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## Can China's Socialist Market Survive WTO Accession - Politics, Market Economy and Rule of Law

Jan Hoogmartens

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# Can China's Socialist Market Survive WTO Accession? Politics, Market Economy and Rule of Law

*Jan Hoogmartens\**

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\* Master of Arts (Leuven-Heidelberg), Master in Laws (Leuven-Illinois Urbana-Champaign), LL.M (Hong Kong), Postgraduate Research Fellow in International Financial and Economic Law, London.

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- a. Legal Redress
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#### 4. Observations

#### D. CONCLUSION

At the time of writing, China still has not managed to become a proud member of the WTO, but China's membership is imminent.<sup>1</sup> The question this article tries to answer is what factors have delayed China's entry. It is argued here that apart from foreign policy, it is especially the transitional nature of China's economy and legal system that caused the world's major economic powers to delay China's accession into the WTO.

Nevertheless, the answer is complex and structured around the politico-historical problems surrounding the relations between China and the West, discussed in Part A, and the difficulties surrounding the unfinished Chinese economic and legal reforms, discussed in Parts B and C, respectively.

A look at the politico-historical background in Part A will reveal that China's relationship with the West has always been problematic. By looking into the diplomatic efforts of recent decades and evaluating China's performance in other Bretton Woods institutions, this section will try to find out whether China can become a constructive member of the world's multilateral trading system.

Part A will further focus on issues such as Taiwan's accession bid, Chinese human rights, and U.S. ideological questions, which are believed to have stood at the centre of the political debate concerning Chinese accession. They will reveal the complex political nature of WTO accession as part of the explanation why China's accession process has dragged on for such a long period.

Part B will then examine China's necessary economic reforms to make the country WTO compatible. Establishing a market economy is the first fundamental premise upon which WTO compliance is built. More specifically, the difficulties concerning state-owned enterprise reform centered on Articles XVII GATT and VIII GATS will play a decisive role in whether and how China will comply with WTO standards.

Finally, in Part C, domestic legal reforms, as a second prerequisite for WTO compliance, will be discussed mainly in view of the transparency requirements set forth in Article X GATT. Establishing the Rule of Law is another hurdle to be taken by a transition economy like China to support the underlying principles of the WTO. Considerable

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1. Beijing hoped to bring China into the WTO in the year 2000. Recently negotiations have been hampered by disagreements over how China will implement WTO rules on intellectual property and meet its other trade obligations. According to Western diplomats the stalemate could delay China's entry into the WTO well into 2001. See, e.g., *Clinton Signs PNTR Bill into Law*, CHINAONLINE NEWS, Oct. 10, 2000, at <http://www.chinaonline.com>. Currently those parts of the 1997 Draft Protocol that remain open must be finalised. Second, the results of China's bilateral negotiations with WTO members must be tabled formally, and discussed with a view to the Working Party agreeing on how they are to be incorporated into the multilateral system. Third, negotiations must be completed and agreement reached on the annexes to China's Draft Protocol. See Richard Eglin, *Challenges and Implications of China Joining the WTO*, at <http://www.wto.org>.

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effort will therefore be spent on judicial review and enforcement to service a transparent legal system necessary to subsequently implement WTO norms.

Eventually this article explains that apart from the politico-historical difficulties surrounding China's accession, the unfinished reforms form the main difficulty for China to enter the WTO. Despite tremendous progress, the Chinese transition economy does not seem to manage the requirements set forth in Articles X and XVII GATT and VIII GATS in a way that comforts the Western trading powers. Of concern is that China's large state-owned economy could enable the country to evade the effective responsibilities and policies of GATT/WTO, even though such an economy can be in complete conformity with the technical rules of the WTO.

#### A. SOCIO-POLITICAL AND HISTORICAL BACKGROUND TO CHINA'S ACCESSION

Undoubtedly, China's entry into the WTO will be of great political significance. Nonetheless, many contested issues, not only economic, but also human rights questions and ideological differences remain. It is the wish of many that China's accession to the WTO will ensure the country to become a "constructive member" of the global community.<sup>2</sup> To this end, political solutions must be found for the categories, problems and procedure of Chinese membership.

##### 1. *China and the World Community*

The purpose of this section is to identify the many difficulties and hurdles that exist in the political relationship between China and the West. The recent policies of engagement, however, have tried to positively integrate China in the international community.

##### a. Relations in Early Years

Apart from trade along established routes the Chinese Empire had no significant political relationship with the West prior to the Opium Wars beginning in 1839. The Chinese, as the Japanese, were very much reluctant to open doors for Westerners, who they believed were barbarians.<sup>3</sup> Traditional Chinese foreign relations did not fully

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2. See Lester J. Gesteland, *Clinton Says WTO Entry Will Make China "Constructive Member" of Global Community*, CHINAONLINE NEWS, Jan. 29, 2000, at <http://www.chinaonline.com> (quoting from President Clinton's State of the Union Address: "We must continue to encourage our former adversaries, Russia and China, to emerge as stable, prosperous, democratic nations.").
  3. See CONRAD BRANT ET AL., *A DOCUMENTARY HISTORY OF CHINESE COMMUNISM* 17 (1952): "Ethnocentrism was inbred in Chinese language and institutions, with the assumption that outer barbarian states, however strong in arms, were always inferior in the attributes of strong civilisation." According to the authors anyone taking a quick look at Chinese history must agree that nationalism has not yet by any means realised its full potentialities in Modern China. The Chinese people thought and acted as the centre of the known world in a recorded history for 3000 years. China viewed itself as superior, not just materially, but culturally. Barbarians could come to appreciate the superiority of the Chinese culture if they recognised the unique position of China as the central kingdom exercising the mandate of heaven.
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recognise foreign countries as sovereigns. Only when a country paid tribute to appreciate the superiority of the Chinese culture, did China allow it the opportunity for trade.<sup>4</sup>

The attitude that China did not need anything from other countries sparked conflicts with nineteenth century imperial powers like France and Great Britain. These conflicts caused the tribute system to give way to the Treaty system. Through the "Unequal Treaties" of the nineteenth and early twentieth centuries, these Western powers finally forced themselves in. China was compelled to conclude with many countries treaties that provided for extraterritoriality (also known as consular jurisdiction) for the nationals of those countries in China, restrictive tariff regulations, territorial cessions and leases, the right to station foreign troops in China, and other humiliating infringements on sovereignty.<sup>5</sup> Pursuant to these treaties and the initial hostile contacts, which accounted for the xenophobia in the age of imperialism,<sup>6</sup> China was treated like a semi-colonial country.

While China had exploited and manipulated tributary countries under the tribute system, China became the subject of manipulation under the unequal treaties. Foreign powers rushed to obtain the advantages. However, the MFN principle, introduced as a bargaining tool for China, created the opposite effect of destroying China's bargaining power.<sup>7</sup>

A weakened country, China lost the imperial monarchy in the 1911 revolution led by Sun Yat Sen. The following decades were rare times during which China was actively involved in world politics.<sup>8</sup> Soon after, it was divided by civil warfare between the Communists and the capitalist Kuomintang government. When the Communist Party came to power in 1949, and established the People's Republic of China, the country fell prey to

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4. On the tributary system from the Ming dynasty (1368–1644) through the Manchurian Qing dynasty (1644–1912), see generally JOHN K FAIRBANK, *TRADE AND DIPLOMACY ON THE CHINA COAST: THE OPENING OF THE TREATY PORTS, 1842–1854* (1953). See also MARK MANCALL, *CHINA AT THE CENTER: 300 YEARS OF FOREIGN POLICY* (1984). For the relevance in present day China, see Gretchen Harders-Chen, Note, *China MFN: A Reaffirmation of Tradition or Regulatory Reform?*, 5 MINN. J. GLOBAL TRADE 381, 381–413 (1996).
  5. See Hungdah Chiu, *Comparison of the Nationalist and Communist Chinese Views of Unequal Treaties*, in *CHINA'S PRACTICE OF INTERNATIONAL LAW: SOME CASE STUDIES* 239, 239–67 (Jerome A. Cohen ed., 1972).
  6. On anti-foreignism in China, see KUANG-SHENG LIAO, *ANTI-FOREIGNISM AND MODERNIZATION IN CHINA, 1860–1980: LINKAGE BETWEEN DOMESTIC POLITICS AND FOREIGN POLICY* (1984). See also Yong Deng, *The Chinese Conception of National Interests and International Relations*, CHINA Q. 308–29 (June 1988). According to Deng, the "Realpolitik Thinking" of China is still profoundly conditioned by the historical memory of the "one hundred years of sufferings and humiliations" at the hands of Western powers and fascist Japan. China suffered both materially and psychologically.
  7. The MFN clause proved to be a one-way street—any concession or privilege gained by one Western power at once accrued to all. China could never reverse the tide, and by abolishing the privileges of one power, eliminate those of others. Treaty privileges steadily accumulated against her interest, thus weakening Chinese institutional structure. See Harders-Chen, *supra* note 4, at 390.
  8. E.g., China was represented at the Congress of Versailles where it signed the 1919 peace treaty and in the League of Nations, where it objected to the invasion of Manchuria by the Japanese in 1931. For further reference, see Cohen, *supra* note 5.
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the Cold War politics of isolationism. China was involved in the two hot spots of Korea and Vietnam and therefore put under embargo by the United States between 1953 and 1972.<sup>9</sup> Both the international and domestic situation had limited any further expansion of economic relations with China.

These early psychological and material sufferings under Western treaty rule explain China's insistence on reciprocity to bring home fairness and equity in multilateral trade.<sup>10</sup>

#### b. Official Relations

Notwithstanding the difficulties in the past, governments have adopted policies of engagement since recent decades.

In an effort to doom the Soviet Empire by driving it apart from other Communist allies, President Nixon and his foreign policy advisor, Henry Kissinger, adopted normal diplomatic relations with China.<sup>11</sup> The European Communities soon followed,<sup>12</sup> notwithstanding that some EC Member States already had established diplomatic relations.<sup>13</sup>

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9. As a result of the deterioration of the political atmosphere in the beginning of the 1950s normal trade relations between China and many of the GATT Contracting Parties ceased to exist, but since the 1960s the share of trade with GATT Contracting Parties gradually acquired more importance. See Chung-Chow Li, *Resumption of China's GATT Membership*, 21 J. WORLD TRADE 4, 28 (1987). Despite the U.S. embargo, trade and barter arrangements with the U.K., France and Denmark were concluded and in the early 1960s China purchased a number of industrial plants from EC Member States. See X. Yue, *Current EC Legal Developments—The EC and China*, BUTTERWORTHS 4 (1993).

10. See Harders-Chen, *supra* note 4.

11. The official visit by Nixon led to the Shanghai Communiqué in 1972. On January 1, 1979, the relationship was bolstered in the Joint Communiqué on the Establishment of Diplomatic Relations. See 79 DEP'T ST. BULL. 25 (Jan. 1979). This was followed by People's Republic of China, Consular Relations, Jan. 31, 1979 (U.S.-P.R.C., 30 U.S.T. 17). Soon thereafter, on July 7, 1979, the Agreement on Trade Relations between the two countries was signed. See 31 U.S.T. 4651; see also Fox Butterfield, *U.S. and China Mark Resumption of Ties in Peking Ceremony*, N.Y. TIMES, Jan. 2, 1979, at A1, A10.

