



Addressing Distortions in the Global Economy: Industrial Subsidies, State-owned Enterprises and Overcapacity

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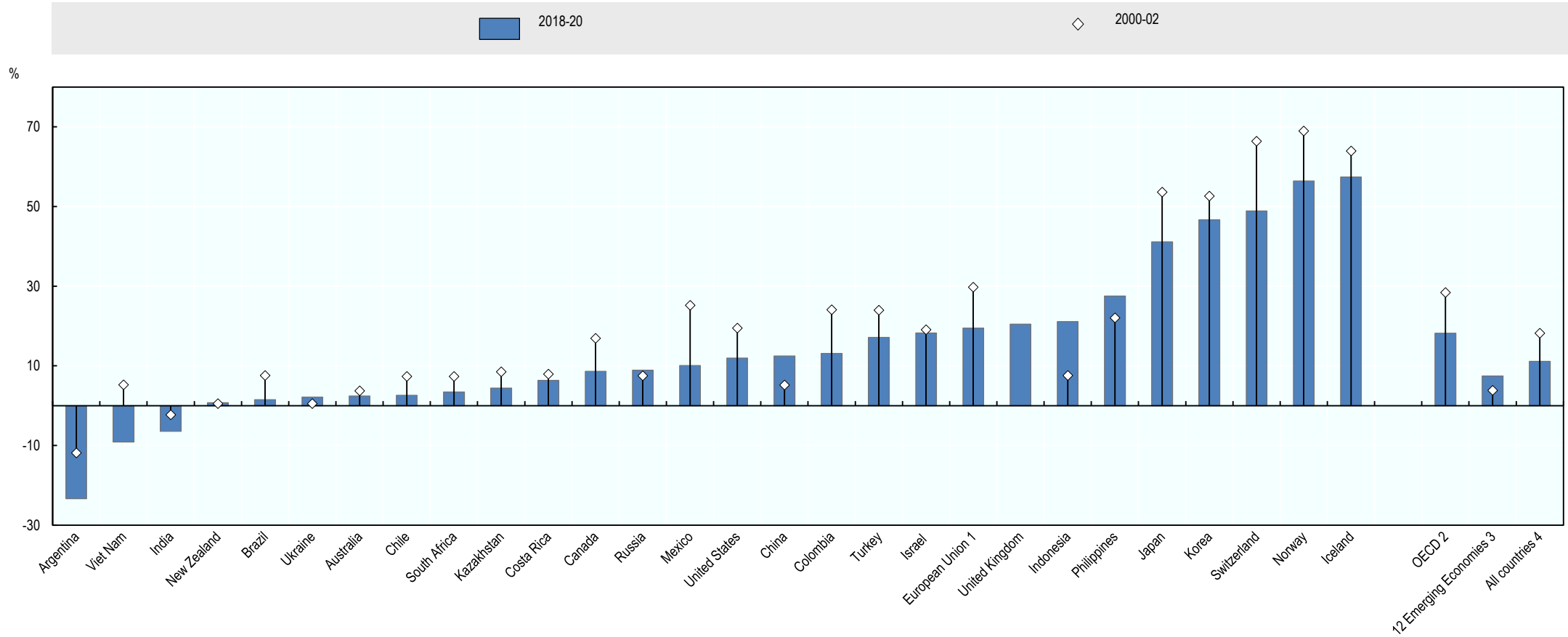
Why do we care?

- Level playing field and **distortions to competition** (beggar-thy-neighbour)
- Encourages **investment in capacity that not otherwise built**, or keeps uneconomic capacity alive (with effects on prices, jobs)
- Impacts on **important social and economic goals** (governance, environment)
- **Undermines faith in global markets and a fair global economy**
- **Support is a growth industry.....and is hard to reform**



Government support is hard to reform

Producer Support Estimates by country, percentage of gross farm receipts, 2000-02 and 2018-20





It's a difficult time to address government support

(i) Significant – essential -- support in COVID-19.

- Design matters – how you go in affects how/if you come out
- How you go out also matters – loan guarantees, tradable sectors

(ii) Resilient supply chains debate

- Role of state increasing, especially on essential goods

(iii) National security/geopolitics

- Dual use and concentration concerns

(iv) Green and digital transformations

- Public investments needed

What's a good subsidy?



