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JAKUB KOCIUBIŃSKI
Uniwersytet Wrocławski
jakub.kociubinski@uwr.edu.pl
ORCID: 0000-0002-4391-7439

Using the free market against itself? The strategy of promoting national champions by authoritarian regimes — motivations and limitations*

Abstract

After the end of the Cold War it seemed that authoritarian regimes are bound to suffer economic marginalization because command economies proved to be unable to compete with free and open markets. Currently, however, we witness a number of non-democratic, authoritarian States capable of abusing market rules to create an unfair advantage to their undertakings — "National Champions" — competing with other enterprises, which are bound into a tight corset of anti-subsidy regulations, so ultimately to achieve regimes' political goals. In this context, the paper — based primarily on analysis and review of literature and secondarily on dogmatic analysis — by presenting a set of interlinked political and economic motivations seeks to argue that, on the one hand, strategic rejection of free market doctrine is an inherent feature of authoritarian regimes, and on the other, that inefficiencies endemic in non-democratic forms of governments reduce the likelihood of successful implementation of the eponymous strategy. On this basis, the secondary aim of this paper is to provide a conceptual basis for answering the following question: Considering the need to adapt to long-term effects of the current economic uncertainty, are the strategies of creating undue competitive advantages for national champions pursued by many authoritarian regimes serious enough threat to free markets to warrant a response from the international community.

Keywords: subsidies, State capitalism, competition, authoritarianism, national champions

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Introduction

The fall of the Soviet Union and the economic underperformance of the Eastern Block has led many to believe that only market economy of (broadly speaking) Western democracies can guarantee economic growth, innovations and stability necessary to ensure global competitiveness. Authoritarian regimes with various forms of command economy were incapable of competing in high-end technology products and were relegated to selling fossil fuels, natural resources and raw materials. This picture has changed. We witness a number of authoritarian States whose strategic rejection of free market doctrine — while retaining only the outward trappings of market economy — allows them to manipulate market outcomes for political purposes.[1] By coupling domestic interventionist policies with an export-oriented approach these countries sought to create national champions capable of competing in global markets.[2] In this context it can be argued that an authoritarian form of government is no longer a "ballast," but since it allows for a more heavy-handed interventions than liberal democracies, it serves as a necessary prerequisite for (admittedly unfair) competitive edge achieved by their national champions.[3] Whereas liberal market economies are bound by competition rules designed to protect enterprises from public authorities facilitating anticompetitive practices, and thus are unable to lend similar backing to their exporters.[4] In a nutshell, authoritarian regimes can exploit what market economy has to offer by disregarding their rules and limitations. In the recent years, the issue has become increasingly salient, reflecting larger role of government in the economy.[5] The sharp rise of interventionism has been observed in the immediate aftermath of COVID-19 outbreak and has remained high in the current time of economic uncertainty.

In view of the above, this paper seeks to demonstrate — by analysing the underlying political economy rationale for creating national champions — that the abuse of an international market system is an inherent and thus unavoidable

[1] I. Bremmer, "State capitalism comes of age: The end of the free market?," *Foreign Affairs* 88, 2009, no. 3, pp. 40–41.

[2] J.A. Brander, B.J. Spencer, "Export subsidies and international market share rivalry," *Journal of International Economics* 18, 1985, nos. 1–2, p. 90; L. Sørgard, "The economics of national champions," *European Competition Journal* 3, 2017, no. 1, p. 49.

[3] Compare I. Bremmer, "State capitalism comes of age," pp. 41–44 with e.g. A. Musacchio, S.G. Lazzarini, *Reinventing State Capitalism: Leviathan in Business, Brazil and Beyond*, Harvard 2014.

[4] In this paper, the term "competition law" is to be understood in a broad sense (similarly as in the European Union's law) as encompassing the so-called substantive competition law — antitrust rules — as well as merger control and State aids. Subsidy rules are thus regarded as a part of competition law.

[5] In times of economic difficulties the State tends to take a more active role in the running of the economy. See C. Bjørnskov, "Economic freedom and economic crises," *European Journal of Political Economy* 45, 2016, supplement: *On Institutions and Well-Being*, pp. 11–23.

feature of authoritarian States. Such regimes will therefore always resort to these practices, insofar as economic realities permit. By putting these partial conclusions together, the analysis will also provide a conceptual basis for formulating answer to the question of whether — given the need to adapt to long-term effects of the current economic uncertainty — strategies of creating undue competitive advantages for national champions pursued by many authoritarian regimes are serious enough threat to free markets to warrant a response from the international community.

1. The notion of national champions

The term "national champions" originally emerged in the French press in the 1980s to describe the government's efforts to support State-owned industries locked in a losing battle against the competition from lower-priced foreign goods and services.[6] Apart from country-specific variations, their core characteristics is that companies should be domestically-controlled, and that they should enjoy State support for their growth.[7]

As regards the former criterion, currently we see departure from the State ownership, typical of the Cold-war era command economies. Oftentimes the government influence over companies extends beyond formal structures, beyond easily recognizable — to use merger control parlance — *de iure* control.[8] Control and influence over specific undertakings can well be exercised through informal channels such as personal contacts. Generally speaking, the stronger ideological stance on the State's role in the economy, the more formal ownership over industries. At the same time, the more oligarchic regime's power base is the more important personal ties are becoming at the expense of formal structures.[9] As a result, control may not be exercised — to all outward appearance — through any identifiable commands from the government. Here, in order to establish the actual level of control and influence over a particular enterprise, it would be necessary to assess the degree of decision-making freedom — not *in abstracto*, but in a very specific situation.[10] It goes without saying that it is almost impossible to carry out

[6] Most notably in E. Cohen, *Le Colbertisme «high tech»: Économie des Télécom et du Grand Projet*, Paris 1992.

