	Competitive (Market)
Railway	National Monopoly	Monopoly
Post Office	Not Separated / Non-business	Monopoly
Broadcast	Not Separated	There are many broadcasting stations in central and local areas and it is competitive
Tobacco	Not Separated	Exclusive (sold with permission from the country)
Salt	Not Separated	Exclusive
Oil Processing	State-owned	Oligopoly of two state-owned companies
Water Supply	State-owned, local government and private, private	Regional monopoly or oligopoly
Electric Power	Power Generation: State-owned, private, mixed ownership	**Mixed market.** Power Generation: Mixed market with five state-owned companies, private and mixed ownership
	Power Transmission: State-owned	Power Transmission: Regional divisions of two state-owned companies
Aviation	State-owned, private, private / foreign capital mixed ownership. Mixed market	**Mixed market.** 3 state-owned companies, 1 mixed company, 4 private companies
Communication	Landline and Mobile Phone: State-owned	Fixed Line: 4 companies, Mobile phone: 3 companies, Data communication: 6 companies,
	Data Communication: State-owned and private	Mixed market.
Steel	National, private and mixed ownership. Mixed market	**Mixed market.** Several thousand companies
Home Appliances	Mixed, private, foreign capital. Mixed market	**Mixed market.** 10 companies
E-Commerce	All leading companies are privately owned	Alibaba, JD and its affiliates are leading companies
Mobile Payments	All major companies are privately owned	Alipay and We Chat Pay are prominent. Many others. Also the state-owned UnionPay.
Semiconductor Foundries	State-owned, mixed ownership of state-owned and foreign capital	**Mixed market.** Leading companies are SMIC (state-owned), Huahong (state-owned and foreign-owned mixed ownership)
Fabless Semiconductor Design and Manufacturing	Private, state-owned, foreign capital	**Mixed market.** The leading companies are private (HiSilicon) and state-owned (ZTE, Uni). However, this market is competing globally and competes with Qualcomm (USA) and MTK (Taiwan).

(Source) Prepared by the author

tition conditions depending on ownership. In (4) markets with private enterprises only, competition occurs based on the competitive advantage of the enterprise itself, and there is naturally expected to be no impact based on ownership.[1]

III. Trade Rule Issues and Characteristics of the Chinese Economy

Following the typology above, we will now review and analyze the characteristics of the Chinese market and the systems surrounding it, based on two important issues pertaining to the formation of trade rules.

The case is a review of the assertion that subsidies to state-owned enterprises create a distortion in competition. The analysis will introduce the case of steel companies, and will examine the possibility that harmful competition is occurring due to soft budget constraints, and that state-owned companies may distort competition, specifically in the mixed market the mixed market type #1, where different competitive conditions exist. At present, it is argued that a stipulation to ensure the neutrality of competition among state-owned enterprises is necessary when creating WTO and other trade rules. In particular, the problem of competitive neutrality of state-owned enterprises is an issue.

III-1. State-Owned Enterprises: Subsidy Rules and Competitive Neutrality

In this section, we will consider the case of the steel industry with regards to subsidies for state-owned enterprises. The discussion in this section is based on Watanabe (2017) and Watanabe (2020).

III-1-1. Subsidy Rules Within WTO framework

Under the World Trade Organization (WTO) framework, certain types of subsidies are considered to have a substantial trade distortion effect, and rules to correct this have been introduced. The “Agreement on Subsidies and Counterbalances” categorizes subsidies in the following three ways: red (prohibited subsidies), green (allowable subsidies such as research and development, regional development and environmental subsidies that meet certain conditions), and yellow (subsidies that are neither red nor green, and have potential for general application), and it stipulates standards and investigatory procedures as counterbalances.

This subsidy framework defines (1) the definition of the subsidy, (2) the benefits that the subsidy provides to the recipient, (3) the specificity (in the case of a yellow subsidy), and (4) any adverse effects caused by the subsidy(Table 4).