12. Official relations between the European Economic Community and China were initiated in 1975. In 1983, the relationship was officially expanded to include also the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (EAEC). A trade agreement was signed in 1978, followed by the 1985 Trade and Co-operation Agreement (see OJ L250 19. 9.85 p. 1). In 1995, a Long-term Policy for China-Europe Relations was adopted (see Com (95) 0279-C4-0288/95). For more on China-Europe relations, see Willem Van der Geest, *Bringing China into the Concert of Nations: An Analysis of Its Accession to the WTO*, 32 J. WORLD TRADE 3, 99–114 (1998); see also Yue, *supra* note 9, at 4. For the latest details on EU-China relations, see "Report from the Commission to the Council and the European Parliament on the Implementation of the Communication 'Building a Comprehensive Partnership with China,'" at [www.europe.org](http://www.europe.org), COM (2000) 552, Aug. 9, 2000.

13. Among the earliest were Denmark (11 May 1950), United Kingdom (17 June 1954), Netherlands (19 November 1954) and France (27 January 1964). A number of EC Member States took the opportunity to establish diplomatic relations during the 1970s. These are *inter alia*: Italy (6 November 1970), Belgium (25 October 1971), Greece (5 June 1972), Germany (11 October 1972), Luxembourg (16 November 1972), Spain (9 March 1973), Portugal (8 February 1979) and Ireland (22 June 1979).

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The U.S. administration has repeated its commitment to supporting China's accession to the WTO in almost every bilateral negotiation. The realisation of the commitment, however, depends on the actual improvement of the bilateral relationship between the United States and China. This relationship is still unpredictable, even after the Jiang-Clinton summit in October 1997.<sup>14</sup> It is also under threat from non-economic issues like human rights,<sup>15</sup> the Taiwan channel,<sup>16</sup> and nuclear proliferation.<sup>17</sup> U.S. President Clinton explained his 'pragmatic policy of engagement' as "expanding our areas of co-operation with China while confronting our differences openly and respectfully."<sup>18</sup>

The overall aim of the European policy is to foster a greater European presence in the Asia-Pacific region. Political-strategic matters thereto are reviewed in an EC Communication. The EU approach of "engagement" focuses on increasing the likelihood that China will act as a "responsible" member of the international community. This encompasses the degree of economic openness, the reliability of the judicial system, and the protection of individual, human and social rights.<sup>19</sup>

In 1971, the People's Republic of China replaced capitalist rival Taiwan in the United Nations Organisation and took a seat in its Security Council.<sup>20</sup> By 1980, China joined the IMF and the World Bank<sup>21</sup> and after it gained observer status to the GATT in 1984, it applied for membership in 1986. It renewed this application in 1995 to become a member of the newly established WTO.<sup>22</sup>

Further, China developed good relations with its trading partner Japan; strong relations with Vietnam, India, and Nepal; and diplomatic ties with Uzbekistan, Turkmenistan, Kyrgyzstan, Kazakhstan and Tadjikistan were also established.<sup>23</sup>

14. Wei Zhao, *China's WTO Accession: Commitments and Prospects*, 32 J. WORLD TRADE 2, 51-75 (1998); see also THE POLITICAL ECONOMY OF SINO-AMERICAN RELATIONS: A GREATER CHINA PERSPECTIVE (Y.Y. Kueh & Brian Bridges eds., 1997).
15. See *infra* section A.2.b (Human Rights Issues).
16. See *infra* section A.2.a (Taiwan's bid for WTO access).
17. For example, the proposal to add weapons non-proliferation language to the Permanent Trade Relations Bill. See Charles A. Snyder, *U.S. Senate Rejects Thompson Amendment, Virtually Assuring Passage of PNTR*, CHINAONLINE NEWS, Sept. 13, 2000, at <http://www.chinaonline.net>. On Permanent Trade Relations, see *infra* section A.2.c (Ideological Differences: United States Law).
18. Remarks by President in Address on China and the National Interest, VOICE OF AMERICA, Oct. 24, 1997.
19. See COM (1998) 181 and COM (2000) 552, *supra* note 12; see also Van der Geest, *supra* note 12, at 101.
20. On October 25, 1971, the United Nations General Assembly adopted Resolution 2758 (XXVI) to restore the lawful rights of the People's Republic of China and to expel the representatives of Chiang Kai-shek from the U.N. See General Assembly Official Records, 26th Sess., Supp. No. 29 (A/8429) at 2.
21. See HAROLD KARAN JACOBSON & MICHEL OKSENBERG, CHINA'S PARTICIPATION IN THE IMF, THE WORLD BANK, AND GATT: TOWARD A GLOBAL ECONOMIC ORDER 59. The IMF and World Bank were, just like the United Nations, initially not open to communist Beijing, but to capitalist Taipei. In 1950, Czechoslovakia, Yugoslavia and India already asked the PRC to replace Taiwan.
22. For full details, see *infra* section A.2 (The Road to WTO Accession).
23. Guiguo Wang, *Economic Integration in Quest for Law: The Chinese Experience*, J. WORLD TRADE 10 (Apr. 1995).

### c. International Relations with Chinese Characteristics

Because of its difficult past in establishing international relationships, many observers are interested in how China will develop as a member of international organisations and the international community at large. As a growing economic power China understands the need of participating in international and regional affairs.<sup>24</sup> Its domestic economic reforms require this participation.<sup>25</sup>

International economic law has taken a prominent place in international relations.<sup>26</sup> The economic component in international affairs has expanded sharply, largely at the expense of ideological and security concerns. Perhaps nowhere has this happened more clearly than in Sino-U.S. relations.<sup>27</sup> Liberalism and economic nationalism address the economic characteristics of these relations.

By joining the international economy, China tries to enhance its national aggrandisement (exactly what realism, alternatively called economic nationalism, stands for<sup>28</sup>). China's WTO membership brings the country international acclaim and prestige. The international investor confidence resulting from WTO membership determines its attractiveness and allows the country to amass foreign capital to pay for sound domestic reforms and, hence, further industrialisation. The momentum of this drive must turn China into an economic powerhouse.<sup>29</sup> An export-oriented growth policy suits this doctrine.

To some scholars China has taken the protective coloration of a market economy while at the same time retaining an overall mercantilist policy.<sup>30</sup> Neo-mercantilism will inescapably lead to more protectionism and interventionism in international economic affairs.<sup>31</sup>

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24. See, e.g., Samuel S. Kim, *Mainland China in a Changing Asia-Pacific Regional Order*, 30 ISS. & STUD. 1 (Oct. 1994); see also JONATHAN R. WOETZEL, *CHINA'S ECONOMIC OPENING TO THE OUTSIDE WORLD: THE POLITICS OF EMPOWERMENT* (1989). China must play a role in global economic management. Some Western authors therefore believe China should participate in the finance G-7, the club of finance ministers and central bank governors. See, e.g., C. Fred Bergsten, *The New Agenda with China*, Institute for International Economics, May 1998, at <http://www.iie.com>.
  25. Wang, *supra* note 23, at 7. Specific steps to participate in multilateral organisations were taken almost immediately after China started economic reforms.
  26. See generally Anne-Marie Slaughter et al., *International Law and International Relations Theory: A New Generation of Interdisciplinary Scholarship*, 92 AM. J. INT'L L. 367, 367-97 (1998); see also John Setear, *An Iterative Perspective on Treaties: A Synthesis of International Relations Theory and International Law*, 37 HARV. INT'L L.J. 139, 139-229 (1996).
  27. Jacques deLisle, *Of Chinese Walls, Battering Rams, and Building Permits: Five Lessons About International Economic Law from Sino-U.S. Trade and Investment Relations*, 17 U. PA. J. INT'L ECON. L. 513, 515 (1996).
  28. See Monica Hsiao, *China and the GATT: Two Theories of Political Economy Explaining China's Desire for Membership in the GATT*, 12 UCLA PAC. BASIN L.J. 431, 437 (1994). Illuminating in this regard is also the article by Deng, *supra* note 6.
  29. See generally Hsiao, *supra* note 28, at 439.
  30. See JACOBSON & OKSENBØRG, *supra* note 21, at 10.
  31. See generally RAH BHALA, *INTERNATIONAL TRADE LAW: CASES & MATERIALS*, ch. 1 (1996); see also JOHN H. JACKSON ET AL., *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS*, ch. 1 (1995).
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It must be acknowledged, however, that with China embracing capitalism in the age of globalisation, *realpolitik* has somewhat been put in the defensive in favour of a more liberal rhetoric in China.<sup>32</sup>

The surge in liberalism explains why China's Marxist-Leninist-Maoist ideology is downgraded in present economic policy. In undertaking WTO commitments, China is devoted to economic efficiency, maximisation of economic growth, and improvement of living standards.<sup>33</sup>

Realism and liberalism are especially useful for China's political rulers to sell WTO principles domestically. China's past experiences with the world community would not easily accept WTO concessions if they resulted from foreign pressure instead of an allegedly more neutral political forum. It also helps local leaders reinforce domestic reforms.<sup>34</sup> These reforms are the focal point to improve domestic performance. If they achieve success then China will seek greater voice and power. A more assertive China could then begin to express itself.

WTO membership will further legitimise China's stance in the world community and will confirm China's economic integration in the world economy by adopting a free market based on liberalised trade.

#### d. China's Participation in IMF and World Bank

China's participation in the IMF and the World Bank might reveal something about the possible course China will take in the WTO. However, the policy vis-à-vis IMF and World Bank is distinct from an envisaged WTO membership, because neither IMF nor World Bank membership involved such large economic reforms in China as WTO membership. What image of China can we possibly expect and can the Bretton Woods organisations continue to support the underlying Western economic values?

The importance of lending by the World Bank and the International Development Association (IDA) should not be underestimated.<sup>35</sup> These loans serve as a sign of security to private investors and help funnel foreign capital and technology to China.<sup>36</sup> Several

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32. E.g., Jiang Zemin's speech at the quasi-summit on November 15, 1994, talking about how nuclear proliferation, AIDS prevention, etc. are all of an interdependent nature and require co-operation and commonly observed standards, as well as trade contracts and market development. *FBIS-China*, Nov. 15, 1994, at 2; see also Deng, *supra* note 6, at 320, 329 (Deng acknowledges a liberal undercurrent in the dominant realist paradigm).

33. See Hsiao *supra* note 28, at 446.

34. See, e.g., JACOBSON & OKSENBURG, *supra* note 21, at 93.

35. China is a major recipient of multilateral official lending. The United States has recently questioned whether China should continue to receive concessional finance through the International Development Association (IDA), the World Bank soft loan window. IDA funds have accounted for about a quarter of China's \$22 billion in World Bank loans since 1980, and China has been receiving approximately \$1 billion annually from IDA for the last several years. See Marcus Noland, *China and the International Economic System*, Institute for International Economics, Working Paper 95-6, at <http://www.iie.com>.

