Targeted Consultation

European Union Chamber of Commerce in China (EUCCC) – Summary

7 December 2020

The EU Chamber of Commerce in China (EUCCC) perceives the issue of subsidization as one of the highest priorities along with market access, non-discrimination of foreign companies and transparency issues regarding authorization and licensing processes in China.

Based on the EUCCC Business Confidence Survey 2020, 71% of the EU multinational companies surveyed benefited from subsidies in China and only 36% of the surveyed European SMEs. Additionally, EUCCC members perceive unequal treatment compared with Chinese companies, both state-owned and private as regards access to government funding (about 25% of respondents say that their competitors have access to subsidies that they don't).

Many companies do not oppose subsidies as long as they have equal access to them, some companies benefit from subsidies through their partners.

Most distortive subsidies:

According to EUCCC, subsidies in China are provided at various levels (provincial governments compete by providing funding to companies) and can take different forms (tax rebates, land rights, etc.) It is difficult to provide specific examples as they are built into the whole system.

Entry subsidies – SMEs can get funding to enter a market and create an overcapacity effect.

Production subsidies – a number of existing programs, e.g. in the area of shipbuilding, China has put a scrap and build program in place, whereby subsidies are provided for the demolition of an old vessel and a construction of a new one. Turkey also put into practice a similar program.

Investment subsidies – in the context of the ongoing COVID crisis, EUCCC has not seen much investment from China so far. However, with the ongoing economic crisis and deflated value of EU companies, it is likely that Chinese SOEs will become more active, and it is likely that the acquisitions will be more targeted but also smaller and thus more difficult to detect (e.g. innovative SMEs).

Procurement subsidies – last year, an EIB funded project in Cyprus was awarded to a consortium led by Chinese SOEs, the price was built in a way that made it impossible for others to compete.

In the shipbuilding sector, there has been an important shift after the crisis of 2008. Now, in the context of COVID, there is yet another shift in the market. Around 90% of new orders of ferries are at the hands of

Chinese shipbuilders, who offer prices, which are an conservatively estimated 30% below the production costs. This makes it impossible for others to be competitive in the market.

Ships are not imported into the EU as goods, which limits the use of trade defence instruments. When the vessels are sold to EU stakeholders, they may not fly an EU flag. A horizontal tool may therefore not be enough for the shipbuilding sector, as well as for other specific sectors, and a specific tool may be required.

Consequences of foreign subsidies:

EUCCC considers that a typical example of subsidies are SOEs offering prices below variable costs. They lower the prices when a competitor enters the market, once the SOE consolidates its position, it again increases the prices, which damages the consumers.

Wind and photovoltaics were virtually a non-existent market 20 years ago, after a long period of sustained subsidisation by the Chinese, EU companies have completely lost this market.

In the area of rail transport, the cost of moving a container from central China to central Europe is about 5000 euros, but companies only pay 2500 euros, while the rest is a subsidy.

Within shipping, China came up with a proposal in March that Chinese companies should switch from FOB to CIF terms, allowing the seller, not the buyer, to decide who will transport the products. This will presumably promote that Chinese cargo goes on Chinese vessels and will benefit the Chinese inter-continental shipping sector.

EUCCC perceives as highly problematic how SOEs have integrated their sectors. For example within transportation, there is one vast vertically integrated value chain of SASAC-owned SOE's that produces and controls all elements in the transportation chain, i.e. produces steel for vessels and containers, manufactures containers, builds ships and ports, operates ships, ports and provides financial services for all these parts, while also having access to implicit guarantees from the state. This allows flexibility and closed-loop value systems where the real importance is not the economic performance of the individual SOE, but of the entire SASAC-owned value chain.

The merger of CSSC and CSIC, creating the world's largest shipbuilding group, was not even notified to the competition authority by arguing that they were already part of one group, i.e. SASAC. This would seem an admission by China that the entirety of SASAC owned companies should be treated as one state-owned entity and not as separate entities. This "new" reality obviously requires a completely overhauled and powerful set of tools to be applied ex ante to effectively prevent or mitigate the distorting effects on competition in the EU market that follows Internal market rules should also take into account that this type of consolidations that happen outside EU borders may anyway damage the European Union shipbuilding industrial ecosystem.