[7] The definition is loosely based on O. Falck, C. Gollier, L. Woessmann, "Arguments for and against policies to promote national champions," [in:] *Industrial Policy for National Champions*, eds. O. Falck, C. Gollier, L. Woessmann, Cambridge 2011, p. 4 ff.

[8] Explanation of the concept of *de iure* control see I. Kokkoris, H. Shelanski, *EU Merger Control: An Economic and Legal Analysis*, Oxford 2014, p. 118 ff. and the referred case law.

[9] See the overview in L. Tihanyi *et al.*, "State ownership and political connections," *Journal of Management* 45, 2019, no. 6, pp. 2293–2321.

[10] This has been proven problematic even with full access to data and broad investigative powers. See per analogiam cases C-278/00 Hellenic Republic v Commission of the European Commu-

an assessment such as this "from the outside" because of the lack of data of the simplest kind in the absence of political will to cooperate (as this is almost always the case).[11] Nevertheless, there is no need to delve into the specifics of State control/influence as long as — and this is a necessary condition — the ownership is national.

As regards the latter criterion, the following preliminary remark must be made: Not all enterprises are deemed "national champions" purely by virtue of receiving State support. National champions emerged in the historical context as a way to secure provision of various public services. Originally electricity supply but later extended, among others, to garbage disposal, gas supply, water services and so on.[12] Although a somewhat economically debatable means to an end, the original argument ran that full public control can eliminate the risk of any service disruptions and ensure the sufficient capacity for all vital services. This approach has largely been abandoned in the European Union following the wave of deregulation in the 1990s, nevertheless it is still practiced, at least at the rhetorical level, outside the EU.[13]

Generally speaking however, such an inward focus of national champions is no longer a priority. Instead, they should be seen as means of advancing national interests abroad. However, as will be described below, even outwardly international rationale will have a significant domestic component — economic as well as purely political. Rather than focusing on a multitude of country specific and potentially self-conflicting policy goals it is much better — both practically and from a methodological standpoint — to embrace a functional approach and focus on *prima facie* empirically observable features: the company must have its output directed at foreign markets and must be competitive internationally.

Hence, for the subsequent discussion, all these national idiosyncrasies can be boiled down to their bottom-line common denominator: National champions will be understood as undertakings, regardless of their nominal organizational structure; regardless of whether State-owned or State-run as long as nationally

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nities, ECLI:EU:C:2004:239, para 53; T-136/05 EARL Salvat père & fils, Comité interprofessionnel des vins doux naturels et vins de liqueur à appellations contrôlées (CIVDN) and Comité national des interprofessions des vins à appellation d'origine (CNIV) v Commission of the European Communities, EU:T:2007:295, paras 140–165.

[11] J. Kociubiński, "The proposed regulation on foreign subsidies distorting the internal market: The way forward or dead end?," *European Competition and Regulatory Law Review* 6, 2022, no. 1, p. 58.

[12] S. Viallet-Thévenin, "From national champion to international champion: Resistance and transformations to a model of competition in the energy sector during the period 1990–2010," *Revue française de science politique* 65, 2015, nos. 5–6, p. 41.

[13] Cf. e.g. J. Hayward, "Europe's endangered industrial champions," [in:] *Industrial Enterprise and European Integration: From National to International Champions in Western Europe*, ed. J. Hayward, Oxford 1995 with T.A. Hemphill, G. White III, "China's national champions: The evolution of a national industrial policy — or a new era of economic protectionism?," *Thunderbird International Business Review* 55, 2013, no. 2, pp. 194–210.

owned and controlled; active on competitive international markets; which due to any policy considerations are deemed important and are supported by the State to further bolster their international position.

2. Authoritarian regimes — conceptual framework

Authoritarian regime can be defined by its opposite concept — democratic States — which, following Samuel Huntington's minimalistic standard, can be described as political systems where "their most powerful collective decision makers are selected through fair honest and periodic elections in which candidates freely compete for votes."[14] However, such an approach provides only a very generalized understanding and fails to capture country-specific idiosyncrasies.[15] A significant proportion of the world's regimes has some form of outwardly electoral system but fails to pass Larry Diamond's or Inglehart's and Welzel's "substantive test," or does so only ambiguously.[16] In other words, most of the regimes do not fit into a rigid and dogmatic dichotomy — democracy or authoritarianism.

As regards the positive definition, Juan Linz in his seminal work on the Franco era Spain described the following distinguished features of authoritarian regimes:[17] limited political pluralism; legitimacy based upon appeal to emotion — either through unifying masses against a common enemy or through a sense of pride in a success story (e.g. sport achievements or global economic position of their national champions);[18] low electoral awareness linked with suppression of anti-regime activities; and boundaries of executive powers poorly defined by law that allow the exercise of uncontrolled discretion.[19] Similarly to the negative approach mentioned earlier, these are general indicators rather than exhaustive or exclusive clear-cut criteria. A certain common denominator can be seen in indefinite political tenure. This does not necessarily mean the long tenure of a particular leader, but rather a setup where constitutional and political structures are designed to guarantee a ruling group's position (*vide* Iran).[20]

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[14] S. Huntington, *The Third Wave: Democratization in the Late Twentieth Century*, Norman 1991, p. 7.