UNDERSTANDING GOVERNMENT SUPPORT



Government support takes many forms

		Statutory or Formal Incidence (to whom and what a transfer is first given)						
		A: Output returns	B: Enterprise income	C: Cost of intermediate inputs	Costs of Value-Adding Factors			
					D: Labour	E: Land and natural resources	F: Capital	G: Knowledge
Transfer Mechanism (how a transfer is created)	1: Direct transfer of funds	Output bounty or deficiency payment	Operating grant	Input-price subsidy	Wage subsidy	Capital grant linked to acquisition of land	Grant tied to the acquisition of assets	Government R&D
	2: Tax revenue foregone	Production tax credit	Reduced rate of income tax	Reduction in excise tax on input	Reduction in social charges (payroll taxes)	Property-tax reduction or exemption	Investment tax credit	Tax credit for private R&D
	3: Other government revenue foregone		Waiving of administrative fees or charges	Under-pricing of a government good or service		Under-pricing of access to government land or natural resources	Debt forgiveness or restructuring; soft loan from the government	Government transfer of intellectual property rights
	4: Transfer of risk to government	Government buffer stock	Third-party liability limit for producers		Assumption of occupational health and accident liabilities	Credit guarantee linked to acquisition of land	Loan guarantee; non-market debt-equity swaps and equity injections	
	5: Induced transfers	Import tariff or export subsidy; LCRs	Monopoly concession	Monopsony concession; export restriction	Wage control	Land-use control	Credit control (sector-specific); non-market M&As	Deviations from standard IPR rules



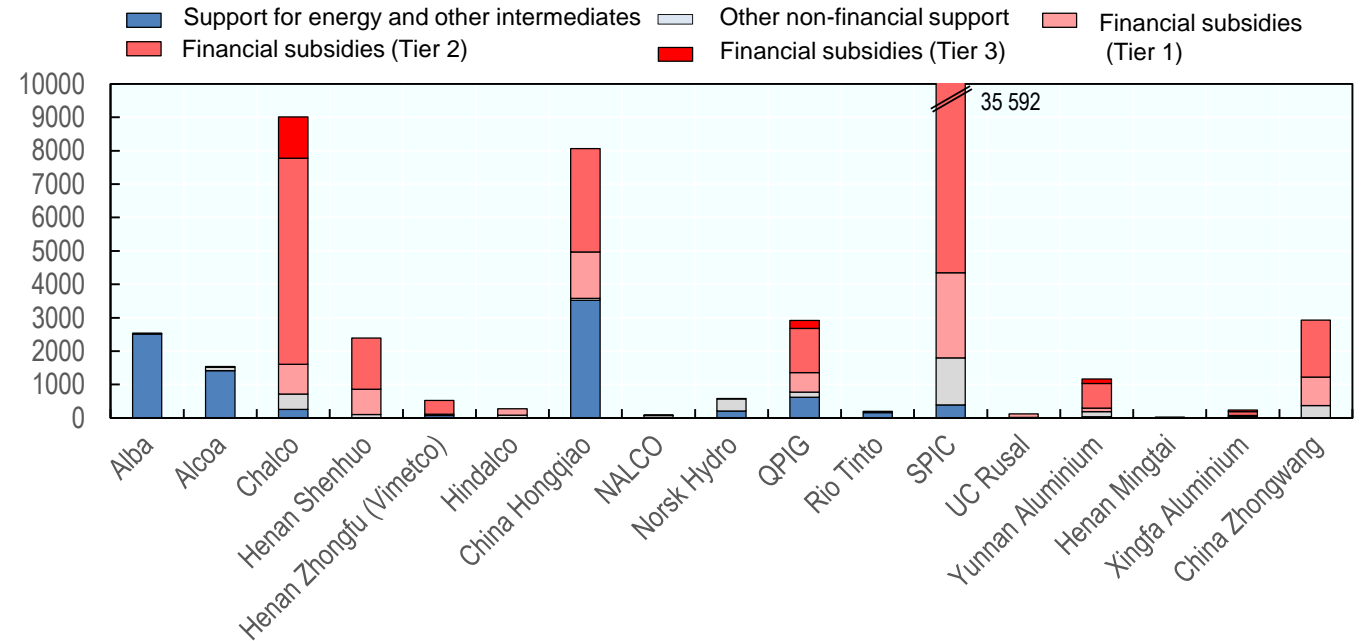
Understanding support in industrial sectors is challenging

