

## CHINA'S PARTICIPATION IN THE WTO: A LAWYER'S PERSPECTIVE

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On 10 November 2001, China finally acceded to the World Trade Organization (WTO) after a marathon negotiation spanning 15 years. China's membership in the WTO raises interesting questions for both the WTO and China. For the WTO, the question is how to deal with China—a huge country of growing importance as a major global exporter and importer but is still in economic transition. For China, the question is how to implement the numerous obligations in the WTO accession package. This paper sets out by reviewing China's experience in the General Agreement on Tariffs and Trade (GATT) and the WTO. It then discusses the benefits and challenges arising from China's WTO accession, in particular the challenges arising from market access commitments and rules obligations. The author is of the view that whilst the market access commitments are relatively easy to deal with, the rules obligations may have much broader implications on both China and the multilateral trading system. This is especially true for the "WTO-minus rights" provisions which are embodied in the Accession Protocol and Working Party Report of China. Finally, the author analyses the actions taken by the Chinese government since its WTO accession to implement the commitments and to deal with the challenges, and suggests some trade policy reforms.

### I. A SHORT HISTORY OF CHINA'S RELATIONSHIP WITH THE GATT AND WTO

As the WTO is the successor to the GATT, an account of China's participation in the WTO would not be complete without discussing China's participation in the GATT. Indeed, the origin of many of the problems which arise from China's participation in the WTO can be traced back to China's experience with the GATT. To start, a brief overview of China's participation in the GATT<sup>1</sup> is in order.

As one of the Allied Powers which won the Second World War, The Republic of China (ROC) was invited, in 1946, along with 17 other countries, by the UN Secretary General to participate in the Preparatory Committee for the UN Conference on Trade and Employment.

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<sup>1</sup> There have been many books and articles discussing China's accession to the WTO. An excellent survey of the relevant materials can be found at John H. Jackson & James V. Feinerman, eds., "China's WTO Accession: Survey of Materials" (2001) 4 J.I.E.L. 329 at 329-335. For a good summary of the position of the Chinese government, see Yang Guohua & Cheng Jin, "The Process of China's Accession to the WTO" (2001) 4 J.I.E.L. 297. For a good summary of the process from the perspective of the Secretariat, see Jeffrey Gertler, "China's WTO Accession—The Final Countdown" in Deborah Z. Cass *et al.* eds., *China and the World Trading System: Entering the New Millennium* (Cambridge: Cambridge University Press, 2003) at 55-67. For a discussion on some of the stumbling blocks in China's accession process, see Kym Anderson, "On the Complexities of China's WTO Accession" (1997) 20(6) *The World Economy* at 749-772. For a good account of the several rounds of bilateral negotiations between the US and China during the accession process, see Raj Bhala, "Enter the Dragon: An Essay on China's WTO Accession Saga" (2000) 15 *Am. U. Int'l L. Rev.* 1469. For a discussion on the US domestic law affecting China's WTO accession, especially the Jackson-Vanik Amendment, see Sylvia A. Rhodes & John H. Jackson, "United States Law and China's WTO Accession Process" (1999) 2 J.I.E.L. 497 at 497-510.

The Chinese government took this matter very seriously as the 17 countries (one country, the USSR, was also invited to participate in the Committee but declined) which participated in the work of the Preparatory Committee accounted for over 70% of world trade.<sup>2</sup> The Chinese government sent a strong delegation led by their veteran trade negotiator Wunz King, the then Chinese Ambassador to Belgium.<sup>3</sup> The Chinese delegation attended both sessions of the preparatory committee in London and Geneva, as well as the final conference in Havana.<sup>4</sup> After extensive negotiations, China signed the Protocol of Provisional Application of the GATT on 21 April 1948 and became a founding contracting party of the GATT.<sup>5</sup> Evidence of this now can still be found in the preamble of the GATT, which states in the very first paragraph that “the Republic of China”, along with 22 other countries, was one of the founding contracting parties of the GATT.

On 1 October 1949, the communists came into power and established the People’s Republic of China. The communists controlled most of the mainland, while the ROC, or the Kuomintang government, was forced to go into exile on the outlying island of Taiwan. This raises interesting questions under the rules on the succession of state or government in respect of treaty obligations. Theoretically, arguments can be made for two rather different positions.<sup>6</sup>

The interim constitution of the Peoples’ Republic, the Common Program of the Chinese People’s Political Consultative Conference of 1949, seems to take a cautious approach by stating in Article 55 that, “with respect to the treaties and agreements made by the Kuomintang government and foreign governments, the Central People’s Government of the Peoples’ Republic of China shall conduct examination and may either recognize, repeal, revise or renegotiate them according to their respective contents”.<sup>7</sup> Even though the communist government did recognise or repeal several treaties according to this provision, it never explicitly stated how it would deal with the GATT. With the establishment of the Council for Mutual Economic Assistance in 1949 as the trade organisation of socialist countries, and Mao Zedong’s announcement that “China will side with the socialist camp”<sup>8</sup>, it seemed quite clear that the People’s Republic would not participate in the activities of the GATT, a “capitalist club” boycotted by the USSR from the very beginning.<sup>9</sup>

Even though the Kuomintang government might still claim that it is the legitimate representative of China in the GATT, in reality, it can no longer enjoy its rights or honour its obligations under the GATT as the communists effectively control most of the territories of China. For the government of the ROC, the contracting party status in the GATT has now

<sup>2</sup> Liu Xiangping, “Wunz King and the GATT”, (2002)5 *Twenty-First Century* (web edition), online: <<http://www.cuhk.edu.hk/ics/21c/supplem/essay/0204056g.htm>>.

<sup>3</sup> *Ibid.*

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

<sup>6</sup> See, e.g., Reporters’ Notes 1 to the Restatement (Third) of Foreign Relations Law §208 (1987), which notes that “[t]he international law and the practice of states as to succession have been uncertain and confused. In recent decades several views have emerged. Some suggest that the new state succeeds to no rights or obligations of its predecessor but begins with a *tabula rasa*. At the other pole is the view that a successor state is responsible for all obligations and enjoys all rights of its predecessor. Intermediate views have distinguished different circumstances of succession and different rights and obligations”. Thus, Restatement (Third) adopts the view that succession has varying effects on state rights and duties. Brownlie also notes that “state succession is an area of great uncertainty and controversy. This is due partly to the fact that much of the state practice is equivocal and could be explained on the basis of special agreement and various rules distinct from the category of state succession. Indeed, it is perfectly possible to take the view that not many settled legal rules have emerged as yet”: Ian Brownlie, *Principles of Public International Law*, 6<sup>th</sup> ed. (Oxford: Oxford University Press, 2003) at 622.

<sup>7</sup> The full text of the Common Program is available at <[http://news.xinhuanet.com/ziliao/2004-12/07/content\\_2304465.htm](http://news.xinhuanet.com/ziliao/2004-12/07/content_2304465.htm)>.

<sup>8</sup> Mao Zedong, “On People’s Democratic Dictatorship”, online: <[http://www.gdyunan.gov.cn/SGDBJT/SGDB\\_GCDXYP5.htm](http://www.gdyunan.gov.cn/SGDBJT/SGDB_GCDXYP5.htm)>.

<sup>9</sup> See Liu Xiangping, *supra* note 2.

become more of a liability than a benefit. On the one hand, as most of the goods from China originate from the Mainland, the communists would reap most of the tariff benefits that the ROC has negotiated in the GATT. On the other hand, for most of the goods shipped to mainland China from other contracting parties, the ROC would not be able to guarantee that they will receive the preferential tariff that it had agreed to grant under the GATT. Moreover, Taiwan's trade was rather insignificant during the 1950s, and most of the trade with its major trading partners already enjoyed preferential tariff under the bilateral trade agreements anyway.<sup>10</sup> Thus, it does not make sense for the Kuomintang government to stay in the GATT any more. The United States was the first to notice the potential legal complexities that could arise from this issue.<sup>11</sup> On 10 February 1950, the Secretary of State of the US notified the embassy of the ROC in Washington DC that it would request the Contracting Parties to terminate the Most Favoured Nation (M.F.N.) treatment for China under the GATT as the People's Republic of China refused to fulfil its GATT obligations.<sup>12</sup> Both Wunz King and Wellington Koo, the then ROC Ambassador to the US, suggested that the Kuomintang government withdraw from the GATT.<sup>13</sup> On 6 March 1950, the Kuomintang government notified the UN Secretary General that it would withdraw from the GATT pursuant to Article 5 of the Protocol of Provisional Application.<sup>14</sup> The withdrawal took effect on May 5 of the same year.<sup>15</sup>

One may argue that Taiwan's withdrawal was invalid because in 1950, the Kuomintang government did not control most of China and thus was not the legitimate representative of China. Indeed, this was the exact argument made by the People's Republic of China when it tried to "resume" its contracting party status more than three decades later. As discussed earlier, however, the Mainland then never explicitly recognised the GATT as a valid agreement nor implemented its obligations under the GATT. Moreover, the Mainland did not challenge the validity of Taiwan's withdrawal until more than thirty years later. Thus, for all practical purposes, Taiwan's withdrawal is probably valid.<sup>16</sup>

In 1971, China scored a major diplomatic victory. On 25 October 1971, the UN General Assembly, by UN General Resolution 2758, decided "to restore all its rights to the People's Republic of China and to recognize the representatives of its Government as the only legitimate representatives of China to the United Nations, and to expel forthwith the representatives of Chiang Kai-shek from the place which they unlawfully occupy at the United Nations and *in all the organizations related to it*" (emphasis added). Even though the GATT, straightly speaking, was not a UN specialised agency like the United Nations Conference on Trade and Development (UNCTAD) or the Food and Agriculture Organisation of the United Nations (FAO), it was guided by the UN in all political decisions.<sup>17</sup> Thus, China

<sup>10</sup> Ying-jeou Ma, "The ROC (Taiwan)'s Entry into the WTO: Progress, Problems and Prospects", 15 Chinese Yearbook of International Law & Affairs (1996-97) at 36, cited in Pasha L. Hsieh, "Facing China: Taiwan's Status as a Separate Customs Territory in the World Trade Organization" (2005) J. World Trade 39(6) at 1195-1221, note 18.

<sup>11</sup> See Liu Xiangping, *supra* note 2.

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

<sup>14</sup> According to this article, "[a]ny government applying this Protocol shall be free to withdraw such application, and such withdrawal shall take effect upon the expiration of sixty days from the day on which written notice of such withdrawal is received by the Secretary-General of the United Nations." See World Trade Organisation, *GATT Analytical Index: Guide to GATT Law and Practice*, 6<sup>th</sup> ed. (Geneva: WTO and Bernan Press, 1995) at 1071.

<sup>15</sup> See Liu Xiangping, *supra* note 2.

<sup>16</sup> The issue became moot as China did not manage to "resume" its contracting party status before the WTO was established and the GATT, as a *de facto* international organisation, no longer exists today.

<sup>17</sup> As summarised by the Chairman of the Contracting Parties during the discussions on the observer status of Taiwan in the GATT in 1965, "it had been the policy of the CONTRACTING PARTIES to avoid unproductive controversies over political questions which did not bear significantly on the many substantial questions with which the CONTRACTING PARTIES were concerned. For this reason the CONTRACTING PARTIES had

could have easily restored its contracting party status in the GATT by requesting the GATT to follow UN General Resolution 2758. Unfortunately, China did not immediately make any formal request to the GATT.<sup>18</sup> There are several possible explanations for this. First, China might not have realised the importance of the GATT. Secondly, China still viewed the GATT as a “rich (capitalist) countries’ club”<sup>19</sup> and “tools for imperialist countries to exploit poor countries”<sup>20</sup> and was thus reluctant to join. Thirdly, other than barter trading with its communist brothers, China did not have much trade with the outside world at the time. Finally, the Chinese were busy fighting among themselves during the ongoing Cultural Revolution (1967-1977) and thus took little interest in the outside world.

From the late seventies onwards, under the new leadership of the late Deng Xiaoping, China began to reform its economic system. Drawing from the experiences of other countries, China saw foreign trade as a good way of lifting the country out of poverty and encouraged the development of export-oriented industries. At that time, the WTO had just completed the Tokyo Round, which brought the average tariff on industrial products down to 4.7%. Even though they were still not very clear about how the GATT system worked, the Chinese realised that the GATT M.F.N. tariff could greatly help to boost Chinese exports. On 5 July 1982, China submitted a communication to the GATT.<sup>21</sup> In the communication, China requested to participate as observers in the Thirty-Eighth Session of the Contracting Parties to be held in November 1982, while noting that such request shall be “without prejudice to the position of [China] with regard to its legal status vis-à-vis the [GATT]”.<sup>22</sup> This request was approved at the meeting of the Council on 21 July 1982, where “[a] large number of representatives spoke in favour of approving the request”.<sup>23</sup> At a Council meeting on 2 November 1982, the Chinese delegation noted in a speech that “China is one of the Contracting Parties of the GATT. The relations between China and the GATT are strengthening. We are willing to explore the possibilities of furthering improving relations with the GATT”.<sup>24</sup>

After four years of observation, China made a formal request in 1986 to resume its contracting party status in the GATT.<sup>25</sup> In seeking resumption of its contracting party status, the Chinese government announced three basic principles.

First, China was applying for resumption of its contracting party status, rather than accession to the GATT as a new contracting party.<sup>26</sup> The political message is clear: the

followed the policy expressed in Article 86 of the Havana Charter, namely to avoid passing judgment in any way on essentially political matters and to follow decisions of the United Nations on such questions”. See *GATT Analytical Index: Guide to GATT Law and Practice*, *supra* note 14 at 877.

<sup>18</sup> After the UN restored China’s seat, China also replaced Taiwan in the International Monetary Fund and World Bank. See Zhang Hanlin, *Reviewing China’s WTO Accession* (Beijing: China Economic Daily Press, 2002) at 16-18. Also, after Taiwan withdrew from the GATT in 1950, it sought and was granted observer status in the GATT in 1965. After China restored its seat in the UN, the GATT revoked Taiwan’s observer status in the same year. See Hsieh, *supra* note 10 at 1197-98.

<sup>19</sup> Tong Zhiguang, “China’s Relationship with the WTO” in Wang Guiguo & David Smith, eds., *The WTO and China: The Road to Free Trade* (Beijing: Law Press, 2002) at 232.

<sup>20</sup> Yang Guohua, *Legal Problems on China’s Accession to WTO* (Beijing: Law Press, 2002) at 30.

<sup>21</sup> *People’s Republic of China: Attendance at Thirty-Eighth Session*, GATT Document L/5344.

<sup>22</sup> *Ibid.*

<sup>23</sup> *Minutes of Meeting: Held in the Centre William Rappard on 21 July 1982*, GATT Document C/M/160, at 2.

<sup>24</sup> Yang Guohua & Cheng Jin, *supra* note 1 at 301.

