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Chasing paper tigers: Need for caution and priorities in EU countervailing duties (CVDs)

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INTRODUCTION

The 1964 movie 'Dr Strangelove (Or How I Learned To Love The Bomb)', is a brilliant satire of the Cold War and the logic of nuclear deterrence. Fear of nuclear retaliation, and the inevitable mutually assured destruction (a policy abbreviated to 'mad' in real life) that would follow a nuclear attack dissuaded world powers from ever starting World War III in real life, but in the film the world ends in a nuclear Armageddon. It is tempting to use Dr Strangelove as a metaphor for trade policy as an equivalent to 'mad' is looming in the international trading system over the increasing use of subsidies and countervailing duties (CVDs). The economic crisis has put state activism as well as mercantilist ideas back into fashion, often in disguise of addressing market failures. There is an increasing pressure on governments to subsidise their industries to maximise exports, while there are increasing calls to employ trade defence instruments against subsidies by others that in one way or the other distort competition and trade.

Few proponents of open trade are willing to lend support to the ways the EU and others use trade defence instruments, especially antidumping. But CVDs are different from anti-dumping duties. While the concept of anti-dumping is fraught with economic problems, there is no doubt that subsidies distort competition; while anti-dumping often targets healthy free-market price competition, CVDs are, when properly used, tools to correct problems arising from subsidies that

SUMMARY

A new trade war is looming as the EU is now embarking on its first countervailing duty (CVD) against Chinese subsidies over coated fine paper. As the EU gives a significant amount of subsidies to local production, China is not short of sectors to retaliate against – especially as the evidence in the paper case is weak: The share of Chinese exports is yet too small to inflict any injury on EU producers, and China holds less than 4% of the EU market; alleged subsidies through grants, subsidised electricity, VAT and tax rebates have little impact on the final price; and the main argument is based on an assumption that Chinese commercial banks are state owned and are thereby public bodies.

Given the risk for retaliation, CVDs are a risky and costly means to buy time for sunset industries and as CVDs alone cannot remove subsidies in the target country, they are therefore often inferior to a WTO dispute. This calls for a new policy on CVDs where the EU only addresses urgent cases of serious injury against unsubsidised sectors with high value-added and where the EU represents a significant market share. China directs most of its subsidies to strategic emerging industries, and even amongst these sectors only a handful live up to these criteria.

have disabled free-market price competition. Hence, CVDs are in some (but far from all) circumstances a last line of defence, which is justified for economic reasons. Even with such justification however, they are not always an effective means to change the policies of the targeted countries.

Judging by recent developments we may see two jurisdictions moving towards a more intensive use of CVDs against subsidies – namely, the EU and China. The EU has in recent years increased its use of CVDs and is about to impose such duties on Chinese coated fine paper, in its first ever CVD case against China.[2] It is the first of several expected cases that target China's ambitious 'going-out' strategy. China immediately retaliated by initiating an investigation against the EU on potato starch.[3] Both economies are also characterised by significant state influence and vast amounts of subsidies, and if the EU and China believe that CVDs should be used extensively against each other, there is no end to the number of CVD duties they can introduce. But a tit-for-tat retaliatory use of CVDs has no winners, only losers.

This risk of 'mutually assured destruction' is prompting policymakers to formulate a new strategy to define when they are justified, effective and in the interest of the EU. To that end, this paper will examine the coated fine paper case to illustrate some of the problems of today's approach to CVDs and propose a structure for such policy for the EU.

THE EU CASTING THE FIRST STONE – THE COATED FINE PAPER CASE

China is rapidly transforming itself from being a net importer of paper products to being one of the leading world exporters. The EU and the US are still leading globally, accounting for more than half of world exports. China, in contrast, only represents 7% of world exports[4]. This might be rapidly changing. The Chinese paper industry has, according to somewhat shaky estimates, added 26% new capacity every year on average since 2004.[5] Chinese manufacturers that cater for domestic demand are the reason for most of the new capacities. China is hungry for resources, and sources them extensively from its neighbours. Also a Sino-centric production network has been established in a similar fashion as we have seen in many other consumer goods. As a result, the US, EU and China together now account for half of global imports.[6] China's domestic demand is increasingly supplied by local producers and EU firms are also moving lower value-added production to China. These firms do not only supply the emerging Chinese market but also the rest of the world, including the EU, from their China-based production network.

