


# Down with subsidies

Posted By Clyde Prestowitz ▪ Thursday, May 16, 2013 - 9:41 PM ▪ Share

Over the past five years, the issue of global currencies and unfair currency manipulation has received much attention as countries like China, Brazil, Switzerland, and the United States have been accused of distorting trade by the application of their currency policies. But a new book suggests that more attention should be focused on subsidies.

In ***Subsidies to Chinese Industry***, Usha and George Haley of West Virginia University and the University of New Haven respectively argue that in addition to cheap labor and an undervalued currency China's economic miracle and industrial competitiveness owes a very large debt to good old fashioned subsidies. After exhaustive research into hard to find and even harder to understand numbers, they have calculated that between 1985 and 2005, China's biggest State Owned Enterprises (SOEs) were the recipients of more than $300 in gifts from the state. This included preferential access to cheap capital and underpriced inputs not available to other global competitors. In several cases, the significance of the subsidies is astounding. Take Geely Automotive which recently bought Sweden's Volvo as an example. In 2011, more than half its profits came from subsidies. (I had wondered at the time how Geely could afford to take over Volvo when no other global auto company was willing to step forward. Now I know why).

The consequences of this kind of government funded largess are severe both domestically and internationally. Consulting firm **Fathom China** notes that small and medium sized Chinese companies are usually starved of capital because their bigger state owned and private sector brothers are being fed capital at little or no cost. At the global level, subsidies have created huge gluts of overcapacity in the steel, solar panel, and other industries. In steel, for example, China's excess capacity of roughly 200 million tons exceeds the entire potential output of the Japanese industry. The solar panel glut has driven virtually the entire global industry into bankruptcy.

Nor is China the only subsidizer. South Korea, Taiwan, Brazil, India, the United States, France, and many others are culpable in various sectors, although China appears to make the most far reaching and aggressive use of subsidies.

As the World Trade Organization (WTO) is about to appoint a new director, this subsidy situation raises some profound questions. The kinds of subsidies noted above are all strictly illegal under WTO rules. This is not like currency issues on which the International Monetary Fund (IMF) plays a companion role to the WTO and which, in any case, are the collateral damage of macroeconomic



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policies. There is no ambiguity here. The subsidies are illegal and the WTO is supposed to be in charge of stopping them. Yet, they continue, apparently unabated. Why?

The main reason is that the WTO is not really structured to enforce its own rules. It does not monitor the policies, practices, and actions of its members. The U.S. government publishes every year a compendium of the unfair trade practices of other countries, and, as a kind of retaliation, China now does the same, at least with regard to what it sees as the unfair trade practices of America. But the WTO does no monitoring, or data collection, or issuing of warning letters, and does no direct policing. Rather it relies on member countries to file formal complaints in the dispute settlement mechanism. Such filings lead to appointment of a formal dispute settlement panel which then conducts an investigation, listens to the arguments of the contending parties, and finally renders a judgement that may then be appealed. The point is that this can take a very long time during which the subsidy continues so that by the time a conclusion is reached the possibility that the original victims are bankrupt and out of business is quite high. Countries thus hesitate even to enter into the process.

But wait. It gets worse. National governments also don't proactively monitor and take cases on their own initiative to the WTO. Rather, they wait for corporations to file formal complaints with them. But the corporations are often hesitant to do so for fear of offending the subsidizing governments whose markets they wish to enter. Think about it. If you were the head of Ford Motor, for example, and you had plans to make a big push into the Chinese market. Would you be running to Washington to complain to the U.S. government about China's subsidies to Geely? Or, if as is the case with GM, you were getting perhaps as much as half your sales in China, would you run to complain to Washington or to the WTO in Geneva? I thought not.

Now imagine that you are the President in Washington. You want the Chinese to help you with North Korea, Syria, and Iran. You also want the Chinese to stop being beastly to the Japanese in the Senkaku Islands and you want them to get their pollution and greenhouse gases under control before their environmental degradation becomes ours as well. You also want them to stop hacking all your computer systems and you have a lot of other wants as well. Are you going quickly and rashly to file a formal complaint over subsidies at the WTO? Again, I thought not.

And I rest my case. The anti-subsidy codes of the WTO are essentially unenforceable and worthless as presently constituted.

If the WTO is to remain a significant arbiter of global trade, it must find a way effectively to police and enforce its rules without relying on the complaint system. This should be the first task of the new director.

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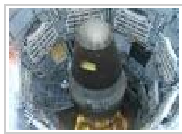

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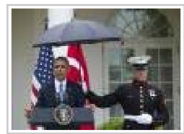

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"If the WTO is to remain a significant arbiter of global trade, it must find a way effectively to police and enforce its rules. . ."

It's not just the WTO. Similar criticism is made of other key international institutions responsible for finance; when they were created they were deliberately kept weak. Sovereign immunity is one reason.

Another reason was described by former US secretary of state Henry Kissinger in his book 'Diplomacy': "Empires have no interest in operating within an international system; they aspire to be the international system. Empires have no need for a balance of power. That is how the United States has conducted its foreign policy in the Americas, and China through most of its history in Asia."

Interational oil companies and banks are especially vulnerable to the financial arbitrage the rules allow at present.

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