<sup>25</sup> *China’s Status as A Contracting Party: Communication from the People’s Republic of China*, GATT Document L/6017. According to Liu Xianming, Counselor in the Chinese mission to Geneva from 1984, China originally thought that it would have to pay the arrears of GATT membership dues if it chose to seek resumption of its membership status, while such liability would be discharged if China joined the GATT as a new contracting party. Later, China discovered that such membership fees could be waived as China did not have much international trade and thus decided to seek “resumption” of its contracting party status instead. See Liu Xianming, “I Didn’t Know That Was A Historical Moment”, *Beijing Youth Daily* (28 October 2001).

<sup>26</sup> *Ibid.*, noting that China is seeking “the resumption of its status as a contracting party to GATT” rather than joining as a new party.

People's Republic deems itself to be the legitimate representative of China since 1 October 1949 and thus denies the validity of Taiwan's withdrawal from the GATT in 1950. From a legal perspective, this principle serves a more important purpose. At that time, the US applied the Jackson-Vanik Amendment to its trade relationship with China, which essentially meant that China could not enjoy normal trade relationship with the US unless the US congress granted China normal trade relationship in its annual review.<sup>27</sup> The public humiliation and economic risks brought by the annual review of the US congress were enormous and China was eager to get rid of this ordeal. If China were to join the GATT as a new contracting party, the US could still invoke Article XXXV of the GATT to continue this practice.<sup>28</sup> However, it would be impossible for the US to invoke this if China were only "resuming" its contracting party status because Article XXXV could only be applied at the time of initial tariff negotiation between the parties<sup>29</sup> or at the time when one country became a contracting party.

Second, China shall join the GATT as a developing country and "expects to receive treatment equivalent to that accorded to other developing contracting parties".<sup>30</sup> When the GATT was first started, tariff negotiations were supposed to be conducted on reciprocal and mutually advantageous bases.<sup>31</sup> With the waves of decolonization in the 1950s and 1960s, many former colonies became independent countries and joined the GATT. However, they regarded the GATT obligations to be onerous and argued that they should be granted special treatments because they were at lower levels of economic development. In response to this pressure, the GATT Contracting Parties added Part IV to the GATT in 1965, and "Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries" (the "Enabling Clause") in 1979. The former codified the concept of non-reciprocal preferential treatment for developing countries, which permits developing countries to undertake lower levels of tariff concession commitments. The latter enables developed members to give differential and more favorable treatment to developing countries without the need to grant the same to other developed countries as they would normally be required to under the M.F.N. principle. Both provisions effectively provide developing countries a longer timeframe to fulfil their GATT obligations. In addition, developing countries also benefit from the technical assistance provided by the GATT. Curiously, there is no official definition for the term "developing countries" under the GATT. By convention, it has largely been a matter of self-selection.<sup>32</sup> At the same time, other countries can challenge the status of a country which regards itself as a "developing country" when that country

<sup>27</sup> Sylvia A. Rhodes & John H. Jackson, *supra* note 1 at 502-508.

<sup>28</sup> Article XXXV: Non-application of the Agreement between Particular Contracting Parties:

1. This Agreement, or alternatively Article II of this Agreement, shall not apply as between any contracting party and any other contracting party if:

(a) the two contracting parties have not entered into tariff negotiations with each other, and

(b) either of the contracting parties, at the time either becomes a contracting party, does not consent to such application.

<sup>29</sup> The ROC already held initial tariff negotiation with the US when the GATT entered into force.

<sup>30</sup> *China's Status as A Contracting Party: Communication from the People's Republic of China*, *supra* note 25.

<sup>31</sup> See, e.g., the preamble of the GATT, noting that the contracting parties shall "contribut[e] to these objectives by entering into *reciprocal and mutually advantageous* arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce" (emphasis added).

<sup>32</sup> During the drafting process of Part IV of the GATT, the Committee on the Legal And Institutional Framework of GATT In Relation To Less-Developed Countries also discussed the problems concerned with identifying the less developed contracting parties (developing countries) and defining the term "less-developed contracting party". Two main views emerged in the Committee. On the one hand, some members considered that it was not at this stage either necessary or feasible to attempt a definition of a less-developed contracting party and that if a problem as to identification arose such a problem could be dealt with at that time. On the other hand, some members felt that it was possible by a systematic identification of either less-developed contracting parties or developed contracting parties to resolve the matter at a later stage. In the end, they decided to leave

tries to leverage on special provisions available to developing countries. Apparently, by insisting on being a developing country, China's aim was to enjoy the special and differential treatments for developing countries, which was what China badly needed at that time as it tried to better integrate its own economy with the global one.

Third, China should join the GATT on the basis of tariff concessions, rather than quantitative import commitments. First introduced during the Polish accession in 1967, the quantitative import commitments were designed for planned economies without tariff regimes.<sup>33</sup> Traditionally, economic activities in communist countries are arranged by state planning, which covers not only domestic production and consumption but also foreign trade. The state would decide the amount of exports and imports each year and, as everything was planned by the state, there was no need for tariffs as trade measures. The contracting parties of the GATT, most of which were capitalist countries, were worried that the communist countries could simply choose to decide by state planning to not import anything at all, thus nullifying the value of tariff concessions that they had negotiated with such countries. To avoid this problem, it appeared to make more sense to require the communist countries to agree to import an increasingly larger amount of goods every year. In appearance, quantitative import commitments seem to be no different from tariff concessions because a country could easily convert tariff concessions into the amount of goods imported every year. In practice, however, because most countries usually have a cushion between the binding tariffs and applied tariffs, the quantitative import commitment would actually translate into a much higher tariff concession. Moreover, as the quantitative import commitment requires increases in imports every year, the contracting party would effectively lose the flexibility needed to deal with unexpected changes in the domestic and world markets. China argued that, in its case, quantitative import commitments should not apply as it no longer imposed state planning on exports and imports and its foreign trade was regulated by tariffs.<sup>34</sup> Nonetheless, because China, at least back then, still had strict foreign exchange controls, and one would have to apply for foreign exchange before importing goods from abroad, China's argument does not seem very persuasive.

In March 1987, the GATT established a working party to examine China's status.<sup>35</sup> Reflecting China's insistence on "resumption, not accession", the working party was named "Working Party on China's Status as a Contracting Party", rather than the usual "Working Party on Accession".<sup>36</sup> Because the GATT does not have rules governing the resumption of contracting party status, for all practical purposes, the working party followed the procedure for that of an accession working party.<sup>37</sup> China also accepted this as a practical compromise, and indicated in its resumption request that it "is prepared to enter into negotiations with GATT contracting parties".<sup>38</sup> Such negotiations would involve two steps: first, bilateral

the issue to be resolved later. See *Committee on the Legal and Institutional Framework of GATT in Relation to Less-Developed countries: Report of the Committee, Revision*, GATT Document L/2195/REV.1.

<sup>33</sup> Alexander Polouektov, "Non-Market Economy Issues in the WTO Anti-Dumping Law and Accession Negotiations: Revival of a Two-tier Membership?" (2002) 36(1) *J. World Trade* at 9-11. See also K. Grzybowski, "Socialist Countries in GATT" (1980) 28(4) *Am. J. Comp. L.* 539 at 547-548.

<sup>34</sup> This would seem to be in line with the precedent set by the accession of Yugoslavia. Even though it was still a Communist economy at the time, Yugoslavia was able to accede to the GATT in 1962 by embracing the principles of the GATT as the basis for its trade relationships with other GATT members with the establishment of a tariff regime in 1960. See Grzybowski, *ibid.*

<sup>35</sup> Minutes of Meeting: Held in the Centre William Rappard on 4 March 1987, *supra* note 23 at 9-12.

<sup>36</sup> GATT Document L/6191.

<sup>37</sup> As stated in its Terms of Reference, the Working Party "will examine the foreign trade regime of the People's Republic of China, develop a draft Protocol setting out the respective rights and obligations, provide a forum for the negotiation of a schedule, address as appropriate other issues concerning the People's Republic of China and the GATT, including procedures for decision-making by the CONTRACTING PARTIES".

<sup>38</sup> *Supra* note 25. According to Mr. Qian Jiadong, then Permanent Representative of China, China originally used the word "restore" when seeking to rejoin the GATT, but then opted for the word "resume" upon discovering that the word "restore" means "restore everything" while "resume" means "restore some of the original".

tariff negotiations with any contracting party that expressed interest; second, multilateral negotiations in the working party to work out the accession protocol, annexes and the working party report. Pursuant to this procedure, 37 contracting parties requested bilateral negotiations with China.<sup>39</sup> At first, the negotiations progressed very fast. This was partly due to the eagerness of the Chinese to get back into the GATT which they regarded as essential in promoting the exported-oriented economic reform of China. At the same time, the other contracting parties, especially the US and the European Communities (EC), also wanted China to be in as early as possible so as to set an example for other communist countries which were behind China in starting economic reforms.<sup>40</sup> Indeed, in early 1989, people were expecting China to enter the GATT within the year if everything went as planned.<sup>41</sup> Unfortunately, the hand of fate always brings surprises. After the Tiananmen "incident" in early June, everything came to a halt. A meeting of the working party was originally scheduled right after 4 June 1989, but when the Chinese delegation went into the meeting room, nobody else was there.<sup>42</sup> For the next two and half years, the working party went into hibernation.<sup>43</sup> It was not until 1992, when the Fourteenth National Congress of the Communist Party made "Socialist Market Economy" the goal of the reform, that the process resumed. Nonetheless, this did not solve all the problems. Many observers were skeptical about the willingness of China to embrace true capitalism. For example, Douglas Newkirk, the then Assistant US Trade Representative, was once quoted as stating that "[t]he GATT was not written with a Socialist Market Economy in mind".<sup>44</sup> Also, even though in China's political context, a Party resolution carries much more weight than the laws passed by its parliament, many foreigners, drawing from the experience in their own countries, see it the other way around. It was not until the term was incorporated into the PRC Constitution in the 1993 amendment that they began to appreciate that China was indeed taking this seriously.

During the first half of the 1990s, China participated in the Uruguay Round negotiations in the hope that discussions on its status could be concluded in time for it to become a founding member of the WTO.<sup>45</sup> Unfortunately, the world had changed much from the 1980s. The Cold War was over, and China had lost its symbolic value to encourage changes in the communist bloc. With the former Soviet countries also eager to join the GATT, the terms of the accession deal for China were increasingly regarded as a template for the other transition economies.<sup>46</sup> Thus, the Western governments decided that China should be subject to more rigorous terms.<sup>47</sup> At the same time, the Uruguay Round negotiations turned out to be much more difficult than originally imagined, and most countries concentrated their resources on the Uruguay Round rather than the China Working Party. Also, for the first time in history, the Uruguay Round included negotiations in the areas of trade in services

Also, he recalled that the sentence "China is prepared to enter into negotiations with GATT contracting parties" was added at the request of the former GATT Director General Arthur Dunkel, who deemed such phrase helpful to "reduce the worries of the Contracting Parties" and "reduce unnecessary troubles". See "China Opens the Door to the WTO after 15 Years", *Beijing Youth Daily* (12 November 2001).

<sup>39</sup> GATT Document L/6191/Rev.3.

<sup>40</sup> Yang Yongzheng, "China's WTO Accession: The Economics and Politics" (2000) 34(4) *J. World Trade* 77, at 88-89.

<sup>41</sup> Yang Guohua, *supra* note 1 at 42; Yang & Cheng, *supra* note 1 at 312; Yang Yongzheng, *ibid.* at 88-89. Rhodes & Jackson, *supra* note 1 at 500.

<sup>42</sup> Nicholas Lardy, *Integrating China into the Global Economy* (Washington: The Brookings Institution, 2002), at 63; "China Opens the Door to the WTO after 15 Years", *supra* note 38. See also Rhodes & Jackson, *supra* note 27 at 500.

<sup>43</sup> Jeffrey Gertler, *supra* note 1. See also "China's Entry Into GATT Is Stalled by Thorny 'Socialist Market Economy'," *Wall Street Journal* (3 March 1993).

<sup>44</sup> Raj Bhala, *supra* note 1 at 1480.

<sup>45</sup> *Ibid.*

<sup>46</sup> Lardy, *supra* note 42 at 63.

<sup>47</sup> *Ibid.*

and trade-related intellectual property rights. Disciplines on rules on non-tariff measures were also strengthened. As China lacked experience in these new areas, they posed new challenges for China.

On the other hand, China itself had also changed since the 1980s. First, the 1990s saw China's rise as a major trader in the world, with goods "Made in China" flooding many parts of the world. Many countries, both developed and developing, felt the threat of China not only in the world market but also in their respective domestic markets. For them, letting China enter into the GATT and enjoy expanded market access opportunities without demanding a pound of flesh would be unthinkable. Second, with the income level of the Chinese on the rise, more and more Western companies started to recognise the potential of China as the largest untapped market in the world. They demanded better market access opportunities in China which went beyond tariff concessions, and this too required extensive negotiation.

With difficulties on both fronts, even though China announced in 1994 that the substantial negotiations should be completed by the end of that year,<sup>48</sup> when the WTO was established on January 1 1995, the end of the negotiations was still nowhere in sight.

In December 1995, the GATT Working Party was converted into a WTO Accession Working Party. Again, the Chinese government announced three principles of WTO accession.<sup>49</sup> First, as an international organization, the WTO would not be complete without the participation of China. Second, as before, China should join as a developing country. Third, the Chinese accession should be based on a balance of rights and obligations. As we will soon see from the detailed analysis of the terms of the Chinese accession deal below, however, China has failed to stand by any of these principles.

In 1999 and 2000, China signed bilateral agreements with the US and EC respectively. In November 2001, the Chinese Accession Protocol was adopted by the WTO Members at the Fourth Session of the Ministerial Conference in Doha, Qatar. One month later, the National People's Congress Standing Committee of China approved the Accession Protocol and China finally became a Member of the WTO.<sup>50</sup>

## II. A COST-BENEFIT ANALYSIS OF CHINA'S ACCESSION TERMS

### A. *Benefits of China's Accession*

To many observers, the biggest benefits China has gained by joining the WTO are lowered tariffs on its exports and elimination of non-tariff barriers. They argue that, by becoming a WTO Member, China can now enjoy the M.F.N. tariff rates, which are lower than the rates applicable to Chinese goods before the accession. Also, Chinese goods may no longer be subject to the many discriminatory non-tariff measures targeted at them as these would be subject to the review of the WTO dispute settlement system. In the view of the author, however, these two benefits have been grossly exaggerated. First, even before its accession, China had signed bilateral trade agreements with most of its trade partners. These agreements would usually include an M.F.N. clause, which meant that China effectively enjoyed the same M.F.N. rates its trade partners granted to other countries under other agreements, including the WTO agreements. Second, the non-tariff barriers against Chinese firms are real problems, but, as we will discuss later, they are far from being eliminated as a result of China's accession.

One considerable victory brought by China's accession is the termination of the application of the US Jackson-Vanik Amendment to China. As mentioned earlier, prior to the WTO

<sup>48</sup> Yang, *supra* note 1 at 45.

<sup>49</sup> Department of WTO, Ministry of Commerce of China, "China's WTO Accession Process", online: <<http://chinawto.mofcom.gov.cn/column/print.shtml?subject/WTO/subjectdd/200611/20061103868282>>.