- **Work to date**
 - Commodity (aluminium)
 - High-tech sector (semiconductors)
 - Below market finance (horizontal)
 - Ongoing work on energy inputs, impacts
- To assess government support in industrial sectors, we looked at **individual firms:**
 - Necessary given lack of policy transparency
 - Enables greater granularity (e.g., of subnational measures)
 - Enables identification of support beyond traditional forms (e.g., below market finance)



What did we learn? Aluminium

- **Support upstream** can have sizable **effects downstream**.
 - Need to take a **value chain approach**
- Support mostly takes the form of **energy subsidies** and **below-market financing**.
 - Below-market financing is hard to measure but even conservative estimates suggest it is significant. (USD 7-56 billion)
 - Aluminium multinationals obtain support in the different countries in which they operate, but large SOEs get most support from their home countries.
- There **is strong involvement of the state** in the aluminium value chain, and SOEs are both recipients and providers of support:
 - SOEs account for almost half of all smelting capacity
 - Cheap finance (debt) is often delivered through state-owned financial institutions
 - Issues for transparency

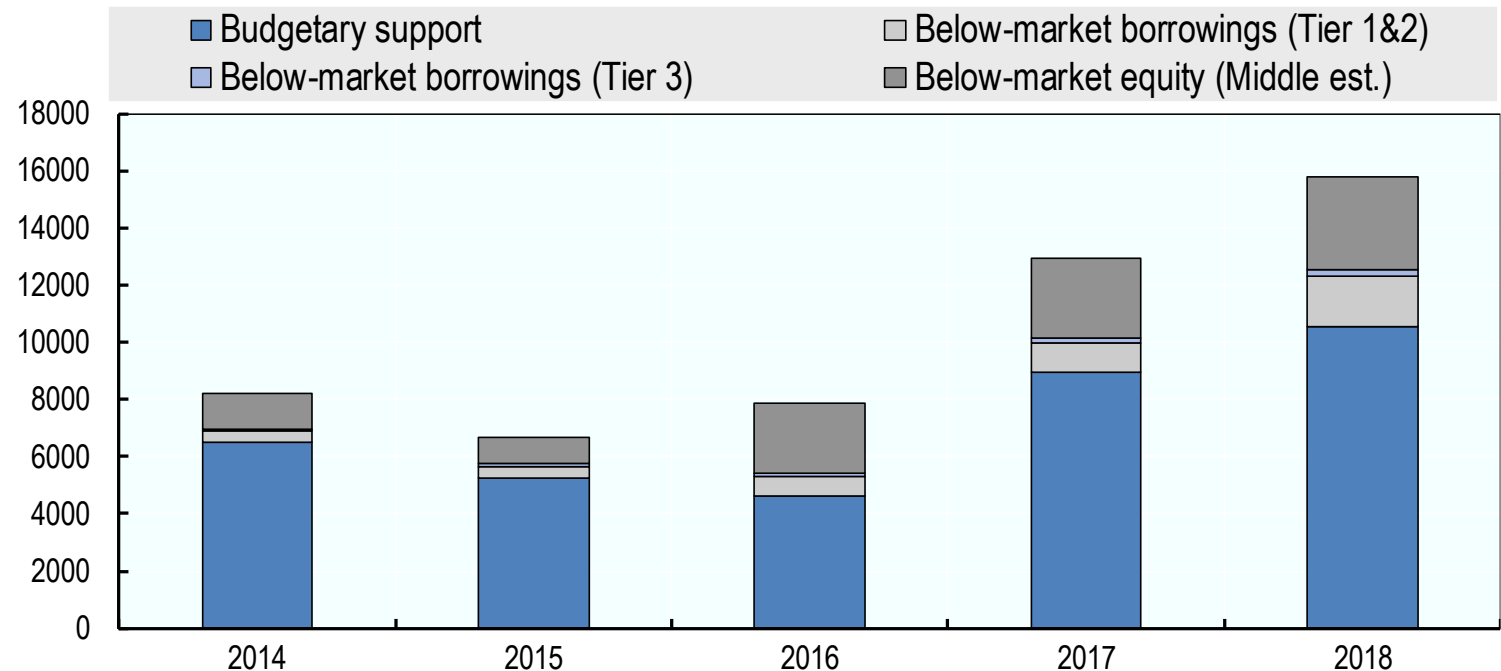




What did we learn? Semiconductors

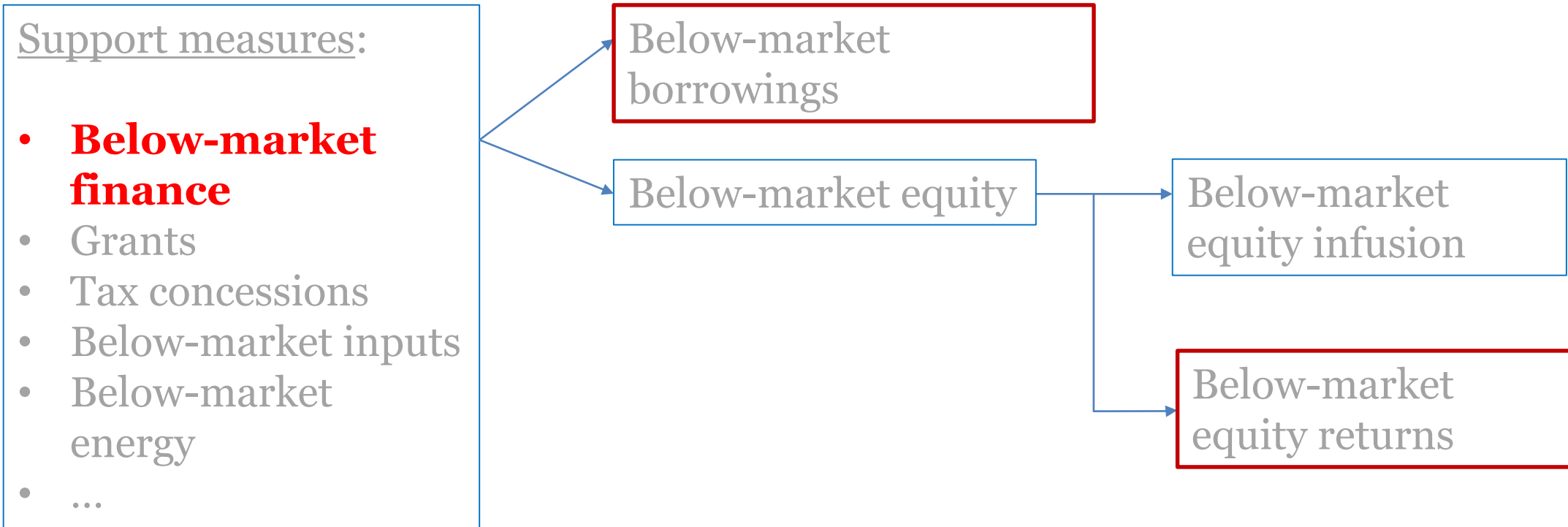
- R&D subsidies are significant
 - But do they work in high-tech sectors?
- Below market finance significant: loans (debt), but also equity
 - Hard to measure equity
 - Not just one off benefit
- How to treat government ownership in firms?
 - SOEs vs government invested firms