36. See Bing Ling, *China and International Institutions*, 90 AM. SOC'Y INT'L L. PROC. 397 (1996). Since China's membership in the World Bank, the latter has approved many projects. China has been the Bank's biggest borrowing member country since 1993, and has one of the best project implementation records. To attract more loans, the country joined the Asian

Chinese bureaucrats highly praise the technical assistance that they have received from the Bank and the Fund.<sup>37</sup> Financial assistance, competitive bidding, foreign consultants, and training of personnel have changed the Chinese mind about how to undertake certain projects and how to reduce costs and improve quality.<sup>38</sup>

However, China slowly wants to get rid of its image as a passive receiver of capital, technology, or economic and social values from other nations. By gradually flexing its economic power, China wants a share of mercantile diplomacy to influence decisions at the international level.<sup>39</sup>

Therefore, the incorporation of China into the IMF, the World Bank and the WTO on terms that preserve and advance the neo-liberal international economic order is not easy. It is a test to the capacity of these institutions to adjust to a changing environment.<sup>40</sup> So far, China is not seeking to make incremental changes in the rules of the Bretton Woods institutions so that Chinese traditions and practices would be incorporated into the operations of these institutions. But, in future the existing arrangements could come under pressure if China continues to pursue political power under economic nationalism.

Moreover, China has had its own values shared by foreign countries and individuals and still employs its own values of conducting economic exchanges.<sup>41</sup> China's participation in international organisations and economic exchanges creates interaction between the legal, social and other values of the Chinese people<sup>42</sup> and those of other peoples' jurisdictions in the process of globalisation and regionalisation of business law.<sup>43</sup> It reveals,

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Development Bank without the pre-condition of Taiwan's leaving in 1986. See Wang, *supra* note 23, at 8. On China's membership in the Asian Development Bank, see Bruce Murray, *Prospects for Prosperity*, CHINAONLINE NEWS, Oct. 19, 2000, at <http://www.chinaonline.com>.

37. See JACOBSON & OKSENBURG, *supra* note 21, at 141–42.

38. The U.S. administration regards technical assistance as the primary channel through which it can influence economic reform in China. See Noland, *supra* note 35.

39. See Deng, *supra* note 6, at 314 (noting that China's foreign policy is still very much pulled back by power politics and *Realpolitik*). On realism and liberalism in China, see *supra* part A.1.c. (International Relations with Chinese Characteristics).

40. See JACOBSON & OKSENBURG, *supra* note 21, at 4.

41. Reference is made here to the tributary system mentioned *supra*.

42. Deng, *supra* note 6, at 312 contends that the recent debate over civilizational clashes and human rights must be viewed in terms of the struggle between Western cultural expansion and third world countries' attempts to defend their "cultural sovereignty."

43. A clear example in this regard according to Wang is the Chinese favour for the use of a non-adversarial dispute resolution system. See Wang, *supra* note 23, at 22. On dispute resolution in China, see, e.g., Stanley B. Lubman, *Dispute Resolution in China after Deng Xiaoping: 'Mao and Mediation' Revisited*, 11 COLUM. J. ASIAN L. 229 (1997); James U. Feinerman, *The History and Development of China's Dispute Resolution System*, in DISPUTE RESOLUTION IN THE PRC, Hong Kong, ASIA L. & PRAC. 5 (1995); A. Crawford, *Plotting Your Dispute Resolution Strategy: From Negotiating the Dispute Resolution Clause to Enforcement Against Assets*, in DISPUTE RESOLUTION IN THE PRC, Hong Kong, ASIA L. & PRAC. 22 (1995); S. Harpole, *Procedures and Practices Under the China International Economic and Trade Commission*, in DISPUTE RESOLUTION IN THE PRC, Hong Kong, ASIA L. & PRAC. 51 (1995); S. Finder, *Inside the People's Courts: China's Litigation System and the Resolution of Commercial Disputes*, in DISPUTE RESOLUTION IN THE PRC, Hong Kong, ASIA L. & PRAC. 63 (1995); and D. Lewis & K. Ip, *Domestic Commercial Arbitration in the People's Republic of China*, in DISPUTE RESOLUTION IN THE PRC, Hong Kong, ASIA L. & PRAC. 74 (1995).

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however, a difference of perception. Can China still pursue the values it chooses and integrate at the same time into the global economy? As a totally self-sufficient economy it rejected global interdependency in the past.

Some Chinese view Western pressure on political ideologies, lifestyles, and values as an attempt to reinforce Western hegemony and to discipline a rising China. Furthermore, they believe the spread of a "global culture" has led to a homogenisation of civilizations, hiding the long-standing struggle for power.<sup>44</sup>

Therefore, bringing China into the rule-based world trading system might cause a clash of cultures—with different systems and different objectives having to be accommodated within the context of the WTO and the final act of the Uruguay Round. Indeed, it may shock the WTO and the multilateral rule-based system at large.<sup>45</sup>

In the meantime, China would like to be treated as a special case.<sup>46</sup> China, however, knows that special treatment might come at a discernible cost for other transition economies or developing country members.<sup>47</sup>

Countries like Poland, Romania, Hungary, former Czechoslovakia, and former Yugoslavia received relatively favourable treatment, especially in the IMF and World Bank. However, they were not always diligent in fulfilling obligations, and at times there was disappointment in the trade performance of these countries. So, while imports did not always increase as expected neither did exports increase greatly.<sup>48</sup>

There is no doubt that involvement in these Bretton Woods institutions noticeably affects the structures and policies of the member state. Placed in an optimistic perspective, the interaction between international organisation and state should be reciprocal and beneficial for all members, hence leading to a more peaceful, stable and equitable world.<sup>49</sup>

Many institutional changes and policy modifications have occurred both within China and within the IMF and World Bank to facilitate co-operation. It is difficult to measure the exact influence and sort out the cause and effect, because in the search for mutual adjustment each international player seeks to protect an image of independence.<sup>50</sup>

As an active member of the IMF and World Bank, China's executive directors and their deputies have received wide praise for their competence. They have sought to maintain the effectiveness of the organisations. They have not been ideological and have not introduced extraneous political considerations into the debates.<sup>51</sup> The Chinese value the meetings as occasions to broaden their contacts in the international financial community and to acquire additional knowledge.<sup>52</sup>

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44. See *supra* text accompanying note 42.

45. See Van der Geest, *supra* note 12, at 113.

46. By and large, the World Bank and IMF have not treated China as an exceptional case; they have treated China sympathetically. Instances of special treatment at the margin do exist; but similar allowances existed for other large developing countries like Egypt and Indonesia. See JACOBSON & OKSENBERG, *supra* note 21, at 138.

47. See JACOBSON & OKSENBERG, *supra* note 21, at 133. India, for example, has been concerned that Chinese claims would restrict Indian access to Bank and Fund resources. *Id.* at 137.

48. *Id.* at 28.

49. *Id.* at 8.

50. *Id.* at 129.

51. *Id.* at 131.

52. *Id.* at 132.

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China's membership of the IMF and World Bank blunted the charge that they were instruments of Western imperialism. This has weakened the UNCTAD and strengthened the present position of the WTO. China's entrance into the Bank has helped other developing countries look more realistically at development. The debate about the New International Economic Order has been pushed into the background by the realities of economic difficulties. Developing countries, therefore, sometimes contend that China has adopted the rhetoric of the developed world.<sup>53</sup>

Yet, China's role has also been criticised over the years. For example, the McMillan-Scott report notes that China's participation in multilateral organisations has been very limited and that its attitude to such bodies has been marked by scepticism.<sup>54</sup> In China, the government's soft policy towards the United States has been criticised over time.<sup>55</sup>

Nevertheless, China's involvement in the World Bank and the Bank's involvement in China today reflect a normal and appropriate partnership between a borrowing member country and an international institution.<sup>56</sup> China's membership in the IMF and World Bank has further demonstrated a cautious approach to building a relationship.<sup>57</sup>

WTO membership for China, however, is quite different from Chinese membership in the Fund and Bank. The only requirement for China beyond meeting the financial obligations in its IMF quota and in its subscription to the Bank was the publication of substantial data.<sup>58</sup> The IMF and World Bank have never been the source of ambitious economic reforms in China, but rather inspired a convergence of views. WTO membership will therefore be an even larger intellectual and emotional satisfaction.

## 2. *The Road to WTO Accession and Remaining Political Difficulties*

The second part of our politico-historical overview closes the circle by zooming into some of the political issues that are believed to have stood central in China's accession debate. But before doing so, we turn first to the accession process.

Any state or customs territory having full autonomy in the conduct of its external commercial relations may accede to the WTO on terms agreed with WTO Member States. The process of accession begins when a country submits a request for accession.<sup>59</sup>

53. *Id.*

54. See Van der Geest, *supra* note 12, at 110–11. China's response to this report, prepared by McMillan-Scott in the European Parliament, 1997, was decidedly negative as it denounced the debate as "Anti-China clamour." See European Parliament, 1997: *Report on the Communication from the Commission on a Long-Term Policy for China-Europe Relations* (Com (95) 0279-C4-0288/95) session document A4-040198/97, PE 221.588/fin; 29 May 1997.

55. See Wang, *supra* note 23, at 24–25.

56. See Ling, *supra* note 36, at 398.

57. See JACOBSON & OKSENBERG, *supra* note 21, at 197 (The authors recognise different stages in the incorporation process of a member. First, there is the engagement policy followed by initial participation. Tests of compatibility whether organisation and regular participant can really join harmoniously occur in the phase of mutual adjustment. This stage is followed by a mature partnership).

58. *Id.* at 105.

59. WTO Secretariat, *Accession to the World Trade Organization: Procedures for Negotiations under Article XII, WT/ACC/1* (24 March 1995), at <http://www.wto.org> [hereinafter *Accession Procedures*]; see also John H. Jackson & Sylvia A. Rhodes, *United States Law and China's WTO*

In 1986, after having gained observer status in 1984,<sup>60</sup> China applied to join the GATT,<sup>61</sup> and in 1987, a working party was established to consider its entry.<sup>62</sup> China renewed its application under the WTO in 1995, when it had missed the opportunity to accept the WTO Agreement as an original WTO member state<sup>63</sup> and requested that the GATT working party continue its work as a WTO working party.<sup>64</sup>

The accession process is conducted at both the multilateral and bilateral level. At the multilateral level, a working party prepares a Report, Protocol of Accession, and Schedules of Concessions and Commitments on Goods and Services. The Protocol of Accession contains the terms and conditions of entry into the WTO. China may accede to the WTO when both the WTO members, by a two-thirds majority decision, and the Government of the PRC have accepted the Protocol of Accession.<sup>65</sup>

At the bilateral level, negotiations result in market access for all WTO members. The PRC has been engaged in bilateral market access negotiations with WTO members

*Accession Process*, J. INT'L ECON. L. 497 (1999). The process of accession can be divided into an introductory phase of formalities and three substantive phases, including: (1) the applicant's preparation of a Memorandum on the Foreign Trade Regime describing in detail its policies and institutions that have a bearing on the conduct of international trade; (2) the members' fact-finding phase that allows questions and answers; and (3) the negotiation phase. For the accession process and strategy of transition economies, see C. Michalopoulos, *WTO Accession for Countries in Transition*, on file with author. The latest information on China's accession can also be downloaded from [http://www.wto.org/english/thewto\\_e/acc\\_e/china\\_e.htm](http://www.wto.org/english/thewto_e/acc_e/china_e.htm). For the accession procedures under GATT, see G. Patterson, *The GATT: Categories, Problems and Procedures of Membership*, COLUM. BUS. L. REV. 7 (1992).