[15] L. Diamond, "Elections without democracy: Thinking about hybrid regimes," *Journal of Democracy* 13, 2002, no. 2, pp. 246–256.

[16] See ibid., p. 256; R. Inglehart, C. Welzel, *Modernization, Cultural Change, and Democracy: The Human Development Sequence*, Cambridge 2005.

[17] J. Linz, *An Authoritarian Regime: Spain*, New York 1970, p. 256.

[18] The strategy of "success propaganda" is usually accompanied by a "besieged fortress" rhetoric. These largely complemental narratives appeal to the same set of emotions — "scare and give relief" scheme — originating from the inferiority complex. See e.g. A.T. Beck, *Prisoners of Hate: The Cognitive Basis of Anger, Hostility and Violence*, New York 1999. These are almost universally adopted by both non-democratic regimes as well as populist parties in democracies.

[19] J. Linz, *An Authoritarian Regime: Spain*, pp. 256–291.

[20] M. Svolik, *The Politics of Authoritarian Rule*, Cambridge 2012, p. 25.

It is beyond the scope of this paper to go into details regarding detailed subcategories or alternative classifications of authoritarian regimes, their ideologies, constitutional arrangements and so on, as well as to elaborate on metrics to measure each criterion. Here it is sufficient to regard these generalised criteria outlined above as the necessary prerequisites for economic interventions through means unavailable to (again, generalisation) market-oriented democracies. As a corollary of the definition above, the paper's focus on politically motivated market interventions can, therefore, be seen (albeit only as *obiter dicta*) as a retrospective approach or backwards search of the definition of authoritarian regimes.[21]

Such an approach may be considered reminiscent of Marxist analytic traditions whereby market relations and State-market relations have been primarily viewed through the lens of social relations of production.[22] Even though economies declaring themselves as Marxist have largely failed and faded away, the underpinning premise that through ownership (or control) of productive enterprise, the State manifests certain interest remains broadly true still, even today. Of course, the rhetoric of "collective societal ownership" as a rationale for the State's involvement in the economy has largely been dropped, if not explicitly renounced, then at least not put on the forefront.[23] The detailed ideological and theoretical foundations can thus largely be set aside for purposes of the present work.[24]

Every analysis seeking to create and use broad, generalized categories must inevitably filter out some country-specific idiosyncrasies and fit the remainder into the general model. The terms "State" and "government" used in this paper must be broadly understood in terms of the state apparatus as a coherent whole.[25] Therefore, without going into details about specific constitutional arrangements it would suffice to assume that the state/government displays elements of purposeful, volitional action.[26] There is no need to delve into internal powerplays behind a particular course of action.

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[21] It must be stressed that this paper does not seek to create comprehensive definition of authoritarianism, so the characteristics of authoritarian regimes provided in the text should be regarded merely as a working definition, relevant for this particular subject.

[22] See K. Marx, *A Contribution to the Critique of Political Economy*, transl. S.W. Ryazanskaya, ed. M. Dobb, London 1971.

[23] The idea of collective ownership is implemented in some democratic market economies, especially in agricultural sector, but these relatively niche in scale form of the "actual" societal ownership permits no analogy with the realities of collective ownership in command economies discussed here where — despite the official narrative — owners had no control of and no benefits from their property and all assets were centrally managed by the State apparatus.

[24] R.D. Duvall, J.R. Freeman, "The state and dependent capitalism," *International Studies Quarterly* 25, 1981, no. 1, pp. 265–266.

[25] In the same way as the State is understood in the EU competition law.

[26] T. Skocpol, *States and Social Revolutions: A Comparative Analysis of France, Russia and China*, Cambridge 1979, p. 29.

3. Political economy of authoritarian regimes

States, like all complex systems, are generally subject to chaos theory.[27] That is, with an increase of interactions and dependencies between various elements within a given system — interest groups, businesses, political pressures, economic factors and so on — the number of possible scenarios rises exponentially with the number of new variables.[28] As a result, these systems that are essentially deterministic, because the basic rules of social and economic relations are known, can behave chaotically.[29] While this does not rule out a purposeful nature of State action but indicate the inability to predict all economic, political and social outcomes.[30] Such an inability stems from limitations in data collection capability and analytical capacity rather than from the lack of understanding of the mechanisms involved. In other words, governments operate largely along the lines of trial-and-error, or, as Karl Popper stated, "conjecture and refutation."[31] The following implications can be drawn from the above: First, the lack of observable anticompetitive effect at present does not automatically imply that an authoritarian regime do not attempt to create unfair competitive advantage for their national champions. Second, the complex nature of interactions does not require the reaction to foreign subsidization to be identically reciprocal — i.e. by allocating equivalent subsidies to own enterprises.

The effect of State intervention in non-democratic regimes is heavily conditioned by the dependent character of society and the economy.[32] A considerable freedom of manoeuvre allowed by the authoritarian regime together with ideologically motivated imperative to intervene in the economy in order to achieve political goals usually leads to the so-called dependent society.[33] Thus, the

[27] The term was initially used to describe behavior of nonlinear deterministic systems especially in hydrodynamics, meteorology and biological sciences (E. Lorenz, "Deterministic nonperiodic flow," *Journal of Atmospheric Science* 20, 1963, no. 2, pp. 130–141). Later the concept has been adapted into economics.

[28] E. Lorenz, "The butterfly effect," [in:] *The Chaos Avant-Garde: Memories of the Early Days of Chaos Theory*, eds. R. Abraham, Y. Ueda, Singapore 2000, pp. 91–95.