<sup>50</sup> Pursuant to Article XIV of the WTO Agreement, "[a]n acceptance following the entry into force of this Agreement shall enter into force on the 30<sup>th</sup> day following the date of such acceptance".

accession, many of China's trade partners had already granted China M.F.N. treatments. One notable exception was the US, which, by the virtue of the Jackson-Vanik Amendment, did not automatically grant China M.F.N. treatment. Instead, an annual review was conducted by the US Congress before China could be given M.F.N. treatment, even though, in practice, M.F.N. treatment was always granted to China, even after the Tiananmen "incident" in 1989. For the Chinese government, the probability of not being able to get M.F.N. treatment created a great deal of political and economic risk as well as public humiliation. Because M.F.N. treatment is a fundamental principle of the WTO, however, it would be illegal for the US to continue to apply the Jackson-Vanik Amendment to China after China's accession to the WTO. To ensure consistency with its WTO obligations, the US had several options to choose from. First, the US could invoke Article XIII of the WTO Agreement and decline to apply the WTO Agreements in its trade relationship with China. This option would have been rather risky, considering the considerable political costs such a move would entail both domestically and on the diplomatic relationship with China. Second, the US could abolish the whole amendment so that it does not apply to any country. Again this was unlikely because the US still applied the Amendment against several countries and there would have been significant political opposition from the US Congress against such a move. The third option was for the US to carve out an exception for China only while keeping the whole amendment intact. Indeed this was the option taken in the end. In anticipation of China's accession, the US congress adopted the US-China Relations Act in 2000, which basically exempts China from the scope of the Amendment.<sup>51</sup> Of course, the Act has many strings attached. These include the establishment of a Congressional-Executive Commission on the People's Republic of China to monitor China's compliance with human rights standards and development of the rule of law in China<sup>52</sup>; annual review of China's compliance with its WTO commitments in the WTO, as well as annual reviews by domestic institutions such as the US Trade Representative and other government ministries.<sup>53</sup> Interestingly, the Act also explicitly states that "the United States should be prepared to aggressively counter any effort by any WTO member, upon the approval of the General Council of the WTO of the terms and conditions of the accession of the People's Republic of China to the WTO, to block the accession of Taiwan to the WTO."<sup>54</sup> No name was mentioned here, but it is all too self-evident that this provision is targeted at China.

There are several other benefits brought about by China's accession, including participation in making the new rules for the multilateral trading system, and making use of the WTO dispute settlement mechanism. Both of these are available only to WTO Members. These two benefits will be discussed in the next section.

## B. Challenges

As the price for its accession, China made concessions on both market access and trade rules. These two are also where most of the challenges of China's accession lie.

### 1. Market access commitments

China's market access commitments cover both trade in goods and trade in services. For goods, China has agreed to reduce its tariff to one of the lowest levels in the world, with the overall tariff level to 10% by 2008.<sup>55</sup> In the breakdown, the average tariff rate for

<sup>51</sup> 22 USC Chapter 77.

<sup>52</sup> 22 USC Sections 6911-6919.

<sup>53</sup> 22 USC Sections 6931-6951.

<sup>54</sup> 22 USC Section 6991.

<sup>55</sup> Shi Guangsheng, "Working Together for a Brighter Future Based on Mutual Benefit", in Henry Gao & Donald Lewis, eds., *China's Participation in the WTO* (England: Cameron May, 2005).

agricultural products will be reduced to 15% and that for industrial products will be reduced to 9.1%.<sup>56</sup> Many observers are worried that, as a result of these tariff concessions, the Chinese market will be flooded with imported goods, with the domestic industries being destroyed by big multi-national companies. A deeper examination reveals, however, that the situation might not be as bad as it looks. First, even though the statutory tariff rates in China were high prior to the accession<sup>57</sup>, the tariff collection rate, derived by dividing the total tariff collected by the value of the total imports, was much lower. According to Lardy, from 1994 to 2000, the average effective tariff rate in China was only 3-4%.<sup>58</sup> This seemingly strange phenomenon is actually easily explainable. Most of the economic miracle in China in the last two decades of the twentieth century was built upon exports. In order to encourage exports, the Chinese government waived the import duties for goods that were imported as raw materials or equipments for manufacturing exports, as well as those for the firms which are located in various special economic zones, duty-bound zones, coastal economic development zones, and high and new technology development zones. For those products which are subject to prohibitively high tariffs, they are mostly smuggled into China rather than imported through the proper channels. Thus, no tariffs on them were paid at all.<sup>59</sup> Second, attracted by the lower costs of raw materials and labour, the tax breaks and favorable land-use policies granted by the Chinese government to attract foreign direct investment, as well as the huge market potential of the Chinese domestic market, more and more multi-nationals chose to establish joint-ventures in China rather than export their products to China from their home countries. These products would not be affected by the reduction in tariff rates either.

Turning to specific industries, two sectors stand out as potentially vulnerable. The first is the automobile sector, with the tariff to be reduced from the pre-accession rate of 100% to 25% by 1 July 2005. With the fall in tariffs, many observers predicted a rise in automobile imports after the accession. Indeed, the import data for the first two years after accession seem to confirm this prediction. In 2002, for example, the number of imported automobiles was 127,000, up by 76.8% over that of the previous year.<sup>60</sup> The next year also saw a further increase of 34.6% to 170,000 units.<sup>61</sup> The growth slowed down considerably in 2004, however, with a total import of 177,100 units, or 2.6% growth only.<sup>62</sup> In 2005, there was not only no growth at all, but a reduction, with the total imports at only 160,000 units.<sup>63</sup> Moreover, that year also saw, for the first time in history, the total automobile exports (172,800 units) exceed that of total imports.<sup>64</sup> This trend continued in 2006, with total imports and exports at 228,000 units and 342,400 units respectively.<sup>65</sup> In the view of the author, this confirms that the hype about the threat of imported automobiles were

<sup>56</sup> *Ibid.*

<sup>57</sup> China's average statutory tariff rate was 55.6% in 1982. This was gradually reduced during the 1990s so that the rate in 2001 is 15.3%. See Lardy, *supra* note 42 at 33-35.

<sup>58</sup> *Ibid* at 37-38.

<sup>59</sup> Lardy, for example, noted that there was an 80 percent increase in the absolute value of tariff revenues collected in 1999 when the anti-smuggling campaign of the Chinese government was in full swing. See Lardy, *supra* note 42 at 38.

<sup>60</sup> Shi Miaomiao, "China's Participation in the Doha Negotiations and Implementation of its Accession Commitments", in Gao & Lewis, eds., *supra* note 55 at 29.

<sup>61</sup> *Ibid.*

<sup>62</sup> Zhang Yi, "The Share of Imported Automobiles in Domestic Market was Further Reduced in 2004", *Xinhua News* (17 January 2005) online: <[http://news.xinhuanet.com/auto/2005-01/27/content\\_2514097.htm](http://news.xinhuanet.com/auto/2005-01/27/content_2514097.htm)>.

<sup>63</sup> Wang Xiaokun, "Six Features of the Automobile Market in 2005", *Beijing Youth Daily* (18 January 2006) online: <[http://www.tj.xinhuanet.com/2006-01/18/content\\_6075942.htm](http://www.tj.xinhuanet.com/2006-01/18/content_6075942.htm)>.

<sup>64</sup> China News Network, "Big Changes in the Automobile Import and Export Market in 2005: Imports Shrank while Exports Strong", 22 February 2006, online: <<http://fec.mofcom.gov.cn/aarticle/xiangmht/bx/200602/20060201557050.html>>.

<sup>65</sup> "Trade in Automobile Products Continued High Growth in 2006", online: <<http://www.cinic.org.cn/HTML/2005/1908/20072260065.html>>.

mostly unfounded speculations. Even the surge of imports from 2002 to 2004 might be bare illusions, as the increased imports might simply be of those automobiles that would have been smuggled had the tariff remain the same. Several other measures taken by the Chinese government also contributed to the cooling down of imports. On May 21, 2004, the National Development and Reform Commission issued the Automobile Industry Development Policy.<sup>66</sup> Article 58 of the new policy requires that automobiles can only be imported from six designated ports, *i.e.*, Dalian, Tianjin, Shanghai, Huangpu, Manzhouli and Shenzhen (Huanggang).<sup>67</sup> Moreover, the same article also prohibits the duty-bound zones of the importing ports from storing automobiles destined for entering the domestic market.<sup>68</sup> Normally, the cost of imported automobiles includes the following: ex-factory price, tariff, value-added tax (VAT), and consumption tax.<sup>69</sup> As the ex-factory price is relatively stable, the main determining factors are the import quota, tariff, VAT and consumption tax. As the quota system has been abolished since 2005, and the tariff rate has gradually gone down, the main determining factors are now domestic taxes and measures. Before the 2004 policy was issued, the importers usually stored the automobiles bound for the domestic market in the duty-bound zones.<sup>70</sup> All they needed to pay is the storage fee of several Renminbi (RMB) per day.<sup>71</sup> It was only after the car is sold to the consumer that they would need to pay the tariff, VAT and consumption tax.<sup>72</sup> Under the new policy, however, this is no longer possible. Instead, the importer will be required to pay the tariff from the very moment the automobile arrives at the port.<sup>73</sup> This has placed serious restraints on the cash position and liquidity of the importer. According to one estimate, under the new policy, in order to import a car worth one million RMB, the importer would also have to pay about half a million RMB in tariff, VAT and consumption tax.<sup>74</sup> Thus, suppose the importer has three million RMB in cash, he could import three cars before, but only two cars now.<sup>75</sup> Furthermore, even after paying the tariff and taxes, the importer has no guarantee that the automobiles can be sold. The business became more risky and the importers in turn became more cautious in importing automobiles. Also, this risk itself is a cost, which is added to the final price of the car and makes the imported car even less attractive to consumers. On 26 February 2005, the Ministry of Commerce (MOFCOM), National Development and Reform Commission and State Administration of Industry and Commerce issued the Implementing Measures on Management of Automobile Brand Marketing, which mandates that only those distributors with the authorisations to sell particular brands and capacity to provide the relevant services can sell automobiles<sup>76</sup>. This has effectively driven many smaller distributors out of business and severely restricted the marketability of many imported automobiles. In the Tianjin Duty-bound Zone, for example, out of more than 400 automobile dealers, only 20 of them meet the qualifications under the new regulation.<sup>77</sup> Also, many auto-makers have

<sup>66</sup> The full text of the policy is available at <<http://www.people.com.cn/GB/qiche/1049/2537256.html>>.

<sup>67</sup> There is also another designated port—Alashankou of Xinjiang, but the imports for that port are limited for automobiles originating from CIS (Commonwealth of Independent States) countries and destined for the self-use of the Autonomous Region of Xinjiang.

<sup>68</sup> Art. 58.

<sup>69</sup> Wang Hongru, "Automobile Prices Rose with the Reduction of Tariffs: Who is Determining the Price?", *China News Week* (20 March 2006) online: <<http://biz.163.com/06/0320/10/2CLD4AJE00020QEN.html>>.

<sup>70</sup> *Ibid.*

<sup>71</sup> *Ibid.*

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*

<sup>74</sup> "Quotas Abolished, Tariffs Reduced—Why Did the Imports of Automobiles Still Drop Instead of Rise?", *Xinhua Net* (20 June 2006) online: <[http://news.xinhuanet.com/auto/2005-06/20/content\\_3107481.htm](http://news.xinhuanet.com/auto/2005-06/20/content_3107481.htm)>.

<sup>75</sup> *Ibid.*

<sup>76</sup> The full text of the regulation is available at <<http://www.fdi.gov.cn/resupload/0000000000000000009/01/200509024009.doc>>.

<sup>77</sup> "Quotas Abolished, Tariffs Reduced—Why Did the Imports of Automobiles Still Drop Instead of Rise?", *supra* note 74.

established joint-ventures in China, which usually manufacture the same models as their plants in other countries. Thus, it makes no sense for them to import the same cars to China. Indeed, for the automobile sector, excess production capacity of the joint-ventures in China seems to be a bigger problem.<sup>78</sup> For example, the National Development and Reform Commission estimated in 2005 that the overall production capacity of all automobile manufacturers in China in 2007 might reach 14 million, while only half of them could be sold in the domestic market.<sup>79</sup>

Agriculture was also viewed as another sector that might suffer because of China's WTO accession. Again, however, the problems have been exaggerated. To be sure, the arable land per capita in China is only that of 40% of the world average, and both the land quality and level of agricultural technological development are below those of many other countries. As the most populous nation in the world, however, China's comparative advantage is in the production of labour-intensive crops, such as fruits and vegetables, livestock products, horticulture and aquaculture products. For those crops which are of vital importance, such as wheat, corn, rice, cotton, sugar, soybean oil, palm oil, rape-seed oil and wool, China actually did not commit to unlimited imports as the general public might have thought. These crops are protected by tariff-rate quotas (T.R.Q.), which greatly soften the impacts of the potential import surges. However, it has become fashionable in the past few years to blame the WTO for everything that goes wrong. One recent example is a report released by Oxfam on December 7, 2005. Entitled "No Soft Landing", this report alleged that the plights of the Chinese cotton farmers have worsened due to China's WTO commitments and the US' cotton subsidies.<sup>80</sup> Putting aside the complicated issue of American cotton subsidies, China's WTO commitments actually have nothing to do with the farmers' problems at all. Under the terms of its accession, China's final T.R.Q. for cotton is only 894,000 metric ton, to be implemented by 2004. The imports within the quota are subject to a symbolic tariff of 1%, while those exceeding the quota will be subject to a much higher tariff of 40%. Due to wrong market forecasts by the Chinese government, however, the actual imports for 2004 reached 1.98 million ton, or about two times of the TRQ commitments.<sup>81</sup> Moreover, China also voluntarily reduced the tariff for imports outside the quota from 40% to 1%.<sup>82</sup> Thus, it is probably more appropriate to put the blame on the mismanaged policy of the Chinese government rather than China's WTO commitments. Many observers also argue that, with cheap imported farm products flooding the Chinese market, many Chinese farmers will be displaced, and this could lead to social problems.<sup>83</sup> For one thing, as discussed earlier, the Chinese accession commitments actually include safety valves such as the T.R.Q. which could be used to limit imports. Moreover, even though Chinese farmers may not be able to compete on land-intensive crops, they could do very well on labor-intensive crops. Another problem with these studies is that they use out-dated data. Many studies cite 900 million as the number of farmers in China.<sup>84</sup> While many people may still have their official status or "Hu Kou" (residence permit) as farmers, in reality, a lot of them no longer live in the rural areas or engage in agriculture activities any more. Instead, many of them now work as peasant workers in big cities or work in factories or businesses that are established in the very

<sup>78</sup> See, e.g., Lardy, *supra* note 42 at 111–113; and Nicholas R. Lardy, "China and the Asian contagion", (Jul/Aug 1998) 77(4) *Foreign Affairs* 78.

