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ARTICLE

Special Issue: The Resurgence of the State as an Economic Actor–International Trade Law and State Intervention in the Economy in the Covid Era

Unpacking the Black Box of China's State Capitalism

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Abstract

Much ink has been splashed on the ideological, conceptual, and practical challenges that China's state capitalism has posed to global trade rules. There is a growing perception that the current international trade rules are neither conceptually coherent nor practically effective in tackling China's state capitalism. This perception has not only led to the emergence of new trade rules in regional trade agreements, but also culminated in the US-China trade war, only further aggravated by the Covid-19 pandemic. This Article contributes to the debate of what trade rules may be needed to counteract China's state capitalism by unpacking the black box of China's state capitalism. Based on an analysis of the nature of China's state capitalism, this Article provides a preliminary evaluation of current trade rules taken to counteract China's state capitalism, in particular the new rules in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, and explain why they are unlikely to be successful.

Keywords: State-owned Enterprises; Party Committee; China; WTO; Comprehensive and Progressive Agreement for Trans-Pacific Partnership

A. Introduction

There is no unified definition of the term "state capitalism," despite its wide use in the economics, finance, management, international business, and legal literature. Scholars have deployed the concept to refer to an extremely wide array of practices, policy instruments and vehicles, institutional forms, relations, and networks that involve the state to different degrees and at a variety of levels, time frames, and scales.[1] In this Article, state capitalism is seen as a particular organizational and governance form in emerging and transition economies. It refers to an economic system in which the state uses various tools for proactive intervention in economic production and the functioning of markets.[2]

[1]*See* Ilias Alami & Adam D. Dixon, *State Capitalism(s) Redux? Theories, Tensions, Controversies*, 24 Competition & Change 70, 71 (2020).

[2]*See* Mike Wright, Geoffrey Wood, Aldo Musacchio, Ilya Okhmatovskiy, Anna Grosman & Jonathan P. Doh, *State Capitalism in International Context: Varieties and Variations* 56 J. World Bus. 2 (2021).

State capitalism is not new. It has been around for almost as long as capitalism itself. Every rising power has relied on the state to kickstart growth or at least to protect fragile industries.[3] State capitalism had a gradual global expansion between the late nineteenth century and the 1970s, during which state-owned enterprises (SOEs) were considered as necessary solutions for coordination problems and market failures and as an important tool to overcome the difficulties of regulating certain natural monopolies.[4] However, as a consequence of the oil shocks of the 1970s and the global liquidity crisis of the early 1980s, governments began to rethink the role of SOEs in the state apparatus and a major overhaul of systems of state capitalism through massive privatization programs started in the 1980s and 1990s.[5] Yet the privatization itself was not as sweeping as what was portrayed in the literature. Governments around the world kept large SOEs, either because they were in politically sensitive industries or simply because it was difficult to privatize them.[6]

Since the early 2000s, state capitalism has re-emerged as a genuine challenge to free-market capitalism. Two main reasons account for the recent comeback of state capitalism. For one, the height of the post-Cold War global wave of democratization in the developing world has stalled and gone into reverse.[7] State capitalism can be an effect of the rollback of political reform combined with extensive state involvement in the economy being an entrenched characteristic with long historical roots in the emerging markets and in the post-socialist countries.[8] The second reason is the failing of the Washington Consensus which captured the imaginations of developing countries in pursuing economic development in the 1990s.[9] The financial crisis has further enhanced the appeal of state capitalism. Around the world, economists, policymakers, and ordinary citizens have increasingly come to see neoliberalism has reached its limits.[10]

The rise of state capitalism has brought about a wide range of concerns. Some of these concerns are that state capitalism will foster democratic regression, which will further undermine political stability in some strategically important developing countries; that state capitalism fails in the long run so badly that it may be a cause of major economic collapses in developing nations, taking down the rest of their regions and seriously undermining the world economy; and that, if state capitalism succeeds in the long term, it could help China and other authoritarian but efficient state capitalists to remake the liberal international economic system, amass strategic power, and potentially use SOEs as weapons of trade and investment policy.[11] It is now widely acknowledged that the competition of liberal capitalism and the state capitalism, with the United States and China as their leading example respectively, will shape the future of the global economy.[12]

State capitalism has come in different varieties.[13] China is by far the biggest and most influential torch bearer of state capitalism. For example, even if market-oriented reforms have led to a

[3]*See generally* HA-JOON CHANG, KICK AWAY THE LADDER: DEVELOPMENT STRATEGY IN HISTORICAL PERSPECTIVES 13–68 (2002).

[4]*See* THE RISE AND FALL OF STATE-OWNED ENTERPRISE IN THE WESTERN WORLD 14–21 (Pier Angelo Toninelli ed. 2000).

[5]*See* ALDO MUSACCHIO & SERGIO G. LAZZARINI, REINVENTING STATE CAPITALISM: LEVIATHAN IN BUSINESS, BRAZIL AND BEYOND 39–45 (2014).

[6]*See* Bernardo Bortolotti & Mara Faccio, *Government Control of Privatized Firms*, 22 REV. FIN. STUD. 2907, 2908–2909 (2009).

[7]*See* Anna Lührmann & Staffan I. Lindberg, *A Third Wave of Autocratization is Here: What is New About It?*, 26 DEMOCRATIZATION 1095, 1096–1097 (2019).

[8]*See* Judit Ricz, *New Developmentalism in the 21st Century: Towards a New Research Agenda*, 245 INST. WORLD ECON. 3 (2018).

[9]*See* Dani Rodrik, *Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's Economic Growth in the 1990s: Learning from a Decade of Reform*, 44 J. ECON. LIT. 973, 975–976 (2006).

[10]*See* Miatta Fahnbulleh, *The Neoliberal Collapse*, FOREIGN AFF. 38 (2020).

[11]*See* JOSHUA KURLANTZICK, STATE CAPITALISM: HOW THE RETURN OF STATISM IS TRANSFORMING THE WORLD 72–73 (2016).

[12]*See* Branko Milanovic, *The Clash of Capitalisms*, 10 FOREIGN AFF. 12 (2020).

[13]*See* Wright et al., *supra* note 2, at 6.

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rapid expansion of the private sector in China, SOEs continue to dominate commanding heights of the Chinese economy.[14] There are more than 150,000 SOEs in China today and their share in employment was between 5 percent and 16 percent in 2017.[15] The evidence confirms that China's economy has in some respects become more state-controlled since the 1990s and early 2000s. In the mid-1990s, China's SOEs contributed to only about 10 percent of China's annual gross domestic product (GDP), but by 2017, SOEs had grown so much that they contributed to 23 to 28 percent of China's GDP, even though the total number of SOEs has reduced.[16] More than one thousand SOEs are listed on China's stock markets, accounting for 44 percent of total market capitalization and 50 percent of revenues of publicly listed companies.[17] In 2021, 143 Chinese firms appeared on the list of Fortune Global 500, among which 82 were SOEs.[18] It has been widely accepted that SOEs are, and will be, a hallmark of China's state capitalism model, rather than a transitional phenomenon leading to liberal capitalism as many critics of SOEs had expected.[19]

Not only do Chinese SOEs play a key role in China's domestic economy, they are also an important player in international trade as well as a major force in implementing the Government of China (GOC)'s ambitious "Go Out" strategy and more recently the Belt and Road Initiative (BRI), the Chinese paramount leader Xi Jinping's signature foreign policy undertaking.[20] Earlier statistics showed that at least 80 percent of all China's outbound foreign direct investment was funded by SOEs. With the growing strength of privately-owned enterprises (POEs) in China, a smaller proportion of China's outbound investment is coming from SOEs. Still, the evidence shows that of 650 Chinese investments in Europe from 2010 to 2020, roughly 40 percent have moderate to high involvement by state-owned or state-controlled companies.[21] As of October 2018, Chinese SOEs contracted about half of BRI projects by number and more than 70 percent by project value.[22] Indeed, Chinese SOEs lie at the center of China's top-down, state-driven trade strategy to push for indigenous innovation, driving self-sufficiency, and enhancing national security.[23]

The expansion of Chinese SOEs' global footprint has caused widespread concerns about their implications for national security, fair competition, reciprocity, transparency, corruption, the function of free market at home and the future of the rule-based liberal international economic order.[24]

[14]There is no uniform definition of SOEs in part because of the ambiguity about the degree of state ownership or control needed to be call an SOE. The OECD defines it as "any corporate entity recognized by national law as an enterprise, and in which the state exercises ownership." Ownership is understood to imply control, either by the state holding full or majority of voting shares or otherwise exercising an equivalent degree of control. Examples of equivalent degree of control would include, for instance, cases where legal stipulations or corporate articles of association ensure continued state control over an enterprise or its board of directors in which it holds a minority stake. Entities in which the government holds equity stakes of less than ten percent that do not confer control are excluded. *See Guidelines on Corporate Governance of State-Owned Enterprises*, Organisation for Economic Co-Operation and Development ["OECD"] 14–15 (2015).

[15]*See* Chunlin Zhang, *How Much Do State-Owned Enterprises Contribute to China's GDP and Employment?* (The World Bank, Working Paper, 2019), https://documents1.worldbank.org/curated/en/449701565248091726/pdf/How-Much-Do-State-Owned-Enterprises-Contribute-to-China-s-GDP-and-Employment.pdf.

[16]*See id.*

[17]*See* Xianchu Zhang, *Integration of CCP Leadership with Corporate Governance: Leading Role or Dismemberment?*, 2019-1 China Perspectives 55, 57 (2019).

[18]*See Global 500,* Fortune (2021), https://fortune.com/global500/2021/search/?fg500_country=China.

[19]*See* Jude Blanchette, *Confronting the Challenge of Chinese State Capitalism, CSIS Global Forecast*, Ctr Strategic & Int'l Stud. (Jan. 22, 2021), https://www.csis.org/analysis/confronting-challenge-chinese-state-capitalism.

[20]*See* Andrew Chatzky & James McBride, *China's Massive Belt and Road Initiative Backgrounder*, Couns. on Foreign Rel. (2019), https://www.cfr.org/backgrounder/chinas-massive-belt-and-road-initiative; Robert J.R. Elliot & Ying Zhou, *State-Owned Enterprises, Exporting and Productivity in China: A Stochastic Dominance Approach* 36 World Econ. 1000, 1001 (2013).

[21]*See* Daniel Michaels, *Behind China's Decade of European Deals, State Investors Evade Notice*, Wall St. J. (2020).

[22]*See* Rafiq Dossani, Jennifer Bouey & Keren Zhu, *Demystifying the Belt and Road Initiative* at 13–15 (Rand Corp., Working Paper No. 1338, 2020), https://www.rand.org/pubs/working_papers/WR1338.html.

[23]*See Economic Power Play: Assessing China's Trade Policies*, The Economist Intelligence Unit, 8–9 (2021), https://impact.economist.com/perspectives/sites/default/files/economic_power_play_assessing_chinas_trade_policies_0608.pdf.

[24]*See State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?*, OECD 52–53 (2016), https://read.oecd-ilibrary.org/finance-and-investment/state-owned-enterprises-as-global-competitors_9789264262096-en.

Concomitant to the rise of China's state capitalism, there is a growing perception that the current WTO rules are neither conceptually coherent nor practically effective in tackling heterodox institutional forms such as China's state capitalism because the multilateral trade regime that took shape in the post-war period simply did not anticipate many of the special features of China's state capitalism.[25] Consequently, states such as the United States have resorted to unilateral trade measure to counteract Chinese SOEs' competitive advantages in international economy.[26] On the international front, states have adopted new trade rules in regulating SOEs' behavior through bilateral and regional free trade agreements (FTAs). *Different from earlier FTAs, a separate and extensive SOE chapter features in almost all new-generation mega-regional FTAs, such as the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), the United States-Mexico-Canada Agreement (USMCA), and the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the EU-China Comprehensive Investment Agreement (CAI)*[27] Significantly, China formally submitted a request to accede to the CPTPP in September 2021.[28] China's accession request is a clear indication that China is prepared to accept the SOE rules embodied in the CPTPP. Yet there are serious doubts about the effectiveness of the new trade norms on SOEs, arguing that they add little beyond the WTO rules and the rules contained in China's WTO Accession Protocol.[29]

This Article is premised on the assumption that diagnosis should precede prescription. Although public debates have demonstrated deep anxiety over the resurgence of China's state capitalism in global economy, the features, institutional mechanisms, and global trade implications of China's state capitalism remain poorly understood. This Article contributes to the debate of what trade rules may be needed to counteract China's state capitalism by unpacking the black box of China's state capitalism: how is this model embedded in China's political and economic context? What are the pros and cons of China's state capitalism model? How has the model evolved in the Xi Jinping era in light of new waves of SOE reforms? Armed with an exploration of the nature of China's state capitalism, this Article will proceed to an evaluation of new trade rules in FTAs designed to counteract China's state capitalism. Although the new rules on subsidies and SOEs in FTAs represent an important improvement over the WTO disciplines,[30] this Article seeks to explain why they are unlikely to be successful when applying to Chinese SOEs.