[1] You cannot determine that competition between private companies is not influenced by politics. In practice, certain private companies may not behave in accordance with business principles, and may be swayed by politicians with overlapping interests. In some cases, companies may act as a “wallet” that bestow monetary benefits to individual politicians, causing them to act outside their scope of business in order to exercise the influence of the government. These private companies have been nicknamed politician’s “white gloves.” For example, Hainan Airlines, including Hong Kong Airlines and Hong Kong Express, is reputed for its good service and low prices. However, there was also a level of share ownership that could be used to exert influence over Deutsche Bank. There are rumors that a prominent politician was behind this company.

Table 4. Subsidy Definitions

Subsidy Definitions Article 1 (1)	For the purposes of this agreement, a subsidy shall be deemed to exist if either (1) or (2) of the following (a), as well as (b), are met. (a) (1) The government or public authority in the territory of the Member State (referred to in this Agreement as "Government") contributes financially. That is, (i) The government takes actions involving direct transfer of funds (e.g. gifts, loans, and contributions), actions involving the possibility of direct transfer of funds, or actions involving debt (e.g. debt guarantee). (ii) The government abandons or does not collect items that should be collected (e.g. financial incentives such as tax credits). (iii) The government purchases goods or provides services other than general social capital. (iv) The government pays funding agencies, or entrusts or instructs a private sector company to perform one or more of the duties specified in (1) to (3) normally belonging to the government, or to take measures that are not substantially different from the measures normally taken by the government. (2) There is support for income or price in some form, as stipulated in Article 16 of GATT in 1994. Benefits are obtained from provisions in (1) or (2) in (b) or (a).
Profit Article 14	"Profit" means that the government's financial contribution creates conditions that are more favorable for the recipient than market price. Article 14 specifically states that it is necessary to confirm that the conditions are more favorable than domestic market conditions for investment, lending, debt guarantee, and purchase of goods.
Specificity Article 2	(a) There is specificity when subsidies are explicitly limited to specific companies or industries. (b) There is no specificity when the subsidy grant target and amount are determined by objective standards and conditions. (c) In cases where there is no specificity based on (a) and (b), but it can be determined that the subsidy is actually used by a specific company/industry, there is specificity.
Adverse Effects Article 5	(a) Damage to domestic industries in other Member States, (b) Invalidation/infringement of profits based on GATT, (c) Damage to other Member States
Significant Harm Article 6 (3)	(a) Import substitution/export interference in the subsidy-granting country, (b) Import substitution/export interference in third country markets, (c) Significantly lowering prices of ancillary products to levels below those of similar products in the same market, significantly impeding price increases, and significantly reducing prices or sales, (d) (abbreviated).