[29] S.A. Gunaratne, "Thank you Newton, welcome Prigogine: 'Unthinking' old paradigms and embracing new directions, part 1: Theoretical distinctions," *Communications* 28, 2003, no. 4, p. 435.

[30] This demonstrates a phenomenon famously described by H. Demsetz as "Nirvana Fallacy" (H. Demsetz, "Information and efficiency: Another viewpoint," *The Journal of Law & Economics* 12, 1969, no. 1, pp. 1–22). It relates to an approach where a government is basing its intervention on an unrealistic, idealised understanding of general rules applicable to the market without taking into consideration how they would function under highly case-specific, imperfect circumstances.

[31] K. Popper, *Objective Knowledge: An Evolutionary Approach*, Oxford 1973, p. 9.

[32] R.D. Duvall, J.R. Freeman, "The state and dependent capitalism," pp. 267–268; P. Evans, *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil*, Princeton 1979.

[33] T. Skocpol, *States and Social Revolutions*, p. 29 ff.

occurrence of such a dependency should be considered an important indicator of domestic conditions conducive to heavy-handed interventions in support of national champions.

At the certain level of generality, the distinguishing feature of dependency is the heavily mediated structure of reciprocal reaction between State and society.[34] The dependency relationship emerges when the State apparatus is capable of controlling information — almost impossible in the digital era — and production.[35] It is this latter aspect that deserves attention here: Currently, there are almost no examples of "textbook," orthodox command economies with full State ownership of property. Most of the authoritarian regimes allow some degree of private entrepreneurialism while maintaining a surface-level rhetoric of much greater economic freedom and fairness. At the same time, the State apparatus can selectively change business conditions through i.e. permits, concessions, taxes or subsidies. While it goes without saying that all market-oriented democracies have the same intervention instruments at their disposal, but the crucial difference lies in the fact that authoritarian regimes can use them in an arbitrary manner or on a personal whim. The lack of access to a fair and impartial judicial review — inherent in all authoritarian regimes — is responsible for the resulting dependency. Since authoritarian regimes cannot coexist with a rule of law, they are intrinsically incapable — regardless of the intention in a particular case — to act as a neutral arbiter between market players.[36] For these reasons dependency should be viewed not as a result of policy decision, but rather as an unavoidable side-effect of authoritarian form of government.

In this context authoritarian regimes are in a situation — to quote a Chinese proverb — of the man who caught the tiger by the tail.[37] They are in no position, regardless of the ideological rhetoric, to eliminate dependency, therefore they are forced to exploit interventionist opportunities offered by said dependency before

[34] R.D. Duvall, J.R. Freeman, "The state and dependent capitalism," pp. 267–268.

[35] There are voices saying that advances in new technologies allow for an increasingly tight control over information flow, the Internet and so on — the so-called Great Digital Wall of China is being brought up as a particularly telling example. However, in reality such a tight control requires extensive resources, beyond the reach of most regimes, therefore the evidence is anecdotal at best (and even the Great Wall is not entirely effective). In reality, while most regimes can limit information flows, they are unable to completely monopolize it (C. Choi, S. Hoon Jee, "Differential effects of information and communication technology on (de-)democratization of authoritarian regimes," *International Studies Quarterly* 65, 2021, no. 4, pp. 1163–1175). Since a simple dichotomy "control–no-control" does not exist in reality, authoritarian regimes tend to manipulate the information to fit the official line and the success story narrative built around national champions should be seen in this context (S. Guriev, D. Triesman, "Informational autocrats," *Journal of Economic Perspectives* 33, 2019, no. 4, pp. 100–127.

[36] Cf. e.g. H. Brabazon, *Neoliberal Legality: Understanding the Role of Law in the Neoliberal Project*, Abingdon 2017, p. 178 with e.g. L. Som, *State Capitalism: Why SOEs Matter and the Challenges They Face*, Oxford 2022, pp. 41–42.

[37] The Chinese proverb was translated into English in the 1870s. The most popular translation is: "He who rides a tiger is afraid to dismount."

other unavoidable adverse economic effects negatively affect the government's political position and power base. This can be done by *inter alia* supporting national economic champions. Sets of motivations behind and advantages offered by such strategy will be discussed in the next section.

4. National champions as a tool of authoritarian regimes

At a certain level of generality, the policy of promoting national champions can be viewed in three overlapping and interdependent contexts: From an economic standpoint, the policy of creating national champions is based on assumption that a stronger larger company would be better positioned to compete at the international arena.[38] The argument runs that an active industrial policy, coupled with synergetic effect of scale and scope, can result in a medium- to long-term profits to domestic economy generated by these champions.[39] From a domestic political standpoint supporting international champions (active on international market) offer a way to reap some political and economic benefits from interventionist model thus boosting the authorities' legitimacy by presenting a success story. Whereas from a foreign policy perspective national champions can be exploited diplomatically as a soft power asset.[40]

As regards the economic context, the rationale for subsidizing national champions is debatable. Subsidies are often portrayed as inefficient because they redistribute and reallocate resources through non-economic, political criteria resulting in ineffective allocation of resources in the Pareto sense.[41] Consequently, the consensus among most mainstream economists has for a long time been inclined towards for the non-intervention case. It remains doubtful whether costs of subsidising — in a broad sense of the word — national champions are indeed proportional do profit generated abroad and their subsequent redistribution to national economy through mainly taxes paid by these companies.[42] At the same time, it is

[38] L. Sørgard, "The economics of national champions," p. 49.