Critics of China's export-led economy, and proponents of trade defence instruments, often allege that incentive structures (for want of a better word) in China create vast overcapacities in China and that surplus production is 'dumped' on foreign markets. While true in some instances, it is difficult to make that argument for the paper industry where the excess capacities have been decreasing since China entered the market. Instead, capacities in the EU or US that were previously exported to China are simply relocating to China. Nevertheless, China poses a challenge to current exporters in the EU and the US. Industrial restructuring of the paper industry seems inevitable as the price of key input goods (log, recycled paper and pulp) have increased by 30 to 150%,[7] while world prices of paper products are not increasing to the same extent as China's ability, given increasing capacity, to undercut margins is moderating such price increases. This development is similar to industrial reorganisations in shipping, mining, electronics, textiles and other consumer industries. In short, the paper industry has all the characteristics of a sunset industry – high entry costs, little value-added or product development, and increasing dependency on maintaining high volumes to survive.

Against this background, the EU has decided to follow the US in a dual-track approach of investigating China for both dumping and subsidies on the paper industry.[8] The European Commission imposed an antidumping duty in November 17th 2010.[9] The complaint on subsidies was lodged on 17th April 2010 and the decision to impose duties allege it is benefiting domestic industry by maintaining 28 various programmes for subsidies, divided into preferential lending (by state-owned banks), tax and tariff benefits, various grants and government provision of goods and services for less than adequate remuneration.

Under the rules of the World Trade Organization (WTO), a subsidy is defined as any financial contribution by a 'government or public body' such as grants, loans, equity, tax credits and the provision of goods and services others than general infrastructure bringing an advantage to one specific firm or sectors.[10] Such subsidies are 'actionable' if they cause injury to the domestic industry and are specific: hence, rules exclude general and non-specific measures, e.g. support for R&D, disadvantaged regions and promoting adaptation of existing facilities. Furthermore, a CVD investigation by the importing country must establish that there is a de facto subsidy, which is specific, and prove injury – with a causal link between them.

In this regard, the subsidy part of the EU investigation is unsatisfactory. For starters, it is questionable how significant these benefits are to the supposed injury on EU producers, even if one assumes that domestic Chinese producers benefit from subsidies. Although EU imports from China have increased considerably in the past ten years, it still accounts for less than 4% of EU consumption.

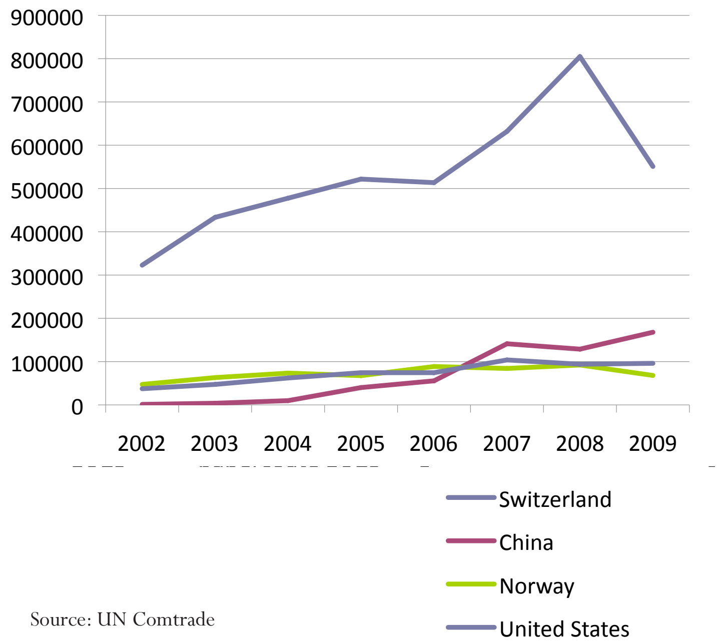
EU COATED FINE PAPER IMPORTS IN 2009 BY COUNTRY:

	Country	Share of EU consumption (by quantity)
1	Switzerland	12.38%
2	China	3.77%
3	United States	2.16%
4	Norway	1.53%
5	Indonesia	1.36%
6	Korea, Rep.	0.82%
7	Japan	0.66%
8	Canada	0.65%
9	Brazil	0.49%
10	Chile	0.38%

Source: Own calculations; UN COMTRADE; Case AS557

It is questionable whether some of the benefits, like income tax deduction and tariff exemptions, amount to a considerable unfair advantage, at least in the case of paper. China is not alone in providing tax breaks or duty drawbacks (which also became an issue under the EU-Korea FTA), and several economies have zero tariffs across the board, without ever developing a competitive paper industry. Instead, such regimes drive investments. While there are discriminatory elements in the Chinese system – e.g. restricting the drawbacks to foreign invested firms

MAIN EXPORTERS OF COATED FINE PAPER TO EU



Source: UN Comtrade

(FIFs) that purchase machinery made in China – they are not market distorting for the paper industry in the EU per se. They represent, rather, market access concerns for exporters of machinery to China.

The injury on the EU market from government provision of goods and services in another country is by all accounts likely to be weak. The cost structure of the products in the current case shows that raw materials (pulp, recycled paper) account for almost 75% of total costs while electricity, for example, accounts for 3%.[11] It is unlikely that any subsidisation of the electricity from government or municipality utilities would amount to such benefits that they have a meaningful impact on the price of these goods in an export market. In the event that they have an effect, they are also offset by shipping costs and regular tariffs on paper, making the market distortion insignificant.

Instead, the most serious subsidies relates to fixed costs, or the financing of it through preferential loans. Like many arguments employed to justify trade defence, this case takes advantage of China's non-market economy status. The issue of preferential loans are based on the fact that the large Chinese commercial banks are state-owned enterprises (SOEs), and therefore alleged to be public bodies.

The banking sector in China is indeed highly protected and underdeveloped, but few would dispute that these SOEs compete amongst each other on market terms, often vying hard with each other for lucrative market segments. Extending the definition of public bodies to commercial banks could have repercussions. Almost every firm in China with a line of credit from a local commercial domestic bank could then be subject to a subsidy accusation on what is actual 'market-lending rates' through creative exercises by trade defence authorities.

Furthermore, sauce for the goose is sauce for the gander: it is equally possible for many companies to launch subsidy allegations against European firms for the simple fact that many banks have been heavily supported by governments in the past few years, and that monetary authorities like the ECB have used, for good reasons, monetary tools to artificially depress lending rates. This would be absurd grounds for a CVD, but it is in principle no different from the allegations thrown at Chinese companies of subsidies through domestic lending rates via government interventions.

Such arguments against state-owned banks are particularly problematic for the EU as they echo the EU's own arguments in subsidy disputes in the WTO.[12] In the Boeing-Airbus case, the US filed a complaint over preferential loans by the European Investment Bank (EIB), an EU development bank that funds public and private initiatives for the purpose of accomplishing of the Single Market or social goals. The EIB offered specific loans to Airbus on favourable conditions, which according to EU statues are not state aid as under the Treaties they are '*aid to promote the execution of an important project of common European interest' and 'does not adversely affect trading conditions to an extent contrary to the common interest*'.[13] The WTO Panel made no exceptions for pan-European causes, and the WTO Panel report on the Boeing-Airbus dispute concludes the subsidies were illegal advantages given to Airbus. In its defence the EU did not deny that such loans were politically motivated, but argued that as the EIB's purpose '*does not focus on profit maximization [it] would mean, if followed by the Panel, that any of these international lending institutions provides subsidies. That would not only be legally incorrect, it would also constitute a major obstacle to developmental policies around the globe*'.[14]

Regardless of the core substance issue over subsidies, it is inconsistent to argue that it is justified for a public body like the EIB to have such developmental aspirations while it is not for a commercial state-owned Chinese bank, if that now is the case. It is not far-fetched to say that the EU is using double standards. It favours one standard for subsidies by European authorities but another standard for foreign authorities. It would not be the first time in history that a government acts inconsistently, but it presents a difficult problem in a politically charged area like CVDs i.e. you are likely to get the same treatment by other countries.