21 Semiconductor Firms received USD 50B over 2014-18





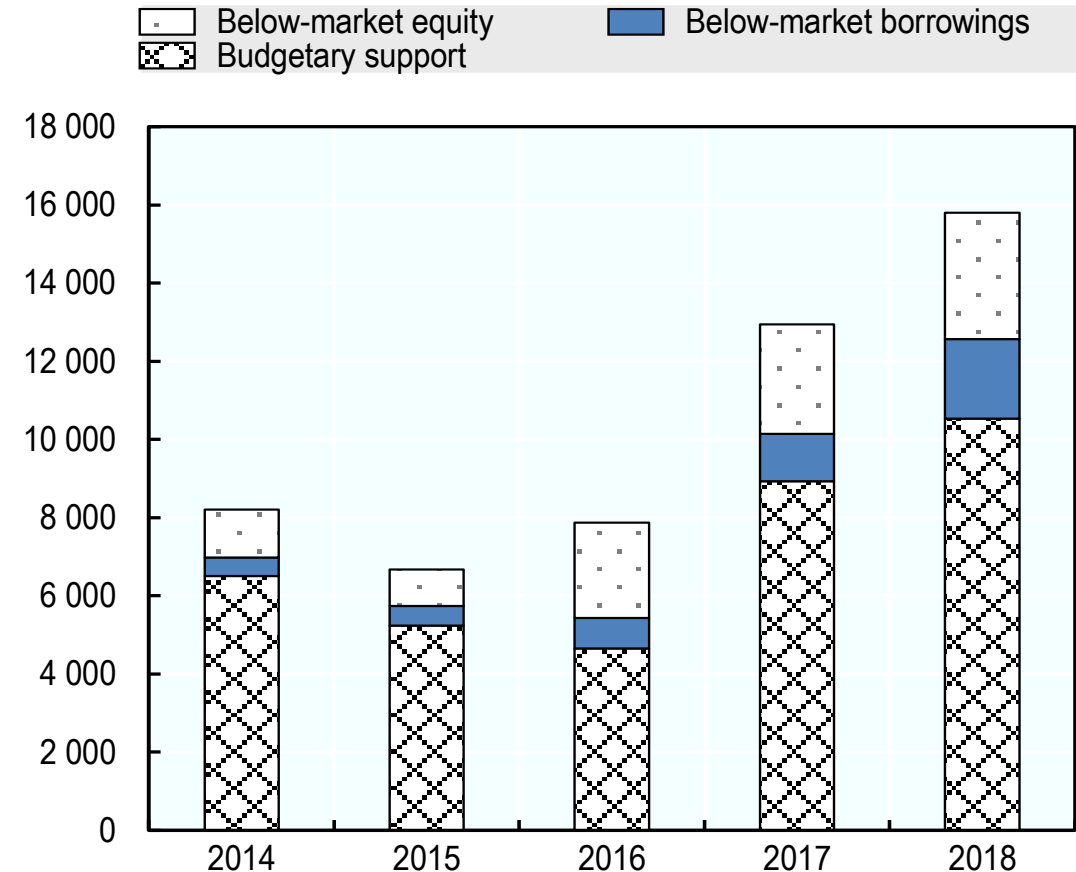
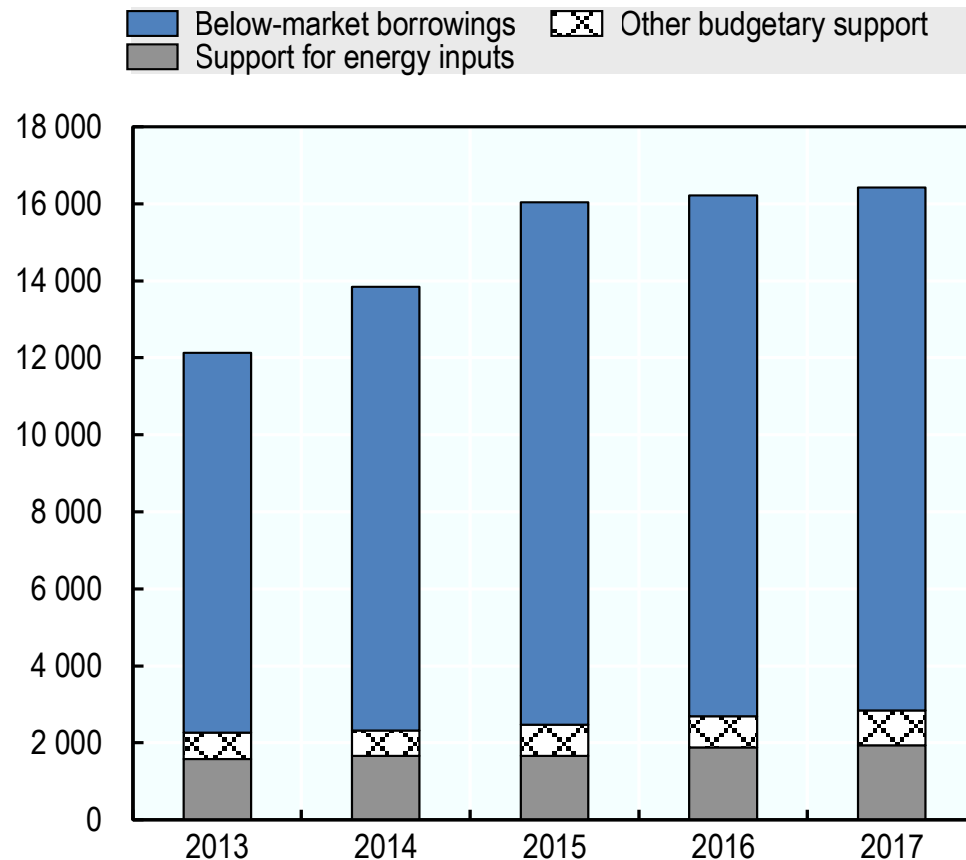
What did we learn? Below market finance