[39] J.A. Brander, B.J. Spencer, "Export subsidies and international market share rivalry," p. 90.

[40] *International Business Diplomacy: How Can Multinational Corporations Deal with Global Challenges*, ed. H. Ruël, Den Haag 2018, p. 187; *Research Handbook on Economic Diplomacy: Bilateral Relations in a Context of Geopolitical Change*, eds. P.A.G. van Bergeijk, S.J.V Moons, Cheltenham 2018, p. 305 and sources quoted therein.

[41] M.J. Trebilcock, D.G. Hartle, "The choice of governing instrument," *International Review of Law and Economics* 2, 1982, no. 1, pp. 29–46.

[42] Subsidies lead to inefficient allocation of resources in the majority of cases. From this it can be tentatively inferred that a purely economic cost to benefit analysis would not justify subsidizing national champions. S. Mestelman, "General equilibrium modelling of industries with production externalities," *The Canadian Journal of Economics / Revue canadienne d'Economique* 19, 1986, no. 3, p. 522, https://www.jstor.org/stable/i300989.

well established that subsidising companies may provide a disincentive to investments and innovation by creating a risk free operating environment.[43] This in turn creates a moral hazard whereby a company is more inclined to risky behaviour because of lenient subsidy policies will not be facing negative consequences of their business decision being able to count on a public lifeline. Resulting in allocative and dynamic inefficiencies it would then usually lead to a state of affairs characterised as a market failure requiring governmental corrective measures thus propelling a "regulatory spiral."[44]

As a result — the argument runs — the subsidising country will become poorer due to not using their limited resources efficiently.[45] Even if one accepts the general premise of the above, the conclusion is based upon unsupported theoretical assumptions: First, that market conditions resemble perfect competition and thus were not distorted prior to the decision to support a company, and second, that the government is willing and able to act in a perfectly rational way.[46] Therefore, economic motivations — described below — should not be viewed through the lens of pure, theoretical, economic (Pareto-type) rationality, but rather perceived in highly subjective categories of political economy.

Regimes may justify subsidising national champions as a means of promoting industrial development. Michael Porter has argued that through consistent, long-term investments states can create competitive edge by leveraging their natural comparative advantages — such as geographic position, access to resources, etc. In other words, governments can enhance natural endowments.[47] This argument further runs that companies strive to locate their operations in the country best suited to advance particular industry and take advantage from existing synergies. Nevertheless, such a relatively short term benefits from subsidies do not outweigh their long-term detrimental effects. They delay industrial adaptation and innovation, and since most subsidies come with explicit or implicit politically-driven strings they may lead to suboptimal allocation of resources.[48]

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[43] Cf. M. Pauly, "The economics of moral hazard: Comment," *The American Economic Review* 58, 1968, no. 3, p. 531 with *European State Aid Law: A Commentary*, eds. F.-J. Säcker, F. Montag, Munich 2016, pp. 10–11.

[44] L. Morawski, *Główne problemy współczesnej filozofii prawa. Prawo w toku przemian*, Warszawa 1999, pp. 65–66.

[45] R. Behboodi, *Industrial Subsidies and Friction in World Trade Trade Policies or Trade Politics?*, Abingdon 1994.

[46] Determining economic rationality for the purpose of applying law is far from straightforward proposition, therefore all rationality-based assumptions are debatable: J. Kociubiński, "Racjonalne przedsiębiorstwo jako racjonalne założenie prawodawcy w obszarze prawa konkurencji: zarys problemu," *Przegląd Prawa i Administracji* 120, 2020, part 2, pp. 393–403.

[47] M. Porter, "The competitive advantage of nations," *Harvard Business Review* 1990, no. 3–4, pp. 87–89.

[48] Ibid., pp. 89–91.

However, Porter's line of reasoning rests on the premise that businesses, not States, compete on international market.[49] It assumes that companies are independent from States. Whereas in most authoritarian regimes there are State-run or at least State-influenced national champions. The goal, therefore, is not to create an environment conducive for foreign businesses to move in, but rather for local selected companies to operate under advantageous conditions.[50] In addition to concerns about the lack of business incentive — which are valid regardless whether domestic, foreign, public or private companies benefited from subsidies — such a selective advantage to national champions may come at the expense of other domestic market player. Conversely, however, Katz and Summers point out that subsidies may raise standard of living by increasing wages and thus stimulate subsequent spending. Especially subsidizing higher wage industries stimulates demand for all consumer products/services and thus indirectly lowers wage workers can collect in industrial rents.[51]

To conclude, the success — both political and economic — of national champions-based industrial development strategy is far from certain and requires a careful balancing of many factors. Since the very decision to support a national champion is ideologically biased in authoritarian regimes, doubts must be raised about whether that regime will be ready and able — that is objective and sufficiently open-minded — to successfully carry out such balancing.

Another motivation behind supporting national champions through subsidies can also be knowledge acquisition. This can be understood not only as enhancing the beneficiary's technological know-how through R&D funding, but even more so in the context of using mergers and acquisitions to acquire foreign proprietary technology. Which, in turn, can either be utilized by the acquirer or, more importantly, funnelled in the State's economy so other businesses can also benefit from it.[52] Subsidies provide the necessary capital for such operations allowing undertakings to outbid non-subsidized foreign enterprises.[53] Notably, the whole scheme of using national champions to facilitate a technology drain can fully succeed in the economy-wide context when carried out by non-democratic regimes with lax — more often *de facto* than *de iure* — intellectual property regimes, with

[49] Ibid., p. 89.