The Article proceeds as follows. Part B introduces the debate on the pros and cons of China's state capitalism model. Part C provides an overview of China's SOE reforms in the past four decades, highlighting the close relationship between Chinese SOEs and the Chinese Party-state and the blurred boundary between SOEs and large successful POEs in China. Part D explores whether the new SOE rules in mega-regional FTAs, in particular the CPTPP, are fit for purpose when applying to Chinese SOEs. It argues that although the new SOE norms in the CPTPP are promising, it is far from clear that they will be effective in constraining Chinese SOEs. This Article ends with a short conclusion that reflects on the tenacious challenges of Chinese SOEs to the

[25]*See*, *e.g.*, Mark Wu, *The "China, Inc." Challenge to Global Trade Governance*, 57 HARV. INT'L L. J. 261, 285 (2016); Petros C. Mavroidis & Andre Sapir, *China and the WTO: Why Multilateralism Still Matters* 162–166 (2021).

[26]*See* Patricia Zengerle and Michael Martina, *U.S. House Backs Sweeping China Competition Bill as Olympics Start*, Reuters (Feb. 4, 2022), https://www.reuters.com/world/us/us-house-set-pass-sweeping-vote-china-competition-bill-2022-02-04/; *see also* European Commission Press Release IP/21/1982, *Commission Proposes New Regulation to Address Distortions Caused by Foreign Subsidies in the Single Marke*t (May 5, 2021).

[27]*See* Chapter 18 of the CPTPP (concluded on March 8, 2018); Chapter 22 of the USMCA (concluded on September 30, 2018); Chapter 18 of the CETA (concluded on September 26, 2014) and Article 3bis in Section II of the CAI (concluded on December 30, 2020).

[28]*See* Eleanor Olcott, *China Seeks to Join Transpacific Trade Pact*, FIN. TIMES (Sept. 16, 2021) https://www.ft.com/content/df94b345-8fb9-473f-8e58-0cb230c0a1fa.

[29]*See* Weihuan Zhou, *Rethinking the CPTPP as a Model for Regulation of Chinese State-Owned Enterprises*, 24 J. INT'L ECON. L. 572, 578–588 (2021); *see also* Jaemin Lee, *The "Indirect Support" Loophole in the New SOE Norms: An Intentional Choice or Inadvertent Mistake?* 20 CHINESE J. INT'L L. 63 (2021).

[30]*See* Leonardo Borlini & Claudio Dordi, *Deepening International Systems of Subsidy Control in EU PTAs: A Comparative Analysis. Normative Rationales and Legal Implications,* 23 COLUM. J. EUR. L., 551, 551–606 (2017).

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liberal international trade order and urges the GOC to utilize external pressure as incentive to push forward market-oriented SOE reforms.

B. The Debate on China's State Capitalism

For a long time, leading Western economists have been questioning whether China's state capitalism is a sustainable development model that could succeed in the long term. For example, China collapse theorists have been touting China's coming financial and economic meltdown caused by the failure of state economic policies for over two decades.[31] However, there is mounting evidence that China's state capitalism is far more resilient than was conventionally assumed. Given the right conditions, China's state capitalism *may* work as a long-term economic strategy, and it could be a serious competitor for the free market model in the twenty-first century.[32]

Indeed, China's meteoric economic rise has challenged some fundamental assumptions of the superiority of free market capitalism. As Xi Jinping has highlighted, one key advantage of China's state capitalism is to enable the Chinese government to make decisions efficiently, to coordinate the efforts and to mobilize the resources across the whole country to accomplish large undertakings.[33] That is true to some extent. For example, China's state capitalism has enjoyed some tremendous success in building infrastructure projects. At the beginning of the 21st century, China had no high-speed railways. Today China has by far the world's largest network of high-speed railways. No fewer than 37,900 kilometers (approximately 23,500 miles) of lines crisscross the country, linking all of its major mega-city clusters, and all have been completed since 2008.[34] China's mobile-phone network is the world's largest, and China boasts the world's biggest number of internet users, nearly 1 billion by the end of 2020.[35]

Nevertheless, it has long been argued that although China's state capitalism system is good at infrastructure projects, it is not so good at innovation. Josh Lerner famously described state-sponsored innovation as a "boulevard of broken dreams."[36] Relying on a seemingly limitless supply of cheap labor, China devoted itself to the production of other countries' innovations and earned a reputation as a global copycat. With its pool of younger workers shrinking, China will have to rely on innovation instead. But China is not innovation-friendly because the political world in which the business needs to operate is very much bounded.[37] That view was recently challenged by an alternative proposition that one should recognize that state capitalists are copying and innovating at the same time, and that the state's role in promoting innovation cannot be simply ignored. For instance, one feature of China's innovation ecosystem is that hundreds of millions of Chinese consumers have developed an astonishing propensity for adopting and adapting to innovations. That gives China a huge innovation advantage because innovations must be judged by people's willingness to use them.[38]

[31]*See, e.g.*, GORDON G. CHANG, THE COMING COLLAPSE OF CHINA 256–283 (2d Rev. ed. 2003); JAMES R. GORRIE, THE CHINA CRISIS: HOW CHINA'S ECONOMIC COLLAPSE WILL LEAD TO A GLOBAL DEPRESSION 99–105 (2013).

[32]*See* Kurlantzick, *supra* note 11, at 176.

[33]*See* Xi Jinping, *Resolution of the Central Committee of the Communist Party of China on the Major Achievements and Historical Experience of the Party Over the Past Century* (Nov. 11, 2021), http://www.gov.cn/zhengce/2021-11/16/content_5651269.html.

[34]*See* Ben Jones, *Past, Present and Future: The Evolution of China's Incredible High-Speed Rail Network*, CNN (Feb. 9, 2022), https://www.cnn.com/travel/article/china-high-speed-rail-cmd/index.html.

[35]*See* Palash Ghosh, *China Now Has Almost 1 Billion Internet Users*, FORBES (Feb. 4, 2021), https://www.forbes.com/sites/palashghosh/2021/02/04/china-now-has-almost-1-billion-internet-users/?sh=641d2eed26d9.

[36]JOSH LERNER, BOULEVARD OF BROKEN DREAMS: WHY PUBLIC EFFORTS TO BOOST ENTREPRENEURSHIP AND VENTURE CAPITAL HAVE FAILED—AND WHAT TO DO ABOUT IT (2009).

[37]*See* Regina M. Abrami, William C. Kirby & F. Warren McFarlan, *Why China Can't Innovate*, HARV. BUS. REV. 107, 111 (Mar. 2014).

[38]*See* Zak Dychtwald, *China's New Innovation Advantage*, HARV. BUS. REV. (May 2021), at 55, 57–58.

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Another example is the efficiency of Chinese SOEs. The majority of the empirical literature found that Chinese SOEs performed poorly compared to POEs both for financial performance and innovation.[39] As mighty leviathans of the Chinese planned economy, Chinese SOEs were long depicted as "muscle-bound goons" or the "relics of a failed economic experiment," characterized as possessing a lack of managerial flair, little concern for profit, low employee motivation and mobility, and a tendency to maximize corporate size.[40] A variety of reasons account for the relatively poor performance of SOEs. To begin with, the classic agency theory suggests that the separation of ownership and control in large firms gives rise to a misalignment of incentives between shareholders and managers. Managers may pursue a personal agenda for their own interests rather than work for the interest of shareholders.[41] The agency problem is exacerbated in SOEs due to the weak monitoring of state assets caused by high costs of monitoring, as well as the lack of incentives on the part of supervisory government officials who represent the state.[42] Another cause of inefficiency of state ownership is the so-called "soft budget constraint" problem. When SOEs face financial distress, the government often bails them out because the state is ultimately accountable for the losses of SOEs. SOEs could count on surviving even after chronic losses.[43] Finally, during the process of China's economic development, SOEs are not only expected to be profit-oriented, but also to fulfill various government policy objectives, such as maintaining the employment of redundant workers which contributed to social stability, developing national strategic industries, leading sectoral and regional restructuring, maintaining macroeconomic stability by increasing investment when growth slows, and even contributing to natural disaster management.[44] The policy burdens negatively affect Chinese SOEs' investment decisions and corporate performance.[45]

However, it is not always the case that SOEs perform poorly compared to POEs. The relationship between state ownership and the financial performance of firms varies greatly across national contexts. For example, Singapore's government-owned companies are comparable to the most profitable POEs in efficiency.[46] One recent IMF research study suggests that SOEs perform as well as POEs in core sectors (mining, electricity and gas, water, and transport) when corruption is low.[47] Others found that the political ideology of the government (e.g., economic liberals or

[39]*See, e.g.*, Ann Harrison, Marshall Meyer, Peichun Wang, Linda Zhao & Minyuan Zhao, *Can a Tiger Change Its Stripes? Reform of Chinese State-Owned Enterprises in the Penumbra of the State* 4–6 (Nat'l Bureau of Econ. Rsch., Working Paper No. 25475, Jan. 2019), https://www.nber.org/papers/w25475; Shang-Jin Wei, Zhuan Xie & Xiaobo Zhang, *From "Made in China" to "Innovated in China": Necessity, Prospect, and Challenges*, 31 J. ECON. PERSP. 49, 51 (2017).

[40]John Hassard, Jonathan Morris, Jackie Sheehan & Xiao Yuxin, *China's State-Owned Enterprises: Economic Reform and Organizational Restructuring*, 23 J. ORG. CHANGE MGMT. 500, 501 (2010).

[41]*See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–309 (1976).

[42]*See* Curtis J. Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and Chinese Firm* 103 GEO. L. J. 665, 676–678 (2015); Nguyet Thi Minh Phi, Farhad Taghizadeh-Hesary, Anh Tu Chuc, Naoyuki Yoshino & Chul-Ju Kim, *Performance Differential Between Private and State-Owned Enterprises: An Analysis of Profitability and Leverage* 1, 2 (Asian Dev. Bank Inst., Working Paper No. 950, May 2019), https://www.adb.org/publications/performance-differential-between-private-state-owned-enterprises.

[43]*See* János Kornai, Eric Maskin & Géard Roland, *Understanding the Soft Budget Constraint* 41 J. ECON. LIT. 1095, 1096–1097 (2003).

[44]*See* Chong-En Bai, Jiangyong Lu & Zhigang Tao, *The Multitask Theory of State Enterprise Reform: Empirical Evidence from China*, 96 AM. ECON. R. 353, 354 (2006).

[45]*See, e.g.*, Justin Yifu Lin & Zhiyun Li, *Policy Burden, Privatization and Soft Budget Constraint*, 36 J. Comp. Econ. 90, 92–93 (2008); Ying Hao & Jing Lu, *The Impact of Government Intervention on Corporate Investment Allocations and Efficiency: Evidence from China*, 47 FIN. MGMT. 383, 415 (2018).

[46]*See* Fang Feng, Qian Sun & Wilson Tong, *Do Government-Linked Companies Underperform*, 28 J. BANKING & FIN. 2461, 2486–2487 (2004).