<sup>79</sup> "Alarm in the Automobile Sector", *MoneyChina* (13 June 2006) online: <<http://www.moneychina.cn/d/2005/06/13/1118613752003.html>>.

<sup>80</sup> The full report is available at <[http://www.oxfam.org.uk/what\\_we\\_do/issues/trade/bp83\\_china\\_cotton.htm](http://www.oxfam.org.uk/what_we_do/issues/trade/bp83_china_cotton.htm)>.

<sup>81</sup> "Reasons for the "Reverse Control" of Agricultural Trade", *Caijing Magazine*, 14 April 2005, online: <<http://finance.sina.com.cn/chanjing/b/20050414/13451517877.shtml>>.

<sup>82</sup> *Ibid.*

<sup>83</sup> Li Shantong & Zhai Fan, "The Impact on the Chinese Economy of China's WTO Accession" (2000) 3 *Forecasting* at 8.

<sup>84</sup> See e.g., Sylvia Ostry, "WTO Membership for China: To be or Not To Be—Is That The Answer?" in *China and the World Trading System: Entering the New Millennium*, *supra* note 1 at 38.

villages they live. In the author's hometown, for example, some 40 to 60 percent of the rural population now regularly lives in the cities. It is no wonder that no accurate results may be reached from the use of such flawed data.<sup>85</sup> In the view of the author, the biggest problem in rural China is the long-standing practice of the "agri-industrial scissor price differential", which involves the undervaluation of agricultural prices relative to industrial prices and is a rip-off of farmers in support of the industrial development of the nation. Moreover, the farmers also had to pay an agricultural tax. The elimination of the agri-industrial scissor price differential and the agricultural tax<sup>86</sup>, combined with agricultural subsidies to farmers, are the best way to solve many of the problems that might emerge in implementing China's WTO commitments on agriculture.

In addition to trade in goods, China has also made extensive commitments in its services sectors. Mattoo, for example, observes that China's services commitments, in terms of both the width of coverage and depth of market-opening, are generally higher than other WTO Members and praises China's commitments under the General Agreement on Trade in Services (GATS) as "the most radical services reform program negotiated in the WTO".<sup>87</sup> Overall, the services sectors in China are less developed than those of most developed countries and vulnerable to foreign competition. Of all sectors, financial services might stand out as one that is probably the most vulnerable. On the one hand, the foreign financial institutions are generally more diversified in their financial holdings, have more experience in credit analysis and structuring financial products. Even though their physical networks are smaller than those of their domestic counterparts, such limited presence still serves them well as they focus on only the best clients. On the other hand, most domestic banks rely heavily on conventional loans and thus lack diversification in their investment portfolios. Many domestic banks, especially the state banks, are required to assume policy roles such as providing loans to state-owned enterprise (S.O.Es) and maintaining physical networks in small towns and cities even though such activities might not be sound business decisions. They also lack the management skills and product development capacities in order to run the businesses efficiently. In conclusion, foreign banks pose significant threats to the domestic banks. Of course, as the specific commitments for services are generally made on a "positive listing" basis, and Members have the option of choosing from the whole spectrum of "no limitation" to "unbound" in scheduling their commitments, the foreign banks are not going to conquer the Chinese market overnight. Instead, most of China's commitments for financial services will not kick in until 5 years after China's accession. Even after the transition period, China can still impose other restrictions in the activities of foreign banks so long as they qualify as "prudential regulations", a term vaguely defined in the GATS Annex on Financial Services as "measures ...for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system". The loose definition of "prudential measures" gives national authorities a lot of leeway in designing financial regulations. A good example of a prudential regulation is the Regulation on the Administration of Foreign Financial Institutions, which was promulgated by the State Council on 12 December 2001,

<sup>85</sup> Lardy estimated that the absolute number of workers employed in agriculture was only 354 million in 1999. Moreover, the number has fallen by an average of more than 4 million annually in the 1990s. Thus, the Development Research Center's projection of loss of about 11 million farm jobs in the ten years after China's accession is actually a much slower rate of reduction than what would happen even without the accession. See Lardy, *supra* note 42 at 109-110, 114.

<sup>86</sup> With effect from 1 January 2006, the agricultural tax has been abolished in China. See *The Nineteenth Session of the Standing Committee of the Tenth National People's Congress, Decision on Abolishing the Regulations on Agricultural Tax*, online: <[http://www.gov.cn/ziliao/flfg/2005-12/30/content\\_142025.htm](http://www.gov.cn/ziliao/flfg/2005-12/30/content_142025.htm)>.

<sup>87</sup> Aaditya Mattoo, "China's Accession to the WTO: The Services Dimension", (2003) 6 (2) *Journal of International Economic Law* 300. .

one day after China's WTO accession.<sup>88</sup> Article 7 of the Regulations requires foreign banks which want to open branches in China to maintain a capital adequacy ratio of 8%. This Regulation is supplemented by a set of Implementing Rules issued in 2004, which state that the capital adequacy ratio shall be calculated on the basis of the capital of the branches in China only rather than the bank's global capital.<sup>89</sup> In effect, this forces a foreign bank either to allow its branches in China to retain their earnings in China, which could then be counted towards its capital, or to contribute more capital to its Chinese branches which may limit its ability to expand its business in China.<sup>90</sup> Either way, the foreign banks would have to lock up more capital in their China operations and cannot remit most of their profits out of China. Article 5 of the Regulations requires foreign banks to contribute as operating capital at least 100 million RMB to its branch in China. Article 17 of the Implementing Rules further clarifies that the minimum operating capital requirement applies on a branch by branch basis, which further increases the financial burden of foreign banks conducting business in China. Article 24 of the Regulation also requires foreign banks to maintain at least 30% of their operating capital in the form of interest-bearing deposits, which, according to Article 68 of the Implementing Rules, shall be saved in domestically-owned commercial banks in China. While this is a good way to get business for the local Chinese banks, it further limits the abilities of foreign banks to compete against local banks.

In summary, the market access challenges in both trade in goods and trade in services may not be as great as people think. Moreover, as noted by Lardy in his study, even if there were short-term adjustment problems, in the long run, they might well be alleviated by the efficiency gains resulting from more competition and better allocation of resources brought about by the opening of the market.<sup>91</sup> Instead, the bigger problem lies in the area of rules.

## 2. Rules issue

China's rules commitments can be divided into two groups: WTO-plus obligations, *i.e.*, obligations that are beyond those normally required of WTO Members; and WTO-minus rights, *i.e.*, rights that are below those generally enjoyed by WTO Members.

The WTO-plus obligations include the following. First, China is required to translate all foreign trade laws and regulations into one of the WTO official languages<sup>92</sup>, *i.e.*, English, French or Spanish, while there is no general obligation for other WTO Members to do so. Second, China is required to have its trade policies reviewed by the WTO every year since its accession. There will be a total of nine such reviews, with the first to the eighth of such reviews conducted annually after 2001 and a final review no later than the tenth anniversary after China's accession. Under the normal Trade Policy Review Mechanism, however, China would only need to be reviewed every four years at the time of its accession.<sup>93</sup> Third, China is required to grant national treatment to foreign individuals, enterprises and foreign-funded enterprises<sup>94</sup>, while the WTO National treatment clause only cover measures applicable to

<sup>88</sup> Regulations on the Management of Foreign Financial Institutions, which is available at <<http://www.investchina.com.cn/market/zcxx/418494.htm>>.

<sup>89</sup> Article 69, Implementing Rules of the Regulations on the Management of Foreign Financial Institutions, available at <[http://www.chinacourt.org/flwk/show1.php?file\\_id=95606](http://www.chinacourt.org/flwk/show1.php?file_id=95606)>.

<sup>90</sup> Lardy, *supra* note 42 at 119.

<sup>91</sup> *Ibid.* at 119-122.

<sup>92</sup> Para. 334 of the Report of the Working Party on the Accession of China, WT/ACC/CHN/49, 1 October 2001, online: <[http://www.wto.org/English/thewto\\_e/acc\\_e/completeacc\\_e.htm](http://www.wto.org/English/thewto_e/acc_e/completeacc_e.htm)> (Working Party Report).

<sup>93</sup> Section C of the Trade Policy Review Mechanism, Annex 3 to the Agreement Establishing the World Trade Organization, online: <[http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm#annex3](http://www.wto.org/english/docs_e/legal_e/legal_e.htm#annex3)>.

<sup>94</sup> Section 3 of the Protocol of Accession of the People's Republic of China, Decision of 10 November 2001, WT/L/432, online: <[http://www.wto.org/English/thewto\\_e/acc\\_e/completeacc\\_e.htm](http://www.wto.org/English/thewto_e/acc_e/completeacc_e.htm)> (Accession Protocol).

products. As these provisions have been discussed rather extensively by other scholars<sup>95</sup>, the author will not pursue them further here.

The WTO-minus rights provisions include the following. First, as China is a country with a long history of government planning in economic development, many WTO Members suspect that the Chinese government still interferes with micro-economic activities and thus doubt the reliability of market data in China. Thus, Section 15(a) of the Accession Protocol allows WTO Members to treat China as a non-market economy in anti-dumping investigations. The first step in anti-dumping investigations involves the determination of the existence of dumping, which is derived by comparing the export price and normal value of the product in question. Normal value is usually the sales price of the product in the exporting country. This provision, however, would allow WTO Members to disregard the domestic sales price in China and use a proxy price from some surrogate country or a constructed price. Because China's comparative advantages mostly derive from the low costs of its factors of production, this provision makes it more likely for other WTO Members to arrive at a higher normal value and thus makes it easier for them to reach a determination of the existence of dumping. This mechanism is available to WTO Members for up to fifteen years after China's Accession. Sub-section (b) of Section 15 also includes a similar provision applicable to the determination of the existence of subsidy benefits under the Subsidy and Countervailing Measures (SCM) Agreement. Again, here, the domestic market conditions in China will be ignored and the alternative benchmarks in surrogate countries will be used. Even though this provision has been rarely invoked since China's accession, it is potentially more damaging than Section 15(a) of the Accession Protocol (*i.e.*, the one relating to anti-dumping) as S.O.Es by definition receive many government subsidies. Also, there is no end date for the application of the alternative benchmark mechanism. Thus, at least theoretically speaking, it could be invoked even one hundred years after China's accession.

Also, as China has become the biggest producer of many products in the world, many WTO Members fear that their markets will be flooded with products "Made in China" and their domestic producers will be destroyed. Even though Article XIX of the GATT and the Safeguards Agreement provide for the possibility of the application of safeguard measures to deal with sudden increases of imports, many Members worry that that the normal safeguard measures might not be enough to deal with the China threat. Thus, China had to agree to two special safeguard mechanisms in its accession package. The first is the transitional product-specific safeguard mechanism (T.P.S.S.M.) as provided under Article 16 of the Accession Protocol. Compared with the normal safeguard mechanism under the WTO, the T.P.S.S.M. includes many unique features. First, the T.P.S.S.M. may be triggered by "market disruption", which is deemed to exist so long as imports are "a significant cause of material injury", rather than causing "serious injury", as would have been required under the Safeguards Agreement. Second, while the WTO rule requires that safeguard measures shall be applicable to products from all countries on an M.F.N. basis, the T.P.S.S.M. specifically targets products from China only. Third, under the normal WTO rule, if a safeguard measure is taken for relative increase of imports, the affected export Members are allowed to retaliate immediately. The T.P.S.S.M. provides, however, China would have the right to retaliate only if such measure remains in effect for more than two years. Fourth, while the Safeguard Agreement explicitly prohibits any safeguard measure to be applicable for more than eight years, the T.P.S.S.M. allows the safeguard measures to be applied for "such period as may be necessary", which implied that it might exceed the 8-year limit. Fifth, the T.P.S.S.M. also includes a trade diversion clause, which allows any third WTO Member that fears that the application of the T.P.S.S.M. by any other WTO Member might divert the Chinese products to its own market to invoke the T.P.S.S.M. without any

<sup>95</sup> See Julia Ya Qin, "WTO-Plus' Obligations and Their Implications for the World Trade Organization Legal System: An Appraisal of the China Accession Protocol" (2003) 37(3) J. World Trade 491.

need to conduct any investigation. This means that, once the T.P.S.S.M. is invoked by any WTO Members, it would create a domino effect and all the other 148 WTO Members could, at least in theory, invoke the T.P.S.S.M. against the Chinese products affected. The T.P.S.S.M. is available for use for 12 years after China's accession.

In addition to the general safeguard mechanism mentioned above, textile products were also singled out as the one that has the most potential for causing damage. Thus, in addition to the T.P.S.S.M., which might be applied against any kind of Chinese products, another safeguard mechanism which specifically targets textile products from China was also included in the accession package. The threshold for invoking this special textile safeguard is even lower than that of the T.P.S.S.M.: it does not even have to be "material injury", instead, "market disruption threatening to impede the orderly development of trade in these products" is enough. Once it is invoked, the Member applying the measure could limit Chinese textile imports to a level of 7.5% (6% for wool products) above the amount entered during the previous year. Also, China is deprived of the right to retaliate entirely, not even for safeguard measures taken in response to relative increases. This measure is available for use until the end of 2008.

Even though China claims itself to be a developing country, and its economy shares many characteristics in common with those of many transition economies, China have been denied many of the rights available to WTO Members which are developing countries or transition economies. For example, China has agreed, under Section 10(2) of the Accession Protocol, that its subsidies to S.O.Es will be regarded as specific subsidies under the SCM Agreement, thus making them actionable even without the "specificity" element as would normally be required under the SCM Agreement. Similarly, according to the commitment made under paragraph 171 of the Working Party Report, China agreed that it would not invoke the special treatment for developing countries under Article 27(13) of the SCM Agreement, which means that the direct forgiveness of debts by the Chinese government in privatisation programmes would also be actionable. Furthermore, with respect to agricultural subsidies, China agreed, under paragraph 235 of the Working Party Report, that its *de minimis* exception for agricultural supports would be capped at 8.5%. Even though this is higher than the general *de minimis* level of 5% for all WTO Members, it is lower than the 10% which is available to developing countries.<sup>96</sup>

These China-specific provisions raise some really difficult legal questions. First, what is the status of these provisions in the WTO legal system? The legal validity of some of the provisions seems to be rather questionable. Take the special textile safeguard measure for example: China is required to consult with the Member invoking the clause to limit its own exports and to hold its textile exports during the consultation period. This is the very kind of measures that have been explicitly prohibited under Article 11(b) of the Safeguard Agreement, *i.e.*, grey area measures which include voluntary export restraints, orderly marketing arrangements or other similar measures.<sup>97</sup> One might argue that the prohibition here does not apply to the Chinese Accession Protocol because Article 11(c) states that the entire Safeguards Agreement does not apply to "measures sought, taken or maintained ...pursuant to protocols ...concluded within the framework of GATT 1994". The author wishes to point out, however, the Chinese Accession Protocol, legally speaking, is not concluded "within the framework of GATT 1994" as the old Accession Clause, Article XXXIII of the GATT, has been replaced by Article XII of the Marrakech Agreement. Thus, it is a protocol concluded within the framework of the Marrakech Agreement, and, as such, does not fall under the carve-out of Article 11(c) of the Safeguards Agreement.