FROM COATED TO UNCOATED PAPER, AND FURTHER

Indeed, some programs seem to give Chinese paper exporters access to financing facilities at preferential interest rates compared with the interest rates for ordinary short-term commercial credits. Such loans enable an exporting producer to write off necessary investments (thus modernise equipment or consolidate) faster, which represents a substantial part of the costs in the paper industry. In other words, these are preferential loans that lower entry barriers, whereas such investments are written off years ago for paper mills in the developed world.

The schemes are contingent upon economic performance, and the level of subsidy will be assessed against the turnover of the company. In other words, Chinese commercial banks give better rates to commercially successful firms, like any other bank in the world. But the question is whether contingents on economic performance always imply contingents on export performance.

Once again there is also a question over double standards. The EU has argued against such assumptions in the Boeing-Airbus case. Loans to Airbus were also performance contingent, but as the global market is largely divided between Boeing and Airbus, the EU argued that any company operating in a global market will significantly link its profits to exports: '*First, because, in the long term, a company doing business in a truly global market is likely to have to sell into that global market in order to survive. Second, because achieving a market-based return on royalty based project finance is likely to include global sales, or in other words sales in both* *domestic and export markets.*[15] This is an argument that could have been perfectly applied to China's paper industry.

The EU claims that Chinese coated fine paper producers receive favourable grants for technological development, mostly in the provinces of Wuhan and Shandong.[16] But the economic impact and specificity in these cases are clearly disputed. For example, only one of these grants is specifically dedicated to forestry development and management. Both grants and loans are general measures that affect all types of paper production. They are given to firms or paper mills, not a specific type of paper production. For example, China exports an additional 30% of uncoated paper in the fine paper segment that could be subject to the same duties. Various products made of paper, cardboard – or any firm that has a line of credit from a Chinese commercial bank – could be subject to CVDs for preferential loans.

Furthermore, one must also bear in mind that similar directed grants are the most popular instrument for EU subsidies, and account for 51% of state aid provided in the EU.[17] Therefore, both the Boeing-Airbus dispute and the CVD on coated fine paper are cases where the warring parties have raised complaints on subsidies they themselves engage in. The similarities between the arguments used by the EU in other cases demonstrate a position that is unprincipled at best. More worryingly, it leaves the EU open for retaliation.

AVOIDING THE RISK OF TIT-FOR-TAT OVER SUBSIDIES

Between 2001 and 2010, 1487 anti-dumping measures have been imposed compared with only 75 countervailing duties (CVDs), where the main user of CVDs is the US with 41 anti-subsidies measures.[18] These countervailing duties mainly target subsidies in two countries – China with 21 and India with 19 cases – and mostly relates to articles in base metals and machinery. But the risk of tit-for-tat is most likely the reason why the EU has so far refrained from raising a case against China. The risk of retaliation is particularly palpable for the EU – subsidies in various forms are used intensively in the EU and still represent an important (and politically necessary) complement to some economic sectors. China will not have difficulty in finding examples where they can impose CVD duties against Europe on equally weak grounds.