From the point of view of the Chinese state, the economic performance of individual operators is less important than the totality of the value chain, so that the costs can shift along the value chain as needed. In addition to focusing on individual SOE's, there is therefore a pressing need to look at these integrated value chains, which should be subjected to enhanced transparency requirements based on a presumption of subsidy

EUCCC notes the importance of a proper definition of a subsidy. In China, the entire system is designed with this element embedded, not only individual tax rebates or preferential loans. Any kind of intangible benefit is a form of subsidy and should be considered (e.g. preferential regulatory treatment, market access, land rights, anything that results in a lack of reciprocity).

EUCCC advises that particular attention be paid to mergers and acquisitions by Chinese companies that may use subsidies to enter the EU market. The sectors identified in the Made in China (MIC) 2025 strategy should be considered as well as highly political plans and investment decisions outside of China (e.g. Belt-and-Road Initiative, new trade agreements, etc.)

EUCCC expressed concerns about competition policy in China, noting the lack of notifications in some merger cases, but also the use of "restructuring aid" to keep alive companies, which have not gone through a bankruptcy. They receive new finance, arrange new terms with suppliers and are restructured, basically following a bankruptcy procedure. It is important to tackle these "zombie companies" under the subsidy regulation as these Chinese companies active in the EU have access to easy financing with the possibility of not repaying loans for very long times.

Policy options:

EUCCC sees a need for new EU legislation, as well as a new definition of "the internal market" and "subsidy", as the current ones are getting blurred in a more and more globalised world.

EUCCC also sees a need to update existing rules – there is an issue on how we think China may improve vis-à-vis the EU's approach. In some sectors, the EU may need to reconsider adapting existing rules to match European aid (not state aid) with support granted by others (e.g. Korea).

EUCCC supported the adoption of an EU FDI screening mechanism in order for EU companies to be able to compete in Europe against Chinese companies.

The IPI should be finalised much faster, this is a big problem for some industries (e.g. maritime) as companies are unable to participate in tenders if the vast majority is intended for SOEs.

EUCCC stressed that the definition of a subsidy should capture indirect subsidies, which are much more important, but hard to tackle. Other tools than direct financial subsidies are being used by China, the state is dealing with policies at an extremely granular level, therefore the need that these non-financial subsidies are considered.

Transparency is crucial when dealing with countries like China to develop a better understanding of how closed value chains can distort competition. With limited transparency requirements, the issues are not well understood and there should rather be a presumption of subsidies for SOEs. Perhaps a list of presumptions would enhance the information/notification requirements.

On competitive neutrality, EUCCC cautioned about the practical application of the term in China despite claims of applying the principle.

Impact of policy options:

EUCCC distinguishes impacts of a subsidy in a greenfield and brownfield investment:

- Greenfield is perhaps innovative, creates jobs, etc.
- Brownfield is simply that a subsidised company wins against a non-subsidised company.

The largest and most important establishments from China, which are active in Europe, are not greenfield projects, but brownfield ones, and bring limited added value to the EU.

EUCCC considers that the proposal should not threaten EU's open market economy but must be built on market-based principles.

Social/environmental impact – many subsidies in China are wasteful and come at the expense of other public services provided. China is becoming much smarter to provide benefits without actually paying for it, for example, by shifting the handling of cargo to Chinese entities.

EUCCC stated that the impact of the instrument on investment should be considered.

It should be considered how the instrument will affect European companies, who also benefit from subsidies in China. On the other hand, decoupled companies who are mostly localised in China, if they are not doing business or exporting to Europe, they might not be affected. Another issue to take into account is the impact of the instrument on European SMEs, and the importance to make sure it doesn't have negative impacts on their development.

Administrative burden should be reduced as much as possible. The burden on authorities to process the notifications will depend on how it would be done and how long it would take.