60. GATT Activities 1984, at 55 (1985). Before that, the PRC had already been accepted as an observer to the GATT Textile Committee. By unanimous consent of all Contracting Parties, China attended the meetings of the GATT Council and other specialised agencies within the GATT in 1984. See GATT Activities 1983, at 35 (1984). For secondary literature, see Wang, *supra* note 23, at 8. See also Y. Feng, *China's Membership of GATT: A Practical Proposal*, 22 J. WORLD TRADE 53 (1988) (stating that the Chinese government submitted to the GATT a formal application requesting the restoration of China's status as a Contracting Party in the organisation on 11 July 1986); Li, *supra* note 9, at 39 (contending that the Chinese ambassador in his statement on 17 June 1986 at a GATT Special Council Meeting indicated that China wished to participate in the Uruguay Round, leading to a Chinese government communication informing the Contracting Parties of its candidacy on 11 July 1986).
61. See *supra* note 60 for secondary literature; see also GATT Activities 1986, at 76–77 (1987). Membership would be negotiated under Article XXXIII of the GATT.
62. See GATT Activities 1986, at 75, 108–09 (1987).
63. Although the PRC wanted to obtain GATT membership in time for it to become an 'original member' of the WTO, the United States and other WTO members failed to agree on terms for its entry before the December 1994 deadline. See GATT Activities 1993, at 105 (1994); see also *China Delay on Trade Pact*, N.Y. TIMES, Dec. 15, 1994, at D7.
64. Communication from China, WT/ACC/CHN/1 (7 December 1995) (requesting that the GATT Working Party on China's Status as a Contracting Party be converted to the Working Party on China's Accession to the WTO. The WTO General Council agreed). See WTO Secretariat, General Council (31 January 1995): Minutes of Meeting, WT/GC/M/1 (28 February 1995).
65. See Jackson & Rhodes, *supra* note 59, at 498; Accession Procedures, *supra* note 59; see also Eglon, *supra* note 1.

on concessions and commitments on goods and services.<sup>66</sup> Although these bilateral and multilateral market access negotiations are well advanced, some political issues remain unresolved.

a. Taiwan's Bid for WTO Accession

International organisations are created by states to serve the needs of states.<sup>67</sup> Becoming a member of the WTO is a political decision and for many years international politics has overshadowed China's membership.

A key factor in China's accession struggle is Taiwan's bid to join the WTO.<sup>68</sup> Since the early 1980s, the Republic of China, or in short, Taiwan, has been eager to gain admission to the WTO.<sup>69</sup> As for international politics, the entrance of a regime, which is neither a member of the U.N., nor recognised by most of the world's nations, is a troubling prospect.<sup>70</sup> But especially, the candidacy of the People's Republic of China presented a further obstacle.<sup>71</sup> The position of Taiwan and its relationship with China<sup>72</sup> became evident again prior to Taiwan's presidential elections in March 1996, when the Chinese threatened with a military takeover of Taiwan and were launching missiles close to Taiwan's north and south seaports.

It is only after the PRC will be admitted to the organisation that it is willing to help Taiwan join under an appropriate name.<sup>73</sup> Both Hong Kong and Macau became members of the WTO through the sponsorship of Great Britain and Portugal, after China consented regarding their respective handover.<sup>74</sup> In the case of Taiwan, the PRC always feared that allowing Taiwan into the WTO would allow it a back door entry as a recognised member of the world community.

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66. See, e.g., Sino-U.S. Bilateral Trade Agreement of 15 November 1999; Sino-Canada Bilateral Trade Agreement of 23 November 1999; Sino-EU Bilateral Trade Agreement of 19 May 2000.
67. See L. Fisler Damrosch, *GATT Membership in a Changing World Order: Taiwan, China and the Former Soviet Republics*, COLUM. BUS. L. REV. 19 (1992).
68. Taiwan applied to join the GATT under Article XXXIII in September 1992 as the autonomous customs territory of Taiwan, the Pescadores, Kinmen, and Matsu (referred to as Chinese Taipei). See GATT Activities 1992, at 95 (1993).
69. See, e.g., Susanna Chan, *Taiwan's Application to the GATT: A New Urgency with the Conclusion of the Uruguay Round*, 2 IND. J. GLOBAL LEGAL STUD. 275 (1994); James V. Feinerman, *Taiwan and the GATT*, COLUM. BUS. L. REV. 39 (1992).
70. See also THE INTERNATIONAL STATUS OF TAIWAN IN THE NEW WORLD ORDER: LEGAL AND POLITICAL CONSIDERATIONS (Henckaerts ed., 1996). This work explains Taiwan's past and present political and legal positions in the international community. See also L. Chen, *Taiwan's Current International Legal Status*, NEW ENG. L. REV. 675 (1998).
71. See the elaborate discussion in W. Cai, *China's GATT Membership: Selected Legal and Political Issues*, 26 J. WORLD TRADE 35, 51 (1992).
72. On the relationship between China and Taiwan, see C. Joyner, *The Spratly Islands Dispute: What Role for Normalizing Relations between China and Taiwan*, NEW ENG. L. REV. 819 (1998).
73. The PRC is afraid to lose face in its 'one China policy' if Taiwan were to become a member first.
74. Macau was granted full membership of the GATT on 11 January 1991 and Hong Kong on 23 April 1986. See Cai, *supra* note 71, at 37.
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Moreover, China was a founding member of GATT 1947. It participated in the negotiations in 1947, and became a party to the Protocol of Provisional Application, which came into force in 1948. In the aftermath of the October 1949 Communist coup, the government of the Republic of China, from its new home base in Taiwan, gave notice of withdrawal from the GATT in 1950. The PRC does not acknowledge this withdrawal, but neither did it contest the legality at the relevant time, in the 1950s, nor did the PRC observe the obligations of membership from the 1950s onward.<sup>75</sup> This historical event created the difference over China's accession rather than its resumption of membership. In sum, this matter has become a diplomatic trifle,<sup>76</sup> because GATT 1947 has lost much of its relevance since the establishment of the WTO in 1995, and GATT 1947 was replaced by GATT 1994.

As of this writing, China still continues to negotiate to enter the WTO, whereas Taiwan's Protocol of Accession was substantially completed in May 1999.<sup>77</sup>

#### b. Human Rights Issues

Since 1989, there have been pressing demands on China to improve its human rights record. Western economic powers consider a fair and open society as one of the premises the WTO is built upon. Some legal scholars therefore propose a "single basket approach," linking all political and economic dealings with China to human rights.<sup>78</sup>

The Tiananmen massacre in June 1989<sup>79</sup> left some wounds in the political relationships with major trade powers.<sup>80</sup> The United States had negotiated some of its bilateral terms for the PRC's accession to the GATT, but withdrew its support for accession after the June protests, and the June meeting of the working party was cancelled due to the

75. See, e.g., Fislser Damrosch, *supra* note 67, at 21; see also John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* 329 (1997); A. Neil Tait & Kui-Wai Li, *Trade Regimes and China's Accession to the World Trade Organization*, 31 J. WORLD TRADE 93, 98 (1997).

76. See Fislser Damrosch, *supra* note 67, at 23. Membership must be examined *de novo*, but no harm will be done if the WTO members defer to Beijing's insistence on the term "resumption."

77. See Jackson & Rhodes, *supra* note 59, at 501.

78. See, e.g., Patricia Stirling, *The Use of Trade Sanctions as an Enforcement Mechanism for Basic Human Rights: A Proposal for Addition to the World Trade Organization*, 11 AM. U. J. INT'L L. & POL'Y 1 (1996) (she proposes that the multilateral enforcement of human rights should be made possible through the investigative and dispute settlement procedures already in place within the WTO); see also Randal Green, *Human Rights and MFN Tariff Rates for Products from the People's Republic of China*, 17 U. PUGET L. REV. 611 (1994); Diane Orentlicher & Timothy Gelatt, *Public Law, Private Actors: The Impact of Human Rights on Business Investors in China*, 14 NW. J. INT'L L. & BUS. 66 (1993); Jennifer Morris, *Human Rights Violations During the Tiananmen Square Massacre and the Precedents Obliging United States Response*, 13 CARDOZO L. REV. 1375 (1991).

79. See, e.g., Nicholas D. Kristof, *Troops Attack and Crash Beijing Protest; Thousands Fight Back, Scores are Killed*, N.Y. TIMES, June 4, 1989, at A1.

80. On the U.S. response, see Morris, *supra* note 78. See also Matthew W. Cheney, *Trading with the Dragon: A Critique of the Use of Sanctions by the United States against China*, 8 J. INT'L L. & PRAC. 1 (1997).

political upheaval.<sup>81</sup> The EC also condemned the Chinese Government's suppression of the pro-democracy demonstration.<sup>82</sup>

But already in September 1989 GATT decided to resume consideration of the Chinese accession, and the working party met in December of that year.<sup>83</sup> By 1992, foreign investment was roaring again and, following a period of inactivity, the working party resumed its task in February 1992.<sup>84</sup>

### c. Ideological Differences: United States Law

Because of the ideological differences that exist between the capitalist West and the communist East, U.S. statutes sometimes still constrain the ability to enter into a commercial agreement with a non-market economy.<sup>85</sup> In respect to China's accession, these statutes come into play as well. Theoretically, China could become a member of the WTO without the support of the United States as soon as a two-thirds majority approves the accession.<sup>86</sup> But even if the United States voted in favour of China's entry, it would have to opt out and could not simply extend permanent, unconditional most-favoured-nation treatment to the PRC.<sup>87</sup>

Pursuant to Title IV of the 1974-enacted Trade Act, it is required that the U.S. President denies non-discriminatory treatment to products of any country whose products were not eligible for such treatment on January 3, 1975.<sup>88</sup> It involved products of communist countries that deny its citizens the right to emigrate, or impose conditions on