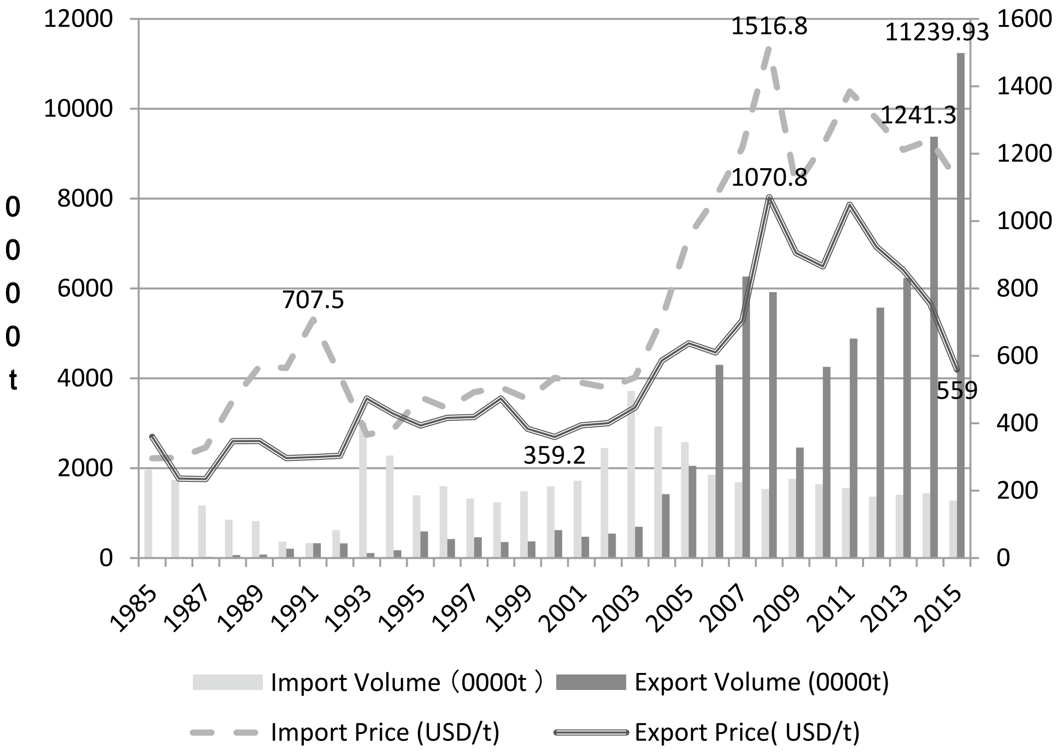
(Source) https://www.wto.org/english/docs_e/legal_e/24-scm.pdf

III-1-2. Definition of the Subsidies in China

This issue of subsidies recently gained attention when it was linked to the problem of excess production capacity in China. From 2014 to 2015, overproduction of steel in China became apparent, and in 2015, most companies in the industry ran a deficit, sparking a large-scale export of cheap products. This was interpreted as excess production capacity in the Chinese steel industry causing damage to the global economy. Furthermore, there were indications of preferential treatment and subsidies for state-owned enterprises which distorted trade transactions and competition. At the G20 held in Hangzhou, China in 2016, members agreed to establish the Global Steel Forum as a place to discuss this issue internationally, and forum meetings have been held since. As shown in Figure 1, the export volume of steel, which was reduced in 2009, has expanded rapidly, and in 2015 it recorded about 110 million tons. Export prices have fallen below import prices and have continued to decline since 2010, with average export prices falling to $559 per ton in 2015, half of $1048 in 2011 (Figure 1).

Well then, did Chinese subsidies have a trade-distorting effect? We will consider this point in two steps. First, in this section we will confirm whether subsidies in China correspond to subsidies as specified in the Agreement on Subsidies and Counterbalances detailed above. In the next section, we will examine whether subsidies have caused adverse and significant harm.

Figure 1. Changes in Steel Import/Export Volume and Price



(Source) Special Steel Yearbook 2016

Table 5. Definition of Subsidies in China: Corporate Accounting Standards, Item 16

“Government Assistance”	(b) Direct acquisition of cash or non-cash assets, (a) transferred free of charge from the government,
Profit	Subsidy amounts provided free of charge serve as profit.
Specificity	It depends on the situation. For example, instances where subsidies can be received by state-owned companies but not by privately owned companies would point to specificity.

(Source) Corporate Accounting Standard No. 16 for government assistance and author for profit and specificity

First, let us examine the definition. Item 16 of China’s Corporate Accounting Standards stipulates “government assistance” as follows: “Government assistance” refers to (b) direct acquisition of cash or non-cash assets (a) transferred free of charge from the government. In addition, it requires that these expenses be recorded as “non-operating income,” and specify from what entity, in what name, and how much was received (Table 5).[2]

So do these subsidies provide benefit to the beneficiary? It should be clear per the above definition of subsidies, which specifies assistance transferred free of charge. Any government-transferred cash, or anything related to the value of non-cash assets will be to the full benefit of the beneficiary.