[47]*See* Anja Baum, Clay Hackney, Paulo Medas & Mouhamadou Sy, *Governance and State-Owned Enterprises: How Costly is Corruption?* 5 (Int'l Monetary Fund, Working Paper No. 253, Nov. 2019), https://www.imf.org/en/Publications/WP/Issues/2019/11/22/Governance-and-State-Owned-Enterprises-How-Costly-is-Corruption-48800.

economic socialists), both independently and in conjunction with political institutions (state capacity and political constraint) affects the financial performance of SOEs.[48] It is also argued that China's SOEs have a positive impact on China's long-term economic growth by undertaking policy burdens because SOEs stabilize growth in economic downturns by carrying out massive investments; promote technical progress by investing in riskier areas of technology; and follow a high-road approach to compensation and benefits which is favorable for China to move toward a more sustainable growth model in the future.[49]

As will be examined closely in Part C below, it is unrealistic today to uphold the simplistic and pessimistic view of Chinese SOEs as industrial dinosaurs fit only for dismemberment or bankruptcy after extensive reforms over the past four decades. Chinese SOEs have vastly improved their corporate governance and financial performance, some of which can rival the best private-sector multinational corporations in the world.[50] They have become competitive by leading on new technologies, finding niches, exploiting economies of scale, using cheaper labor, working harder, and making investments that pay off, other than relying on domestic monopolies and state supports.[51] Significantly, Chinese SOEs are no longer content to dominate China's domestic market. They have proactively engaged in global partnerships and acquisitions, aiming to become global champions.[52]

My argument is not that China' SOEs are as efficient as or even better than POEs. The point is simply that Chinese SOEs have drastically improved their performance and that they are serious competitors to private multinationals in global markets. More importantly, even if China's SOEs are not so efficient economically, they will continue to exist for the foreseeable future for political reasons.[53] In the Chinese context, as an authoritarian Party-state, the Chinese Communist Party (CCP) cannot base its political legitimacy on free democratic elections. To cling on to power, the CCP has to ensure that it controls sufficient economic, political, and social resources.[54] Given the economic might of Chinese SOEs, they are in essence the economic foundation of the CCP's power base. As Xi Jinping unequivocally stated, SOEs are "an important material and political basis for socialism with Chinese characteristics, serving as a key pillar and supporting force for the Party to govern and prop up the country."[55] Ideologically, still upholding Marxism-Leninism and Mao Thought as guiding ideology, at least rhetorically, the primary goal of China's economic reforms is to build a socialist market economy with the state-owned sector as a leading sector.[56] The political connections that SOEs have with the CCP as the sole ruling party in China and the strong ideological preference in favor of SOEs allow them to capture the political decision that SOEs must be kept and improved, rather than fully privatized.[57] Therefore, the issue of giving autonomy to SOEs and making them truly independent market entities on the one hand and strengthening monitoring

[48] *See* Ruth Aguilera, Patricio Duran, P.P.M.A.R. Heugens, Steve Sauerwald, Roxana Turturea & Marc VanEssen, *State Ownership, Political Ideology, and Firm Performance around the World*, 56 J. WORLD BUS. 2 (2021).

[49] *See* Hao Qi & David M. Kotz, *The Impact of State-Owned Enterprises on China's Economic Growth* 52 REV. RADICAL POL. ECON. 96, 112 (2020).

[50] *See* Liwen Lin, *A Network Anatomy of Chinese State-Owned Enterprises* 16 WORLD TRADE REV. 583, 593 (2017).

[51] *See* Dani Rodrik, *China as Economic Bogeyman*, PROJECT SYNDICATE (July 9, 2020), https://www.project-syndicate.org/commentary/west-should-stop-criticizing-china-industrial-policy-by-dani-rodrik-2020-07.

[52] *See* Sidney Leng, *China's State-Owned Giants Given New Order: Create Global Industrial Champions*, S. CHINA MORNING POST (Aug. 11 2020), https://www.scmp.com/economy/global-economy/article/3096924/chinas-state-owned-giants-given-new-order-create-global.

[53] *See* Andrei Shleifer & Robert W. Vishny, *Politicians and Firms*, 109 Q. J. ECON. 995, 995–997 (1994).

[54] *See* Jiangyu Wang, *The Political Logic of Corporate Governance in China's State-Owned Enterprises*, 47 CORNELL INT'L L. J. 631, 660–661 (2014).

[55] Xi Jinping, *Upholding the Party Leadership over SOEs Unwaveringly*, PEOPLE'S DAILY (Oct. 12, 2016), http://en.people.cn/n3/2018/1218/c90000-9529701.html.

[56] *See* XIANFA art. 7 (1982) (China).

[57] *See* Paul Dragos Aligica & Vlad Tarko, *State Capitalism and the Rent-Seeking Conjecture* 23 CONST. POL. ECON. 357, 375–376 (2012); *see also* Kemel Toktomushev, *China and Its Zombies: Traps of State-Owned Enterprises*, CHINAUS FOCUS (Nov. 27, 2020), https://www.chinausfocus.com/finance-economy/china-and-its-zombies-traps-of-state-owned-enterprises.

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of SOEs and making more and more demands on SOEs on the other hand, has been a recurrent issue in Chinese SOE reforms. It is precisely within this complex institutional environment that Chinese SOEs have evolved and transformed over the past four decades.

Nor do I argue that China's state capitalism model is more advantageous than free market capitalism or that it is the best development strategy that other developing countries should consider following. It may be the case that state capitalism may work well in some areas but not so well in others. It is also possible for state capitalism to boost growth at one stage of development and impede it at another.[58] Nevertheless, it is submitted that there is strong evidence that China's state capitalism has been successful enough by the standards of developing countries at any time in history to allow for growth, that it can be maintained for a long time, and that it has created a degree of legitimacy and stability for the government.[59] It is now clear that the Chinese government no longer sees state capitalism as a way-station on the road to liberal capitalism; rather, it is seen as a sustainable model in its own right.[60]

C. The Transformation of China's SOEs

SOEs have existed in China for many years, but their form, function, and implications for the global economy have changed dramatically over the past decade. To grasp the nature of Chinese SOEs, it is essential to understand China's economic and institutional transformation from a socialist planned economy to a socialist market economy with the state-owned sector as a leading sector. The reform of Chinese SOEs lies at the center of this grand economic transformation.[61] When SOE reform started in the early 1980s, SOE reforms were deemed to be necessary in order to reduce economic losses, increase economic growth and raise living standards, from which the Chinese Communist Party (CPP) derives its governing legitimacy.[62] Fast forward now to the twenty-first century. Not only have Chinese SOEs survived in the ecology of business organizations, but they also evolved into major players in both the domestic and the global economy.[63]

I. An Overview of China's SOE Reforms (1978–2021)

1. China's SOE Reforms before 2012

After the CCP defeated the Nationalist Party and founded the People's Republic of China in 1949, the communist regime discarded the previous market economic order and, emulating the Soviet Union, created a socialist planned economy.[64] The new economic structure was, by and large, a replica of the Leninist model of a "state syndicate," in which state ownership was the sole basis of almost all economic activities.[65] In the socialist planned economy era, SOEs were basically production units rather than autonomous profit-seeking corporations. The absence of autonomy and incentives were widely recognized as the central problems facing SOEs in the period prior to

[58] *See Visible Hand*, THE ECONOMIST (Jan. 21, 2012), https://www.economist.com/special-report/2012/01/21/the-visible-hand.

[59] *See* Kurlantzick, *supra* note 11, at 98.

[60] *See* Alberto Gabriele, *The Role of the State in China's Industrial Development: A Reassessment*, 52 COMP. ECON. STUD. 348 (2010).

[61] *See* INTRODUCTION TO STATE CAPITALISM, INSTITUTIONAL ADAPTATION AND THE CHINESE MIRACLE 2 (Barry Naughton & Kellee S. Tsai eds., 2015).

[62] *See* Xi Li, Xuewen Liu & Yong Wang, *A Model of China's State Capitalism* 5 (H.K. Univ. Sci. Tech. Inst. Emerging Mkt. Stud., Working Paper No. 201512, Feb. 2015), =http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2061521.

[63] *See* Barry Naughton, *The Current Wave of State Enterprise Reform in China: A Preliminary Appraisal*, 12 ASIAN ECON. POL. REV. 282, 289 (2017).

[64] *See* IMMANUEL CY HSU, THE RISE OF MODERN CHINA 643 (6th ed. 1999).

[65] *See* Wang Lixin & Joseph Fesmith, Wang Lixin & Joseph Fesmith, *Bulwark of the Planned Economy: The Structure and Role of the State Planning Commission*, in DECISION-MAKING IN DENG'S CHINA 52 (Carol Lee Harmrin & Suisheng Zhao eds., 1995).

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SOE reform.[66] Since the historic decision in 1978 to reform and open up the economy, the GOC has taken a gradual, experimental and pragmatic approach—known as "crossing the river by touching the stone"—to bring about the reform of Chinese SOEs.[67]

China's SOE reforms had gone through three distinct phases before Xi Jinping came to power in 2012. The first phase ran from the early 1980s until the early 1990s. Due to strong ideological and political perceptions of the need for the state to control all critical means of production, state ownership of SOEs remained intact in the first phase. Inspired by the success of the household responsibility system in the rural reforms in the early 1980s, reform measures in the first phase focused on increasing SOE autonomy and introducing a market mechanism to improve the performance of SOEs.[68] The contract responsibility system was introduced in 1985 to create a formalized relationship between most small and mediumsized SOEs and the government. Under the contract responsibility system, SOE managers signed contracts with the government giving them the right to run day-to-day operation and greater emphasis on SOEs' responsibilities for profits and losses. Nevertheless, the firm remained a state asset. Profits were shared between the SOEs and the state in accordance with the terms of the contract.[69]

The contract responsibility system entailed the emergence of industrial product markets and competition among SOEs. There was evidence that SOEs made some productivity gains as a result of these firm-level reforms.[70] However, it was soon viewed as inherently flawed because it did not solve the short-termism of management behavior. Managers were rewarded for their successes but not punished for their failures. This enabled managers to exploit their effective control over SOE assets for personal benefit at the expense of the state, damaging firms' long-term development. The lack of adequate monitoring after SOEs were given managerial autonomy further contributed to SOEs' poor performance.[71]

The development of township and village enterprises (TVEs) and foreign-invested enterprises (FIEs) during this period deepened the woes of SOEs. Due to increasing competition from the private sector, SOEs stacked up huge losses.[72] In aggregate, China's industrial SOEs no longer provided net revenues for the government and absorbed fiscal and quasi-fiscal resources that were estimated to be as large as 5 percent of the national GDP in the early 1990s.[73] The mounting losses put substantial pressure on government revenue, its fiscal burdens and banking stability and were a key factor leading to further reforms.[74]

The second phase of China's SOE reforms commenced after the historic Southern tour of Deng Xiaoping in 1992. This period was characterized by drastic ownership restructuring, with a focus on reducing the government's holdings of SOE assets through partial or full privatization. In practice,

[66] *See* Becky Chiu & Mervyn K. Lewis, Reforming China's State-Owned Enterprises and Banks 61 (Edward Elgar Pub. 2006).

[67] *See* Xu Chenggang, *The Fundamental Institutions of China's Reforms and Development* 49 J. Econ. Lit. 1076–1151 (2011); *see also* Justin Lin, Fang Cai & Zhou Li, *Competition, Policy Burdens, and State-Owned Enterprise Reform* 88 Am. Econ. Rev. 422–27 (1998).

[68] *See* Ligang Song, *State-Owned Enterprises Reform in China: Past, Present and Prospects in* China's 40 Years of Reform and Development (1978–2018) 345, 349 (Ross Garnaut Ligang Song & Cai Fang eds. 2018).

[69] *See* Li Wei, *The Impact of Economic Reform on the Performance of Chinese State Sector Enterprises: 19801989,* 105 J. Pol. Econ. 1080–1106 (1997).

[70] Mary M. Shirley & Colin Xu, *Empirical Evidence of Performance Contracts: Evidence from China* 17 J. L. Econ. & Org. 168–200 (2001).

[71] Yingyi Qian, *Enterprise Reform in China: Agency Problems and Political Control*, 4 Econ. in Transition 427–447 (1996).

[72] *See* Shaomin Li, Shuhe Li & Weiying Zhang, *The Road to Capitalism: Competition and Institutional Change in China*, 28 J. Compar. Econ. 269–292 (2000); Cao Yuanzheng, Yingyi Qian & Barry B. Weingast, *From Federalism, Chinese Style to Privatization, Chinese Style*, 7 Econ. in Transition 103–131 (1999).

[73] *See* Fan Gang & Nicolas C. Hope, *US China Economic Relations in the Next Ten Years* ch. 16 at 5 (China–U.S. Exchange Foundation, 2013).

[74] *See* Ross Garnaut, Ligang Song & Yang Yao, *Impact and Significance of State-Owned Enterprise Restructuring in China*, 55 China J. 35, 37 (2006).