81. Jackson & Rhodes, *supra* note 59, at 500; see Robert S. Ross, *Enter the Dragon*, 104 FOREIGN AFFAIRS 18, 22 (1996); see also Chan, *supra* note 69, at 279; Feinerman, *supra* note 69, at 43 (both mention that the student massacre in June 1989 caused a setback in the WTO accession negotiations). Cai, *supra* note 71, at 35–36 (who noting that due to the June 1989 political disturbance the Uruguay Round did not become a success for the Chinese). Nonetheless, the GATT Working Party on China's Accession had reached a relatively advanced stage. See GATT Activities 1989, at 130 (1990).
82. On 6 June 1989, the then 12 Member States issued a joint statement of condemnation. See EC Bull. 6-1989, point 2.4.1. During the Madrid Summit in the same month, the EC announced sanctions against China. The United States, Japan, and other industrialised countries acted likewise.
83. Jackson & Rhodes, *supra* note 59, at 500; GATT Activities 1989, at (1990); see also GATT *Weights China's Entry*, N.Y. TIMES, Sept. 15, 1989, at D2.
84. GATT Activities 1992, at 94 (1993).
85. Particularly useful in this regard are Jackson & Rhodes, *supra* note 59, and Taunya L. McLarty, *MFN Relations with Communist Countries: Is the Two-Decade Old System Working, or Should It Be Revised or Repealed?* 33 RICH. L. REV. 153 (Mar. 1999). See also BEYOND MFN—TRADE WITH CHINA AND AMERICAN INTERESTS (James R. Lilley & Wendell L. Willkie eds., 1994).
86. See Joseph J. Borich, *China, the WTO, and Permanent Normal Trade Relations with China*, CHINAONLINE, Mar. 24, 2000, at <http://www.chinaonline.com> (noting that China's bid to join the WTO is now on its own trajectory, and cannot be blocked by U.S. legislative action).
87. The United States would be obliged to invoke the "non-application" clause of WTO Article XIII, and China would certainly reciprocate.
88. See Trade Act of 1974 § 401, 19 U.S.C. § 2431 (1994). According to the legislative history of section 401, non-discriminatory treatment should be denied to the products of communist countries except Poland and Yugoslavia. S. Rep. No. 93-1293 (1974), reprinted in 1974 U.S.C.C.A.N. 7186, 7333. The following countries were ineligible to

emigration. Section 402, the so-called Jackson-Vanik amendment, contains a complicated scheme for determining when the United States will grant non-discriminatory treatment to communist countries. In 1998, the term 'most-favoured-nation treatment,' which was interchangeably used with the term non-discriminatory treatment, was changed to 'normal trade relations.'<sup>89</sup>

Under Jackson-Vanik, the President may extend normal trade relations status to the PRC only if the PRC permits free emigration. It requires him to submit a report to Congress twice a year certifying that the PRC is in full compliance with the freedom of emigration requirements. The President may waive the freedom of emigration requirements if he determines that the PRC is making certain progress toward the goal of free emigration. Presidential waivers are subject to a joint resolution of disapproval by the two Houses of Congress. The President can veto the joint resolution, but Congress has the authority to override it. To override, each House must vote such action by a two-thirds vote.<sup>90</sup>

Following the 1979 U.S.-China bilateral trade agreement, the United States first granted MFN treatment in 1980, and extended it every year since. The issue became controversial, however, after the 1989 Tiananmen Square incident. President Bush continued to renew MFN treatment altogether.<sup>91</sup> In 1993, Bill Clinton, a critic of the Bush administration, renewed MFN treatment and declared his intent to link MFN status to improvements in the PRC's human rights performance. Despite some views that progress on human rights was limited, President Clinton renewed MFN again in 1994. At the same time, his Administration announced the intention to break the link between MFN treatment and human rights issues.<sup>92</sup>

After passing through the U.S. House of Representatives and the Senate, an historic trade bill granting permanent normal trade relations to China was signed by President Bill Clinton.<sup>93</sup>

### 3. Observations

Previous sections of this article have demonstrated some of the many political concerns raised by Western powers in terms of China's WTO accession. They have shown the material and psychological sufferings of China in the past and its concern for reciprocity in trade relations, how the global economy dominates international law and relations,

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receive non-discriminatory treatment: Albania, Bulgaria, the PRC, Cuba, Czechoslovakia, East Germany, Estonia, Hungary, those parts of Indochina under communist control or domination, North Korea, the Kurile Islands, Latvia, Lithuania, Outer Mongolia, Romania, Southern Sakhalin, Tanna Tuva, Tibet and the USSR. *Id.*

89. Jackson & Rhodes, *supra* note 59, at 502-03.

90. *Id.* at 503.

91. Determination No. 90-21, 55 Fed. Reg. 23, 183 (1990).

92. Jackson & Rhodes, *supra* note 59, at 504.

93. See Clinton Signs PNTR Bill into Law, *supra* note 1. See C. Fred Bergsten, *The Next Trade Policy Battle*, International Economics Policy Briefs, January 2000, at [www.iie.com](http://www.iie.com); Gary Glyde Hufbauer & Daniel H. Rosen, *American Access to China's Market: The Congressional Vote on PNTR*, International Economics Policy Briefs, April 2000, at [www.iie.com](http://www.iie.com); see also Charles Snyder, *PNTR Given Green Light by U.S. Senate*, CHINAONLINE NEWS, Sept. 19, 2000, at [www.chinaonline.com](http://www.chinaonline.com).

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and how cautious Western powers are to engage in relationships with China. They have also taught us that the accession process is foremost a political event, and not a legal or economic one.

While there is controversy about the degree of Chinese adherence to international agreements, it is clear that a mixed and somewhat improving picture is the norm. Notably, Chinese compliance with sovereign treaties and agreements is superior to enforcement of commercial agreements between private parties.<sup>94</sup> It would therefore definitely be premature to conclude that China would not be able to fulfill its role as a constructive member of the world trading system.

Undoubtedly, China's accession to the WTO is an event of great political significance, nonetheless that negotiations at times were tough (e.g., because of NATO's bombing of the Chinese Embassy in Belgrade in May 1999 and the U.S. Congressional report on Chinese espionage regarding U.S. nuclear missile technology).<sup>95</sup> Entry into the WTO is foremost a political decision. Parts B and C of this article, however, will explore whether China can comply economically and legally.

#### B. ESTABLISHING A MARKET ECONOMY AND WTO COMPLIANCE

The previous sections dealt with issues that are almost exclusively political and/or procedural and had nothing to do with the substantive economic concerns that WTO membership requires. Because WTO membership impacts on so many different areas of economic activity, profound reforms are necessary to implement the delicate policy decisions surrounding it.

It is here also that much controversy over China's accession exists. China is asked to demonstrate with these reforms how it intends to meet the existing WTO provisions. It is this author's opinion that significant delays have occurred in China's accession because members' fact finding about Chinese policies merges into the negotiations about how existing policies need to be changed to ensure conformity with the WTO.

China's admission ticket is complex, reflecting the intersection of the interests and concerns of both policy makers in China and in current WTO members. Instead of reviewing the widespread reductions in protection, the opening up of a wide range of sectors, and to represent the accession simply as a move to free trade, this part establishes the inextricable link of China's trade regime with the reform of the state-enterprise sector to allow indirect regulation through market-determined prices and to replace direct regulation of enterprise output through the planning system.<sup>96</sup>

To this end, we will discuss the foreign trade regime in China, then zoom into the reforms of its state-owned enterprises (SOE) and finally discuss the compliance of Chinese SOE reform with Articles XVII GATT and VIII GATS. These Articles both

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94. I can refer here to recent research by James Feinerman and Daniel Chang, Georgetown University Law Center, Washington D.C. (Chinese Practice of International Law in the Post-Mao Era). See also Hufbauer & Rosen, *supra* note 93.

95. See, e.g., Gary Hufbauer & Daniel Rosen, *Spies, Bombs, and the WTO*, at [www.iie.com/TESTMONY/Spies.htm](http://www.iie.com/TESTMONY/Spies.htm) (last visited Nov. 3, 2000).

96. That a link between state enterprise reform and China's trade regime exists is proven by Elena Ianchovichina, Will Martin, and Emiko Fukase, World Bank, *Assessing the Implications of Merchandise Trade Liberalization in China's Accession to WTO*, 23 June 2000.

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address the concerns raised by a large state presence in the economy and the possible negative impacts on the multilateral trading system. The important struggle of transition economies to bring their large state sectors in line with WTO market requirements explains this narrow scope.

### 1. State Trading and Article XVII GATT

Article XVII GATT addresses the concerns that State trading raises. However, its provisions are not rigorous. Article XVII only tackles the problem by requiring notification<sup>97</sup> and the supply of information.<sup>98</sup> It does not prevent any member from establishing or maintaining State enterprises, but it demands that such enterprises shall respect non-discriminatory treatment<sup>99</sup> and take into account commercial considerations.<sup>100</sup> The serious obstacles to trade, which these enterprises can create, must therefore be limited in negotiations to expand international trade.<sup>101</sup>

Article XVII makes an important exception for government procurement,<sup>102</sup> which is addressed separately in the relevant plurilateral agreement.<sup>103</sup> The U.S.-China Bilateral WTO Agreement, however, explicitly clarifies that purchases of goods or services by state-owned and state-invested enterprises are not government procurement and thus subject to Article XVII and WTO rules.<sup>104</sup>

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97. See § 4(a) of Article XVII. Members must notify all products that are imported or exported by state enterprises. On this notification requirement, see also GATT ANALYTICAL INDEX: GUIDE TO GATT LAW AND PRACTICE (1995), 481-82, and the Understanding on the Interpretation of Article XVII of GATT 1994, which tries to improve notification. Notification is done through an established questionnaire.
  98. See § 4(b), (c), (d) of Article XVII.
  99. According to the GATT ANALYTICAL INDEX, this involves only MFN and no National Treatment (p. 475, referring to early Geneva discussions). Recent case law from 1984 and 1988 did not answer the issue decisively. See 1984 "Canada—Administration of the Foreign Investment Review Act," L/5504, adopted on 7 February 1984, 30S/140, 163, para. 5.16; and 1988 "Canada—Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies," L/6304, adopted on 22 March 1988, 35S/37, 90, para. 4.27.
  100. Like price, quality, availability, marketability, transportation, etc. The idea is to afford enterprises of other members to compete for participation. See § 1(b) of Article XVII.
  101. See § 3 of Article XVII.
  102. See § 2 of Article XVII (stating that paragraph 1 shall not apply to imports of products for immediate or ultimate consumption in governmental use).
  103. The Agreement on Government Procurement, 1994, does not come under the single package of WTO accession and applies only to parties that explicitly have ratified the agreement. For further reference on government procurement and China, see Robert F. Dodds, *Offsets in Chinese Government Procurement: The Partially Open Door*, 26 L. & POL'Y IN INT'L BUS. 1119 (1995); John Linarelli, *China and the GATT Agreement on Government Procurement*, 8 J. CHINESE L. 185 (1994). On government procurement in transition economies, see also Sam Laird, *Transition Economies, Business and the WTO*, WTO, May 1998.
  104. See Sino-U.S. Bilateral WTO Agreement, 15 November 1999. It must further be noted that accession to the WTO by nonmarket economies that have State-trading practices is addressed in the U.S. 1988 Omnibus Trade and Competitiveness Act, Pub. L. No. 100-418, 102 Stat. 1107. Section 1106 provides that before any major country with significant State-trading enterprises can enter, the U.S. President must determine whether trade between the United
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The central concern for our purposes here is that the Chinese government could act in indirect ways to influence world trade in an uneconomic direction. Acting through State enterprises, it could provide protection against imports or to advance exports, to the detriment of foreign producers. Bringing these State enterprises within the realm of private industry competition is therefore the main focus. In other words, State enterprises must learn how to behave as private competitive traders.