The recipients of EU subsidies are concentrated in ten sectors (excluding the financial sector under national rescue plans), where agriculture accounted for over 60%,[19] making it probably the most subsidised sector in the world. Although agricultural subsidies under the WTO follow special conditions, it has not stopped China from retaliating against the EU on derivative products. The Chinese Ministry of Commerce (Mofcom) initiated a CVD investigation on potato starch from the EU, in particular from Germany and the Netherlands, in addition to the antidumping duties that have already been imposed since 2007.[20] Furthermore, there are also Chinese accusations of unfair subsidies to French bio-fuel and investment projects in the Netherlands. A tit-for-tat trade war over subsidies between China and EU is not a remote possibility – the basis for escalation has already been established. Apart from China, Australia imposed CVDs on French Brandy in 2007; the US has duties on Italian pasta and steel products from Italy and Belgium; Peru is currently investigating a possible anti-subsidy case against Spanish and Italian olive oil.[21]

TABLE 1: EU STATE AID BY SECTOR IN 2009

RANK	SECTOR	QUANTITY	EVOLUTION FROM PREVIOUS PERIODS
1	Agriculture	□11180 million	Consistent
2	Coal	□2700 million	Declining
3	Maritime Transport	□1800 million	Declining
4	Road Transport	□641 million	New regulation
5	Shipbuilding	□606 million	Increasing
6	Aviation	□338 million	Increasing
7	Fisheries	□200 million	n/a
8	Steel	□108 million	Declining
9	Car Sector	n/a	Increasing, national schemes approved under the Temporary Framework
10	Railways	n/a	n/a

Source: European Commission, DG Competition

The table shows that EU subsidy programmes are by and large aimed at non-competitive sectors. The export competitiveness (so-called revealed comparative advantage, or RCA) of EU exports on agriculture, mining of coal and metals and fishery (but also forestry and logging) has been declining steadily for some time, and some of these sectors show remarkably low competitiveness. This is distinctly different from subsidy policy in economies like China, which focuses on emerging industries. In many cases, these sectors are sunset industries in the West that are being gradually phased out and moving downstream in the value chain. The coated fine paper is such a case where the Chinese state support and the need for industrial restructuring in the EU overlaps.

The risk of retaliation would be reason enough to be cautious about use of CVDs and to consider them as a last line of defence. Moreover, they are rather ineffective as policy tools as CVDs alone cannot, and are not intended to, change policy in another country. They are merely instruments to address the consequences of subsidies in individual circumstances, mostly for individual or smaller groups of companies. Yet trade-distorting subsidy programmes are often sprinkling public resources on many companies and sectors, and it is far too cumbersome to use trade defence instruments to address all beneficiaries of a subsidy programme. Furthermore, a CVD does not address the problems of market access, discrimination and free competition on the subsidised market.

A different, and often better, strategy in cases such as this is to file a complaint at the World Trade Organization's (WTO) dispute-settlement body. Apart from other benefits of using an established adjudicator, a legal process at the WTO has the chance of providing a change in policy, or eliminating a subsidy inconsistent with WTO rules. It is interesting to note that the arguments used to support imposition of CVD duties are often similar to a legal basis for tabling a complaint in the WTO. In other words, the claims made are equally valid if they can be evidenced in dispute-settlement as they are in a CVD investigation. In fact, there are several examples where China has eliminated illegal subsidies due to WTO disputes being filed against it. For example, in February 2007, China agreed to scrap its subsidies and tax rebates to various sectors, including steel, computers, clothes, wood and paper.[22] These rebates required firms to chose domestic over imported goods and meet certain export performance criteria; in December 2010, subsidy programmes contingent on use of domestic goods in wind power equipment ('Ride the Wind' and the 'Export Research and Development Fund') were discontinued before the dispute was resolved.[23] China also agreed to amend requirements that foreign enterprises have experience supplying equipment to China and relaxed some domestic content requirements. Finally, there are consultations over 'China World Top Brand Programme' and 'Famous Export Brand Programme' that appear to provide grants, loans and other incentives contingent upon the export performance of Chinese enterprises.[24]

The examples show that a WTO process not only leads to positive rulings – they could also reform Chinese policy. It is also something of a myth that a WTO process would be more time consuming than a CVD investigation – especially if it is made in such a manner that would stand up to scrutiny in a WTO complaint: CVDs may offer quick results through provisional duties for the industry, but they are retaliated against and contested in the WTO almost without fail. A process in the WTO is therefore far less politicised than the use of CVDs.