Below-market finance is a large source of support in aluminium (left) and semiconductors (right)

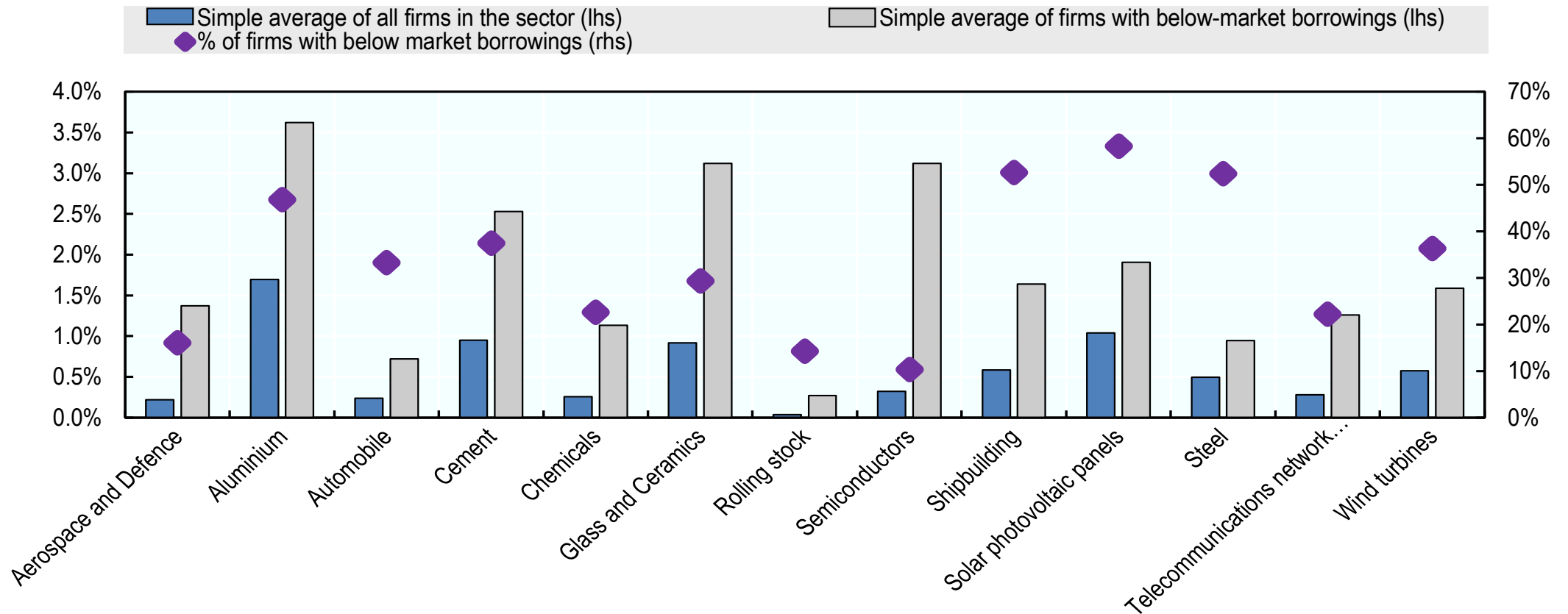
Government support by year and type of support, USD millions, current





Below-market borrowings appear especially marked in industries with excess capacity