The most prominent negative effects of uncontrolled State trading are violations of market access obligations and the use of proprietary directions to evade the elimination of quantitative measures. The disciplines on State trading are contained in other articles of GATT. Market access can be harmed by setting resale prices of imports at very high levels, and so negate tariff concessions bound in WTO Schedules conforming Article II GATT.<sup>105</sup> The other prominent effect, the creation of quantitative restraints, is addressed in Interpretative Notes to Articles XI, XII, XIII, XIV and XVIII. Governments might abuse ownership in enterprises to give directions that limit the amount of trade and thereby protect the domestic market without having to issue trade-distorting legislation. In doing so, governments create quantitative restrictions.<sup>106</sup>

It is a nuisance that for its purposes Article XVII does not define 'State-trading enterprises.' But it is clear from the text that various types of enterprises come within its scope: (1) a 'State enterprise' or 'any enterprise' that has been granted 'formally or in effect, exclusive or special privileges' (paragraph 1(a)); (2) 'Marketing Boards' (interpretative note to paragraph 1); (3) 'any enterprise' under the jurisdiction of a contracting party (paragraph 1(c)); and an 'import monopoly' (paragraph 4(b)).<sup>107</sup>

A clarification of what is considered to be a state-trading enterprise for notification purposes is provided in the WTO Understanding on the Interpretation of Article XVII. Members shall notify state-trading enterprises in accordance with the following working definition: "Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports."<sup>108</sup>

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States and that country is significant, and if the trade unduly burdens the United States. If so, WTO rules will apply only if the State trading is conducted on a commercial basis.

105. See John H. Jackson, *State Trading and Nonmarket Economies*, 23 INT'L LAW. 891, 892 (1989). Even if there is a tariff binding for the product in question, a markup could effectively evade the tariff binding. After all, the provision of Article II, section § 4 (in case of monopolised state trading) is hard to police, and furthermore many products could be unbound anyway.
  106. See Laird, *supra* note 103 (noting that state-trading countries and state-trading enterprises are perceived as making purchasing and sales decisions that need not be determined on the bases of the best price for equal quality of products or services, duplicating the effects of quantitative restrictions); see also Jackson, *supra* note 105, at 892 (noting that Article XI can easily be evaded by proprietary directions from the State owner).
  107. The Working Party on State trading is developing an illustrative list showing the kinds of relationships between governments and State trading enterprises, and the kinds of activities engaged in by these enterprises.
  108. Citation from Raj Bhala, *International Trade Law—Documents Supplement*, Charlottesville, Michie, 1996, at 97.
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Even without a clear definition of what constitutes a State enterprise,<sup>109</sup> it is clear that Chinese SOEs come under the umbrella of Article XVII and must be scrutinised for their uneconomic behaviour. This requires first some knowledge about the foreign trade system in China.

## 2. China's Foreign Trade System<sup>110</sup>

China's trade system is unusually strict because Chinese law imposes limitations on the capacity of Chinese enterprises to engage in foreign trade. Only those enterprises that have permission from the government are qualified to import or export goods. The ability to enter into foreign trade contracts is proscribed by an agency system<sup>111</sup> and complicated procedures exist to license<sup>112</sup> Chinese businesses to legally contract with foreigners.<sup>113</sup> The rationale justifying these restraints on foreign trade is the necessity to maintain order in the Chinese foreign trade system.<sup>114</sup>

There exists a whole range of Foreign Trade Operators (FTO) permitted to conduct import and export business, but apart from Foreign-Invested Enterprises (FIE) and maybe Sino-Foreign Investment Foreign Trade Corporations (SFIFTC), the bulk of trading companies remain state-owned or involve state capital. These entities comprise National Foreign Trade Corporations (NFTC) and Local Foreign Trade Corporations (LFTC), Production Enterprises with Foreign Trade Rights (PEFTR), Commercial and

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109. The U.S. Draft Charter of GATT 1947 contained a definition of State enterprise in the section on State trading: "For the purposes of this Article, a State enterprise shall be understood to be any enterprise over whose operations a Member government exercises, directly or indirectly, a substantial measure of control." For further reference, see GATT ANALYTICAL INDEX 473.
  110. Substantial economic research concerning the reform of the foreign trade system was done by NICHOLAS R. LARDY, *FOREIGN TRADE AND ECONOMIC REFORM IN CHINA, 1978-1990* (1991) and Thomas Y. Man, *National Legal Restructuring in Accordance with International Norms: GATT/WTO and China's Foreign Trade Reform*, 4 *IND. J. GLOBAL LEGAL STUD.* 471 (1997).
  111. Under this system a Foreign Trade Corporation (FTC) enters into a contractual relationship directly with a production enterprise or other entity to serve as its agent in conducting purchasing and selling in the international market. The FTC will sign on behalf of the entity and charge a commission, but the principal will bear the responsibility of all of the profits and losses of the transaction. See PRC, *Foreign Trade Law (FTL)*, 12 May 1994, art. 13; see also Bing Wang, *China's New Foreign Trade Law: Analysis and Implications for China's GATT Bid*, 28 *JOHN MARSHALL L. REV.* 495, 505-06 (1995).
  112. Art. 9 *FTL*, *supra* note 111; see Wang, *supra* note 111, at 502 (also dealing with import and export licensing). Apart from a positive list for trading companies, there also exists a negative list for commodities that these companies can trade. The negative list is used to reserve a list of commodities for trading by specified enterprises. Firms wishing to trade in other products are required to be on a positive list of firms with trading rights for those particular goods. See Ianchovichina et al., *supra* note 96.
  113. The sanction is that parties end up with a void, thus unenforceable, contract if the Chinese contracting party has no FTR. See M. Williams & J. Zhong, *The Capacity of Chinese Enterprises to Engage in Foreign Trade: Does Restriction Help or Hinder China's Trade Relations?* 8 *J. TRANS. L. & POL'Y* 197, 217 (1999).
  114. Williams & Zhong, *supra* note 113, at 197-98 (further arguing that this system does not support an orderly trade system but rather sustains disorder, leading to the separation of these enterprises from international markets).
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Material Enterprises with Foreign Trade Rights (CMEFTR), and Science Research Institutes with Foreign Trade Rights (SRIFTR).<sup>115</sup>

This diversification of FTOs is a recent phenomenon and definitely indicates that China is gradually releasing its tight hold on the capacity of Chinese enterprises to engage in foreign trade. In this regard, a 1984 landmark report from the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) ended the thirty-year monopoly over foreign trade by NFTC and LFTC.<sup>116</sup> It has, therefore, become possible for a wider spectrum of Chinese enterprises to get actively involved in international competition. Recently, China has begun an experimental registration system in several Special Economic Zones (SEZ). The partial replacement of the licensing system, however, does not indicate that China's practice fully reflects the principle of free trade.<sup>117</sup>

An important aspect of China's foreign trade system reform was the grant of Foreign Trade Rights (FTR) to individual SOEs. These SOEs were traditionally separated from international markets.<sup>118</sup> Thus, neither could they directly import what they needed for their production, nor export what they produced until the 1984 MOFTEC report changed this. Today, large and medium SOEs are qualified to apply for FTR.<sup>119</sup> But, the departments in charge of foreign trade must consider applications according to a

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115. See Williams & Zhong, *supra* note 113, at 203.

116. The full text appeared in *A Collection of Laws and Regulations of the People's Republic of China (Zhonghua Renmin Gongheguo Fagui Huibian)* (Law Department of the General Office of the State Council of the PRC ed., 1986). The report concluded that SFTC would remain the principal force of foreign trade; they should, however, not enjoy a monopoly over foreign trade operations. MOFTEC therefore recommended that a limited number of small- and medium-sized enterprises should be allowed to enter the market as complementary traders to revitalise China's foreign trade. See Williams & Zhong, *supra* note 113, at 201. Furthermore, it should be noted that around the same time, MOFTEC had approved a profound decentralisation of foreign trade authority. In the beginning only twelve NFTC existed. By the mid 1980s national production ministries created their own FTCs, and secondly provincial governments established hundreds of FTCs. See Lardy, *supra* note 110, at 39 (noting also that the monopoly position eroded slowly since 1981). On decentralisation and the two-tiered foreign trade management, see also Wang, *supra* note 111, at 497.

117. Williams & Zhong, *supra* note 113, at 198–99.

118. While prices in international markets continue to respond to changes in supply and demand, China's price structure appears to have diverged increasingly over time from world prices. See Lardy, *supra* note 110, at 20 (who calls it an "airlock" system, *id.* at 41).

119. See State Council, Regulations on Transformation of the Operating Mechanism of the State-owned Industrial Enterprises (1992) (Transformation Regulations); State Council, Opinions of Granting Production Enterprises Foreign Trade Rights (FTR Opinion); see also MOFTEC and State Economic and Trade Commission (SETC), Joint Circular on Further Promoting the Work of Granting the Production Enterprises FTR (Joint Circular), Jan. 30, 1997. Similar requirements exist for CMEFTR. See State Council, Opinion on Experimentally Granting FTR to CME (CME Opinion), Nov. 4, 1993. CMEs are differentiated because they deal either with consumer goods or extractive products, petro-chemical products, and mechanical and electrical equipment. See Williams & Zhong, *supra* note 113, at 207–11.

certain order of priority.<sup>120</sup> Further, the application for FTR cannot be approved unless a number of administrative conditions are fulfilled.<sup>121</sup> Additional requirements exist when the applicant is a local production enterprise.<sup>122</sup>

The reform process gradually increased both the numbers of firms allowed to trade and the different types of firms eligible for trading rights. Moreover, the traditional State-trading enterprises or FTCs have been awarded independent legal status, and SOEs of this type now appear to operate very strongly along commercial lines.<sup>123</sup> Consumers and producers wishing to purchase imports or sell exports will typically have a range of enterprises through which they can undertake these transactions.

However, State trading goes beyond the operation of traditional FTC-monopolised trade. It also encompasses the production and commercial SOEs. Either because the Chinese government directly controls the enterprise through ownership, or because the FTR grants it through a complex administrative licensing system, a special privilege is created.<sup>124</sup> Therefore, SOEs, which have been granted FTR, undoubtedly come within the realm of Article XVII of GATT.

What we should remember from this section is that the administrative licensing of the capacity to engage in foreign trade still seals off SOEs from international markets, and competition insofar as the commercial decision-making is preoccupied by administrative

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120. See FTR Opinion, *supra* note 119, art. 1. First come priority enterprises, i.e., technology intensive enterprises or enterprises, which produce machinery and electrical equipment and need to provide after-sale services abroad or enterprises that produce and export machinery and electrical equipment. Second come strictly-controlled enterprises, which are enterprises mainly producing primary materials, products subject to quota control, or products with only a single market. Third are the flexibly-controlled enterprises, which are granted by evaluating the nature of demand and supply in both domestic and international markets if the enterprises do not produce machinery or electrical products but rather technology-intensive products or products with a short commercial life span. Finally there is a category of disqualified enterprises, which shall not be granted FTR, including core enterprises in an enterprise group that has been granted FTR, large SOE groups that have established a subsidiary specialising in import and export operations, or enterprises which have joined any export combine or joint export corporation.

121. See Joint Circular, *supra* note 119, § 1. An application for FTR cannot be granted unless the enterprise is (a) an independent economic entity, which enjoys the autonomy to manage and has separated its business form administration by government; (b) has its own premises and facilities for operations, funds, and other materials necessary for import and export operations; (c) has personnel qualified for foreign trade operations; and (d) produces its own products for export and meets the set export value. However, as of January 1997, the set export value requirement no longer applies to large SOEs. See Williams & Zhong, *supra* note 113, at 209.

122. See FTR Opinion, *supra* note 119, arts. 3, 4.

123. Ianchovichina et al., *supra* note 96.

124. It is considered that the government conferring the exclusive or special privileges should assume the responsibility of exercising effective control over operations affecting the external trade of such enterprise. See GATT ANALYTICAL INDEX 473 (based on the London report of the Preparatory Committee).