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corporatization was seen as a means of achieving ownership restructuring. The first general Chinese Company Law was enacted in order to provide for the incorporation of SOEs in 1994. Thereafter, newly corporatized SOEs proliferated all over the country.[75] Along with corporatization, central to SOE reforms in the 1990s was the policy of "nurturing the large and letting go of the small" adopted in 1995, a reference to the policy of concentrating the government's resources and control on the larger SOEs in strategic and profitable sectors, while relaxing state control over smaller SOEs and retreating from labor-intensive competitive sectors.[76] The economic logic behind this policy was that the large firms performed much better than the smaller firms and had greater importance in the economy. Many small and medium-sized SOEs were assessed for reorganization, bankruptcy, debt write-offs, merger into partnerships, leasing, contractual operation, or sales.[77]

It is vital to understand that the corporatization of Chinese SOEs did not initially and to this day does not implicate privatization of the Chinese economy or its traditional SOEs, much less any withdrawal of the Party State from the corporatized SOEs. This is because even if the incumbent Party state no longer wholly owns 100 percent of equity interest in most newly corporatized SOEs, it retains a controlling equity interest in many of them. Thus, the corporatization of SOEs leaves the control of the Party state over SOEs largely undisturbed.[78] China's "corporatization without privatization" SOE reform has the dual effects of reducing the government's cost burden from inefficient SOEs and creating opportunities for POEs to expand.[79] After this round of reform, the state sector shrank dramatically in absolute terms and their productivity and profitability improved.[80] Nevertheless, Chinese SOEs still lagged behind POEs and serious efficiency problems persisted.[81]

The third phase of SOE reforms started in 2003 and focused on restructuring large SOEs and improving their corporate governance.[82] One key reform was the establishment of the State Assets Supervision and Administration Commission (SASAC), a quasi-governmental, ministerial level agency operating directly under the State Council. Prior to the creation of the SASAC, no single entity was ultimately responsible for an SOE's performance, a problem known as the absence of an ultimate principal.[83] The SASAC was primarily designed to fill this regulatory lacuna, combining the administrative functions previously carried out by various government agencies. The SASAC was legally recognized as an "investor" and as such, SOEs enjoy legal rights and duties of a shareholder, holding SOE shares on behalf of the State.[84] The SASAC also enjoys a broad mandate that includes drafting regulations on the management of SOE assets, preserving and enhancing the value of state-owned assets, appointing and removing executives of SOEs under its supervision, and pushing

[75] *See* Leyin Zhang, *The Roles of Corporatization and Stock Market Listing in Reforming China's State Industry*, 32 World Dev. 2031–2047 (2002).

[76] *See* Mikael Mattlin, *Chinese Strategic State-Owned Enterprises and Ownership Control*, 4 BICCS Asia Paper 8 (2010), https://www.academia.edu/32844355/Chinese_Strategic_state_owned_enterprises_and_ownership_control.

[77] *See* Exit the Dragon? Privatization and State Control in China 1, 2 (Stephen Green & Guy Shaojia Liu eds., 2006).

[78] *See* Nicholas Calcina Howson, *China's "Corporatization Without Privatization" and the Late Nineteenth Century Roots of a Stubborn Path Dependency*, 50 Vand. J. Transnat'l L. 961, 969–970 (2017).

[79] *See* Garnaut et al., *supra* note 74, at 35–36.

[80] *See* Chang Tai Hsieh & Zheng (Michael) Song, *Grasp the Large, Let Go of the Small: The Transformation of the State Sector in China* 24 (Nat'l Bureau Econ. Rsch., Working Paper No. 21006, Mar. 2015).

[81] *See* Song, *supra* note 68, at 354.

[82] *See* James Feinerman, *New Hope of Corporate Governance in China?*, 191 The China Q. 590–612 (2007).

[83] *See* Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 China Econ. Rev. 494 (2003).

[84] Zhonghua Renmin Gongheguo Qi Ye Guo You Zi Chan Fa [Xian Xing You Xiao] (中华人民共和国企业国有资产法 [现行有效] [Law of the People's Republic of China on the State-Owned Assets of Enterprises] (promulgated by Standing Comm. Nat'l People's Cong., Oct. 28, 2008, effective May 1, 2009) 2008 Standing Comm. Nat'l People's Cong. Gaz. 192, Chap. 2 (China).

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forward further reforms of SOEs.[85] However, the SASAC does not intervene directly in SOEs' business operations, so that the SASAC's ownership rights are separated from those of management.[86]

The GOC has consistently emphasized the control of large SOEs in strategic industries. The logic behind the policy is "less is more," for example, by controlling the most powerful and profitable SOEs in strategic industries, the state can maintain disproportionate control over profits, investments, and the national economy.[87] Accordingly, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) serves as a unitary holding company for non-financial "central SOEs". When the SASAC was established in 2003, 196 central SOEs were under its direct supervision. Under the oversight of SASAC, that number was reduced to 96 by May 2022, as the smaller and less competitive firms were absorbed by the larger ones.[88] Although not large in number, the size and importance of Central SOEs to the national economy in many respects surpass that of all the other SOEs combined.[89] Out of 96 central SOEs, 49 were ranked in the Fortune Global 500 in 2021.[90] Chinese central SOEs are the most powerful economic force in Chinese economy, representing the core of state capitalism in China.

2. SOE Reforms in the Xi Jinping Era (2013–Present)

The fourth and the most recent phase of SOE reforms has started from the third plenum of the 18th CCP Congress held in November 2013 until now. In this "Xi Jinping era," the Chinese central authorities laid out important directions for reforming SOE governance and operation structure, including: 1) defining the functions of SOEs to determine levels of state ownership and control; 2) promoting mixed ownership with cross holding between state-owned capital and private capital; 3) shifting from state-owned asset management to state-owned capital management; and 4) improving corporate governance of SOEs.[91] The core document guiding the overhaul of SOEs issued in 2015, *Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of SOEs* (the "One") is supplemented by a wide range of supporting policies (the "N"). The comprehensive and thorough Chinese SOE reform in the fourth phase of Chinese SOE reforms has been guided by the "One Plus N" policy framework.[92]

First, Chinese SOEs were classified as commercial SOEs and public service SOEs. Commercial SOEs are further divided into SOEs in fully competitive sectors and SOEs in strategic sectors (i.e., key industries related to national security and national economic lifelines). Commercial SOEs should stick to commercial operations and aim to increase state-owned assets, while public service SOEs exist to improve people's quality of life and provide public goods and services. Accordingly, different levels of state ownership and control, growth strategies, regulations, and evaluations are outlined based on the classification of SOEs. For instance, commercial SOEs in

[85]*See* State-Owned Assets Supervision and Administration Commission of the State Council, Main Functions and Responsibilities of SASAC (2018), http://en.sasac.gov.cn/2018/07/17/c_7.htm.

[86]*See* Chiu & Lewis, *supra* note 66, at 122.

[87]Mikael Mattlin, *The Chinese Government's New Approach to Ownership and Financial Control of Strategic State-Owned Enterprises*, Finnish Inst. of Int'l Affairs 45 (Bank Fin. Ins. Econ. Transition, Discussion Paper No. 10/2007, 2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1001617.

[88]*See List of Central SOEs*, StateOwned Assets Supervision and Administration Commission of the State Council (2022), http://www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html.

[89]*See Economic Performance of StateOwned and StateControlled Enterprises in 2021*, Ministry of Finance of the PRC (Jan. 27, 2022), http://zcgls.mof.gov.cn/qiyeyunxingdongtai/202201/t20220126_3785083.htm.

[90]*See* State-Owned Assets Supervision and Administration Commission of the State Council, *49 Central SOEs and 33 Local SOEs are Listed in the Fortune Global 500* (Aug. 2, 2021), http://www.gov.cn/xinwen/2021-08/02/content_5629061.htm.

[91]*See* Decision of the Central Committee of the CCP on Some Major Issues Concerning Comprehensively Deepening the Reform (Central Committee of the Communist Party of China, Nov. 12, 2013), http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm.

[92]Karen Jingrong Lin, Xiaoyan Lu, Junsheng Zhang & Ying Zheng, *State-Owned Enterprises in China: A Review of 40 Years of Research and Practice*, 13 China J. Acct. Rsch. 31, 39 (2020).

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fully competitive sectors will be evaluated according to financial performance metrics whilst commercial SOEs in strategic sectors will be evaluated not only in terms of their business performance indicators, but also on their efforts to serve important national strategies, safeguard national security and the operation of the national economy.[93]

Second, the purpose of the mixed ownership reform (MOR) is to bring private-sector investment and management into SOEs to improve the efficiency and governance of the state sector.[94] The MOR applied specific sectoral policies. Commercial SOEs in fully competitive sectors shall actively attract other state capital and non-state capital to diversify equity, and state capital may take only a minority position. In contrast, state capital should maintain the position as the controlling or sole shareholder in strategic and public service SOEs and encourages non-state capital to become minority shareholders.[95] A significant example of the MOR was the share sale plan for China Unicom, China's second-largest telecom carrier. It was announced in August 2017 that it would sell US$11.7 billion in shares worth 35 percent of its Shanghai-listed subsidiary to a group of fourteen private and state investors, including tech giants Alibaba, Baidu, Tencent and JD.com. The sale saw China Unicom's stake in the listed subsidiary drop from 63 percent to 37 percent, but still the largest shareholder.[96] By the end of 2020, more than 70 percent of central SOEs and 54 percent of local SOEs had completed the MOR.[97]

Third, the role of the SASAC at the central and local levels will shift from "asset management" to "capital management." Specifically, two types of investment holding companies, state capital investment companies and state capital operation companies, were established under the auspices of the SASAC or directly under the local governments to serve as the state shareholder in SOEs. Both state capital investment and operation companies are authorized to perform the role of the shareholder and participate in the governance of the SOEs in which they invested through nominating directors and supervisors and voting in shareholders' meetings. However, they would not intervene in the daily operations of the SOEs.[98] The SASAC, in turn, will become the state shareholder in such state capital investment or operation companies. The rationale for creating such state capital companies is to establish a firewall between the SASAC and the SOEs so as to stop the tendency for the SASAC to become involved in the business operation of SOEs.[99]

Fourth, another key point of the SOE reforms since 2013, is the call for ongoing government-directed mergers to make SOEs "stronger, better and bigger."[100] The consolidation of SOEs is motivated by both economic and political factors. Economically, it would eliminate unprofitable SOEs, cut excess industrial capacity and overlapping investment, minimize competition among SOEs, and increase economies of scale. Moreover, the consolidation would create more

[93]*See* Notice of the SASAC, the Ministry of Finance, and the National Development and Reform Commission on Issuing the Guiding Opinions on Functional Definition and Classification of SOEs (No. 170 [2015] of the SASAC (Dec. 7, 2015).

[94]*See* The CCP Central Committee & the State Council, *Guiding Opinions on Deepening the Reform of SOEs* para. 16 (Aug. 24, 2015), http://english.www.gov.cn/policies/latest_releases/2015/09/13/content_281475189210840.htm.

[95]*See* Notice of the SASAC, *supra* note 93.

[96]*See* Eric Ng, *China Unicom Gets Funding and Stake Boost from Parent in 'Mixed Ownership Reform,'* S. China Morning Post (Aug. 23, 2017), https://www.scmp.com/business/companies/article/2107875/china-unicom-gets-funding-and-stake-boost-parent-mixed-ownership.

[97]*See* Wang Jiang, *Deepening Mixed Ownership Reform of SOEs*, Econ. Info. Daily (Jan. 29, 2021), http://www.xinhuanet.com/politics/2021-01/29/c_1127039088.htm.

[98]*See Opinions on Implementation of Pilots of State Capital Investment and Operation Companies*, St. Council (July 14, 2018).

[99]*See* Jiangyu Wang & Tan ChengHan, *Mixed Ownership Reform and Corporate Governance in China's State-Owned Enterprises*, 53 Vand. J. Transnat'l L. 1055, 1067–1068 (2020).

[100]Frank Tang, *Xi Jinping Calls for China's SOEs to be "Stronger and Bigger", Despite US, EU Opposition*, S. China Morning Post (Nov. 3, 2020), https://www.scmp.com/economy/china-economy/article/3108288/xi-jinping-calls-chinas-state-owned-enterprises-be-stronger.