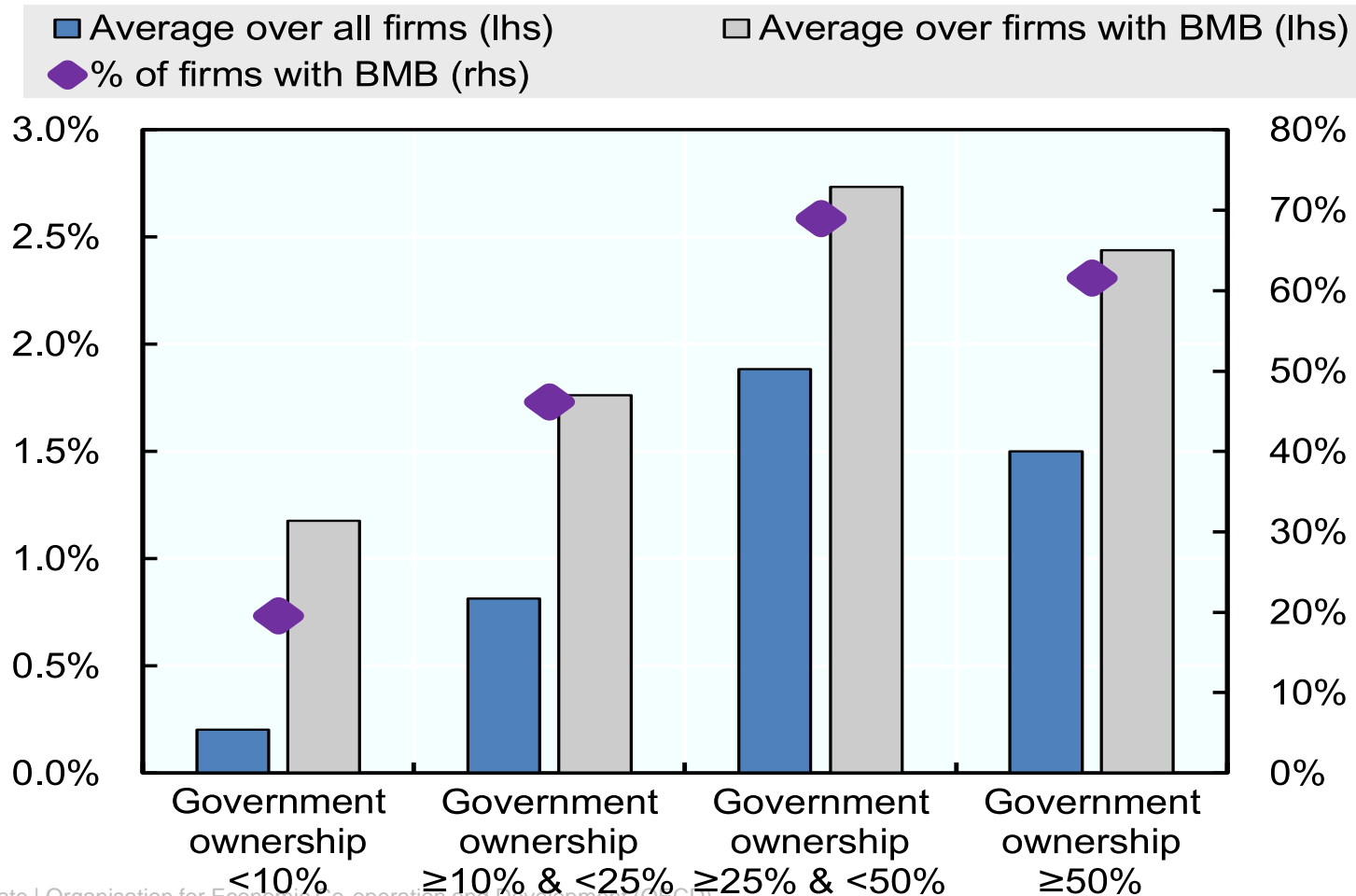
Average below-market borrowings, % of revenue





Government-invested firms tend to benefit more from below-market borrowings

Average below-market borrowings [BMB], % of revenue





An important challenge is knowing where the state is

- Firms with more than 25% government ownership receive more support
 - State an important shareholder in a number of industrial sectors (aerospace, aluminium smelting, shipbuilding, steel), including those until recently largely private (semiconductors)
- Government-invested firms are also important providers of support
 - State owned/influenced financial institutions and cheap loans
 - Utilities and below market energy
- Not just SOEs....but lack of transparency is a problem
 - Size, but also golden shares, Board appointees
 - Lack of transparency masks government support by giving appearance of regular commercial transactions