[50] This is not always the case: See e.g. U. Haley, G. Haley, *Subsidies to Chinese Industry: State Capitalism, Business Strategy and Trade Policy*, Oxford 2013, pp. 16–28.

[51] L.F. Katz, L.H. Summers, "Can inter-industry wage differentials justify strategic trade policy?," [in:] *Trade Policies for International Competitiveness*, ed. R. Feenstra, Chicago 1989, p. 85.

[52] Chinese takeover of German robotics company Kuka in 2016 serves as a particularly striking example. See also commentary: E. Braw, "Cutting-edge tech takeovers are a strategic threat to the West," *Financial Times*, 7.10.2019, https://www.ft.com/content/763cae4e-e5ed-11e9-b8e0-026e07cbe5b4 (accessed: 2.05.2024).

[53] See White Paper on levelling the playing field as regards foreign subsidies: COM(2020) 253 final, 2.2.

no rule of law.[54] The latter successfully prevent private claims concerning foreign IP violations in domestic courts.[55]

It can also be argued, however, that such a strategy can have a double-edged sword impact. An unsavoury reputation for being near the forefront of disregard for IP rights — once earned — can deter foreign companies from doing business in a given State.[56] In other words, States are spending their credibility in exchange for pursuing this policy.[57] This factor is being increasingly recognized by the European Union as a concern beyond the ability of the market forces alone to solve.[58] Because from the technology proprietor's perspective the broader problem of technology drain is largely irrelevant as long as the initial acquisition is done under satisfying business terms. And (more than likely) will be because subsidized foreign purchaser would be able to offer much better price than other potential non-subsidized buyers.[59]

Consequently, in 2022 the EU has adopted a new regulation introducing mandatory *ex-ante* notification system akin to merger control when foreign subsidies are used to facilitate an acquisition of an EU target or participate in an EU procurement contract.[60] On the one hand, this development might be viewed as anecdotal, but on the other it might be seen as a sign of growing awareness and an early precursor that subsidy-driven technology drain is backfiring. Also, European Union is, together with United States, at the forefront of technical innovations, thus the regulation in question is by no means insignificant as it covers large proportion of attractive acquisition targets.[61] On a cautionary note, however, the jury is still out how "militant" the European Commission would be in enforcing

[54] U. Haley, G. Haley, *Subsidies to Chinese Industry*, p. 13; X. Tan, *Managing International Business in China*, Cambridge 2016, p. 242. Despite the official rhetoric proclaiming a law-abiding environment, fines may be too small to deter infringers, who may simply regard them as the cost of doing business and resume their activities once penalties are paid.

[55] X. Tan, *Managing International Business in China*, pp. 242–244.

[56] N.M. Jensen, N.P. Johnston, "Political risk, reputation, and the resource curse," *Comparative Political Studies* 44, 2011, no. 6, pp. 662–688; L. Johns, R.L. Wellhausen, "Under one roof: Supply chains and the protection of foreign investment," *American Political Science Review* 110, 2016, no. 1, pp. 32–33.

[57] L. Som, *State Capitalism*, p. 40.

[58] White Paper on levelling the playing field as regards foreign subsidies, pp. 6–8.

[59] J. Blockx, "The proposal for an EU regulation on foreign subsidies distorting the internal market: How will it impact corporate mergers and acquisitions?," SRRN, 5.10.2021, https://ssrn.com/abstract=3936624 (accessed: 4.01.2023).

[60] Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market. Unpublished as of 04.01.2023. The act received final approval on 28.11.2022 and after being signed by the President of the European Parliament and the President of the Council, the regulation will be published in the Official Journal of the European Union and will enter into force on the 20th day following its publication.

[61] See e.g. Latham & Watkins, M&A Report 2022. Available at: https://www.lw.com/admin/upload/SiteAttachments/IFLR%20M-A%20Report%202022%20-%20Germany,%20UK%20and%20US.pdf (accessed: 4.01.2023).

these rules and how strict the envisaged *ex ante* control would be.[62] Although at this point, it is too early to make any firm assessment of the regulation's impact, it may be that the policy of subsidy-driven acquisitions finally outplayed itself.

Subsidizing national champions can also be seen in the context of strategic trade policy. The argument — based largely on the works by Brander and Spencer — runs that subsidies can help capture large shares of markets in target countries, thereby siphon out revenues from these foreign market into domestic economy.[63] Broadly speaking, the underlying assumption is similar to that of promoting industrial development mentioned earlier: Subsidies can be targeted at specific export-oriented national champions to maximally exploit the pre-existing national advantages.[64] Assuming this line of reasoning is economically valid, despite limitations imposed on export subsidies by WTO states will have incentives to cheat on any restrictions, especially considering that these rules require regular scrutiny and oversight to be effective.[65] Something that is highly problematic in the international law-based environment.[66]

At the same time, there exists a rich seam of literature pointing out the inherent inefficiency of subsidizing market seeking opportunities abroad. Such a policy can lead to a whole host of suboptimal rent seeking, inefficient allocation of resources and so on.[67] While these economic concerns are at least partially correct — both *pro* and *contra* positions are defensible — the fact that some regimes (if general conditions permit) pursue these policies goes to show the limit of economic factors in authoritarian States' decision-making.[68] States can willingly pay the price of economic efficiency to accomplish political, social, diplomatic and even personal goals. These non-economic objectives should not be seen as a policy counterweight to purely economic considerations, assessable through

[62] Criteria are directly based on those from Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings [2004] OJ L 24/1 thus allow a high degree of interpretive flexibility.