<sup>96</sup> Article 6.4 of the Agreement on Agriculture, Annex 1A of the Multilateral Agreements on Trade in Goods, online: <[http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm#annex3](http://www.wto.org/english/docs_e/legal_e/legal_e.htm#annex3)>.

<sup>97</sup> For a discussion on the historical background on the prohibition of Voluntary Export Restraints, see Matsushita *et al.*, eds., *The WTO: Law, Practice and Policy* (Oxford: Oxford University Press, 2003) at 209-216.

Second, many of these provisions are ambiguous and nobody is quite sure exactly how they work. In a recent article, for example, two senior officials in the MOFCOM argued that the following questions have to be addressed before the product-specific safeguard mechanism could be properly applied by other WTO Members against China.<sup>98</sup> First, what is the definition of “market disruption” and “trade diversion”?<sup>99</sup> Second, even though the special safeguard measures could be applicable solely against China, should the parallel imports from other WTO Members also be considered by the importing Member?<sup>100</sup> Third, what is the relationship between the ordinary safeguard measures and the Special Safeguard Measures? Should the standards and procedures stipulated under Article XIX of the GATT and the WTO Agreement on Safeguards be applicable to the Special Safeguard Measures where the latter is silent?<sup>101</sup> Fourth, should the other WTO Members be free to choose between the Special Safeguard Measures and other trade remedy measures or should they only be allowed to invoke the Special Safeguard Measures as a last resort when no other trade remedy measures, such as antidumping, countervailing measures or ordinary safeguard measures, are applicable?<sup>102</sup> Similarly, the Special Textile Safeguard Mechanism is also fraught with ambiguities. This is illustrated in the recent spat between the Chinese and US governments as to whether the US had properly satisfied the requirements under paragraph 242 of the Working Party Report before applying special textile safeguard measures against Chinese textile products.

Even though these terms are discriminatory and China might not like them, they are already part of China's accession package. Theoretically, China could try to have the WTO amend the terms of its accession<sup>103</sup>, or waive some of its obligations<sup>104</sup>. In reality, however, neither is an attractive option as the WTO decision-making mechanism has essentially become paralyzed in recent years. Instead, China will have to learn to live with these terms for a long period after its accession. In the next part, the author will discuss how China has dealt with these obligations since its accession.

### III. CHINA'S PARTICIPATION IN THE WTO: A CRITICAL ANALYSIS

Accession to the WTO brought many challenges to China, and China took various actions in response to these challenges. Such challenges and responses are reflected at several different levels, *i.e.*, the domestic level, the bilateral/regional level, and the multilateral level. In this section, the author will assess China's participation in the multilateral trading system at all these levels.

#### A. *The Domestic Level*

China's WTO obligations include two main components: The Marrakesh Agreement Establishing the WTO (The WTO Agreement) and the annexed Multilateral Trade Agreements,

<sup>98</sup> Yuqing Zhang & Guohua Yang, “China as a WTO Member in the First Two Years”, in Mitsuo Matsushita & Dukgeun Ahn, eds., *WTO and East Asia: New Perspectives* (England: Cameron May, 2004) at 322-324. At the time of the writing of the article, Yuqing Zhang was the Director General of the Department of Treaty and Law at the MOFCOM, while Guohua Yang was the Director for WTO Legal Affairs of the Department of Treaty and Law. In those capacities, they were the senior legal advisors to the MOFCOM.

<sup>99</sup> *Ibid.* at 323.

<sup>100</sup> *Ibid.*

<sup>101</sup> *Ibid.*

<sup>102</sup> *Ibid.*

<sup>103</sup> Pursuant to Article X of the Marrakech Agreement Establishing the World Trade Organization, 15 April 1994, online: <[http://www.wto.org/english/docs\\_e/legal\\_e/04-wto\\_e.htm](http://www.wto.org/english/docs_e/legal_e/04-wto_e.htm)> (Marrakech Agreement).

<sup>104</sup> Pursuant to Article IX of the Marrakech Agreement.

and the Protocol of Accession of China and the schedules annexed thereto. Under Article XVI of the WTO Agreement, China is required to “ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements”. Similarly, under Section 2 of its Accession Protocol, China’s “local regulations, rules and other measures of local governments at the sub-national level shall conform to the obligations undertaken in the WTO Agreement and this Protocol”.

Even though both the WTO Agreement and the Accession Protocol require China to ensure its laws to “conform” to the WTO obligations, neither prescribes a particular method for achieving such conformity. Generally speaking, there are two ways to apply international treaties: apply them directly by adopting them directly into the domestic legal system, or apply them indirectly by enacting domestic legislations based on the contents of the treaties, or revising domestic legislations accordingly. Different countries take different approaches. In the case of China, neither the Constitution nor the Law on the Procedure of the Conclusion of Treaties<sup>105</sup> specifies the general approach that should be taken. Instead, China’s practice is rather inconsistent in this regard. For example, Article 142 of the General Principles of Civil Law explicitly states that “in case of a conflict between the provisions in the international treaties China concludes or accedes to and the provisions in the domestic civil laws of China, the provisions in the international treaties should be applied, except where China has made a reservation.” On the other hand, some other treaties have to be transformed into domestic legislation before they can be applied. For example, the Law on the Territorial Sea and the Contiguous Zone and Law on the Exclusive Economic Zone and the Continental Shelf are domestic legislation passed in China to give effect to the United Nations Convention on the Law of the Sea.

In China’s WTO Working Party Report, China agreed to the following:

All individuals and entities could bring to the attention of central government authorities cases of non-uniform application of China’s trade regime, *including its commitments under the WTO Agreement and the Draft Protocol*. Such cases would be referred promptly to the responsible government agency, and when non-uniform application was established, the authorities would act promptly to address the situation utilizing the *remedies available under China’s laws*, taking into consideration China’s international obligations and the need to provide a meaningful remedy.<sup>106</sup> (emphasis added)

This seems to suggest that the WTO obligations are directly applicable in China without the need of being transformed into domestic legislation first. Of course, as the WTO Agreements are treaties entered between governments, they do not provide direct remedies for individuals. That is why the same paragraph also states that the only remedies available are those prescribed under domestic laws.

In August 2002, the Judicial Committee of the Supreme People’s Court of China issued Rules on Several Issues on Trying Administrative Case on International Trade.<sup>107</sup> According to Rule 7, the courts shall apply the domestic laws and regulations of China in trying such cases. While the rule itself does not explicitly rule out the possibility of applying WTO Agreements directly, Justice Li Guoguang, a Deputy President of the Supreme People’s Court, has interpreted this rule to mean that WTO Agreements cannot be directly applied

<sup>105</sup> Adopted at the 17th Meeting of the Standing Committee of the Seventh National People’s Congress on December 28, 1990, promulgated by Order No. 37 of the President of the People’s Republic of China on December 28, 1990, and effective as of the same date.

<sup>106</sup> Para. 75 of the Working Party Report. This commitment is incorporated in the Accession Protocol by the virtue of Para. 342 and Section 1(2) of the Accession Protocol.

<sup>107</sup> Fashi [2002] 27, adopted by the 1239<sup>th</sup> Meeting of the Trial Committee of the Supreme People’s Court of China on 27 August 2002.

in China.<sup>108</sup> According to Justice Li, first of all, private individuals or firms cannot directly invoke WTO Agreements to bring an action or defend themselves in court; second, the courts shall not directly apply the WTO Agreements as the legal basis for their judgments.<sup>109</sup> To support his argument, Li also cited Paragraph 67 of the Working Party Report of China, which states that “the WTO Agreement would be implemented by China in an effective and uniform manner through revising its existing domestic laws and enacting new ones fully in compliance with the WTO Agreement”. In the view of the author, however, there are several problems with this line of argument. First of all, while Paragraph 67 can be interpreted to mean that transforming WTO Agreements into domestic Chinese laws is one option, this does not in any way suggest that direct application is not another option. Indeed, the Working Party Report never explicitly stated that China would not directly apply the WTO Agreements. Second, even if assuming, *arguendo*, Paragraph 67 means that WTO agreements can only be transformed but not adopted, because Paragraph 67 is not included in the list of paragraphs in paragraphs incorporated into the Accession Protocol in Paragraph 342, it is not part of the terms of China's accession. Third, as mentioned above, Paragraph 75 of the Working Party Report explicitly recognises the rights of individuals and entities to invoke China's commitments under the WTO Agreement and the Draft Protocol, denying them such rights would probably violate China's accession commitments.

Interestingly, even though Justice Li insisted that the Rules prohibit the direct application of WTO Agreements, he also recognised that, when the provisions of the relevant domestic laws and regulations could be subject to two or more reasonable interpretations, and one interpretation is consistent with the provisions of an international treaty that China has concluded or acceded to, such interpretation shall be adopted.<sup>110</sup> This, however, only solves part of the problem, *i.e.*, when there is a reasonable interpretation of the law or regulation that is consistent with WTO Agreements. Obviously, when all the reasonable interpretations available are inconsistent with WTO Agreements, the WTO Agreements will not be applied. This would probably amount to a violation of China's WTO obligations.

Even though China is probably legally obliged to make the WTO Agreements directly applicable, in practice, this is hardly a workable option as the average standard of judges in China is much lower than that of their counterparts in the West. Many of them found their way into the judiciary when they were placed into the courts by the Party as reward for their loyal service in the People's Liberation Army.<sup>111</sup> Many have received no formal legal training at all and this is especially true among the senior judges as the legal system was utterly destroyed during the Cultural Revolution from 1966 to 1976. Thus, for many of them, it is quite a challenge to effectively master the rules of the WTO Agreement, which is largely modeled after the Western legal systems and is much more complicated than Chinese domestic civil and criminal laws. Comparatively speaking, the bureaucrats at the ministries of the central government are better educated and generally are better able to understand the WTO Agreements. Thus, after its accession to the WTO, China launched an extensive campaign to revise old laws and regulations or enact new ones. Amidst this huge legislative exercise, the most important law is the Foreign Trade Law of China, which was first enacted in 1994 to set out the basic framework for China's foreign trade regime.

With the changing trading environment, China revised the Foreign Trade Law in 2004, which became effective on 1 July 2004.<sup>112</sup> As an attempt to revamp the foreign trade regime,

<sup>108</sup> Tian Ji & Lin Zi, “Judicial Review on Administrative Cases on International Trade: Chinese Courts Will Start to Accept Administrative Cases Brought by Foreigners” *People's Daily (Overseas Edition)* (7 September 2002) at 3, online: < <http://www.people.com.cn/GB/paper39/7185/694081.html>>.

<sup>109</sup> *Ibid.*

<sup>110</sup> *Ibid.* See also Rule 9.

<sup>111</sup> See He Weifang, “Army Veterans Enters the Court”, *Southern Weekend* (2 January 1998).

<sup>112</sup> Adopted at the 8<sup>th</sup> Meeting of the Standing Committee of the Tenth National People's Congress on April 6, 2004, and effective as of July 1, 2004.

this revision brought substantial changes to the law. Out of the forty-four articles of the original law, only six articles (Articles 7, 15, 23, 33, 37 and 43) remain unchanged. Also, three entirely new chapters were added, with the result that the law now has 70 articles in eleven chapters. While some of the revisions are only rephrasing of the original terms (for example, the original Article 13 “[a]n organization or an individual that does not acquire a license for carrying out foreign trade activities may entrust a foreign trade operator as agent to handle the ad hoc trade operations within the ad hoc scope of business” was changed to Article 12 “[f]oreign trade dealers may accept the authorization of others and conduct foreign trade as an agent within its scope of business”), most of the changes go far beyond mere paraphrasing. As noted by many commentators, a lot of the revisions were made to implement China’s WTO commitments. In the author’s view, however, the more important revisions are the ones made to protect China’s own trade interests.

### 1. *WTO-compliance provisions*

Among the provisions to comply with China’s WTO obligations, the most important one is the liberalisation of foreign trading rights. Before China’s accession to the WTO, only a limited number of Specialized Foreign Trading Companies and some Sino-foreign Joint Foreign Trading Companies had trading rights. In addition, some manufacturing firms, research institutes and foreign invested enterprise have also been granted special approval for exporting their own products and importing technologies, equipments, components and raw materials for their own production needs.

During the negotiations leading to China’s accession to the WTO, many Members urged China to remove its restrictions on trading rights, which they regard as barriers to keep foreign products out of the Chinese market. After extensive negotiations, China agreed to the following commitments with regard to trading rights:

China shall progressively liberalize the availability and scope of the right to trade, so that, within three years after accession, all enterprises in China shall have the right to trade in all goods throughout the customs territory of China ...Such right to trade shall be the right to import and export goods.

Except as otherwise provided for in this Protocol, all foreign individuals and enterprises, including those not invested or registered in China, shall be accorded treatment no less favourable than that accorded to enterprises in China with respect to the right to trade.<sup>113</sup>

In line with this commitment, Chapter 2 of the Foreign Trade Law was revised, with the most extensive revisions on Articles 8 and 9. Under Article 8 of the old Law, only juridical persons and other organisations can apply for trading rights. The newly-revised Article 8 expands the category to include private individuals. It is worth noting that under the old regime for the granting of trading rights, private individuals in China cannot get trading rights. Under the terms of its Accession Protocol, China agreed to grant trading rights to foreign individuals but not Chinese individuals. Thus, strictly speaking, China has no obligation under its WTO commitments to grant private Chinese individuals trading rights. During the drafting process of the new Foreign Trade Law, there was some debate as to whether private Chinese individuals should be granted foreign trading rights as the Chinese government was concerned that the liberalization of foreign trading rights could lead to political instabilities when private individuals begin to import foreign products. In the end, the Chinese government decided to grant private Chinese individuals trading rights to avoid charges of granting “supra-national treatments” to foreign individuals. After the new Foreign Trade Law became effective, however, few individuals applied for foreign trading

<sup>113</sup> Section 5 of the Accession Protocol.

rights. The main reasons are first, under current Chinese law, a person doing business as a sole proprietorship will have to assume unlimited liability, while the corporate form could provide a way to shield and limit liabilities; second, the international trade business typically requires high investment, an established client base abroad and good distribution channels, which are conditions which an individual normally cannot meet.

Under Article 9 of the old Law, foreign traders must satisfy several requirements and seek examination and approval from state authorities before they are granted foreign trade rights. The new Law replaces this with a simple registration procedure, as pursuant to China's commitments.<sup>114</sup>

Another example is Article 15 in the new Law, which is a newly-added provision to implement China's commitment to "bring its automatic licensing system into conformity with Article 2 of the Agreement on Import Licensing Procedures".<sup>115</sup>

## 2. Provisions to protect China's trade interests

In the author's view, the more interesting developments in the new Foreign Trade Law are the provisions designed to protect China's trade interests. These provisions show that China is no longer content to passively implement the commitments that have been (at least according to some observers) forced upon China during its accession process. Instead, with more familiarity with the rules of the game of the multilateral trading system, China has started trying to use the rules, especially the exceptions to the general principles of the WTO, to protect its trade interests.