Understanding impacts is a further challenge

- **Support builds along value chains**
 - Attribution of benefit (downstream and upstream)
- **Interacts with other government policies**
 - E.g., export restrictions lower input costs
- **Interactions among different forms of government support**
 - Cheap inputs enhances profitability, masks below market equity or loans
- **Technically challenging**
 - Market benchmarks
 - Causality vs correlation



INTERNATIONAL DISCUSSIONS



G20: Italian Presidency

G20 MINISTERIAL STATEMENT ON TRADE AND INVESTMENT (<https://www.g20.org/wp-content/uploads/2021/10/G20-TIMM-statement-PDF.pdf>) :

We will continue to work to ensure a level playing field to foster an enabling business environment and to support the integrity and sustainability of the rules-based multilateral trading system, as affirmed in Riyadh and Tsukuba. We underscore the importance of fair competition, as we recognised in the context of the Riyadh Initiative on the Future of the WTO. Reducing trade tensions, tackling distortions in trade and investment, addressing supply chain disruptions and fostering mutually beneficial trade relations will be critical as economies respond to and recover from the COVID-19 pandemic. We reaffirm that structural problems in some sectors, such as excess capacities, can cause a negative impact.

Many G20 members affirm the need to strengthen international rules on industrial subsidies and welcome ongoing international efforts to improve trade rules affecting agriculture. Many of us highlighted agricultural subsidies and agricultural market access.

We recognise the importance of transparency of government support and WTO members meeting their transparency obligations. We reaffirm our commitment to fulfil those obligations and call on other WTO members to also do so.

Difficult debate:

- Industrial vs all subsidies
- Excess capacity?
- Abuse of national security and trade remedies
- Development issues and policy space
- Transparency and burden



G7 UK presidency

- **In-depth discussions, including at Trade Ministers**
 - Features in May, October Communiqués
 - Greater coordination, including of bilateral or unilateral actions
- **Chief economists and measurement/analytical agenda**
 - Keep building evidence base
 - Tackle analytical issues -- market benchmarks, impacts



Other bodies and initiatives

Global Forum on Steel Excess Capacity (GFSEC)

- Est. in German G20 presidency for 3 years to promote multilateral dialogue and cooperation on steel excess capacity. Extended in Tokyo 2019 for 3 years. OECD acts as facilitator.
- No longer includes major EMs (China, KSA, India, Indonesia); invitation to (re)join.
- Ministerial took place on 1 October; current mandate ends in 2022.

OECD Recommendation on Competitive Neutrality

- Competition and trade policy, implications global markets
- Definitions SOEs

US-EU

- **Trade and Technology Council (TTC), Pittsburgh on 29 September 2021,**
 - Work closely together to address global challenges, including unfair trade policies and practices
 - Desire to co-operate and adopt co-ordinated approaches for improving their domestic tools to tackle such policies and practices
 - Working group on ‘Global Trade Challenges’, focus *inter alia* on potential co-operation in dealing with the challenges posed by non-market economic policies and practices.
- **Steel and aluminium deal**
 - TRQs
 - Environmental aspects

- **Need to strengthen rules**
 - Address gaps -- below market finance
 - Usability: evidence, onus
- **Start with transparency**
 - WTO notification gaps – how improve?
 - Link to wider transparency discussions
 - Role for WTO Secretariat? Other IOs?
 - Expand information on government investment
 - Insufficient information on government ownership of companies
- **Government support needs to be addressed multilaterally**
 - Transparency (what's going on)
 - Predictability (lock in)
 - Reduction (starting with the most egregious)
 - Prevention (tomorrow's subsidisers in tomorrow's sectors)



International action, but all multilateralism is local

- Need to **make the domestic case for global policy reform**
- **Government support can be self-defeating**
 - Subnational competition
 - Impacts on productivity
 - Negative correlation to cheap loans
- **Is support achieving its claimed objectives – or doing so efficiently?**
 - Who pays, who benefits?
- **Opportunity costs of scarce public resources**
 - Investments in the public interest (education, digital infrastructure, health systems!)

Thank you – and contact us

We look forward to hearing from you!



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