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decision-making.<sup>125</sup> Besides, the licensing of FTR is also a form of quantitative restriction of trade; insofar it still can restrict the number of FTOs.<sup>126</sup> And finally, the numerical surge of FTOs and the differential treatment amongst them erodes the uniformity in which foreign trade should be administered.<sup>127</sup>

In a moment, we will return to the concerns of Article XVII of GATT, but first, the following section will shed light on the continuing SOE reform to further establish whether SOEs are capable of independent commercial decision making in view of Article XVII GATT.

### 3. State-Owned Enterprise Reform

SOEs are, in belief and fact, the backbone of the Chinese economy. These enterprises produce a variety of products and do involve more than heavy industry. The state sector is a major institution affecting millions directly and the entire population indirectly. The SOEs feed, clothe, and tend from cradle to grave a large portion of the population, and its products and revenues provided to the state benefit the entire population.

Increasing the number and type of enterprises eligible to conduct foreign trade, developing the indirect trade policy instruments that were absent or unimportant under the planning system, reducing and removing the exchange rate distortion, and reforming prices to allow the creation of a market, are all linked with SOE reform. To understand the difficulties of establishing a market economy along commercial lines as a prerequisite to WTO membership, SOE reform is discussed in more detail below.

#### a. Initial Reform

From the foundation of the People's Republic in 1949 to the inauguration of the Economic Reform and Open Door policy in 1978, the economy was based on public ownership.<sup>128</sup> Apart from state ownership, there was also state management regulating all personnel, finance, physical assets, production, supply, and marketing affairs under the guidance of centralised state plans.<sup>129</sup> Therefore, the enterprises did not enjoy

125. Williams & Zhong, *supra* note 113, at 228. The strict control on the capacity of enterprises to engage in foreign trade has led to the separation of enterprises from international markets, and, consequently, their ignorance of international practices and rules.

126. Wang, *supra* note 111, at 504–05.

127. *Id.* at 521–22.

128. See Q. Jiang, *Like Wading Across a Stream: Law, Reform and the State Enterprise*, in *COMMERCIAL LAW IN THE PEOPLE'S REPUBLIC OF CHINA: REGULATION AND REFORM AFFECTING THE MARKET 1* (Bachner & Fu eds., 1975). By 1978, the public sector was responsible for 98 percent of the GNP and accounted for almost 100 percent of the industrial output, of which 77.6 percent was produced by SOEs and 22.4 percent by other Collectively-Owned Enterprises (COE) in the economy.

129. In a traditional command economy the state is viewed as one giant vertically integrated productive firm: "China Inc." See Donald D. Clarke, *Regulation and Its Discontents: Understanding Economic Law in China*, 28 *STAN. J. INT'L L.* 287 (1992) [hereinafter Clark (1992)]. At the top of the system stood the State Planning Commission (SPC). The SPC set initial rough targets, then sent to various industrial ministries under the State Council and to provincial planning commissions. The ministries and provinces then disaggregated these targets and added requirements of their own before passing them on to particular enterprises. See also

independent legal status nor did they have any autonomous decision-making power.<sup>130</sup> It must be noted, however, that China's highly centralised command economy was not as rigid as its supermodel in the neighbouring Soviet Union.<sup>131</sup> While the plan played a major role in the national economy, the state had begun to supplement it by market adjustments by the end of the 1970s.

The liberalisation of the agricultural economy was the first systematic effort to incorporate market forces into the Chinese economy.<sup>132</sup> It allowed farmers to provide food products that the agricultural markets were demanding. In addition, the first step for enterprise reform had to readjust the management relationship between the state and the enterprise by delegating independent management authority to and sharing profits with the enterprise.<sup>133</sup>

### b. Main Approaches

The reform strategy that has been implemented is best described as a gradual dual-track approach<sup>134</sup> (*shuang gui zhi*), characterised by the coexistence of a 'new' market track<sup>135</sup> and an 'old' plan track.<sup>136</sup> It caused some ideological difficulty to legitimise

Donald C. Clarke, *What's Law Got to Do with It? Legal Institutions and Economic Reform in China*, 10 UCLA PAC. BASIN L.J. 1 (1991) [hereinafter Clark (1991)]; Robert F. Dodds, *State Enterprise Reform in China: Managing the Transition to a Market Economy*, 27 LAW & POL'Y INT'L BUS. 695, 704-05 (1996).

130. See Jiang, *supra* note 128, at 2; see also Robert C. Art & Minkang Gu, *China Incorporated: The First Corporation Law of the People's Republic of China*, 20 YALE J. INT'L L. 273, 277 (1995). Decision power rested with the Department in Charge, the so-called mother-in-law of the enterprise. Factory managers were responsible to the relevant ministry's bureaucracy. According to enterprise guidelines set out in the *Seventy Policy Points for State Industries*, promulgated September 1961, the duty of the enterprise was strictly limited to the fulfilment of the task quotas stipulated by the state plans.

131. See Clarke (1992), *supra* note 129, at 287; Clarke (1991), *supra* note 129, at 6.

132. See Jiang, *supra* note 128, at 2; see also David Blumental, 'Reform' or 'Opening'? *Reform of China's State-owned Enterprises and WTO Accession—The Dilemma of Applying GATT to Marketizing Economies*, 16 UCLA PAC. BASIN L.J. 198, 228 (1998). Reform spread rapidly from the few areas in Anhui and Sichuan provinces; the Party leaders from those provinces, Wan Li and Zhao Ziyang, were soon thereafter promoted to central leadership positions.

133. Agriculture was essentially decollectivised, with each household making its own decisions on production. See Clarke (1992), *supra* note 129, at 285-86. About rural collectives, see Dodds, *supra* note 129, at 701, and about agricultural reform see *id* at 706.

134. See Y. Cao et al., *Chinese Economic Reforms: Past Successes and Future Challenges*, in *ECONOMIES IN TRANSITION—COMPARING ASIA AND EASTERN EUROPE* 20 (Wing Woo et al. eds., 1997). This dual-track approach pervades almost every aspect of policy making. One encounters it in sectoral reform, price deregulation, enterprise restructuring, regional development, trade promotion, foreign exchange management, central-local fiscal arrangements, and domestic currency issuance. See also Nicholas Lardy, *China's Unfinished Economic Revolution* (1998) (analysing China's Economic Reform Strategy).

135. The 'new' track is the non-state sector, which consists of private and semi-private enterprises, community-owned rural industrial enterprises, and foreign joint ventures or wholly foreign-owned enterprises.

136. The 'old' track consists of the state sector.

profit-seeking private enterprises.<sup>137</sup> But, as a result of the reforms the private, new track economy soon started to supplement the state industry. Today, large numbers of private medium and small businesses operate in China's economy.<sup>138</sup> The Chinese government now even encourages individuals and private firms to buy smaller SOEs to become full owners. Usually it concerns enterprises the government deems itself unable to manage.<sup>139</sup> This obviously has an impact on competition as well.<sup>140</sup>

Gradualism was adopted not because there were no proposals for more radical reforms, but because at the end of the 1970s most ordinary people had not yet totally lost their trust in the old system.<sup>141</sup> It was popularly believed that the economic problems came from the implementation of the political struggle<sup>142</sup> and not from the defects of the central planning system. Gradualism was more of an *ex post facto* description of an unintended evolutionary process.<sup>143</sup>

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137. Because private business conflicts with socialist ideology, it was resolved by distinguishing at first between "individual" enterprises (*geti jingji*) and "private" enterprises (*siying jingji*). The former are essentially based on a person's own labour and may employ a few workers without really changing its nature; the latter, however, relied on hired labour and hence raised issues of worker exploitation. In 1987, the then General Secretary of the party, Zhao Ziyang, advanced the notion that China was in the "primary stage of socialism." This means that in a predominant public sector, the private sector may contribute production and employment. See Art & Gu, *supra* note 130, at 286 and Blumental, *supra* note 132, at 221. Last author therefore calls China "a strange hybrid in which diverse forms of ownership coexist, often in tension with each other." See also Dodds, *supra* note 128, at 703–04.
  138. See *Most of China Economy Not State-Owned*, International Finance Corp. Says, CHINAONLINE NEWS, Oct. 26, 2000, at <http://www.chinaonline.com>. This requires also new law reforms. See *One Size Does Not Fit All: New Laws Tailored for Private Sector*, CHINAONLINE NEWS, Oct. 18, 2000, at <http://www.chinaonline.com> (noting that China will draft new business laws to fit private enterprises).
  139. These enterprises mainly fall into three categories: enterprises that are insolvent or near bankruptcy; businesses suffering from losses or earning only minimal profits over an extended term; or those selected for sale "to perfect the structure of industry." See Art & Gu, *supra* note 130, at 287.
  140. Regarding the structure of the market in China, see Bing Song, *Competition Policy in a Transitional Economy: The Case of China*, 31 STAN. J. INT'L L. 387 (1995). See also Dodds, *supra* note 133, who notes that large numbers of rural workers were able to leave farming to set up small private businesses and to work in township and village enterprises. They began to compete with the SOEs for investment, goods and funds, which caused the latter's profits to decline. The increase in agricultural prices also eroded SOE profits and caused the urban costs of living to rise.
  141. Cao et al., *supra* note 134, at 31. Authors note that the majority of the society and the leadership in 1978 were not in favour of a radical reform package because the economic situation then was improving rapidly.
  142. Crucial here was the end of the decade-long Cultural Revolution. Deng Xiaoping returned quickly to power after the ultra-leftist Gang of Four was arrested by Mao's would-be successor Hua Guofeng, hereby ending the Cultural Revolution. Groundbreaking herein was the Communiqué of the Third Plenary Session in late December 1978. See Blumental, *supra* note 132, at 226.
  143. Cao et al., *supra* note 134, at 31. Authors note that very few people knew what to do in 1978. Participants might have known what the first "piece" should be, but might not know what the
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Politics still is at the centre of gradualism. The transition to a market-oriented economy invariably produces dislocation and social stress, causing uncertainty and discontent. The possibility of unrest<sup>144</sup> is a political problem for the Chinese government, which fears massive restructuring will have devastating political consequences for the Party bureaucracy.<sup>145</sup> The lack of political willingness to carry out painful reforms of inefficient, unprofitable enterprises has caused China's marketisation efforts to stagnate.<sup>146</sup>

Notwithstanding China's commitment to reform and integration, Jiang Zemin emphasised that maintaining political stability is of primary importance.<sup>147</sup> Because of the political risks<sup>148</sup> involved, China hesitates to implement far-reaching and necessary economic reforms.<sup>149</sup> A considerable number of reformers in the PRC still believe in the old track economy and that it should be revitalised. As long as economic policies are geared to regime survival of the communist elite, however, China will have a difficult time convincing WTO members that it can uphold commitments to open its services sector, give away market share to foreign investors, further lower tariff bindings, to eliminate licensing requirements and other Non-Tariff Barriers (NTB).