Regarding specificity, different instances vary depending on the situation. Therefore, it is necessary to confirm each case individually. In instances where a state-owned company could receive subsidies, but a private company having the same ability and conditions could not, it would point to specificity. While this is in fact the real situation to some extent, it is also true that private companies sometimes receive subsidies. For this reason, it becomes an empirical issue whether or not there is actually specificity.

Based on the above, we can see that subsidies as stipulated in China’s Corporate Accounting Standards are in line with subsidies as defined in the Agreement on Subsidies and Counterbalances, and the grant of such would be considered to be beneficial to the recipient company.

III-1-3. Adverse Effects: Overproduction in a Mixed Market

So, have these subsidies brought “bad” and “significant harm” to other member states and their domestic industries?

Watanabe (2017) and (2020) examined whether the subsidies had adverse effects on company management and the industry in China, based on the financial report data of listed steel companies. Specifically, we examined the possibility that subsidies resulted in overproduction through the existence of soft budget constraints in state-owned enterprises. This verification deals with the impact in China, and does not directly assess the impact on other

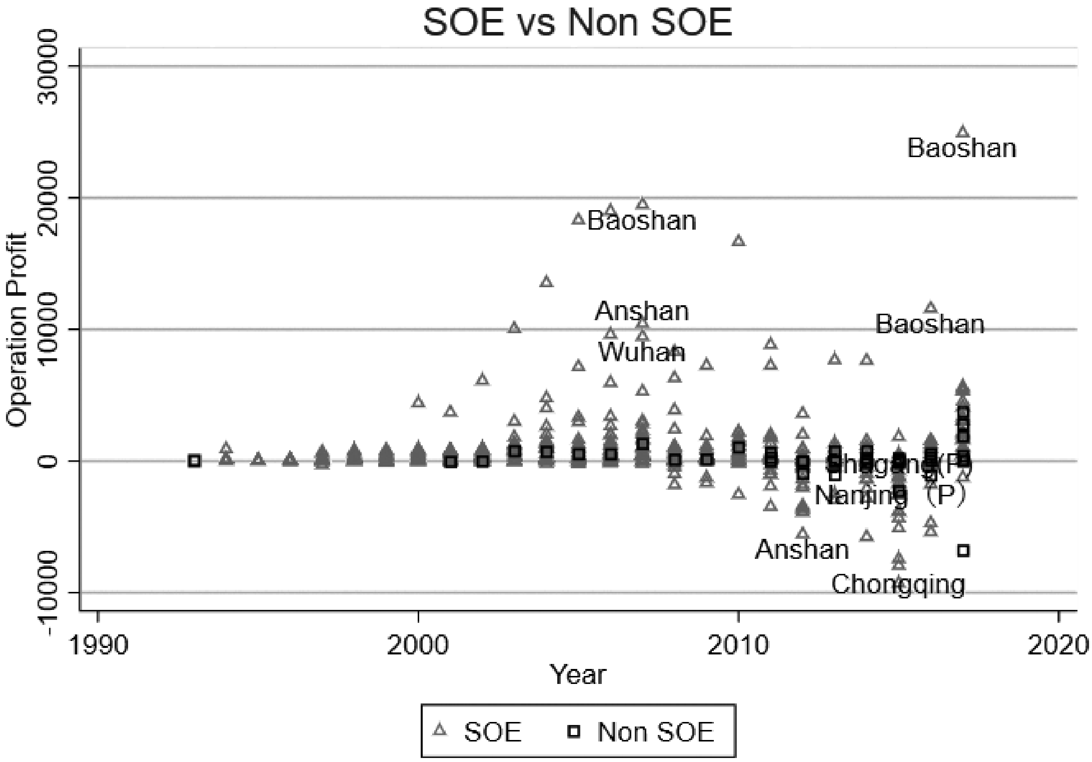
[2] In line with the revision of the Corporate Accounting Standards, it was determined that government assistance related to daily economic activities be recorded as “other revenue,” and government assistance related to extraordinary activities be recorded in “operating income,” from July 1, 2017 onward.

member states. However as shown in Figure 1, the remarkable drop in export prices can be assumed to be linked to the drop in domestic prices.