Some of these provisions appear to be rather harmless. For example, Article 54 of the new Law states that the government shall establish a foreign trade public information service system to provide information to foreign traders and the general public. As most Chinese firms only started their international expansion in recent years, many of them found it very difficult to obtain information about foreign markets. This new public information service system can help them to get the necessary information. Also, most of the new entrants to the international markets are small and medium sized enterprises. Collectively, they have become the largest contributor to the Chinese economy. In 2003, for example, they provided 55.6% of China's GDP and 62.3% of China's export.<sup>116</sup> At the same time, however, as each of them only has limited resources, it is especially difficult for them to explore new markets abroad. Thus, Article 58 of the new Law requires the state to support and promote foreign trade by small and medium-sized firms, which are defined as those firms with annual export volume of less than 15 million US dollars.

In recent years, with its low costs of production and huge export volumes, China has become the primary target of various trade remedies actions taken by countries around the world. These trade remedies measures seriously limit the export growth of Chinese firms. In some serious cases, an entire Chinese industry may be wiped out of the particular export market due to such trade remedies measures. Thus, Article 49 of the new Law establishes a foreign trade early-warning system to deal with emergencies in foreign trade. Unlike similar mechanisms in other countries, this early-warning system monitors not only changes in imports into the domestic market, but also changes in the exports to foreign markets. Indeed, as illustrated by the first Trade Remedy Measures Pre-Warning System established in Shanghai, exports seem to be the primary concern of the Chinese government. There are several possible scenarios in which such a pre-warning system might be useful. First, when a trade remedy measure is taken by a foreign government, the system can warn exporters to shift their exports to other countries or switch to the production of products which are not subject to the particular measure. Second, when some exporters sell their products in the

<sup>114</sup> Para. 84 (a) of the Working Party Report.

<sup>115</sup> Para. 136 of the Working Party Report.

<sup>116</sup> Zhao Cheng & Liu Zheng, "Small and Medium Size Enterprises Account for Half of the Economy", *Economic Reference Daily* (9 July 2004), online: <<http://finance.sina.com.cn/roll/20040916/00531026269.shtml>>.

export market at prices that are so low that there is a risk of triggering anti-dumping investigations, the government, or the relevant trade association, could step in to have the firm raise its prices. Third, when the total volume of exports of all the exporting firms increases at a rate that is so high that it might trigger a safeguard investigation, the government, or the relevant trade association, could arrange for the firms to better coordinate their export volumes so as to reduce the total volume of exports. Since the coming into force of the new Foreign Trade Law took effect, China has established early warning system for three key industries, *i.e.*, automobile, chemical fertilizer and steel industries.

(a) *Trade Remedy Measures*: Compared with the provisions mentioned above, some other provisions take a more aggressive approach to defend the interests of Chinese firms in both domestic and international markets. For example, under the new Chapter VIII, China can take a host of so-called trade remedies measures to address injuries to domestic industries caused by foreign imports. These include the traditional categories, *i.e.*, anti-dumping measures, subsidy countervailing measures, and safeguards.

It is ironic to see that China, the primary target of trade remedies measures, has taken a close interest in making use of these very trade remedies measures itself against foreign competition. What is more interesting, however, is that China is able to take advantage of all these latest innovations in the trade remedies game as it was a late-comer and was eager to learn. Thus, China's arsenal of trade remedies measures is much more advanced than that of many other WTO Members.

For example, under Article 42 of the new Law, even in cases where the dumping occurs in a third country, but causes injuries to the exports of Chinese domestic industries, China could request the government of the third country to take appropriate actions, including antidumping measures. Even though Article 14 of the WTO Antidumping Agreement also envisages such possibility, such heightened extra-territorial protection would only make sense for Members with significant export interests in a given foreign market. Thus, many smaller Members do not have such mechanisms in their domestic legislation. Even for larger Members, not all of them have such a mechanism. For example, the EU does not have this mechanism in its anti-dumping regulation.<sup>117</sup> In this sense, China is much more aggressive than many other WTO Members.

Article 45 is also an interesting provision. It provides for the possibility of safeguard measures for services, *i.e.*, "if any services are being imported into China from the services providers of other countries or regions in such increased quantities as to cause or threaten injury to the domestic industries which offer the like or directly competitive services, the state may take necessary remedy measures to reduce or eliminate such injury or threat". Even though Article X of the General Agreement on Trade in Service (GATS) mandates the Members to hold negotiations on emergency safeguard measures and have the result of such negotiations enter into effect within three years after the establishment of the WTO, the WTO Members have not been able to reach any agreement on this issue due to the difficulties with the Doha Round as a whole. In this context, it is unclear whether China would be allowed to take safeguard measures against services imports. On the one hand, one might argue that such safeguard measures would not be allowed, as Article XVI.2 of the GATS explicitly prohibits this kind of measures unless they have been specified in the schedule. On the other hand, one can also argue that, as Article X.2 of the GATS provides temporary mechanisms for Members to modify or withdraw their commitments before the conclusion of the safeguard negotiations, the legislative intent is that there should be a safeguard mechanism available, and before such safeguard mechanism is available, the Members should be given an opportunity to revise their commitments. In an official guide

<sup>117</sup> Council Regulation (EC) No 384/96 of 22 December 1995 on protection against dumped imports from countries not members of the European Community, online: <[http://ec.europa.eu/trade/issues/respectrules/anti\\_dumping/legis/adgreg01a.htm](http://ec.europa.eu/trade/issues/respectrules/anti_dumping/legis/adgreg01a.htm)>.

to the new Law, China defends this provision by citing the principle of “fundamental change of circumstances” under public international law.<sup>118</sup> The problem, however, is that, first, this principle is not incorporated into the WTO Agreements, and the safeguard measures available under WTO Agreements is not exactly the same as the traditional principle of “fundamental change of circumstances” under public international law; second, even under Article 62 of the Vienna Convention on the Law of Treaties (VCLT), there are two conditions<sup>119</sup> a country has to satisfy before invoking this principle, and it is hard to say that the conditions listed here for services safeguards satisfy these conditions. Moreover, there are many practical problems of applying safeguard measures in services,<sup>120</sup> and that is probably why China has never initiated any services safeguard investigation so far.

Article 46 of the New Law deals with trade diversion. This article provides that, “if, due to the restrictions a third country has placed on its imports, a product is being imported into the domestic market of China in such increased quantities, and under such conditions as to cause or threaten to cause serious injury to the domestic industry, or impedes the establishment of domestic industry, the state may take appropriate remedy measures and restrict the import of such product.” Even though this article does not state exactly which trade remedy measures the state might take, as the main consideration is on the quantity of the imports rather than the price or the grant of subsidies, the most appropriate trade remedy measure should be safeguard measures. This provision, however, does not fit well within the current WTO safeguard framework. First, under the WTO Safeguards Agreement, the injury standard is very high: a Member can invoke safeguard measures if and only if there is injury or threat of *serious injury* to the domestic industry.<sup>121</sup> On the other hand, Article 46 does not require *serious injury*, mere injury, be it serious or slight, is enough. Moreover, Article 46 is available even in cases where there is only impediment to the establishment of a domestic industry, which is a standard even lower than “injury”. In this sense, Article 46 is much wider than the WTO regime. Second, under the WTO Safeguard Agreement, the only thing that matters is the increased quantity of imports. It does not matter what caused such surge in imports. Article 46, however, would only apply to cases where the imports are diverted to China because of restrictions taken by a third country. From this perspective, Article 46 is much stricter. Generally speaking, WTO Members are under no obligations to establish safeguard regimes. If they do, however, they must make sure that their safeguard regimes follow the WTO rules. Thus, the low injury requirement in Article 46 might be illegal as it falls short of the minimum requirement of the WTO rules. Putting the question of the legitimacy of this measure aside, it is interesting to note that this provision mirrors the mechanism established under Section 16(8) of the Accession Protocol of China, which provides that

If a WTO Member considers that an action taken under paragraphs 2, 3 or 7 causes or threatens to cause significant diversions of trade into its market, it may request consultations with China and/or the WTO Member concerned. Such consultations

<sup>118</sup> Department of Treaty and Law of MOFCOM, *Interpretation of the Foreign Trade Law of the PRC*, at 202.

<sup>119</sup> Under Article 62 of the VCLT, two conditions have to be satisfied, *i.e.*,

- (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and
- (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

<sup>120</sup> See *e.g.*, Pierre Sauvé, Ch. 7, “Completing the GATS Framework: Addressing Uruguay Round Leftovers”, in Pierre Sauvé & Robert Stern, eds., *GATS 2000, New Directions in Services Trade Liberalization* (Brookings Institution Press, 2000), online: <<http://www.cid.harvard.edu/cidtrade/Papers/Sauve/sauvegats.pdf>>; Mario Marconini, “Emergency Safeguard Measures in The GATS: Beyond Feasible and Desirable”, online: <[http://www.unctad.org/en/docs/ditctn20054\\_en.pdf](http://www.unctad.org/en/docs/ditctn20054_en.pdf)>; Fernando Pierola, “A Safeguard Regime for the GATS”, paper presented at the World Trade Forum 2006, Bern, Switzerland (on file with the author).

<sup>121</sup> Art. 2.

shall be held within 30 days after the request is notified to the Committee on Safeguards. If such consultations fail to lead to an agreement between China and the WTO Member or Members concerned within 60 days after the notification, the requesting WTO Member shall be free, in respect of such product, to withdraw concessions accorded to or otherwise limit imports from China, to the extent necessary to prevent or remedy such diversions. Such action shall be notified immediately to the Committee on Safeguards.

In the author's view, this shows the bitterness China has against this provision, which is apparently discriminatory and makes it much easier for other WTO Members to invoke safeguard measures against China. Indeed, in its official guide to the new Foreign Trade Law, China also cites, as a model for this provision, 19 USC 2451, which basically incorporates Section 16(8) of the Accession Protocol of China into the domestic legal system of the United States.<sup>122</sup> Under the WTO legal framework, however, Section 16(8) would be justified by Article XII of the WTO Agreement. It would be much harder for China to justify any measures it might take under Article 46, unless it is willing to follow the strict procedural and substantial requirements under the WTO Safeguard Agreement, which would make Article 46 redundant.

Article 47 is another aggressive provision. Under this article, whenever a country or region that is a party to a trade agreement with China breaches the provisions in such agreement and causes nullification or impairment to the benefits accruable to China under such agreement, or impedes the achievement of the aim of such agreement, China may request such country or region to take necessary remedy measures, and may also suspend or terminate its obligations under such agreement. At first glance, this provision is very similar to the highly controversial provision in Section 301 of the Trade Act of 1974 (19 USC 2411). Indeed, China also cites as its legislative model Section 301, in addition to Article XXIII of the GATT and Article 22 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). As Hudec has argued in his classical work on Section 301, the main problem with this type of provision is that unilateral retaliatory measures might be taken under the provision without pre-authorization for such retaliation pursuant to the procedures of the WTO dispute settlement system.<sup>123</sup> It is unclear whether Article 47 would fall under the same category as it does not explicitly state whether China can take some unilateral action in reaction to alleged wrongdoings of foreign countries without the need for formal authorization from the WTO. In either case, however, this provision would not be of much use. On the one hand, if a unilateral measure is taken without WTO authorisation, such measures would violate the WTO agreements and thus are illegal. On the other hand, if China has to go through the WTO dispute settlement procedures before any action is taken, Article 47 would lose its "teeth" and become largely useless. Thus, the only effects this provision might have are symbolic rather than substantial.

(b) *Protection of TRIPS*: Chapter Five of the New Law provides another example of China's aggressive initiative in protecting its own trade interests. Entitled "Protection of Trade-related Intellectual Property Rights (TRIPS)", this Chapter is cited by many observers as a good example of China's campaign to implement its WTO commitments and enforce international intellectual property (IP) protection standards. In the author's view, however, such observations are largely misguided. Instead, this chapter aims more at the protection of the TRIPS of domestic Chinese firms rather than those of foreign firms. For example, even though the first paragraph of Article 29 states that "the state shall protect TRIPS according to the relevant laws and regulations on intellectual property rights", the second paragraph

<sup>122</sup> Department of Treaty and Law of MOFCOM, *supra* note 118 at 203-208.

<sup>123</sup> Robert E. Hudec, "Thinking about the New Section 301: Beyond Good and Evil", in Robert E. Hudec, *Essays on the Nature of International Trade Law* (England: Cameron May, 1999) at 153-206. See also A. Lynne Puckett & William L. Reynolds, "Rules, Sanctions and Enforcement under Section 301: At Odds with the WTO?" (1996) 90(4) *Am. J. Int'l L.* at 675-689

only focuses on trade measures that might be taken when imported goods infringe IP rights. While both imported and exported goods may infringe IP rights, their effects are very different, with imported goods typically affecting the IP rights of domestic products and exported goods affecting the IP rights of foreign products. Moreover, it is an open secret that China is now not only the largest producer of all types of legitimate goods, but also the biggest source of all pirated products in the world. Thus, if China is truly interested in implementing its obligations to protect the TRIPS of other WTO Members, it should focus more on the goods exported from China rather than those imported into China. The way the current provision is worded can only be explained by China's hidden agenda to protect the TRIPS of its own firms. Article 30 further affirms this bias against foreign IP rights holders. Under this article, if the IP rights owner engages in practices such as preventing challenges to the validity of the IP rights in licensing agreements, requiring coercive package licensing, or including exclusive grant-back conditions in licensing agreements, and such practices endanger the order of fair competition in foreign trade, the Ministry of Commerce may take appropriate measures to reduce or eliminate such danger. While both domestic and foreign IP rights owners could engage in such anti-competitive practices, this provision is clearly aimed at foreign IP rights owners because any such anti-competitive practices of the domestic IP rights owners would not be subject to the sanctions under the Foreign Trade Law, which by definition applies only to foreign trade but not to domestic business transactions. The next provision, Article 31, goes one step further by stating that, if other countries or regions fail to provide national treatment with regard to the TRIPS of firms or individuals from China, or fail to provide full and effective IP protection to goods, technology or services from China, China may take appropriate measures according to the relevant laws, regulations or any treaties or agreements that China has signed. This provision is modeled after the Special 301 Clause of the Trade Act of 1974 (19 USC 2242), and will probably face the same quandary of either running afoul of WTO agreements or lapse into redundancy as discussed above with regard to Article 47.

(c) *Foreign Trade Investigations*: China's newly-developed penchant for trade protectionism reaches new heights with the addition of a new Chapter VII in the New Law, which is aptly entitled "Foreign Trade Investigations". Under this Chapter, the MOFCOM can conduct investigations to deal with the following activities which affect foreign trade orders:

- (1) the effects on the competitive strengths of domestic industries by the import and export of goods, technologies and international trade in services;
- (2) trade barriers of other countries or regions;
- (3) matters requiring investigation in order to determine whether foreign trade remedies measures such as anti-dumping, countervailing or safeguard measures should be taken;
- (4) activities that circumvent foreign trade remedies measures;
- (5) foreign trade activities related to national security issues;
- (6) matters requiring investigation in order to enforce the provisions of Articles 7, 29(2), 30, 31, 32(3) and 33(3); and
- (7) any other matters which may have impact on foreign trade order and require investigation.