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competitive "national champions" abroad with increased size and market share. Politically, SOE consolidation would increase state control over the economy.[101] A significant example of SOE megamergers was the merger of China's two state-owned railway companies, CSR Corp and CNR Corp, resulting in the creation of China Railway Rolling Stock Corporation (CRRC), now the world's largest train builder and second-largest industrial company.[102] Other examples include a merger between Shenhua Group (China's largest coal miner) and Guodian Group (one of China's largest power generation companies in August 2017). The new company, China Energy Investment Corp., has become the world's largest power company with assets totaling $271 billion.[103]

Finally, one unprecedented initiative in the new round of SOE reforms was to strengthen and institutionalize the role of the CCP in SOE governance. One motivation for this initiative is plainly to counterbalance the potential loss of Party control over the state sector accompanying an increase in private-capital investment.[104] All Chinese SOEs, including those listed on stock markets, were mandated to incorporate the CCP's leadership role into their articles of association.[105] The Constitution of the CCP was revised in October 2017, which specified that "the party committee of SOEs shall play a leadership role, set the right direction, keep in mind the big picture, ensure the implementation of party policies and principles, and discuss and decide on major issues of SOEs."[106] The campaign to strengthen the party leadership in SOEs is further institutionalized in the Trial Regulation on the Work at Primary-Level Party Organization of SOEs issued by the CCP Central Committee in December 2019.[107] The board of directors must hear the opinions of the party committee before deciding on important issues. The chairperson of the board of directors should ordinarily be the party secretary of a SOE. A cross-appointment system was introduced to ensure that SOEs' party committee members are appointed to key positions and hold decision-making power.[108] The formalized role of the CCP in SOE governance has closed the gap between SOE boardrooms and the CCP's strategic goals.[109]

To further implement SOE reforms discussed above, the SASAC has unveiled a "Three-year Action Plan for SOE Reforms (2020-2022)," setting out a clear roadmap as well as specific targets to meet.[110] Based on a series of performance indicators, Chinese SOEs have become stronger after the recent round of SOE reforms. They are now much less leveraged compared to the leverage level before 2016. The shrinking trend of SOEs both in numbers and the proportion of SOEs' assets in the industrial sector has been reversed and stabilized.[111]

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[101]*See* SEAN O'CONNOR, SOE MEGAMERGERS SIGNAL NEW DIRECTION IN CHINA'S ECONOMIC POLICY 6 (U.S.China Economic and Security Review Commission Staff Research Report, May 24, 2018), https://www.uscc.gov/sites/default/files/Research/SOE%20Megamergers.pdf.

[102]*See* Tom Mitchell, *China Railway Strategy Goes off Track*, CNBC (Dec. 23, 2014), https://www.cnbc.com/2014/12/23/china-railway-strategy-goes-off-track.html.

[103]*See* Josephine Mason & Meng Meng, *China Set to Create World's Top Utility with Latest Government Merger*, REUTERS (Aug. 28, 2017), https://www.reuters.com/article/us-china-power-shenhua-guodian-idUSKCN1B80UG.

[104]*See* Lauren YuHsin Lin & Curtis J. Milhaupt, *Party Building or Noisy Signaling? The Contours of Political Conformity in Chinese Corporate Governance*, 50 J. LEGAL STUD. 187, 193 (2021).

[105]*See* Jennifer Hughes, *Chinese Communist Party Writes Itself into Company Law*, FIN. TIMES (Aug. 14, 2017), https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247afd.

[106]XIANFA art. 33 (amended on Oct. 24, 2017) (China).

[107]*See* CCP Central Committee, *The Trial Regulation on the Work at PrimaryLevel Party Organization of SOEs* (Dec. 30, 2019).

[108]*See id.* at arts. 14, 15.

[109]*See* Jude Blanchette, *From "China Inc." to "CCP Inc.": A New Paradigm for Chinese State Capitalism*, 66 CHINA LEADERSHIP MONITOR at 7 (Jan. 2020), https://www.hinrichfoundation.com/media/swapcczi/from-china-inc-to-ccp-inc-hinrich-foundation-february-2021.pdf.

[110]*See* Frank Tang, *China Approves Plan to Boost Prominence of State Firms, Despite Complaints from Trade Partners*, S. CHINA MORNING POST (July 8, 2020), https://www.scmp.com/economy/china-economy/article/3092339/china-approves-plan-boost-prominence-state-firms-despite.

[111]*See* Kerry Liu, *China's State-Owned Enterprise Reform Since 2013*, 20 EUR. J. EAST ASIAN STUD. 367, 387 (2021).

II. Chinese SOEs and the Chinese Party-State

Through most of the history of China's SOE reforms, the predominant concerns of Chinese policymakers were SOEs' low efficiency and poor incentives for SOE managers. SOE reforms were therefore focused on improving their performance and profitability. Precisely for this reason, the government has been ordered to retreat from SOE governance, not to interfere with the day-to-day management at the firm level and make SOEs independent market entities.[112] However, when SOEs have become vastly more profitable, Chinese policymakers are expecting SOEs to spearhead China's development objectives, pioneering technological advance, maintaining macroeconomic stability, and implementing major government strategies such as the BRI. At the same time, while the GOC has been retreating from interfering in SOE management and more autonomy was granted to SOEs, the CCP has institutionalized its control of SOEs.[113] Xi Jinping openly asserted that party leadership and strengthening party building are the "root and soul" of Chinese SOEs, and that SOE executives shall "bear in mind that their number one role and responsibility is to work for the party." The tenet of Chinese SOE reforms is succinctly described as "the Party's leadership over SOEs is a major political principle, it must be steadfastly upheld; the establishment of modern enterprise system is the direction of SOE reform, it also must be steadfastly upheld."[114]

To be sure, the overall SOE policy under Xi in many aspects exhibits a deepening of preexisting trends rather than a decisive departure.[115] The core goal of molding SOEs that are both market competitive and following the Party line has remained consistent in the Xi Era. Still, the scale of institutionalizing, legalizing, and enhancing of the Party's role in SOEs' corporate governance is unprecedented, which some termed as "party-state capitalism" or the "politicization of corporate governance."[116]

While strengthening the Party' leadership role may help limit opportunistic behavior and decrease mismanagement in the SOEs,[117] the fundamental challenge of this new approach is that there are important contradictions and tensions among the objectives of increasing Party control and giving firms more political and developmental missions, on the one hand, and improving their incentives, corporate governance, and financial flexibility on the other hand.[118] Not only must managers scramble to meet multiple inconsistent targets, they must also use the tradeoff among targets to deflect demands for rigorous profit maximization.[119] In China's institutional context, the principle of party leadership would inevitably assign much greater weight to safeguarding the Party-state's interests rather than to the principle of corporate governance such as maximizing shareholder value in case there is a conflict.[120] To understand the behavioral logic of Chinese SOEs in both national and international markets, it is enlightening to look closely at how the Chinese Party-state exercises authority over Chinese SOEs.

[112]*See* BARRY NAUGHTON, *State Enterprise Reform Today* 375, 384 *in* CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT 1978–2018 (Ross Garnaut, Ligang Song & Cai Fang eds., 2018).

[113]*See* Wang & Tan, *supra* note 99, at 1093–1095.

[114]Xinhua, *Xi Stresses CPC Leadership of State-Owned Enterprises*, CHINA DAILY (Oct. 12, 2016), https://www.chinadaily.com.cn/china/2016-10/12/content_27035822.htm.

[115]*See* Wendy Leutert & Sarah Eaton, *Deepening not Departing: Xi Jinping's Governance of China's State-Owned Economy*, 248 CHINA Q. 200, 217 (2021).

[116]*See* Margaret Pearson, Meg Rithmire & Kellee S. Tsai, China's *PartyState Capitalism and International Backlash: From Interdependence to Insecurity*, 47 Int. Secur. 135, 136 (2022); Tamar Groswald Ozery, *The Politicization of Corporate Governance: A Viable Alternative?*, 70 AMER. J. COMP. L. 43 (2022).

[117]*See* Ozery, *supra* note 116, at 69–75.

[118]*See* NAUGHTON, *supra* note 112, at 378.

[119]*See* Bengt Holmstrom & Paul Milgrom, *Multitask Principal–Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design*, 7 J. L. ECON. ORG. 24, 26–28 (1991).

[120]*See* Zhang, *supra* note 15, at 58–61.

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One key tool for the CCP to ensure its control over SOEs is "personnel power," authority to appoint, evaluate, rotate, and remove SOEs' top management.[121] The leaders of SOEs are appointed in accordance with a highly institutionalized cadre management system to ensure the principle of "absolute control of the (SOE) executives by the Party."[122] By directly managing SOE executives' careers, the Party shapes managerial incentives and in turn influences the corporate behavior of China's SOEs. Different from their western counterparts who stand at the top of the corporate hierarchy and rely on active external labor market for executive career opportunities, top executives in Chinese SOEs have limited opportunities outside the state apparatus.[123] However, they have ample upward potential in the political arena by being appointed to senior party leader or government official positions, which would allow them to climb the political ladder in the Party-state hierarchy, bringing them more prestige and a higher political status.[124] Consequently, when financial and state goals are in conflict, the incentives SOE executives face tend to push them to choose state interests over financial interests of the firm and other non-state shareholders.[125]

Another key mechanism for the CCP to exercise its authority over SOEs is by institutionalizing Party committees' leadership role in SOE corporate governance. Previously, there was an implicit division of labor between SOE Party committees and formal corporate governance institutions prescribed in Chinese Company Law such as the shareholder meeting, the board of directors and the supervisory board. As the "political core" of SOEs, SOE Party committees focused mainly on political, social and personnel matters, such as selecting and evaluating senior personnel, recruiting Party members, circulating political propaganda materials, and organizing study sessions. The board of directors led commercial decision-making with shareholder input and supervisory board oversight.[126] By contrast, the new round of SOE reforms specifies that the Party committee in the SOEs serves a "leadership core" function as well as a "political core" function. A SOE's Party committee has authority to deliberate and discuss major issues concerning the reform, development, and stability of the firm, as well as major operational and managerial issues. The board of directors shall first listen to the opinions of the Party committee before deciding on major issues.[127]

The strengthening of the Party's leadership role in SOEs entails several profound implications. To begin with, there is a risk that the oversight functions of conventional internal governance mechanisms, such as the board of directors, the supervisory board, and independent directors, are being supplanted by political incentive mechanisms and Party committees that are deployed within the SOEs. With both the board of directors and the Party committee prescribed to be the decision-making bodies in the SOEs, the obvious challenge is how to divide the power between the two to ensure that the Party committee's involvement in the decision-making process will not undermine the power of the board of directors to make independent decisions. Moreover, bolstering the Party Committee's leadership role risks undermining the MOR of SOEs because

[121]*See* Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. R. 697, 737–743 (2013); *see also* RICHARD MCGREGOR, THE PARTY: THE SECRET WORLD OF CHINA'S COMMUNIST RULERS 69 (2011).

[122]*See* Xi Jinping, Upholding the Party Leadership over SOEs Unwaveringly, PEOPLE'S DAILY (Oct. 12, 2016).

[123]*See* Wendy Leutert & Samantha A. Vortherms, *Personnel Power: Governing State-Owned Enterprises*, 23 BUS. POL. 419, 423–424 (2021).

[124]*See* Xiaping Cao, Michael Lemmon, Xiaofei Pan, Meijun Qian & Gary Tian, *Political Promotion, CEO Incentives, and the Relationship Between Pay and Performance*, 65 MGMT. SCI. 2947, 2949 (2018).

[125]*See* ANDREW SZAMOSSZEGI & COLE KYLE, AN ANALYSIS OF STATEOWNED ENTERPRISES AND STATE CAPITALISM IN CHINA 79 (Report to U.S.China Economic and Security Review Commission, 2011); *see also* Yang Ruilong, Yuan Wang & Huihua Nie, *The Promotion Mechanism of 'Quasi-Officials': Evidence from Chinese Central Enterprises*, 3 MGMT. WORLD 23, 23–33 (2013).

[126]*See* Wendy Leutert, *Firm Control: Governing the State-Owned Economy under Xi Jinping*, CHINA PERSP. 27, 30–31 (2018).

[127]*See* CCP Central Committee, The Trial Regulation on the Work at Primary-Level Party Organization of SOEs, art. 15 (Dec. 30, 2019).

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it underscores the Party state's willingness to subordinate commercial objectives to political imperatives.[128] It will further exacerbate POEs' concerns about how their interests as minority shareholders would be protected as their stake in SOEs is unlikely to grant them real power.[129] Finally, the move to strengthen Party control of SOEs will exacerbate the rising perception that SOEs are simply Chinese Party state's policy instruments to exercise governmental functions and implement government strategies.[130]

III. The Porous Boundary of SOEs and Privately-owned Enterprises in China

The international trade and investment regimes frequently draw a stark distinction between SOEs and POEs. Because SOEs are controlled by the state, they are widely believed to be uniquely positioned to capture state-generated rents such as privileged market access, receipt of state subsidies, and *de facto* exemption from competition laws. POEs, by contrast, are often idealized as insulated from government intervention. Consequently, extra trade and investment disciplines are considered necessary to ensure competitive neutrality between SOEs and POEs.[131] However, the formalistic distinction between SOEs and large successful POEs tend to break down in the institutional environment in China.[132] With a long tradition of state dominance in the economy, underdeveloped legal institutions, relatively inchoate conceptions of property rights and omnipresent Party leadership, the party-state enjoys fairly extensive informal control rights over POEs, even in the absence of state ownership. Indeed, large POEs, similar to large SOEs, survive and prosper precisely because they have fostered connections to state power and have succeeded in obtaining state-generated rents.[133]

Empirical evidence has shown the value of political connections to Chinese POEs. For example, it was difficult for even large and profitable but less politically connected firms to list shares on Chinese stock exchanges through initial public offerings. These good firms were forced to go public through reverse mergers, an unconventional and much more costly route to access public financing.[134] Likewise, politically connected POEs were more likely to win commercial lawsuits in Chinese courts and to obtain loans from state-owned banks.[135] It is also not unusual for large, successful POEs to receive state subsidies. For example, Huawei is legally an independent, privately held company. Huawei's shares are held by its employees through an Employee Stock Ownership Plan.[136] Yet it was reported that Huawei had access to as much as $75 billion in tax breaks, financing and cheap resources from the GOC as it grew to the world's largest telecommunications equipment company.[137] More revealingly, while the party-building amendments to corporate charters are mandatory for SOEs in the new round of SOE reform, the policy is not even directed at private firms. Nevertheless, almost 6 percent of listed POEs amended their

[128] *See* Leutert, *supra* note 126, at 31–32.