First, an overview of general industry trends. First, a total of 42 companies were identified as steel-related companies listed on the A-share market in Shanghai or Shenzhen in China between 1993 and 2017. As of 2015, there were 28 state-owned enterprises and 6 private enterprises. The distribution of operating profit across the industry is as follows. It turns out that deficit companies appeared at the turning point in 2008, and most companies fell into deficit in 2015 except for a few. Figure 2 shows the trend in operating income for all listed steel industry companies. △ are state-owned, and □ are non-state-owned. From this, it can be seen that until 2007, all companies had recorded operating surpluses. Deficit companies started to appear in 2008, but most were state-owned companies. State-owned enterprises have larger operating profit surpluses and deficits than non-state-owned enterprises. Furthermore, in the post-2008 economic downturn, some private enterprises have slipped into deficit, but the range is very small.

Was there a causal relationship in which subsidies negatively impacted operating profits? Watanabe (2020) confirmed this. In this analysis, item of subsidy was used as an item indicating government support. This paper introduces the main findings.

Figure 2. Changes in Operating Profit of Listed Steel Companies (Total 42 Companies)



(Source) China-listed company financial report database. Data is obtained from Sinofin and prepared by the author

The analysis was performed in the following steps. First, criteria were established for determining that providing subsidies amounted to "rescue." The specific criteria was that[3] subsidies were received at a scale that offset or exceeded the operating deficit/profit from the main business." Furthermore, since the focus of the inquiry was on whether or not "rescued" has been given to state-owned enterprises, "having state-owned enterprise status and receiving rescue" was used as definition for the treatment policy.

The second step is identifying correlation between the operating profit for the next fiscal year and the "rescue" that the firms received. Most of the firms provided with "rescue" are the state owned enterprises. There were only two private companies among those receiving "relief"; one that was converted from a state-owned company to a private company, and one that was consistently a private company in the period since 2008.

Finally, I have checked the trends of operating profits of state-owned enterprises that were "rescued" vs. state-owned enterprises that were "not rescued." Here, it can be seen that operating profits for the following year of state-owned corporate groups that were "not rescued" ranged from deficit to surplus, whereas operating profits for the following year of state-owned corporate groups that were "rescued" were mostly deficit.

In conclusion, there were almost no private enterprises that received rescue in excess of their operating deficits, and among state-owned enterprises, those that were "rescued" may not have converted their deficit to profit, but rather prolonged their deficit. In other words, if the government had decided not to provide "rescue" to state-owned enterprises, or provided them the same rescue as private enterprises, and the same subsequent governance had been carried out, deficits in the following year would not have occurred. Therefore, it can be presumed that there was overproduction in the sense of non-profitable production. In addition, Watanabe (2020) uses data including prices, costs, and production quantities of steel products by product type, and verifies whether such "rescue" has resulted in cost-cutting pricing.

The steel industry market, as categorized in Section 1, is a mixed market where state-owned enterprises, private enterprises, and foreign companies compete. From the results of the above analysis, it is highly possible that competition conditions for state-owned enterprises are softer in budget constraints than private enterprises. In other words, state-owned enterprises and private enterprises are competing under different competitive conditions, and as a result, there may be a problem of overproduction. In other words, we cannot deny the possibility of a mixed market (2), per market categorization in the opening. In addition to the soft budget constraints caused by subsidies, companies in this industry have been accused by the press of excessive pollution due to cost-saving behavior, in which they avoid installing and using desulfurization equipment. Clearly, it would be beneficial to neutralize the market conditions of state-owned enterprises.