Such investigations are generally initiated by the MOFCOM with a public notice.<sup>124</sup> Depending on the type of matter, investigations may take several forms, including written questionnaires, oral hearings, field investigations or entrusted investigations.<sup>125</sup> After the investigation, the MOFCOM shall issue a report or make an appropriate decision, which can be contained in a public notice.<sup>126</sup> It is unclear what "appropriate decisions" include. If it refers to bilateral consultation or the initiation of WTO dispute settlement proceedings, that

<sup>124</sup> Art. 38.

<sup>125</sup> *Ibid.*

<sup>126</sup> *Ibid.*

should be perfectly legal. If it also includes the possibility of unilateral actions without formal authorisation from the WTO, the “appropriate decision” could violate WTO obligations.

Amongst the investigations authorised under Chapter VII, the most important one is the foreign trade barrier investigation, which can be a very powerful tool to deal with trade barriers Chinese firms encounter in other countries. In order to provide detailed guidelines for such investigations, the MOFCOM issued the Provisional Rules on Foreign Trade Barrier Investigation in September 2002, which was further revised and promulgated as the Rules on Foreign Trade Barrier Investigation in February 2005. Under the Rules, “trade barriers” include measures taken or supported by a foreign country that:

- (1) violate the trade agreements that such country has concluded with China, or fail to implement the obligations in such agreements; OR
- (2) cause one of the following adverse effects on trade:
  - a) cause or threaten to cause impediment or restrictions on Chinese products or services’ access to the domestic market of such country or a third country market;
  - b) cause or threaten to cause injury to the competitive strength of Chinese products or services in the domestic market of such country or a third country market;
  - c) cause or threaten to cause impediment or restrictions on the export of products or services from such country or a third country into China.<sup>127</sup>

Pursuant to the 2002 Provisional Rules and the 2005 Rules, the MOFCOM has issued an annual Foreign Market Access Report since 2002. This Report describes and assesses the trade and investment barriers in twenty five major trading partners of China, including Egypt, Algeria, Kenya, South Africa, Nigeria, Saudi Arabia, Turkey, Kazakhstan, Thailand, the Philippines, Malaysia, Indonesia, Vietnam, India, the Republic of Korea, Japan, Russia, the European Union, Canada, the United States, Mexico, Brazil, Argentina, Australia and New Zealand. The Report covers a wide scope of trade barriers, which are placed in fourteen different categories as follows<sup>128</sup>:

- (1) Tariff and tariff administrative measures, e.g., tariff peak and unjustified practices in tariff quota administration;
- (2) Import restrictions, e.g., unjustified import ban and import licensing;
- (3) Barriers to Customs procedures, e.g., procedural obstacles in customs clearance, unjustified charges on imports;
- (4) Discriminatory taxes and fees on imported goods;
- (5) Technical barriers to trade, e.g., unjustified technical regulations and standards applied to imported products, complicated certification and conformity assessment procedures;
- (6) Sanitary and phytosanitary measures, e.g., unnecessarily strict quarantine requirements and procedures applied to imported products;
- (7) Trade remedies, e.g., unfair anti-dumping measures imposed on imported products, insufficient transparency in investigation procedures of trade remedy, in particular the abusive application to Chinese enterprises of measures designed for non-market economy;
- (8) Government procurement, e.g., insufficient transparency, violation of most-favored-nations clause;
- (9) Export restrictions, e.g., extraterritorial legislation that restricts or impedes trade between third countries, and unjustified export control measures in the name of national security;

<sup>127</sup> Rule 3.

<sup>128</sup> MOFCOM, Foreign Market Access Report 2006, at 4, online: <<http://gpj.mofcom.gov.cn/static/column/z/ab.html/1>>.

- (10) Subsidies, e.g., subsidies inconsistent with WTO rules that artificially stimulate exports of particular domestic products;
- (11) Barriers to trade in services, e.g., unjustified restrictions on access of foreign services;
- (12) Inadequate intellectual property right protection, e.g., inadequate intellectual property protection on imported products
- (13) Unjustifiable protection of intellectual property right, e.g., restrictive measures on imported products in the name of intellectual property protection;
- (14) Other barriers, i.e. measures or practices with trade distorting effects other than above categorized.

In terms of both format and substantive content, the Report follows closely the National Trade Estimate Report on Foreign Trade Barriers (NTE), which is issued by the U.S. Trade Representative every year. As China has been featured high in the NTE every year, the Report can be seen as a Chinese counter-attack, with numerous problems in the US trade regime listed in the Chinese Report year after year.

With the introduction of the foreign trade barrier investigation mechanism, China has started a campaign to aggressively protect and expand its trade interests abroad. This is well illustrated by the first and only foreign trade barrier investigation thus far, which is on import restrictions on laver by Japan.<sup>129</sup> In that case, the Jiangsu Laver Association launched a petition in April 2004 on the quantitative restrictions on the imports of laver imposed by Japan. After receiving the petition, the MOFCOM launched a foreign trade investigation. During the investigation, MOFCOM held several consultations with the Japanese authorities. In the end, the Japanese government agreed to open up its laver market to Chinese laver producers. Thus, the MOFCOM terminated the investigation in February 2005.

### B. *The Bilateral/Regional Level*

At the bilateral and regional level, China has also become more aggressive since its accession to the WTO.<sup>130</sup> Historically, China has not displayed much interest in pursuing free trade agreements (F.T.As) with its trade partners. Starting with the signing of the two Closer Economic Partnership Arrangements with Hong Kong, China<sup>131</sup> (June 2003) and Macau, China<sup>132</sup> (October 2003), however, China has gone on a shopping spree of F.T.As. Currently, China has concluded an F.T.A. with the Association of Southeast Asian Nations (ASEAN) (November 2002)<sup>133</sup>, Chile<sup>134</sup> (November 2005) and Pakistan<sup>135</sup> (November

<sup>129</sup> Fair Trade Bureau of MOFCOM, *Selected Cases on Fair Trade in Imports and Exports*, July 2006, at 87-95.

<sup>130</sup> For a more detailed discussion on this issue, see Henry Gao, "The RTA Strategy of China: A Critical Visit" in Asia-Pacific Economic Cooperation (APEC), *APEC Report on Capacity Building for The New International Architecture in Trade and Investment*, March 2007.

<sup>131</sup> The full text of the Arrangement is available at [http://www.tid.gov.hk/english/cepa/legaltext/cepa\\_legaltext.html](http://www.tid.gov.hk/english/cepa/legaltext/cepa_legaltext.html).

<sup>132</sup> The full text of the Arrangement is available at [http://www.economia.gov.mo/page/english/cepa\\_e.htm](http://www.economia.gov.mo/page/english/cepa_e.htm).

<sup>133</sup> The China-ASEAN FTA includes several major instruments: a framework agreement, and agreements on trade in goods, trade in services and dispute settlement mechanism, respectively. The Framework Agreement was signed in November 2002 and is available at <http://gjs.mofcom.gov.cn/aarticle/af/ah/200212/20021200055694.html>. The Agreement on Trade in Goods was signed in November 2004 and is available at <http://www.aseansec.org/16646.htm>. The Agreement on Dispute Settlement Mechanism was signed in November 2004 and is available at <http://www.aseansec.org/16635.htm>. The Agreement on Trade in Services was signed in January 2007 and is available at <http://gjs.mofcom.gov.cn/aarticle/af/ah/200701/20070104261073.html>.

<sup>134</sup> The full text of the Agreement is available at [http://www.direcon.cl/documentos/China2/tlc\\_chile\\_china\\_ing\\_junio\\_2006.pdf](http://www.direcon.cl/documentos/China2/tlc_chile_china_ing_junio_2006.pdf).

<sup>135</sup> The full text of the Agreement is available at <http://gjs.mofcom.gov.cn/aarticle/af/fazzn/200611/20061103845345.html>.

2006), launched F.T.A. negotiations with New Zealand<sup>136</sup> (December 2004), Gulf Cooperation Council<sup>137</sup> (April 2005), Australia<sup>138</sup> (May 2005), Singapore (August 2006)<sup>139</sup> and Iceland<sup>140</sup> (December 2006), with negotiations with Korea and India under feasibility studies<sup>141</sup>.

In the author's view, an aggressive F.T.A. approach is in China's interest for the following reasons. First, as a WTO Member with the world's third largest trading volume, China has more bargaining power in the regional trade agreement (R.T.A.) setting than at the multilateral level. With the exception of ASEAN and Australia, none of China's existing or potential R.T.A. partners are its major trade partners. At the same time, however, China is always one of the top five trade partners with these economies.<sup>142</sup> Thus, while China can afford to ignore these economies, none of them can afford to ignore China. This effectively places China in a relatively stronger bargaining position.

Second, by focusing on R.T.As with those economies which are of minor importance to China, China can divert some of the trade with its major trading partners, so that it can further balance and diversify its import sources and export markets and would not be overly-reliant on one or several economies. At the same time, these R.T.A. partners will have a significant proportion of their trade diverted to China. This would further increase their reliance on China and further strengthen China's bargaining power and political clout.

Third, with such asymmetric trade relationships and its enhanced bargaining position, China can address in R.T.A. negotiations many problems that are difficult to address at the multilateral level. These include the discriminatory provisions which were discussed earlier in this article. A good example is the issue of the market economy status of China in anti-dumping investigations. One way to solve the problem is for China to request the WTO General Council to amend the Accession Protocol. This seems highly unlikely, however, given that the General Council works on the basis of consensus and so far the only instance of consensus was when the Members decided in late July 2006 to suspend the Doha negotiations. The other option is for China to negotiate with each of its trade partners to recognise its market economy status. As China has much more bargaining power at the bilateral/regional level, this strategy seems to be working. So far, 37 economies have recognised the market economy status of China.<sup>143</sup> As more and more economies recognise China's market economy status, there would be mounting pressures on those who still deem China to be a non-market economy to do just the same.

As the multilateral negotiations are now in deadlock, more and more WTO Members will be shifting their attention to regionalism. Moreover, given its geo-political considerations, China will probably continue to aggressively pursue F.T.A. negotiations in the near future.

<sup>136</sup> New Zealand-China Free Trade Agreement Frequently Asked Questions, online: <<http://www.mfat.govt.nz/Trade-and-Economic-Relations/Trade-Agreements/China/0-faqs.php>>.

<sup>137</sup> See "China Completed First Round of FTA Negotiations with Six Gulf States", online: <<http://gjs.mofcom.gov.cn/aarticle/af/ak/200505/20050500088391.html>>.

<sup>138</sup> "Australia-China FTA Negotiations", *Subscriber Update* (26 May 2005), online: <[http://www.dfat.gov.au/geo/china/fta/050526\\_subscriber\\_update.html](http://www.dfat.gov.au/geo/china/fta/050526_subscriber_update.html)>.

<sup>139</sup> China and Singapore to Launch FTA Negotiations, 26 August 2006, online <<http://app.mti.gov.sg/default.asp?id=148&articleID=4421>>.

<sup>140</sup> See "Vice Minister Yu Guangzhou Signed the Protocol to Initiate FTA Negotiations with Iceland", online <<http://gjs.mofcom.gov.cn/aarticle/af/ak/200612/20061203947215.html>>.

<sup>141</sup> Department of International Trade and Economic Affairs, "Regional Economic Cooperation: New Orientation for the Opening-up in the New Period", 11 January 2007, online <<http://gjs.mofcom.gov.cn/aarticle/ztxx/200701/20070104250984.html>>.

<sup>142</sup> See data on the Trade Profiles Page of the WTO website, online: <<http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E>>.

<sup>143</sup> "37 Countries Regard China's Market Economy Status", *People's Daily Online* (6 January 2005), online: <[http://www.chinadaily.com.cn/english/doc/2005-01/06/content\\_406523.htm](http://www.chinadaily.com.cn/english/doc/2005-01/06/content_406523.htm)>.

### C. *The Multilateral Level*

At the multilateral level, China, just like any other WTO Member, can participate in both WTO negotiations and dispute settlement.

As the WTO makes its decisions on the basis of consensus, China's participation in WTO negotiations is important in shaping the future rules of the multilateral trading system. Both before and after China's accession to the WTO, there have been many debates as to whether China should take on the role of a leader of developing countries in the WTO. The experience since China's accession is rather mixed. On the one hand, China is a power which no WTO Member can afford to ignore. It has continuously affirmed that its interests are aligned with those of developing countries and has been a core member of the major developing country grouping, G20, since its inception in 2003. In his speech at the High-Level Meeting on Financing for Development at the United Nations Summit on 14 September 2005, President Hu Jintao announced an ambitious foreign aid programme. This included zero tariff treatment for certain products from all the 39 Least Developed Countries (LDCs) having diplomatic relations with China, covering most of the China-bound exports from these countries; forgiveness of the loans owed by the Heavily Indebted Poor Countries (HIPC) and LDCs to China; US\$10 billion in concessional loans and preferential export buyer's credit to developing countries to improve their infrastructure and promote mutual cooperation; medical assistance to developing countries, especially African countries; and training of professionals for developing countries within the next three years.<sup>144</sup> All this seems to indicate that China wants to take on the role of a leader among developing countries. On the other hand, China has consistently taken a low profile in all WTO activities. Be it in the informal green room meetings, the formal meetings of the various committees and councils or the grand sessions of the Ministerial Conferences, China has generally been reticent. So far China has only been vocal on two matters: the annual transitional review and the title of the Taiwan delegation. With regard to the former, it is China's own show and China must be more active in providing sufficient answers to the questions from other WTO Members. With regard to the latter, even though Chinese Taipei is, legally speaking, a separate Member in the WTO, China has consistently claimed Taiwan to be one of its separate custom territories and has asked Taiwan to behave accordingly. After Taiwan's accession to the WTO, Taiwan established a "Permanent Mission to the WTO" and appointed officials such as Permanent Representative, Minister, Counsellor, First Secretary, Second Secretary and Third Secretary to the mission. China, however, deems such titles to have sovereign connotations and asked the WTO Secretariat in early 2003 to re-title the Taiwan mission as an "Economic and Trade Office", just like those of Hong Kong and Macau, and remove references to the diplomatic titles of the Taiwan officials from the WTO Directory. Normally the WTO Secretariat would update its directory twice a year: once in April, and again in October. Due to the unbridgeable differences between China and Taiwan, however, the directory was not updated since October 2002. Finally, in June 2005, two months before the expiration of the term of office for the outgoing Director General Dr Supachai, a compromise was reached and the directory was updated. In the new directory, Taiwan has retained the name of its office as a "Permanent Mission" and the official title of its Permanent Representative, but formal diplomatic titles of other officials have been removed. The then WTO Director-General Supachai also included a "Special Note by the Director General," in which he pointed out that the directory is only for the internal use of the WTO Secretariat and its Members, and does not affect the legal rights and obligations of any delegation in any way. Also, citing Article XII of the Marrakech Agreement, Supachai recalled that separate custom territories which are not sovereign states can also become

<sup>144</sup> For the text of the speech, see <<http://www.china-un.org/eng/zt/shnh60/t212916.htm>>.