SECTORAL PRIORITIES FOR EUROPEAN CVDS

While some WTO members are more prudent than others, it is safe to say that no member is entirely compliant with all of its WTO commitments. But a violation of rules does not, per se, demand a legal remedy out of principle. Instead, every pursuit of action is subject to a careful consideration of consequences, taking into account possible counter actions by the trading partners. Or simply put, just because it is actionable, does not mean a CVD should be imposed.

Therefore any anti-subsidy case must be worth its salt given the costs involved. If the EU is going to break the standoff on CVDs, it ought to address a subsidy that causes serious market injury. This implies that the sector should be productive and competitive to begin with, and thereby worthy of protection from foreign subsidisation. It is in such sectors where foreign subsidies have a demonstrable effect on value-added in Europe. Trying to preserve world market shares of sunset industries is a costly fight against time that makes little sense – especially in the case of coated fine paper where EU manufacturers themselves are relocating to China. Second, the Airbus-Boeing case and other examples show that attacking sectors that also enjoy subsidies at home is futile and leaves all parties involved worse off. As the old proverb goes, people in glasshouses should not throw stones.

China's industrial policy and the upgrade of its economy is meticulously planned and executed. China targets its subsidies to the high value-added sectors carefully. In the recent 11th Five-Year Guideline for National Economic and Social Development for 2006-2010, the following sectors were named as strategic emerging industries(SEIs) that are expected to succeed on a global scale – and trillions of RMBs was spent over the five year period:

- Integrated circuits (ICs) and software
- New-generation networks (internet, digital TV and mobile networks)
- Advanced computing (grid-based and peta/teraflop computer systems)
- Biomedicine, genome research as well as traditional Chinese medicine
- Civil aircraft and advanced engines
- Satellite application (such as meteorological, oceanographic and telecommunication satellites) and thrust-augmented carrier rockets
- New materials needed in IT, biotechnology and aerospace industries.

The following sectors were added in the 12th Five-Year Guideline from 2011:

- New energy and energy conservation
- High-end equipment manufacturing
- Electric cars

Several of the focus sectors in the Chinese five-year plans, like new energy and civil aircraft, are sectors that enjoy subsidies in the EU. The future of electric cars, satellite applications, software and advanced computing industry in the EU may look promising, but European firms do not necessarily outcompete the rest of the world, and represent (so far) low economic value. Furthermore, IC manufacturing is indeed another sunset industry that is being gradually phased out in the EU, the US and Japan. This leaves a few key sectors, such as high-end equipment manufacturing, network equipment, biomedicine, new materials and electrical cars amongst the high-value added sectors that deserve further examination.

MEASURES TO ADDRESS THROUGH CVDS

A CVD is inferior to a WTO dispute in the sense that it does not actually change the policy of the targeted country, but imposing a unilateral CVD could be logical and preferred in some very limited cases.

One condition is when the Single Market represents such a large share that it makes little sense to start the proceedings outside that jurisdiction. If a substantial share of the subsidised exports is destined for the EU, an imposed duty could safeguard against the effects of that subsidy – especially if the market under attack is corroding rapidly. Many of the remaining sectors above seem to fulfil this criterion. To take one example, the EU market in network equipment is valued at €38 bn annually, which represents about one-third of the global market.[25] EU firms are also competitive and dominate on a global scale, holding 70-80% of the world market.

The second condition is when subsidies are difficult to define as illegal under WTO rules (and China is thereby less likely to change its policies through a dispute), but are still legally actionable. Three types of subsidy schemes seem to fall under that category, namely VAT rebates, export subsidiesand specific types of grants. These forms of subsidies are actively used to achieve policy objectives in China, and may well be used because they are not explicitly prohibited under the WTO.

