China spends far more than others to help favoured industries, report finds

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China spends much more in helping favoured industries with state-directed funds, cheap loans and other government incentives than other major economies, according to a new study expected to intensify the debate in Washington and elsewhere over Beijing's use of industrial policy.

The study, to be published by the Center for Strategic and International Studies on Monday, finds that China's backing of its companies amounted to at least 1.73 per cent of its gross domestic product in 2019 – the most recent year for which comprehensive data is available – and the trend is continuing.

In US dollar terms, that is more than $US248bn based on market exchange rates – exceeding estimated Chinese military spending – or $US407bn based on exchange rates that adjust for differing costs across countries.

China's spending, both as a share of GDP and in dollar terms, is significantly higher than that of seven other economies analysed in the report, including South Korea, France, Germany, Japan, Taiwan, the US and Brazil. By comparison, according to the study, the US spent 0.39 per cent of its GDP on industrial support in 2019, while South Korea, the No. 2 spender, devoted 0.67 per cent of its output.

"China is a large outlier," said Scott Kennedy, an expert on China's economy at the Washington-based think tank and an author of the report. "It spends an enormous amount on industrial policy and also uses more tools for such spending than anybody else." Beijing's disclosure of subsidies is murky at best, China analysts say, and its use of industrial policy is one of the most contentious issues involving the country's statist economic model. The CSIS study is the first trying to put a total tally on China's overall manufacturing support and to assess how it stacks up against other economies that have directed resources to help manufacturers rather than leaving their development to market forces.

Since late last year, the Biden administration has been looking for ways to confront Beijing with its use of industrial subsidies that give Chinese companies an edge over their foreign rivals.

The new study, which has been months in the works and already generated some buzz in Washington, could offer administration officials a grasp of the scale of the Chinese support as they are considering whether to launch a new investigation into Chinese subsidies, potentially using Section 301 of the Trade Act, which allows the US to take punitive action against certain practices of a trading partner.

The report also comes as industrial policy is coming back in vogue in the US and among its allies in both Europe and Asia, fuelled by pandemic-driven disruptions to supply chains as well as the competition with China.

From Washington and Brussels to Seoul and Tokyo, officials have been rushing out government subsidies to promote industries they deem strategic, including semiconductors, electric-car batteries and pharmaceuticals.

The renewed interest in the use of interventionist measures by developed economists has prompted Chinese officials to argue that Beijing's industrial support isn't all that different and countries like the US are simply trying to thwart China's rise by targeting its policies.

A purpose of the report, say the authors, who also include CSIS analysts Gerard DiPippo and Ilaria Mazzocco, is to spark more substantive discussions among policy makers, business leaders and academics about the impact of China's industrial spending on the rest of the world.

Many economists and Western officials once assumed that Beijing would gradually reduce the state's role in directing credit and other resources as the economy matured. However, government interventions have increased in China over the years, especially under President Xi Jinping, who sees industrial policy as vital to reducing China's economic dependence on other countries while increasing their dependence on China.

The study points out that Beijing's industrial initiatives have become more ambitious in recent years, with their focus shifting from "catching up" to the West technologically to targeting industries at the frontier of innovation, such as electric vehicles and artificial intelligence.

To quantify Chinese spending, the analysts made estimates based on data such as direct government subsidies, tax incentives, below-market credit and state investment funds. To avoid over-estimating or double-counting, the study excludes tools that are hard to quantify, including restrictions on foreign firms' market access in China and government purchases, which often include incentives for domestic suppliers.

Mr DiPippo noted that government-guided funds are one unique instrument China has used for industrial policy. "China's state ownership of much of its financial sector gives Beijing enormous capabilities to direct financial resources in a way that other economies can't," he said.

These funds are intended to be more commercially oriented vehicles with funding from both the government and the private sector. In practice, however, the state still maintains a heavy hand in running them. "They end up crowding out private capital and distorting the market," Mr DiPippo said.

By the end of 2020, some 1,851 government-guided funds had been established in China, with a total designated funding target of $US1.7 trillion, according to research firm Zero2IPO. The actual funds raised were around $US820bn. One of them is the semiconductor-focused National Integrated Circuit Industry Investment Fund, dubbed the "Big Fund," which has raised more than $US29bn.

The value of funding raised by these state funds from 2015 to 2020 was equal to roughly two-thirds of the total venture-capital and private-equity investments made in China during those years, according to the report.

The study also expands on some of the existing sector-based research on Chinese subsidies, such as those involving chip-making, aluminium and electric vehicles.

For instance, China provided an estimated $US58bn to its EV makers between 2009 and 2017, the report shows. Beijing's largesse has in part fostered overcapacity and a fragmented industry, with the government now calling for consolidation.

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