[63] J.A. Brander, B.J. Spencer, "Export subsidies and international market share rivalry," p. 90 ff.

[64] See M. Porter, "The competitive advantage of nations," pp. 87–91.

[65] U. Haley, G. Haley, *Subsidies to Chinese Industry*, p. 15.

[66] See P. Poretti, *The Regulation of Subsidies within the General Agreement on Trade in Services of the WTO: Problems and Prospects*, Alphen aan den Rijn 2009, Chapter 5.

[67] See e.g. K. Bagwell, *Remedies in the WTO: An Economic Perspective*, Discussion Paper No. 0607-09, New York 2007, https://academiccommons.columbia.edu/doi/10.7916/D8JT02J8/download,; J.M. Finger, H.K. Hall, D.R. Nelson, "The political economy of administered protection," *The American Economic Review* 72, 1982, no. 3, p. 452; A. Green, M. Trebilcock, "Enforcing WTO obligations: What can we learn from export subsidies?," *Journal of International Economic Law* 10, 2007, no. 3, pp. 653–683; P. Krugman, M. Obstfeld, *International Economics: Theory and Policy*, Boston 2005, pp. 99–102, 186–187; A.O. Sykes, *The Economics of WTO Rules on Subsidies and Countervailing Measures*, John M. Olin Program in Law and Economics Working Paper No. 186, Chicago 2003, p. 7.

[68] U. Haley, G. Haley, *Subsidies to Chinese Industry*, pp. 15–16; L. Som, *State Capitalism*, pp. 6–11.

objective criteria, but rather as a hindrance factor inherent in all authoritarian regimes. These issues will be discussed in the next section.

5. The inherent limitations of national champions strategy pursued by authoritarian regimes

Even in the context of liberal democracies it is asserted that interventionist economic policies emerge through political process in which lawmakers and regulators act according to their own preferences within constraints set by various pressure groups — lobbyists, industrialist etc.[69] In authoritarian regimes, when there are no periodic competitive elections the composition of various interest group is different, but the underlying premise of securing regimes' power base is the same. Simultaneously, a policy of promoting national champions can be presented to the general public from the nationalist angle as a country's "success story." For authoritarian regimes, therefore, State capitalism should be viewed as an important mechanism to evoke its own legitimacy by effecting a coalition of key groups including provincial leaders, military, "technocrats," possibly religious leaders. Together these non-electable groups constitute the "techno-bureaucratic elite" — to quote Raymond Duvall and John Freeman — which form a regime's power base and thus have decisive impact on policies.[70] Ultimately, national champions, and broadly speaking State-run enterprises, form the foundations of regimes' power base though collective interests of non-electable administrators — oligarchs, family/clan members, industrialists etc.[71] Even in democratic (aside from transitory period between the Fourth and the Fifth Republic), but relatively *étatiste* governments like France the "revolving door" career transition (fr. *pantouflage*) in State-run businesses is a common practice among senior administrators and thus the defence of State involvement in the economy can be seen as protecting personal financial interests of administering cadre.[72]

When these factors synergises with, on the one hand, relatively high income economy, and a deficit in the rule of law on the other, there is a real risk of the emergence of the so-called "crony capitalism."[73] The term "crony capitalism" and "cronyism" in general refers to a situation where authorities granting favours with

[69] B.J. Spencer, "Countervailing duty laws and subsidies to imperfectly competitive industries," [in:] *Issues in US–EC Trade Relations*, eds. R.E. Baldwin, C.B. Hamilton, A. Sapir, Chicago 1988, pp. 315–348.

[70] R.D. Duvall, J.R. Freeman, "The state and dependent capitalism," p. 274.

[71] T.A. Hemphill, G. White III, "China's national champions," pp. 198–199.

[72] See E. Suleiman, *Les élites en France. Grands corps et grandes écoles*, Paris 1979.

[73] J. Hellman, D. Kaufmann, "Confronting the challenge of state capture in transition economies," *Finance and Development* 38, 2001, no. 3, p. 31.

economic value — subsidies, permits, concessions etc. to those who are closest to them and expecting *quid pro quo* in return.[74]

Direct, often personal, links existing between rule makers and businesses also serve as network by which various public officials can maximize personal gains. In this context Marcus Mietzner claimed that even in democratic societies most politicians enter the legislature with a constant pressure to make money.[75] Since officials share in the rents created by selected, favoured business groups policymaking can become beholden to various predatory personal interest.[76] It stands to reason that the ability to exploit a position of privilege is immeasurably higher in non-democratic regimes due to the inherent lack of transparency and no meaningful periodic elections. Collusion or overlap between officials and business owners — the latter usually existing in form of command economy — usually results in rules either being circumvented, not enforced or in extreme cases adopted in such a way to serve the need of privileged undertakings.[77] Therefore corruption is another inescapable result of cronyism.