In mixed markets where companies compete under different conditions based on ownership, overproduction due to such soft budget constraints, as well as environmental pollution

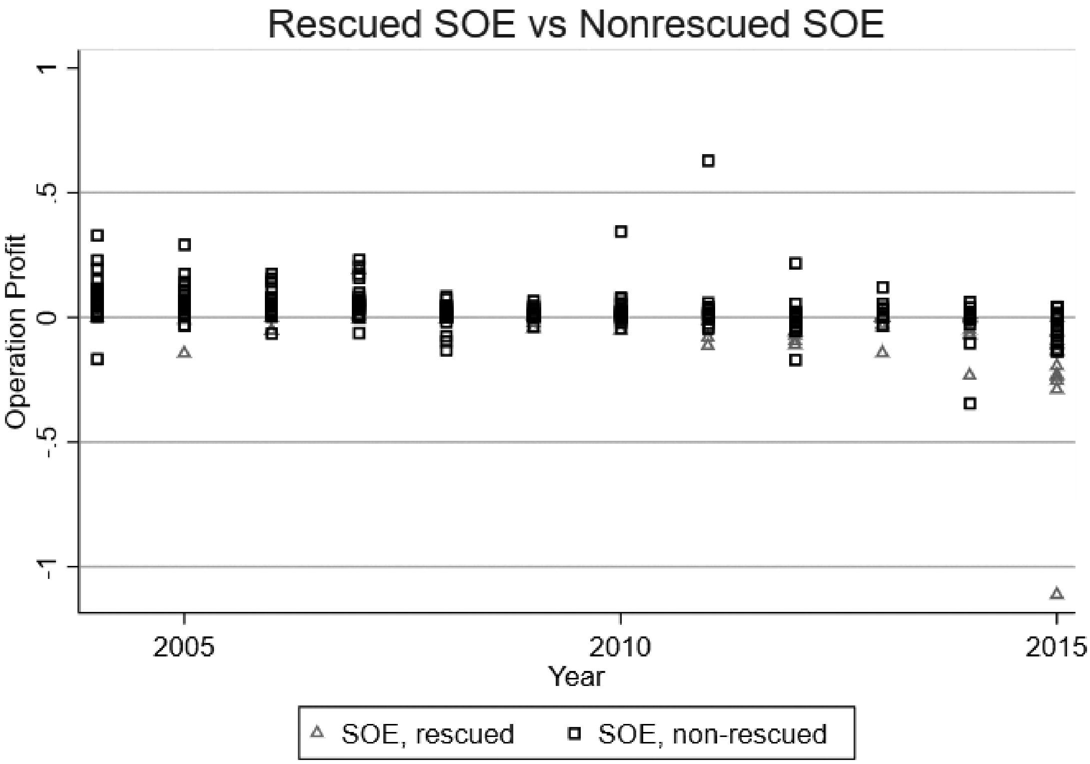
[3] For the analysis, information on "subsidies" and "non-operating income" included in each company's financial reports was used. "Subsidy" amounts were taken from quarterly reports, and "non-operating income" was taken from annual reports. There were also sample(s) where "subsidies" exceeded "non-operating income."