[129] *See* Song, *supra* note 68, at 362.

[130] *See* Jeffrey N. Gordon & Curtis J. Milhaupt, *China as a National Strategic Buyer: Towards a Multilateral Regime for CrossBorder M&A*, COLUM. BUS. L. REV. 192, 212–222 (2021).

[131] *See* Yuri Shima, *The Policy Landscape for International Investment by Government-Controlled Investors: A FactFinding Survey* 8–9 (OECD, Working Paper on Int'l Inv. no. 2015/01, 2015), https://www.oecd.org/investment/investment-policy/WP-2015-01.pdf.

[132] *See* Pearson, Rithmire & Tsai, *supra* note 116, at 150-155.

[133] *See* Milhaupt & Zheng, *supra* note 42, at 668.

[134] *See* Charles M. C Lee, Yuanyu Qu &Tao Shen, *Going Public in China: Reverse Mergers versus IPOs*, 58 J. CORP. FIN. 92, 93 (2019).

[135] *See* Haitian Lu, Hongbo Pan & Chenying Zhang, *Political Connectedness and Court Outcomes: Evidence from Chinese Corporate Lawsuits*, 58(4) J. L. ECON. 829, 830 (2015); Hongbin Li, Lingsheng Meng, Qian Wang & Li-An Zhou, *Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms*, 87(2) J. DEV. ECON. 283, 284 (2008).

[136] *See Who Owns Huawei*, HUAWEI (last accessed Feb. 25, 2022), https://www.huawei.com/en/facts/question-answer/who-owns-huawei.

[137] *See* Chuin-Wei Yap, *State Support Helped Fuel Huawei's Global Rise*, WALL ST. J., Dec. 25 2019.

charters to include some type of party-building provisions from 2015 through 2018 as a means of signaling fealty to the CCP.[138]

Consequently, as Milhaupt and Zheng observed, functionally, "SOEs and large POEs in China share many similarities in the areas commonly thought to distinguish state-owned firms from privately owned firms: market access, receipt of state subsidies, proximity to state power, and execution of the government's policy objectives."[139] To be sure, the claim is not that corporate ownership is completely irrelevant in China or that Chinese POEs are identical in all respects to SOEs, but that the relationship between POEs and the GOC is complex, shifting, and variegated with respect to the level and quality of governmental intrusion, and that the boundary between SOEs and POEs is sometimes blurred in China's weak institutional setting.

D. Is the CPTPP an Ideal Model for the Regulation of Chinese SOEs?

The increased presence of SOEs in international trade and global value chains have given rise to a range of regulatory concerns.[140] One key concern is that SOEs in China often benefit from credits extended by state banks or other forms of financing, implicit guarantees, capital injections, and preferential access to inputs. In addition, the Chinese government may provide SOEs with certain regulatory advantages or influence them to confer such advantages on other entities. That would tilt the playing field and create distortive effects on international trade.[141] Moreover, state ownership has a negative effect on transparency of multinational enterprises.[142] Chinese SOEs are particularly criticized for their lack of transparency compared to POEs.[143] The lack of transparency around SOEs has contributed to growing levels of anxieties over their national security and competitive neutrality implications. The more pronounced presence of SOEs in the global marketplace has also been marked by certain high-profile scandals and occasional evidence of susceptibility of SOEs to corruption or human rights violations.[144] In 2014, the Organization for Economic Cooperation and Development (OECD) reported that 81 percent (by value) of the foreign bribery cases investigated between 1999 and 2013 were promised, offered or given to SOE officials.[145]

The GATT recognized that, by acting as a trader, a government may influence the direction of international trade through its purchase and sales decisions. Nevertheless, international trade disciplines on SOEs in the GATT/WTO regime are limited in scope and are perceived as inadequate.[146] For example Article XVII:1 imposes on state trading enterprises (STEs) the core obligation to undertake purchases and sales on a non-discriminatory basis and solely in accordance with commercial considerations involving either imports or exports. However, the application of Article XVII.1 is flawed in at least three important aspects. First, it is unclear whether the

[138]*See* Lin & Milhaupt, *supra* note 121, at 189-190.

[139]Milhaupt & Zheng, *supra* note 42, at 669.

[140]*See* Ming Du, *China's State Capitalism and World Trade Law*, 63 INT'L COMP. L. Q. 409, 418–426 (2014).

[141]*See State-owned Enterprises as Global Competitors: A Challenge or an Opportunity?*, OECD 52–53 (2016), https://www.oecd.org/corporate/state-owned-enterprises-as-global-competitors-9789264262096-en.htm.

[142]*See* Anthony P. Cannizzaro & Robert J. Weiner, *State Ownership and Transparency in Foreign Direct Investment*, 49 J. INT'L BUS. STUD. 172, 174 (2018).

[143]*See* Yipeng Liu & Michael Woywode, *LightTouch Integration of Chinese CrossBorder M&A: The Influences of Culture and Absorptive Capacity*, 55 THUNDERBIRD INT'L BUS. REV. 469, 479 (2013).

[144]*See* Rep. of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, U.N. Doc. A/HRC/32/45, at 16 (May. 4, 2016); *State-Owned Enterprises and Corruption: What Are the Risks and What Can Be Done?*, OECD (2018), https://www.oecd.org/corruption-integrity/reports/state-owned-enterprises-and-corruption-9789264303058-en.html.

[145]*See OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials* 22–23 (2014), https://read.oecd-ilibrary.org/governance/oecd-foreign-bribery-report_9789264226616-en.

[146]*See* Andrea Mastromatteo, *WTO and SOEs: Article XVII and Related Provisions of the GATT 1994*, 16 WORLD TRADE REV. 601, 617–618 (2017).

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non-discriminatory treatment in Article XVII:1 extends beyond a requirement of MFN treatment and includes a NT obligation.[147] The negotiating history suggests that Article XVII:1 was not intended to include a NT obligation and the GATT/WTO panels declined to take a position on this issue.[148] Second, the AB held that the "commercial considerations" requirement in Article XVII.1 does not impose a distinctive obligation on STEs, and that it suffices for STEs to act in in a non-discriminatory manner to comply with the provision.[149] Third, the AB clarified that the obligation to act solely in accordance with commercial considerations does not require STEs to refrain from using their exclusive or special privileges simply because such use might disadvantage competing commercial actors. The only constraint is that they should be used to make sales which are driven exclusively by commercial considerations.[150] While it is questionable whether the AB's interpretation of acting in accordance with commercial considerations is correct as economic logic would not support this view, there is not one single deviation from this case law in the GATT/WTO history.[151]

Because of the perceived inadequacy of existing WTO rules on SOEs, FTAs provide a new avenue to adopt innovative SOE disciplines.[152] A typical example is the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) concluded in 2018. Largely built upon the SOE disciplines contained in some FTAs that the U.S. had signed before, the CPTPP included a stand-alone chapter that applies "with respect to the activities of state-owned enterprises that affect trade or investment."[153] The inclusion of the SOE chapter in the CPTPP represents the most ambitious attempt of the international community to regulate SOEs in international trade up to date.[154] It is therefore helpful to critically analyze the SOE rules in the CPTPP and interrogate how effective they may be in addressing the challenges posed by Chinese SOEs.

The SOE chapter of the CPTPP has a number of novel features, including a bright line definition of SOEs, cumulative obligations of non-discriminatory treatment and commercial considerations, prohibition of non-commercial assistance to SOE service providers, and better enforcement mechanisms. Fundamentally, the CPTPP seeks to achieve a more level playing field—regulatory and competitive neutrality—for both SOEs and POEs.[155] Nevertheless, as will be argued below, it is far from clear whether the CPTPP would provide an ideal model for the regulation of Chinese SOEs.[156]

I. Is the Definition of SOE too Narrow?

One of the main issues regarding the disciplines on SOEs in international law is the lack of a clear and consistent definition of what SOEs are. Article XVII of the GATT defines STEs as

[147] *See id.* at 608–609.

[148] *See* Panel Report, *Canada–Measures Relating to Exports of Wheat and Treatment of Imported Grain (Canada-Wheat Exports)*, WT/DS276/R ¶¶ 6.48–6.50 (Apr. 6, 2004); GATT Panel Report, *Canada–Administration of the Foreign Investment Review Act*, L/5504–30S/140 ¶ 5.16 (Feb. 7, 1984).

[149] *See* Appellate Body Report, Canada–Wheat Exports, WT/DS276/AB/R ¶ 89 (Aug. 30, 2004).

[150] *See id.* at ¶¶ 145–149.

[151] *See* Mavroidis & Sapir, *supra* note 25, at 74–80.

[152] *See* Kevin Lefebvre, Nadia Rocha & Michele Ruta, *Containing Chinese State-Owned Enterprises? The Role of Deep Trade Agreements* 1 (The World Bank Pol. Rsch., Working Paper no. 9637, April 2021), https://openknowledge.worldbank.org/bitstream/handle/10986/35516/Containing-Chinese-State-Owned-Enterprises-The-Role-of-Deep-Trade-Agreements.pdf?sequence=1.

[153] *See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership, Dec. 30, 2018, art. 17.2.1.

[154] *See* Julien Sylvestre Fleury & JeanMichel Marcoux, *The US Shaping of State-Owned Enterprise Disciplines in the Trans-Pacific Partnership*, 19 J. INT'L ECON. L. 445, 446 (2016).

[155] *See* Mitsuo Matsushita & C.L. Lim, *Taming Leviathan as Merchant: Lingering Questions about the Practical Application of Trans-Pacific Partnership's State-Owned Enterprises Rules*, 19 WORLD TRADE REV. 402, 405 (2020).

[156] *See* Zhou, *supra* note 29, 578–588; Minwoo Kim, *Regulating the Visible Hands: Development of Rules on State-Owned Enterprises in Trade Agreements*, 58 HARV. INT'L L. J. 225, 254–260 (2017).

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"Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports."[157] Although there might be some overlapping between the notion of an STE and that of an SOE, the two are not synonymous. For instance, a private enterprise without state ownership can be a STE. On the other hand, SOEs cover a wider remit than STEs because the latter is limited to SOEs with special rights or privileges.[158] Indeed, only a few Chinese SOEs having the exclusive right to import or export wheat, maize, sugar, tobacco, rice, cotton, crude and processed oil, refined coal, chemical fertilizers, tungsten and tungstate products, antimony, and silver are considered as STEs.[159] As the WTO concedes, the definition of STEs is far from being clear and the absence of a clear definition renders Article XVII ineffective.[160] Similarly, there is much controversy of whether SOEs are "public bodies," and therefore can be a subsidy provider, in the SCM Agreement.[161]

The CPTPP represents a paradigm shift away from the pre-existing definitions and for the first time, adopts a clear-cut rule based exclusively on quantifiable proxies to determine what a SOE is.[162] Article 17.1 of the CPTPP expressly defines a SOE in relation to two main criteria: governmental control and commercial activity. It provides that a SOE is an enterprise that is principally engaged in commercial activities and in which a party: (i) directly owns more than 50 percent of the share capital; (ii) controls, through ownership interests, the exercise of more than 50 percent of the voting rights; or (iii) holds the power to appoint a majority of members of the board of directors or any other equivalent management body.[163] Moreover, "commercial activities" are defined as "activities which an enterprise undertakes with an orientation toward profit-making and which result in the production of a good or supply of a service that will be sold to a customer in the relevant market in quantities and at prices determined by the enterprise."[164] Thus entities engaged mainly in non-profit activities or public services are excluded. The limitation of the definition to those SOEs that are engaged in commercial activities reflects the competitionrelated concerns underlying SOE disciplines. The CPTPP does not seek to regulate SOEs when they engage in non-commercial activities that do not risk distorting competition. It is also a recognition that SOEs, in providing public services, fulfill policy objectives where private participation cannot solve market failures.[165] According to the SOE definition in the CPTPP, it is irrelevant whether an entity enjoys special privileges, monopoly status or exercises governmental authority or not. The government ownership or control of a commercial entity, by itself, is sufficient to identify a SOE.