There are some studies to suggest that, especially in developing economies, a higher tolerance of corruption can lead to higher outputs.[78] Crony connections can make it easier to attract foreign investments, acquire know-how from foreign enterprises by cutting bureaucratic red tape.[79] In this context, bribes to local officials come to be regarded as a cost of doing business. The World Bank estimates that in the 1990s 5% of the exports to developing countries went to corrupt officials but the rate has now crept up to approx. 20–30%, therefore there is a balancing involved of pitting the increased costs of doing business due to corruption against the overall lower operating costs of doing business in low-wage, lax regulations country.[80] In a nutshell — setting aside moral compunctions — for a corruption to contribute country's economy it must not reach a tipping point whereby it would work as a deterrent rather as a way to make things run smoothly. In a somewhat similar vein as with industrial development goals, doubts must be expressed whether any autocratic government can carry out such balancing since

[74] A.O. Krueger, "Why crony capitalism is bad for economic growth," [in:] *Crony Capitalism and Economic Growth in Latin America*, ed. S. Haber, Stanford 2002, pp. 1–23; L. Som, *State Capitalism*, p. 46.

[75] See e.g. M. Mietzner, "Dysfunction by design: Political finance and corruption in Indonesia," *Critical Asian Studies* 47, 2015, no. 4, p. 487.

[76] L. Som, *State Capitalism*, pp. 47–48.

[77] A.O. Krueger, "Why crony capitalism is bad for economic growth," pp. 21–23.

[78] W. Li, G. Roland, Y. Xie, "Crony capitalism, the party-state, and the political boundaries of corruption," *Journal of Comparative Economics* 50, 2019, no. 3, p. 652.

[79] A.O. Krueger, "Why crony capitalism is bad for economic growth," pp. 21–23; L. Som, *State Capitalism*, p. 48.

[80] Qtd in: B. Maude, *International Business Negotiation: Principles and Practice*, London 2020, p. 51.

corruption affects the whole State apparatus which is then fundamentally incapable of any self-restraint — more corruption equals less central control.[81]

This aspect can be seen as a self-defeating in the context of using national champions because State-owned industries are faced with the constant threat of turning into "cash cows" for the ruling elite.[82] Although such exploitation is implicitly assumed (at least to an extent), once it reaches a tipping point — impossible to describe with the help of quantitative criteria — the national champion's ability to engage in interstate competition may become hampered to the extent which renders all economic goals (described in the previous section) unattainable. In other words, excessive cronyism — which by itself is an important part of a ruling's elite power base — can derail or at least impede regimes' attempt to build their legitimacy on national champions' successes.

It must also be mentioned that cronyism and especially associated corruption serves as a crucial safety valve that contributes to authoritarian resilience by relieving public frustration in a way of allowing access to goods and services otherwise unobtainable through official channels.[83] For this reason, in addition to systemic incapability to successfully root out corruption, and regardless of the official stance on it, authoritarian regimes may be inclined to give at least tacit approval for corruption.[84]

The origin of crony capitalism as well as of the whole host of associated problems such as nepotism, clientisms, corruption can be attributed to a common denominator of the lack of — broadly speaking — the rule of law. Access to a fair hearing by an independent and impartial court and in the economic context discipline of market competition can only fulfil its role as a safeguard and discipline mechanism respectively if there are arm-length's principles in the governance and management of State owned enterprises.[85] Something that — as has already been said — authoritarian regimes are inherently incapable of imposing.

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[81] C.S. Fran, C. Lin, D. Treisman, "Political decentralization and corruption: Evidence from around the world," *Journal of Public Economics* 93, 2009, nos. 1–2, pp. 14–34.

[82] See e.g. J. Leightner, *Ethics, Efficiency and Macroeconomics in China: From Mao to Xi*, Abingdon 2017.

[83] See L. Holmes, *The End of Communist Power: Anti-Corruption Campaigns and Legitimation Crisis*, Oxford 1993, pp. 203–212; F. Feher, A. Heller, G. Markus, *Dictatorship over Needs: An Analysis of Soviet Societies*, Oxford 1983, p. 99.

[84] However, corruption provides a fertile ground for con men (see example H.W. Morton, "Who gets what, when and how? Housing in the Soviet Union," *Soviet Studies* 32, 1980, no. 2, p. 250) therefore the so-called "second-economy" — somewhat paradoxically simultaneously weakens and strengthens non-democratic regimes.

[85] L. Som, *State Capitalism*, p. 48.

Conclusions

This paper has demonstrated that the relationship between the multiple and often contradictory motivations behind pursuing national champions strategy as well as the number of possible trade-offs between intended and unintended impacts means that no simple conclusions can be reached regarding whether and to what extent these policies should be viewed as a major and tangible threat to fair competition.[86] The ability to strategically abuse market forces is mitigated by the presence of negative phenomena such as economic inefficiency, cronyism and corruption which are endemic and unavoidable in authoritarian regimes. Therefore, the answer to the question whether systemic rejection of free market doctrine by some authoritarian regimes warrants a response by the international community may unfold differently depending on which perspective one adopts — that of lofty principles, or cold *realpolitik*.

At the present time, the general consensus (but by no means unanimity), at least in Europe and the US, is that these attempts to abuse possibilities offered by free markets should be countered.[87] It can be discussed how much damage has already been done by these policies, but it must also be noted that only relatively few countries managed to pull it off due to the extent of resources required. Hence, the need to respond can be primarily justified to avoid creating a precedent whereby hard-won free market rules are circumvented (this can be simultaneously justified on ethical grounds). As such unilateral actions may be required which in turn may lead to retaliatory spiral that could — *in extremis* — plunge the world economy into a 1930s-style trade war. Therefore, from a short-term economic standpoint a convincing case can be made for inaction, but at the same time the jury is out whether long term damages would not be *per saldo* greater if these national champions promoting policies are left unchecked.

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[87] These voices implicitly, but rather clearly, concern China.

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