Chinese support for knowledge-intensive sectors usually starts through support given in the form of seed capital (often sponsored by the Ministry of Industry and Information Technology, which holds a development fund designated by the Ministry of Finance).[26] Companies listed as one of the SEIs can enjoy multiple grants offered both by central authorities and provincial government bodies, administered in most cases by Mofcom.[27] A Chinese firm can receive up to 200 million RMB from Mofcom alone.[28] Such amounts are rare, but these funds are supplemented by grants from the Ministry of Information Industry (MII) or the Ministry of Science and Technology (MOST) upon approval by the National Development and Reform Commission (NDRC).[29] However, most common grants are project-specific grants and loans that exist on many levels of central and local government – this grant structure is not too dissimilar from the one in the EU and its Member States.

VAT rebates on exports reached 648.7 bn RMB in 2009, approximately 7.9% of total merchandise exports.[30] China imposes a VAT of 17%, but with many categories of rebates relating to exporting goods. In response to the economic downturn, China raised the tax rebate for exporters seven times and rebates have risen by 8.6% in the first 8 months of 2009 as reported by the State Administration of Taxation.[31] In 2010, approximately 3,400 products were covered by tax rebates that typically span between 13-17% (having minor effects on output price of the final good), but measures are designed to improve the conditions for low margin assembly and processing trade where the value-added from China is almost none. While critics argue that VAT rebates in exports applied in a selective fashion for a specific period of time may work like a subsidy subject to exports performance, the Chinese government states that VAT rebates are lower than the VAT rates actually paid and therefore they are not inconsistent with WTO rules.[32] The coated fine paper case showed that injury to EU producers from such rebates is in fact limited.

More serious impact is caused at a later stage, when the company reaches maturing stage and preferential loans are used to nurture key sectors of SEI and ramp up their exports and their overseas expansion. Two financial institutions, EXIM bank and China Development Bank (CDB), offer preferential interest rates, usually around 2-4% (compared to approximately 6% offered on US denominated rate). EXIM remains a public body, while CDB has now been turned into a private entity. Their preferential export credit schemes have helped Chinese exporters to secure lucrative deals on both developed and developing markets. Export credits and insurances are permitted under WTO rules but may have clearly trade distorting effects. The key aspect to avoid legal repercussions for significantly preferential rates is that China has not yet established a commercial interest reference rate (CIRR) for its currency.

By 2009, EXIM Bank had provided 174.2 bn RMB of credit in total supporting exports and an additional 43 bn RMB is supplied annually in credits to foreign buyers of Chinese equipment.[33] A quote from its annual report stresses that it *'has been focusing on supporting export of high and new tech products … provided strong financial policy support to number of Chinese companies with comparative advantage like Haier, CSCO, Huawei, ZTE and many others'*[34]. Approximately 40% (or 70 bn RMB) of its seller export credits in 2009 are in 'High and New Tech Products' and electronic products. The interest rate on credit is individually set per agreement but remains undisclosed, and local governments often step in and assume the liabilities of the company.[35]

Examples of specific projects and companies to benefit from EXIM agreements include:[36]

- The two network equipment giants Huawei and ZTE signed a Financing Co-operation Memorandum worth 10 bn USD each. Details of the financing method were not disclosed, but were most likely a combination of all financing tools offered by EXIM, including seller and buyer credits.[37]
- CNMC Ningxia Orient Group, a tantalum producer, has become the world's number three with international share of 20% (powder) and 45% (wire production) thanks to credit lines from EXIM. Its credit line amounted to 970 million RMB in 2008.[38]
- Chery Auto is a key car exporter focusing heavily on electric cars launched in 2009. A strategic agreement with EXIM of 10 bn RMB to support technological upgrading and 'go global' expanded an existing arrangement from 2005 of 5 bn RMB.[39]
- In 2005, EXIM supported China National Machinery Industry Corporation, which is a large-scale SOE. By then, the value of the support topped 3 bn USD aimed at financing the company's export of mechanical and electronic products, complete sets of equipment, high and new technology products, overseas investment and support for international market expansion.[40]
- TCL is a supplier of consumer electronic and telecommunication products. TCL is mainly engaged in R&D, manufacturing, marketing and service provision for multimedia, telecommunication and household electric appliances. The co-operation agreement in 2005 was worth 6 bn RMB and aimed to help TCL in its export of mechanical and electronic products, complete sets of equipment, high and new technology products as well as its overseas investment and overseas contracting projects, specifically in the category of container examination equipment and telecommunications equipment.[41]