Although a clear-cut definition eliminates uncertainties of what an SOE is, rigid rules may also weaken SOE disciplines. The quantitative thresholds defining ownership/control in the CPTPP fail to consider the many other, lower levels of ownership or board appointment that can actually

[157]*See* Understanding on the Interpretation of Article XVII of The General Agreement on Tariffs and Trade 1994 para. 1, 1994, General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

[158]*See* Mastromatteo, *supra* note 146, at 606.

[159]*See* WTO Secretariat, *Trade Policy Review on China*, WT/TPR/S/415, at 97 (Sept. 15, 2021).

[160]*See* WTO, *Technical Information on State Trade Enterprises*, https://www.wto.org/english/tratop_e/statra_e/statra_info_e.htm.

[161]*See* Kim, *supra* note 156, at 256.

[162]*See id.* at 243–244.

[163]*See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), art. 17.1.

[164]*Id.*

[165]*See* Jan Yves Remy & Iain Sandford, *Rules for State-Owned Enterprises in Chapter 17 of the Trans-Pacific Partnership Agreement: Balancing Market-Oriented Disciplines and Policy Flexibility for States*, *in* The Comprehensive and Progressive Trans-Pacific Partnership: Analysis and Commentary 510, 526–527 (Jorge A. Huerta-Goldman & David A. Gantz eds., 2021) (Some scholars argue that the CPTPP's nonregulation of nonprofit SOEs risks ignoring the impact which nonprofit entities can have on the market, as well as their ability to abuse a dominant position); *see also* Matsushita & Lim, *supra* note 155, at 416.

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be structured so as to retain governmental control, as well as situations of indirect control.[166] For example, how might interlocking directorates and indirect ownership structures influence the determination of a SOE?[167] What if the government holds less than the majority of the shares, but still constitutes the largest block of voting rights?[168] This is particularly an issue for Chinese SOEs after the MOR reform where the GOC no longer owns more than 50 percent of the shares, nor holds power to appoint a majority of the board of directors. Nevertheless, it is clear that the GOC still holds sway over the new firm after the MOR reform in China's institutional context. An example is Yunan Baiyao, one of the most famous listed pharmaceutical companies in China. After two rounds of MOR, Yunnan SASAC now owns 25.14 percent of Yunnan Baiyao's shares. However, it remains one of the two largest shareholders of Yunan Baiyao. Indeed, the bottom line of Yunan Baiyao's MOR was that no single private investor could own more voting rights than Yunan SASAC.[169] Moreover, it is not clear whether the party committee still plays the role of "leadership core" in mixed ownership companies in which the state capital controls less than 51 percent of the voting rights.[170] Although the definition of SOEs in the CPTPP may be stretched to encapsulate *de facto* control, thereby requiring inquiry into inter-locking and indirect ownership structures as well as other forms of indirect control such as through building shareholder coalitions,[171] the concern remains that the SOE definition in the CPTPP may not be able to capture the scenarios where the state may be able to exert strong influence without meeting the quantitative thresholds. After all, it seems fairly easy for SOEs to reorganize their ownership or voting structure to circumvent the rule.[172]

By comparison, under the U.S.-Singapore FTA, a SOE is an enterprise in which the Government of Singapore has "effective influence." Importantly, effective influence may exist when the government owns less than fifty percent of the voting rights of an entity, as long as it can determine the outcome of strategic, financial or operating decisions or plans of an entity, or otherwise exercise substantial influence over the management or operation of an entity. There exists a rebuttable presumption of effective influence when the government ownership exceeds 20 percent and constitutes the largest block of voting rights of the entity.[173] The SOE definition in the U.S.-Singapore FTA was followed by the USMCA and the CAI.[174] Specifically, the CAI widens the SOE definition in the

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[166]*See* Leonardo Borlini, *When the Leviathan Goes to Market: A Critical Evaluation of the Rules Governing State-Owned Enterprises in Trade Agreements*, 33 LEIDEN J. INT'L L. 313, 327 (2020).

[167]*See* Mitsuo Matsushita, *State-Owned Enterprises in the TPP Agreement*, *in* PARADIGM SHIFT IN INTERNATIONAL ECONOMIC LAW RULEMAKING: TPP AS A NEW MODEL FOR TRADE AGREEMENTS? 187, 200–202 (Julien Chaisse, Henry Gao & Chang-fa Lo eds., 2017).

[168]*See* Ben Hancock, *Reach of TPP's SOE Disciplines Limited by Definition, Scope, Exceptions*, 33 INSIDE U.S. TRADE 26 (2015).

[169]*See* David Blair & Li Yingqing, *Traditional Pharma Firm Furthers Reform Efforts*, CHINA DAILY (Feb. 22, 2019), https://www.chinadailyhk.com/articles/41/5/161/1550807394437.html.

[170]*See* SASAC, *Notice by the SASAC of Issuing the Operating Guidelines for the Mixed Ownership Reform of Central Enterprises*, (Oct. 19, 2019). Part 3.1.1 provides:

> Party building of mixed ownership enterprises. Establishing Party's organization and carrying out Party's work shall be the prerequisite of the mixed ownership reform of central enterprises. According to the characteristics of different types of mixed ownership enterprises, the setting methods, responsibilities, positioning and management models of Party's organizations shall be specified ....

The notice seems to suggest that party committee may play different roles in different types of mixed ownership enterprises. Although the SASAC notice only refers to central SOEs, it is reasonable to assume that the guidelines are likely to be followed by local SOEs as well.

[171]*See* Matsushita & Lim, *supra* note 155, at 413–414.

[172]*See* Kim, *supra* note 156, at 257–258; Ines Willemyns, *Disciplines on State-Owned Enterprises in International Economic Law: Are We Moving in the Right Direction?*, 19 J. INT'L ECON. L. 657, 666 (2016).

[173]*See* United StatesSingapore Free Trade Agreement (Sept. 3, 2003), arts. 12.8.1, 12.8.5.

[174]*See* arts. 22.1 of the USMCA; Article 3bis, EUChina Comprehensive Agreement on Investment §2 (the CAI does not use the term SOEs but "covered entities" instead).

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CPTPP, adding that SOEs also include those entities in which the government holds the power to control the decisions through minority ownership as well as enterprise in which the government has the power to legally direct the actions or otherwise exercise an equivalent level of control in accordance with its laws and regulations.[175] This definition is likely to broaden the SOE definition significantly and may even include some ostensible POEs in China.

II. Non-discriminatory Treatment and Commercial Considerations

Article 17.4 requires the SOEs of a CPTPP party to act on a commercial basis, and not to discriminate, in their purchases and sales of goods and services against suppliers, buyers, and investors of other CPTPP parties. Although the obligations of non-discrimination and commercial considerations in the CPTPP is plainly rooted in the GATT STE rules discussed above, there are several important changes.[176] First, Article 17.4 dissolves any uncertainty with respect to the NT principle. The non-discriminatory treatment of SOEs now explicitly incorporates both NT and MFN treatment.[177] Second, NT and MFN obligations are not restricted to trading activities in goods but extend to trade in services and investors from other parties. In a similar vein, the obligations cover not only imports and exports, but also SOEs' activities in the markets of their home states.[178] Third, acting in accordance with commercial considerations is no longer considered as an illustration of non-discrimination treatment but an independent obligation. An SOE must cumulatively satisfy both requirements of non-discriminatory treatment and commercial considerations. Commercial considerations are defined as "the same factors, such as price, quality, availability, marketability, and other factors that a privately owned enterprise in the same business or industry would normally consider in the commercial decisions."[179]

Compared to the GATT rules on STEs, the circumscribing word "solely" was absent from Article 17.4 of the CPTPP. In the WTO Panel's view, the requirement that STEs act solely in accordance with commercial considerations must imply that they should seek to purchase or sell on terms which are economically advantageous for themselves. An STE would not be acting solely in accordance with commercial considerations if it were to make purchases or sales on the basis of such considerations as the nationality of potential buyers or sellers, the policies pursued by their governments, or the national (economic or political) interest of the Member maintaining the STE.[180] Therefore, there are concerns that the absence of the word "solely" in the commercial considerations requirement would allow states to circumvent it by arguing that commercial considerations do not need to be solely market driven.[181] Whether Article 17.4 allows for such a flexibility is uncertain and will have to be clarified later.

Another difficulty with the obligation to act on a commercial basis is that there is no easy economic test to determine whether a firm's behavior is commercially sound.[182] Central to determine whether a SOE has fulfilled this obligation is to inquire whether a POE may perform the same acts in normal business transactions. But actions such as selling at very low prices to hook customers can be practiced by commercially motivated firms and those with

[175] *See* EU-China Comprehensive Agreement on Investment, art. 3 §2.

[176] *See* Leonardo Borlini, *supra* note 166, at 329.

[177] *See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), arts. 17.4.1(b)(i), 17.4.1(c)(i).

[178] *See id.* at arts. 17.4.1(b)(ii), 17.4.1(c)(ii).

[179] *Id.* at art. 17.1.

[180] *See* WTO Panel Report, *Canada–Measures Relating to Exports of Wheat and Treatment of Imported Grain,* WT/DS276/R 6.88 (Apr. 6, 2004), https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds276_e.htm.

[181] *See* Fleury & Marcoux, *supra* note 154, at 456.

[182] *See* Robert Howse, *Official Business: International Trade Law and the Resurgence (or Resilience) of the State as an Economic Actor* at 64–65 (N.Y.U. L. Econ. Rsch. Paper Series, Working Paper no. 21-15, July 2021).

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ulterior motives alike.[183] Further interpretative guidance would be helpful to clarify how to determine whether SOEs are not acting in accordance with commercial considerations.

III. Non-Commercial Assistance

It has long been argued that general principles of nondiscriminatory treatment and commercial considerations would not solve all of the issues and that there is a need for specific disciplines that address specific concerns with regard to SOEs.[184] One example is that many of the inherent advantages of SOEs boil down to direct and indirect subsidization by the government. In this regard, Article 17.6 prohibits the provision of non-commercial assistance (NCA) by the government (or SOEs) to SOEs if such assistance causes "adverse effects" to trade and investment interests of another party or "injury" to a domestic industry of another party.[185] Article 17.1 defines NCA as "assistance to a SOE by virtue of that SOE's government ownership and control," including direct transfers of funds or potential direct transfer of funds or liabilities as well as the provision of goods or services other than general infrastructure on terms more favorable than those commercially available to an enterprise.[186]

In essence, Article 17.6 of the CPTPP extends and adapts WTO subsidy regulation to SOEs. The definition of NCA is reminiscent of the definition of "financial contributions" under Article 1 of the SCM Agreement. Similarly, the term "by virtue of that SOE's government ownership or control" in the NCA definition, which means that the access to NCA favors SOEs as a distinct class, is in effect the specificity requirement in Article 2 of the SCM Agreement. Lastly, the requirements of "adverse effect" or "injury" also resemble Articles 6 and 15 of the SCM Agreement, although the CPTPP defines these two terms more narrowly, arguably making investigations of the violation easier.[187] Of particular significance of the NCA rules in the CPTPP is that they not only apply to the production and sale of goods by SOEs but also to assistance given to SOE in respect of services supply *outside* the providing party's own territory. Therefore, a CPTPP Member is prohibited from causing adverse effects to the interests of another Member by providing NCA to the export of a service by any of its SOEs into the territory of another Member.[188] However, the NCA rules do not apply to a service supplied by a SOE within the territory of the subsidizing party.[189]

Despite the fairly lengthy provisions, the bottom line is that the CPTPP does not generally inhibit NCA as such. Instead, the new rules aim at controlling certain negative effects that may arise from the NCA.[190] One may wonder to what extent the main concerns with the SCM Agreement, such as the high evidentiary burden in proving the existence of a subsidy in China, the failure of the notification process, and the ineffectiveness of remedies in disciplining subsidies, are adequately addressed in the CPTPP.[191] By contrast, the Japan-United States-European Union Trilateral Initiative proposed to expand the list of subsidies prohibited outright while creating a reversal of

[183]*See* Philip I. Levy, *The Treatment of Chinese SOEs in China's WTO Protocol of Accession*, 16 World Trade Rev 635, 641–642 (2017).

[184]*See* Willemyns, *supra* note 172, at 669.

[185]*See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), arts. 17.6.1, 17.6.2. The NCA rules apply not only to assistance from government to a SOE, but also to the provision of NCA by an SOE to another SOE.