WTO Members, thus the title of the delegation of such a separate customs territory does not create any implications of sovereign rights.

Even though China is now the third largest trading power in the world and is fast approaching second and first place, the author would argue, contrary to the popular rhetoric of some scholars, that it would not be good policy for China to claim a leadership role within the WTO for the following reasons. Firstly, the author questions whether it is in China's interest to be the leader. As a newly-acceded Member, China is required to undertake a lot of commitments, many of which are more onerous than those of existing WTO members. It is already a humongous challenge for China to try to implement these commitments. After having been in the spotlight for fifteen years, what China needs now is some quiet breathing space. Shouldering a leadership role would put China back on the front stage again and encourage other Members to pressure China to make more concessions. Secondly, even if we assume that, *arguendo*, it is in China's interest to be the leader, does China have the experience and expertise to lead the crowd? Unlike other developing country leaders such as India and Brazil, China's experience in the multilateral trading system, even including that of the accession process, is still rather limited. This may seem to have changed after the 1990s, when the number of books published in China on WTO issues probably outnumbered those of all other subjects combined together. This is just a false prosperity, however, as most of the books are just introductory in nature and lack substance. The number of people appointed as WTO panelists and Appellate Body members can also be used as an indicator to gauge the level of a country's familiarity with WTO rules. Excluding those from Hong Kong, Macau and Taiwan, so far no Chinese national has been appointed as a panelist<sup>145</sup>, not to mention an Appellate Body member<sup>146</sup>. At the same time, developing countries such as India, Brazil, Egypt, Uruguay, the Philippines and Korea have produced many panelists or even Appellate Body Members. Third, even if assuming, *arguendo*, that China does have the leadership quality, would the other developing countries be content to have China assume the leadership role? The author does not have a crystal ball to predict the future, but history might offer some valuable lessons here. During China's WTO accession negotiation, the WTO Member that held on to the last moment before signing a bilateral agreement with China was a developing country (Mexico). Similarly, in anticipation of the expiration of the WTO Agreement on Textile and Clothing (ATC), textile producer groups from many developing countries signed the Istanbul Declaration Regarding Fair Trade in Textiles and Clothing in March 2004 to request the WTO to extend the ATC for another three years, presumably to fend off the threats of competition from Chinese textile producers.<sup>147</sup> Thus, if history can be of any guidance, it seems doubtful that developing Members would readily allow China to take on the leadership role. This is entirely understandable. With most of its exports being labour-intensive or resource-intensive products, China competes with rather than complements the industrial structures of other developing countries. It is no wonder that other developing countries view China as a competitor rather than a friend. Indeed, notwithstanding that the Chinese government has repeatedly held that China is, and always will be, a developing country, and in spite of the fact that the per capita GDP in China is comparable to that of many LDCs, China is also the third largest trading power in the world and the only one among all developing countries to be among the top five traders worldwide. Thus, on many issues, China's interests are actually closer to those of major

<sup>145</sup> Even though China nominated in February 2004 three individuals to the WTO indicative list for Panelists, none of them have been appointed as panelists in any WTO cases yet. See Henry Gao, "Can Chinese Experts Become WTO 'Judges'?" (May 2004) Hong Kong Economic Journal Monthly, at 49-52.

<sup>146</sup> After the unexpected death of Appellate Body member John Lockhart in early 2006, China did propose two candidates to fill the vacancy. However, neither of them was selected in the end. See Henry Gao, "The WTO Changes China, China Changes the World: A Review at the Fifth Anniversary of China's WTO Accession", 357 Hong Kong Economic Journal Monthly 22.

<sup>147</sup> The text of the *Istanbul Declaration* is online at: <<http://www.fairtextiletrade.org/istanbul/declaration.html>>.

developed countries than those of developing countries. Agriculture is one such example: as China imports a large quantity of agricultural products, it is actually not in China's interests to follow the position of most developing countries and demand the elimination of export subsidies. Trade facilitation, one of the four "Singapore Issues," is another such example: as China exports a lot, it is actually in China's interest to push for the inclusion of trade facilitation in the WTO framework to make the customs process more efficient and cheaper.

With regard to dispute settlement, there have been concerns about whether the WTO dispute settlement system can effectively cope with the challenge brought by China's accession. On the one hand, the WTO dispute settlement system is a rather legalistic rule-based system, which is regarded by some to be the "crown-jewel of the WTO" as well as "the most important international tribunal".<sup>148</sup> On the other hand, China has long been perceived as a country that defies international standards, one that cherishes its hard-won sovereignty so much that it generally shuns the jurisdictions of international tribunals, even though some of its citizens have served or are serving as judges in these tribunals. Two more factors further complicate the situation: First, unlike most other international tribunals, which normally do not have compulsory jurisdiction, the WTO Dispute Settlement Body (DSB) does enjoy mandatory jurisdiction for the following reasons:

- a) The WTO DSU is a multilateral agreement rather than a pluri-lateral agreement, which means that all WTO Members must accept this agreement as part of the terms of their accession to the WTO;
- b) According to Articles 3 and 23 of the DSU, Members shall adhere to "the rules and procedures" in the DSU, and shall "have recourse to, and abide by, the rules and procedures" of the DSU in seeking "the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements";
- c) Thanks to the new "reverse consensus" principle established in Articles 6, 16 and 17 of the DSU, the consent of the respondent or losing Member is no longer needed for the initiation of the dispute settlement process or the adoption of panel or Appellate Body reports.

Second, as noted by the former Director of the WTO Appellate Body Secretariat, the major traders are usually also the major users of the WTO dispute settlement system.<sup>149</sup> For example, the two largest traders, the United States and the European Communities, are the most active participants of the dispute settlement system, while other major traders, such as Australia, Brazil, Canada, India, Japan, Korea, Mexico and New Zealand, are also very active.<sup>150</sup> Even before its accession to the WTO, China was already one of the world's major traders, as well as one of the most important trading partners of most countries in the world. Also, as China has yet to develop a mature market economy, there are many problems in its economic and trade policies. Before China's accession to the WTO, its trade partners could only try to resolve these problematic issues through bilateral negotiations. After China's accession, however, they have every right to drag China before WTO Dispute Settlement Body for any trade disputes. This has led to worries that China's accession will result in "a flood of disputes [which] could overwhelm the already over-burdened system".<sup>151</sup> The problem, however, is that "Chinese foreign policy is deeply state-centric and protection of

<sup>148</sup> Matsushita *et al.*, eds., *supra* note 97 at 18.

<sup>149</sup> Valerie Hughes, "WTO Dispute Settlement: Past, Present and Future" in Gao & Lewis, eds., *supra* note 55 at 272-273.

<sup>150</sup> *Ibid.*

<sup>151</sup> Sylvia Ostry, "WTO Membership for China: To Be and Not to Be: Is that the Answer?" in Patrick Grady & Andrew Sharpe, eds., *The State of Economics in Canada: Festschrift in Honour of David Slater* (Canada: John Deutsch Institute for the Study of Economic Policy, 2001) at 263.

sovereignty is at its core”.<sup>152</sup> Thus, “[t]here is serious concern that China would likely regard these actions as political and, to save face, simply reject the process itself”.<sup>153</sup> If China indeed chooses to reject or attack the dispute settlement system, the credibility of the system would be seriously undermined.<sup>154</sup>

On the other hand, some other observers, especially multinational corporations with experience in China, argue that there will be very few, if any, disputes.<sup>155</sup> The business communities fear that their complaints will not be well-taken by the Chinese government and they might fall out of favour or even invite retaliation by the Chinese government for such complaints.<sup>156</sup> Instead, “[t]hey would prefer informal behind-the-scenes, government-to-government talks so that some new deal could be worked out”.<sup>157</sup> This would result in a two-track trading system: “one set of transparent dispute-settlement rules for all WTO members except China and another set of opaque bilateral arrangements for China”.<sup>158</sup> Other WTO Members question the fairness of such arrangements and this again casts doubt on the credibility or even legitimacy of the system.<sup>159</sup>

In the author’s view, this question is best answered by reviewing China’s post-accession experience with the WTO dispute settlement system. As of January 2007, China has participated in one case as the complainant, *i.e.*, the *United States — Definitive Safeguard Measures on Imports of Certain Steel Products* (hereafter “*US-Steel Safeguards*”) case; two disputes and four cases<sup>160</sup> as the respondent, *i.e.* the *China — Value-Added Tax on Integrated Circuits* (hereafter “*VAT Rebate*”) case and the *China — Measures Affecting Imports of Automobile Parts* (hereafter “*Auto Parts*”) case. In addition, China barely missed being brought before the WTO in two cases, *i.e.*, the case on coke export restraints and the case on antidumping duties on kraft linerboard. In almost all these cases, especially in those in which China was on the defensive side, China either chose to try to reach some amicable solution before a formal complaint was brought before the WTO (in the cases of coke export restraint and kraft linerboard antidumping duties) or to settle the case through private consultations with the complainants rather than let the case go all the way to the panel and Appellate Body levels (VAT Rebate). In the author’s view, this can be explained by the reluctance of the Chinese government, especially the senior leadership, to participate in the WTO dispute settlement process. According to Confucianism philosophy which is deeply rooted in the Chinese society, litigation causes irreparable harm to relationships and should be pursued only as a last resort, or, better still, as the great philosopher himself would have preferred, avoided.<sup>161</sup> To a large extent, the Chinese leadership is still unable to disentangle the legal issues from political and diplomatic concerns and views the initiation of legal disputes in the WTO as synonymous with the break-up of a diplomatic relationship. In the author’s view, the active use of the WTO dispute settlement system is not necessarily

<sup>152</sup> *Ibid.*

<sup>153</sup> *Ibid.*

<sup>154</sup> *Ibid.*

<sup>155</sup> *Ibid.*

<sup>156</sup> *Ibid.*

<sup>157</sup> *Ibid.*

<sup>158</sup> *Ibid.*

<sup>159</sup> *Ibid.*

<sup>160</sup> In the WTO, a single trade measure of a Member might be simultaneously challenged by several WTO Members. Each Member is entitled to bring their separate complaint, which will be assigned a unique case number. In order to ensure consistency and efficiency in the dispute settlement Panel’s examination of the measure, however, the WTO normally would establish only one Panel for such dispute and the Panel will examine all complaints in relation to this dispute. Thus, one dispute in the WTO might encompass several cases. See *e.g.* Article 9 of the Dispute Settlement Understanding (DSU).

<sup>161</sup> James Legge, *The Chinese Classics, Volume One: Confucian Analects*, Book XII, Yan Yuan, Chapter XIII, “The Master said, ‘In hearing litigations, I am like any other body. What is necessary, however, is to cause the people to have no litigations.’” The full text is available at <<http://www.gutenberg.org/dirs/etext03/cnfnl10u.txt>>.

in conflict with China's foreign policy goals; instead, China should adopt the strategy of "Aggressive Legalism" to use the substantive rules of the WTO to counter what it deems to be the unreasonable acts, requests and practices of its major trading partners. As argued in an earlier article by the author, "the major advantage of aggressive legalism is that it turns cross-border disputes from a difficult political, trade or diplomatic issue that might undermine the bilateral relationships of the countries involved into a legal issue that is embroiled in an intricate legal game. Instead of a sensitive issue that can be easily polarized by the popular press, the question now has become a highly technical legal game that is beyond the grasp of the lay people. If the Member wins the case, it was all because the politicians have worked hard to achieve 'real results'; if the Member loses the case, the lawyers, or more frequently, the 'incompetent judges in Geneva' will become easy scapegoats."<sup>162</sup>

There is no guarantee, however, that China will always be content to be bullied by the other WTO Members. Indeed, an over-aggressive litigation strategy against China in the WTO might be the victim of its own success: if the WTO dispute settlement system is used too frequently, it might just turn itself into a catalyst for change in China's litigation strategy at some point. From some of the author's recent interactions with MOFCOM officials, especially the junior and middle-level technocrats from the Department of WTO Affairs and the Department of Treaty and Law, it would seem there is now a policy shift towards more active participation in WTO dispute settlement mechanisms. One can trace this to as far back as August 2003, when China started to participate in almost all WTO cases as a third party. More recently, at the press conference for the 5th session of the 10th National People's Congress (NPC) on 12 March 2007, Minister of Commerce Bo Xilai indicated that China would not hesitate to take cases to the WTO if bilateral consultations do not work out.<sup>163</sup> Now, it seems that even the top leadership has started to endorse the policy shift. This is well illustrated by the recent dispute on China's tax on imports automobile parts, in which China seemed ready to fight the case all the way up to the Appellate Body level. This is in sharp contrast to the 2004 dispute on the Chinese export quota on coke, in which China gave in to the threats of the EU to pursue the case at WTO notwithstanding the fact that China had a perfect case from both legal and moral points of view.<sup>164</sup> When China hits on the path of "aggressive legalism", the other WTO Members will soon find that they have to face a much tougher opponent than expected and it will be too late to close the Pandora's Box again.

#### IV. CONCLUSION

Due to changes in the political and economic environments, it has taken China fifteen years to be finally admitted into the multilateral trading system as represented by the WTO. Such political and economic realities are also reflected in the legal terms embodied in China's final accession package. Generally speaking, during its accession, China made much deeper and broader commitments than most other WTO Members, especially developing country Members. As the Chinese economy is resilient, however, the high level of market access commitments in both trade in goods and trade in services will not have as significant an effect on the economy as people might have thought. Instead, the biggest challenge lies in the area of rules, especially those discriminatory terms which almost downgrade the status of China to that of a second-class Member in the WTO. Such terms, if used rather liberally, could severely affect China's trade interests, especially its export expansion capacities in foreign

<sup>162</sup> Henry Gao, "Aggressive Legalism: The East Asian Experience and Lessons for China" in Gao & Lewis, eds., *supra* note 55 at 315-351.

<sup>163</sup> The text of Minister Bo's statements is available online at <<http://video.mofcom.gov.cn/videocast/netcast.asp?id=21>>.

<sup>164</sup> For a detailed analysis of this case, see Henry Gao, *supra* note 162 at 334-348.

markets and greatly distort the world market. Moreover, if such terms are also imposed on other potential Members seeking accession, there would be an imbalance of rights and obligations among the older and newer Members. In response to these challenges, China has become more aggressive in protecting its own trade interests since its accession. This strategy is reflected in the actions it has taken at three levels: at the domestic level, China has revised its trade laws and regulations to provide for more trade remedies tools for its firms; at the bilateral and regional level, China has been actively pursuing F.T.A. negotiations with many of its trade partners; at the multilateral level, until very recently, China has not been very active in either WTO negotiations or dispute settlement. With better self-assessment of its trade interests and deeper understanding of the WTO dispute settlement system, however, we would soon start to see China become active in the multilateral dispute settlement system as well.