Table 6. Companies that Received Subsidies in Excess of Operating Loss

Policy Number	Company Name	Year	Ownership	Real Governor	Operating Profit (Million Yuan)	Subsidy (Million Yuan)
515	Panzhihua Steel Group Co., Ltd.	2000	State	State-Owned Assets Supervision and Administration	-1	5
717	ST SGIS Songshan Co., Ltd.	2016	State	Guangdong State-Owned Assets Supervision	-218	231
778	Xinxing Ductile Iron Pipes Co., Ltd.	2014	State	State-Owned Assets Supervision and Administration	-439	1,611
932	Hunan Valin Steel	2011	State	Hunan State-Owned Assets Supervision	-1,008	1,165
932	Hunan Valin Steel	2013	State	Hunan State-Owned Assets Supervision	-105	500
932	Hunan Valin Steel	2014	State	Hunan State-Owned Assets Supervision	-3	285
2075	Shagang Group	2012	Private	Shen Wenrong	-24	50
2423	Zhongyuan Special Steel Co., Ltd.	2016	State	State-Owned Assets Supervision and Administration	-76	126
600117	Xining Special Steel Co., Ltd.	2016	State	Qinghai State-Owned Assets Supervision	-42	104
600126	Hangzhou Steel	2014	State	Zhejiang State-Owned Assets Supervision	-43	81
600165	Ningxia Hengli	2004	State	Ningxia State-Owned Assets Supervision	-1	6
600165	Ningxia Hengli	2007	State	Ningxia State-Owned Assets Supervision	-6	9
600165	Ningxia Hengli	2008	State	Ningxia State-Owned Assets Supervision	-5	9
600165	Xinri Hengli	2011	Private	Xiao Jiashou	-4	11
600165	Xinri Hengli	2013	Private	Xiao Jiashou	-19	67
600231	Lingyuan Iron & Steel Co., Ltd.	2012	State	Chaoyang State-Owned Assets Supervision	-461	508
600231	Lingyuan Iron & Steel Co., Ltd.	2013	State	Chaoyang State-Owned Assets Supervision	-413	1,257
600231	Lingyuan Iron & Steel Co., Ltd.	2015	State	Chaoyang State-Owned Assets Supervision	-744	809
600307	Gansu Jiu Steel Group Hongxing Iron & Steel Co., Ltd.	2014	State	Gansu State-Owned Assets Supervision	-7	139
600782	Xinyu Iron & Steel Co., Ltd.	2015	State	Jiangxi State-Owned Assets Supervision	-68	191
600808	Maanshan Iron and Steel	1999	State	Anhui State-Owned Assets Supervision	-74	110
601005	Chongqing Iron & Steel Co., Ltd.	2014	State	Chongqing State-Owned Assets Supervision	-2,843	3,098
601968	Shanghai Baosteel Packaging Co., Ltd.	2016	State	China Baowu Steel	-2	25

(Source) Prepared by the author from Sinofin listed company financial report data

Figure 3. Operating profits for Rescued SOE and Non-rescued SOEs



(Source) Author

due to continued use of degraded technology, etc., may occur in a range of industries in addition to the steel industry.

The 2018 edition of the Trade White Paper points out the possibility of overproduction in the semiconductor industry, together with steel. As of 2019, China's semiconductor production does not meet demand, and developing such industries through subsidies as an industrial policy is a necessary measure for the Chinese economy. In addition, in the current free trade environment, if such industrial policies targeted all firms and not just Chinese firms, such support could lead to improved social welfare. However, even under such a scenario, if there is "specificity" that gives preferential treatment only to specific companies in the country, as long as the same mechanism as the steel industry discussed above is at play, competitive conditions would not be neutral and overproduction might occur. It will be necessary to keep an eye on this point.

IV. Conclusion

In this paper I introduced the typology of market economies in China and the systems surrounding them, and laid out various issues that need to be considered when forming trade rules, referring to the case of subsidies for state-owned enterprises in the steel industry. In the case of "mixed markets" such as the steel industry, where state-owned enterprises receive preferential treatment and compete under conditions different from those of private and foreign companies, subsidies create a vicious circle that has led to excess production capacity. For these "bad mixed markets," it is necessary to stop subsidies and deal with the competitive distortion of state-owned enterprises.

Reference Literature

Japanese References

Ministry of Economy, Trade and Industry, "White Paper on International Economy and Trade 2018" https://www.meti.go.jp/report/tsuhaku2018/index.html

Watanabe, Mariko (2017), "Overcapacity Problems and Subsidies in the Chinese Steel Industry: Verifying the Existence of Soft Budget Constraints" RIETI Discussion Paper 17-J-058

English References

Watanabe, Mariko (2020), "Competitive Neutrality of SOEs in Chinese Steel Industry: A causal and structural estimation," RIETI Discussion Paper 20-E-014

Chinese References

Unirule Institute of Economics [2011, 2015]. "The nature, performance and reform of state-owned enterprises" http://unirule.cloud/index.php?c=article&id=4017

Data

Sinofin Database http://new.ccerdata.cn/