[186]Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), art. 17.1.

[187]*See* Borlini, *supra* note 166, at 330.

[188]Note that the injury limb does not apply to the services sector.

[189]Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), art. 17.6.4.

[190]*See* Borlini, *supra* note 166, at 330.

[191]*See* Chad P. Bown & Jennifer A. Hillman, *WTO'ing a Resolution to the China Subsidy* Problem, 22 J. Int'l Econ. L. 557, 567–572 (2019).

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the burden of proof to establish negative impacts of the subsidies in some cases.[192] The USMCA contains an unconditional prohibition of three forms of NCA provided to an SOE primarily engaged in the production of goods other than electricity.[193]

IV. Will Extensive Carve-Outs Hollow Out the SOE Rules?

The SOE disciplines in the CPTPP are considerably limited by extensive carve-outs and exceptions in recognition of the need for governments to retain some leeway to continue the pursuit of policy objectives through SOEs. Article 17.2 enumerates several areas that are not included within the scope of the SOE chapter: regulatory and supervisory measures from a central bank or a monetary authority; regulatory or supervisory measures over financial services suppliers; measures adopted for the purpose of a failing or failed financial institution; sovereign wealth fund; independent pension fund; government procurement; the provision of goods and services by a SOE to carry out a party's governmental functions; and the establishment or the maintaining of a SOE. Article 17.9 provides the possibility for each party to list elements to which SOE disciplines shall not apply. States can list in their schedule to Annex IV non-conforming activities of SOEs.[194] Article 17.13 allows more flexibility for SOEs by excluding from the obligations smaller SOEs, the adoption of temporary measures in response to a national or global economic emergency, as well as the supply of financial services by a SOE pursuant to a government mandate.[195]

While some exemptions are quite sensible, such as the exemptions of smaller SOEs, government procurement and services supplied in the exercise of governmental authority, other exemptions are more controversial, such as a sweeping exemption for SOEs that a sub-central level government owns or controls, state-owned domestic service providers and SWFs. Combined with reservations and specific exceptions contained in the annexes and side agreements, which go quite far and include a wide range of enterprises, scholars noted that there are more pages devoted to exceptions than there are to the general rules themselves.[196] Apparently, this complex legal framework resulted from political compromises as different states have different views of SOEs and some CPTPP parties continue to rely heavily on SOEs. Still, looking at the extensive carve-outs, the question arises whether the totality of all exemptions and exceptions in the CPTPP does not render the substantial provisions rather useless.[197]

The challenges are even more acute when applying these exemptions to Chinese SOEs. For example, the exemption of sub-central SOEs considerably limits the scope of application of SOE rules. But sub-central SOEs are equally capable of severely distorting international investment. After extensive restructuring and reorganization of the state sector in China, there are only 96 central SOEs under the direct supervision of the SASAC. At the same time, there are hundreds of thousands of sub-central SOEs flourishing in China, accounting for almost half of the total annual revenue of all Chinese SOEs and a quarter of all Chinese enterprises listed on the Fortune Global 500 in 2021.[198] Given that Chinese sub-central SOEs are important players in a wide range of industries of commercial significance, their exemption leaves important lacunae

[192]*See* Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, United States-European Union, Washington D.C. (Jan. 14, 2020), https://trade.ec.europa.eu/doclib/docs/2020/january/tradoc_158567.pdf. For a critique of the new proposed rules in trilateral dialogue, *see* Robert Howse, *Making the WTO (Not So) Great Again: The Case Against Responding to the Trump Trade Agenda Through Reform of WTO Rules on Subsidies and State Enterprises*, 23 J. INT'L ECON. L. 371, 382–384 (2020).

[193]*See* United StatesMexicoCanada Agreement (July 1, 2020), art. 22(6)(1).

[194]*See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), art. 17.9.1.

[195]*See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), art. 17.13 (1), (2), (5).

[196]*See* Borlini, *supra* note 166, at 328.

[197]*See* Willemyns, *supra* note 172, at 675.

[198]*See* Ministry of Finance of the PRC, http://www.gov.cn/shuju/2022-01/28/content_5670891.htm.

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under the SOE rules. In this respect, it is noted that the CAI applies to Chinese SOEs at all levels of government, including sub-central SOEs.[199] Another example of the exception is SWFs. China is actively exploring the potential transformation of SOEs into SWFs, and it is not too farfetched to imagine the SWFs of the next generation as being what SOEs are today.[200] This raises the issue of parties restructuring the mode of state interference rather than eliminating the problem. Lastly, some CPTPP parties, such as Mexico and Vietnam, have successfully negotiated extensive exceptions for certain SOEs in specific sectors or activities. There is no reason why China will not push hard for an extensive list of carve-outs in the accession negotiations.

V. Will China Be Able to Implement SOE Obligations in the CPTPP?

The SOE rules in the CPTPP draw heavily from the existing rules under the GATT/WTO system, including the obligations embodied in China's Protocol of Accession to the WTO, when it comes to the substantive obligations for SOEs such as non-discrimination, commercial considerations, and transparency. Although the SOE rules in the CPTPP have added precision and expanded the scope of SOE obligations, in at least some aspects the CPTPP rules may be even less stringent than the obligations in China's Protocol of Accession to the WTO.[201] To the extent that the existing SOE rules have not been successful in bringing about China's compliance with the WTO rules, the effect of the SOE rules in the CPTPP may also be limited.[202] There is no guarantee that the SOE rules in the CPTPP are able to constrain China's state capitalism effectively. In short, the current SOE rules may serve as a starting point for future negotiations of what rules are appropriate for Chinese SOEs in the 21st Century.

Take the transparency obligation in the CPTPP as an example. As SOEs compete in the global marketplace, transparency and disclosure of the SOE sector has gained importance beyond the domestic reform agenda. Transparency allows host states to be clear of how SOEs are controlled and supported by their home states and to monitor implementation of state obligations in international trade and investment agreements.[203]The perception that Chinese SOEs lack transparency is particularly disconcerting because it is essential for Chinese SOEs to work extra hard to attain local legitimacy, and therefore be more transparent about their financing, structures and objectives.[204]

Article 17.10 of the CPTPP contains extensive transparency requirements of SOEs that each party should provide. The requirements combine the proactive disclosure of SOE information by the home state with a request mechanism to obtain information by other parties.[205] Article 17.10.1 requires each party to provide to the other parties or otherwise make publicly available on an official website a list of its SOEs and to update this list annually. In addition, a party shall provide the following information on a written request of another party regarding a specific SOE: percentage of shares and votes under government ownership; special shares, votes, or other rights; government officials serving as officers or on the board of the SOE; the SOE's annual revenue and total assets, exemptions and immunities accorded to the SOE under national law as well as any other publicly available information.[206] Moreover, the request mechanism allows other parties to

[199]*See* EUChina Comprehensive Agreement on Investment, art. 3bis§1.

[200]*See* Yingyao Wang, *The Rise of the "Shareholding State:" Financialization of Economic Management in China*, 13 SocioEcon. Rev. 603, 615 (2015).

[201]*See* Zhou, *supra* note 29, 581–586.

[202]*See* USTR, 2021 Report to Congress on China's WTO Compliance 2 (Feb. 2022).

[203]*See* *Transparency and Disclosure Practices of State-Owned Enterprises and Their Owners*, OECD 8 (2020), https://www.oecd.org/corporate/Transparency-Disclosure-Practices-SOEs.pdf.

[204]*See* Klaus E. Meyer, Yuan Ding, Jing Li & Hua Zhang, *Overcoming Distrust: How State-Owned Enterprises Adapt Their Foreign Entries to Institutional Pressures Abroad*, 45 J. Int'l Bus. Stud. 1005, 1024 (2014).

[205]*See* Fleury & Marcoux, *supra* note 154, 462–463.

[206]*See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), art. 17.10.3.

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obtain information regarding NCA provided by a state to its SOEs. The response must be sufficiently specific to enable the requesting party to evaluate the effects of the NCA on trade and investment between the parties, including the legal basis and policy objective of the measure, the amount of the assistance, its duration, as well as statistical data permitting an assessment of the effects of the NCA on trade and investment.[207]

Wolfe questioned the effectiveness of the transparency requirements provided in the CPTPP. First, the record of WTO Members' notification of industrial subsidies with respect to SOEs is consistently poor and the same disincentives exist when providing information in response to information request in the CPTPP.[208] Second, the transparency provisions are not accompanied by strong institutional support. The mandate of the Committee on SOEs does not include regular receipt, discussion and dissemination of SOE information. The information provided in response to an information request can be kept confidential if the party supplying the information requests it. As a result, the requested information cannot benefit all affected parties.[209] Lastly, given the number of Chinese SOEs, it may be unrealistic to expect China to create an online list of every SOE, given the size of the state sector in China, and even more unrealistic for any CPTPP party to try to provide written evidence of the trade effects of most SOEs on the list in order to justify a request from China for more information.[210] That said, the CPTPP has set in place a more powerful mechanism to enforce transparency obligations through dispute settlement. A panel is entitled to draw adverse inferences from instances of non-cooperation by a disputing party in the information gathering process. In addition, the panel shall not request additional information to complete the record where the information would support a party's position and the absence of that information is the result of that party's non-cooperation in the information-gathering process.[211] A stronger enforcement mechanism might provide additional incentives for China to comply with the daunting obligations, but that is still an open question.

E. Conclusion

Much ink has been splashed on the ideological, conceptual, and practical challenges that China's state capitalism has posed to global trade rules. There is a growing perception that current international trade rules are neither conceptually coherent nor practically effective in tackling China's state capitalism.[212] This perception has not only led to the emergence of new trade rules, but also culminated in the US-China trade war, only further aggravated by the Covid-19 pandemic and Russia-Ukraine war.[213]

This Article contributes to the debate of what trade rules may be needed to regulate SOEs by unpacking the black box of China's state capitalism. Tracing the reform of Chinese SOEs over the past 40 years, this Article shows that the CCP possesses both formal and informal tools to control SOEs, in particular Central SOEs in strategic sectors and that the boundary of SOEs and POEs is very blurred in contemporary China. Based on an understanding of the dual political and

[207] *See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), arts. 17.10.4, 17.10.5.

[208] *See* Robert Wolfe, *Letting the Sunshine in at the WTO: How Transparency Brings the Trading System to Life* 18–19 (World Trade Org. Staff, Working Paper no. ERSD-2013-03, March 2013). These disincentives include bureaucratic incapacity, worries about providing adverse information for a potential legal dispute, the difficulty for a party's trade authority to notify actions taken by other ministries or other levels of government or by SOEs, and ambiguity about what requires notification, etc.

[209] *See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Dec. 30, 2018), arts. 17.10.9, 17.12.

[210] Robert Wolfe, *Sunshine over Shanghai: Can the WTO Illuminate the Murky World of Chinese SOEs*, 16 World Trade Rev. 713, 725–726 (2017).

[211] *See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership, Dec. 30, 2018, annex 17(B).

[212] *See* Blanchette, *supra* note 19.

[213] *See* Antony J. Blinken, *The Administration's Approach to the People's Republic of China*, U.S. State Dep't. (May 26, 2022), https://www.state.gov/the-administrations-approach-to-the-peoples-republic-of-china/.

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economic nature of China's state capitalism, this Article casts serious doubts on the effectiveness of the new SOE rules in the CPTPP, including the narrow definition of SOEs, wide carve-outs and exceptions, and the likelihood of China's inability to implement the SOE rules.

It must be stressed that China was not a negotiating party when the SOE rules in the CPTPP were written and that there is no guarantee that China will ever be able to join the CPTPP. Therefore, it would be unrealistic to expect the CPTPP negotiators to focus on how to regulate Chinese SOEs, a possibility in the future, as opposed to what are acceptable SOE rules to current CPTPP parties. Given that China formally submitted a request to accede to the CPTPP, it is reasonable to assume that China is comfortable with the new SOE disciplines embodied in the CPTPP. However, even if China might be accepted into the CPTPP in the future, it remains possible that the current CPTPP Members may push for "CPTPP-plus" obligations in China's protocol of accession, in the same manner as China negotiated for its WTO entry two decades ago.[214] Despite the uncertain outcome of China's CPTPP accession, it is hoped that the recent spotlight on Chinese SOEs may serve as an external incentive for the GOC to push forward market-oriented SOE reforms. These reforms will not only reduce suspicion when Chinese SOEs engage in international trade and investment activities, but also help them become truly competitive global champions.

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[214] *See* Julia Ya Qin, *WTO-plus' Obligations and Their Implications for the World Trade Organization Legal System: An Appraisal of the China Accession Protocol*, 37 J. World Trade 483–522 (2003).

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