Additionally, export credit insurance has seen a surge after 2008, as a response to the government policy of helping out exporters to avoid global demand slump. Sinosure is the only official export and credit insurance company in China, and with the sole purpose of facilitating exports in strategic emerging industries. Between 2002 and 2008, $170 bn of China's exports and outward investment were facilitated by Sinosure and assistance worth 350 bn RMB in export financing was provided to 110 commercial banks. The total insurance credit value of Sinosure has reached 22.5% of China's total export value.[42] The Chinese Government argues that Sinosure facilitates exports under established business practices, and that its premium calculations are based on conventional risk ratings.

These are not the only sources of credit for exporters and their buyers. For example, EXIM, CDB and Sinosure credits are sometimes complimented by loans by Mofcom whose preferential policy rates can be 0.12 to 0.6%. Inarguably, China's state apparatus is skilful in directing funds through various channels such as banks, SOEs, venture companies and decentralised government structures in the provinces which are fundamental in supporting its competitiveness through cut-throat pricing on high value-added goods. Chinese technology companies can outbid their competitors on international markets by 20-30%, suggesting a clear pricing strategy to gain market shares.[43] Credit plays a pivotal role in that strategy – especially if they are extended to buyers far below Chinese market interest rates.[44] They fuel the going-out strategy of major players such as Huawei or ZTE and allow them to offer 50% savings in their bids.[45] The total line of credit offered by EXIM, Sinosure and other preferential loans could very well cover half of China's trading volumes – an unprecedented magnitude of public financing for exporters and their buyers.

CONCLUDING REMARKS

In the final scenes of Dr Strangelove, the grey eminence of US defence (portrayed by Peter Sellers) admits being dissuaded from using the doomsday weapon by a think tank report that dismissed the idea as being too dangerous to be practical. This report hopes to play the same role in EU anti-subsidy policy. The purpose of this paper has been to highlight the exorbitant costs of using CVDs to correct market-distorting effects. Even if there were any substantive merits in the coated fine paper case, it is a risky and costly means to buy time for sunset industries – it is clearly the wrong case to push for that reason. The fact that CVDs, like anti-dumping duties, are often used to protect such sectors adds further reason to be suspicious about the material economic evidence used to motivate them. There are simply too many factors that undermine sales and profitability to establish whether subsidy-related pricing strategies in another country contributed to declining sales.

Given the policy process for trade defence instruments in the EU, CVDs are all too likely to be abused by uncompetitive sectors that have nothing to lose from retaliation. Meanwhile, competitive exporters in the EU with substantial market shares abroad are least likely to file a case in fear of retaliation against their market access abroad. Therefore, a sound policy starts with delinking initiatives from complaints and lobbying from protectionist interests. Instead, the EU needs to start looking at the bigger picture with all stakes involved.

This calls for a new anti-subsidy policy in the EU with clear priorities where all illegal subsidies should not be countervailed by default, or we are heading for retaliatory tit-for-tat where everyone loses. This is why only unsubsidised sectors in the EU could come into question, and only to address serious and urgent market distortions in high value-adding sectors that thrive on innovation and efficient use of capital.

Admittedly, such sectors are few – amongst China's strategic emerging industries, only sectors like high-end equipment manufacturing, network equipment, biomedicine and new materials seem to fulfil these criteria – and even amongst these sectors, not all of them have any significant volumes of Chinese exports that pose threats to free trade. Finally, the CVD is only effective to safeguard against rapid and irreversible damages to sectors where the EU represents a substantial share of the world market. In other cases, launching a WTO case against the subsidy practice is often a more efficient and less politicised option.

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