Apart from these political consequences, gradualism raises the issue of whether the two tracks should be merged as rapidly as possible.<sup>150</sup> The state has used the revenue

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next one should be. They also note the absence of a common vision at the elite level. China's gradual reform has been characterised by gradual changing of its reform objectives. China has proceeded through a lengthy path of readjusting its reform objectives from "a planned economy with some market adjustment," to "a combination of plan and market" and now to "a socialist market economy with Chinese characteristics." The last vision having apparently resolved the issue. See also DALI YANG, CALAMITY AND REFORM IN CHINA—STATE, RURAL SOCIETY, AND INSTITUTIONAL CHANGE SINCE THE GREAT LEAP FAMINE (1998) (arguing that next to the role of plans by revisionist leadership and the Cultural Revolution rural reforms incubating later reforms, are also due to the Great Leap Famine).

144. For example, after a trial bankruptcy experiment of a large state-owned knitting mill in Chongqing, 2,000 laid-off workers marched on City Hall in protest and government leaders were only able to avoid riots by going to extraordinary lengths to reassign workers to other jobs. See Dodds, *supra* note 128, at 723; see also Junhua Wu, *The Problem of Social Inequality Confronting China in the New Millennium*, CHINAONLINE NEWS, May 18, 2000, at <http://www.chinaonline.com>; Oliver August, *5,000 Chinese Protest over Unpaid Wages*, THE TIMES, May 18, 2000.

145. See Blumental, *supra* note 132, at 202.

146. *Id.* at 209.

147. At the 15th Party Congress, Jiang stated "[I]t is of the utmost importance to maintain a stable political environment and public order (...). We must uphold the leadership of the Party (...) eliminate all factors jeopardising stability, and guard against (...) subversive (...) domestic hostile forces." *Id.* at 216.

148. See V. Chan, *Exterminate Foes of Reform: Jiang—President Tries to Balance 'Leftists' and Rightists*, SOUTH CHINA MORNING POST, Aug. 23, 2000; Jin-Kyu Joung, *Zhu Rongji Pushes China to an East European-Style Moment of Truth*, CHINAONLINE NEWS, Aug. 23, 2000, at <http://www.chinaonline.com> (both noting a dangerous political conflict in China between pro-reform and conservative forces).

149. Like implementing the Bankruptcy Law. See *infra* note 154.

150. See Cao et al., *supra* note 134, at 32; Lardy, *supra* note 134, at 3. He notes that the economic cost of postponing fundamental transformation of the state sector is overlooked. On the pace of reforms, see also V. Thomas & Y. Wang, *East Asian Lessons from Economic Reforms*,

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from the more productive new sectors not only to cover the losses of the SOEs in the old sector but also to upgrade these SOEs. The result is that the old track has not shrunk proportionately as rapidly as it should have. The most important challenge is not how to speed up the growth of the new track, but how to ensure that the old track does not grow as well. Because of the old track's considerable clout, it may not only prosper as a tumor, but also crowd out the new track. Another reason for the expansion and survival of the old track is believed to be the wielding corruption.<sup>151</sup>

### c. Management Responsibility System

At the end of 1986, China adopted a management responsibility system (MRS), which enabled the management to contract out state assets and to keep the earnings above the level it contractually owed the state in order to provide money for expansion, reinvestment, higher wages and more fringe benefits for the employees.<sup>152</sup>

This resulted from the growing intention in the 1980s to create an enterprise that was relatively independent, a socialist commodity producer and an independent business manager.<sup>153</sup> If such an enterprise conducts its own business, it would be responsible for its own profits and losses,<sup>154</sup> and be capable of reforming and developing itself according to law.

To succeed, power had to be delegated to the management of the enterprises to determine production schedules, purchase supplies, marketing strategies, investment decisions, hiring, firing, rewarding and pricing on the condition that the enterprises respect the state plans and regulations.<sup>155</sup> It also enhanced the recognition that SOEs, like other

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in ECONOMIES, *supra* note 134, at 217–241, and Ronald A. Cass, *Macro-Economic Changes from Centralized to Market Economies: Big Bang v. Gradual Change: The Optimal Pace of Privatization*, 13 B.U. INT'L L.J. 413 (1995). On the issue of privatisation, see also Mark Baker, *Privatization in the Developing World: Panacea for the Economic Ills of the Third World or Prescription Overused?*, 18 N.Y.L. SCH. J. INT'L & COMP. L. 233 (1999); Oleh Havrylyshyn & Donal McGettigan, *Privatization in Transition Countries: Lessons of the First Decade* (IME, August 1999); see also *infra* note 165.

151. Cao et al., *supra* note 134, at 34; see also *infra* note 185 and accompanying text.

152. Sometimes also referred to as "contract responsibility system" (CRS). See Jiang, *supra* note 128, at 4; Art & Gu, *supra* note 130, at 279; see also Dodds, *supra* note 129, at 707–08, 724. In 1979, the government began allowing some firms to retain a portion of their profits after meeting their obligations under the state plan; by 1980, it had implemented profit retention plans nationwide and began introducing work-related pay and bonuses. After meeting their plan targets, SOEs could make purchases and sales on the market. A dual track system emerged under which most goods had a plan price and a market price. See also Lixin Colin Xu, *Determinants of the Re-Partitioning of Property Rights between the Government and State Enterprises*, World Bank (1997).

153. Jiang, *supra* note 128, at 3; Art & Gu, *supra* note 130, at 278–79.

154. An example is the introduction of the PRC Bankruptcy Law enacted by the 6th NPC on 2 December 1986. See Mark E. Montfort, *Reform of the State-Owned Enterprise and the Bankruptcy Law in the People's Republic of China*, 22 OKLA. CITY U.L. REV. 1067 (1997).

155. Decision by the Central Committee of the Communist Party of China on the Reform of the Economic System (1984 Decision), passed on Oct. 20, 1984. Another milestone, the State-Owned Industrial Enterprise Law of the PRC (SOIEL) was enacted on 13 April 1988, by the First Session of the 7th NPC. It formally restricted many of the powers of the Department

enterprises, should have the status of legal person.<sup>156</sup> Gradually, planning decreased while pricing for commodities was liberalised.

To make enterprises sensitive to the difference between costs and revenues, the government required since 1981 that capital construction projects for SOEs had to obtain their funds through interest-bearing bank loans instead of from government sponsored interest-free capital appropriations.<sup>157</sup>

The management responsibility system also had its shortcomings, though.<sup>158</sup> The management contracts encouraged short-term behaviour and neglected long-term investments in order to maximise profits during the contract period. Managers were not always punished for failure. The contract system was also too rigid for China's rapidly changing economic environment, causing the government to adopt a policy of lowering contract targets when external events made it difficult for enterprises to fulfil their contractual obligations. It made the enforcement of contracts discretionary and weakened their incentive effects. So, in January 1994, the government stopped initiating responsibility contracts, with existing contracts expiring in 1996–97. The new system that would have to establish independent enterprise management was *corporatisation*.

#### d. Corporatisation

In the early 1990s, the southern tour by Deng Xiaoping and his remark that "the planned economy is not equivalent to socialism, nor is the market economy equivalent to capitalism" reaffirmed the commitment of the state to economic reform. In October 1992, the 14th Chinese Communist Congress declared that the party would strive to establish a "socialist market economy."<sup>159</sup> Around the same time, new laws tried to radically reshape the financial composition of the state enterprise as a budgetary unit of the

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in Charge (see *supra* note 130), but it provided these rights only subject to "regulations of the State Council." This left the limits of SOE autonomy vague and open to official arbitrariness. See Jiang, *supra* note 128, at 3–4; see also Blumental, *supra* note 132, at 229–30; Henry R. Zheng, *Business Organization and Securities Laws of the People's Republic of China*, 42 Bus. Law. 549, 558 (1988).

156. Article 41, General Principles of the Civil Law of the PRC (GPCL), 12 July 1986, effective 1 January 1987. Article 48 sets forth that the enterprise must meet its civil obligations and Article 82 states that the enterprise enjoys the right to manage the assets as authorised by the State. See also Zheng, *supra* note 155, at 553.

157. Clarke (1992), *supra* note 129, at 296.

158. See Lixin Colin Xu, *The Productivity Effects of Decentralized Reforms: An Analysis of the Chinese Industrial Reforms*, World Bank Policy Research Paper No. 1723 (1997), at 30 (noting that adopting the Management Responsibility System and raising profit retention rates, probably the most important reforms as viewed by the Chinese government and many scholars, did not improve productivity much; in fact, there is weak evidence that MRS even might have reduced productivity growth).

159. Jiang, *supra* note 128, at 5. These reforms were legally consolidated *inter alia* the 1992 Regulations, which redefined the SOIEL (*supra* note 155) in terms of meeting the needs of the market. See State Council, Regulations for the Transformation of Management Mechanisms of the State Industrial Enterprises (1992 Regulations), Promulgated on 23 July 1992. The decrease in government intervention impacted areas such as product pricing, mandatory planning, business operations, technical innovations, labour and personnel affairs and the internal income distribution. See also Blumental, *supra* note 132, at 231. Only the right to negotiate foreign trade contracts had not been delegated to the enterprises.

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state's financial plan, with the objective of course to achieve a balance of enterprise funds rather than to reimburse costs to the state. However, audit results have led to a sobering depiction of economic reality and led to only some degree of fiscal responsibility and accounting of assets and capital.<sup>160</sup>

To clarify the separation of the right to own from the right to manage in the public economic sector the constitution was changed.<sup>161</sup> The 1993 Communist Party Decision<sup>162</sup> called for further renovations of the state enterprise system to effectively separate the government administration from enterprise management and to end the dependency by state enterprises on bureaucratic government agencies.<sup>163</sup> This policy document finally resulted in the 1993 Company Law.<sup>164</sup>

The Company Law reaffirms China's commitment to socialism; however, China's reform programme is not the kind of privatisation experienced by the nations of Eastern Europe.<sup>165</sup> What has happened in China is preferably called *corporatisation*

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160. See, e.g., Ministry of Finance, General Provisions for Enterprise Finance (GPEF) (Nov. 30, 1992); see also Regulations for Enterprise Accounting (REA) (Nov. 30, 1992); Jiang, *supra* note 128, at 6. For further reference, see Chi-Wan Yang & Jiliang Yang, *HANDBOOK OF CHINESE ACCOUNTING* (1999). See also Yun-wei Tang et al., *ACCOUNTING AND FINANCE IN CHINA* (3d ed. 1996). China is apparently planning to bring its accounting systems in line with international practice. See *China to Overhaul Accounting System*, CHINAONLINE NEWS, Nov. 14, 2000, at <http://www.chinaonline.com>.
  161. The First Session of the 8th NPC amended Article 16 to change "state-run enterprise" into "state-owned enterprise." See also Jiang, *supra* note 128, at 8.
  162. Decision by the Central Committee of the Communist Party of China on a Few Issues in Establishing the Socialist Market Economic System, adopted at the Third Plenary Session of the 14th Chinese Communist Party Congress, on Nov. 14, 1993. See Jiang, *supra* note 128, at 8–9. The 1993 Decision goes further than the 1984 Decision (*supra* note 155), which only assured the separation of the right to own an enterprise from the right to manage one. According to the 1993 Decision the state changes its role from the administrative authority in charge of the enterprise to the investor, or shareholder of the company. The State is only entitled to normal shareholder rights and cannot interfere directly in the management. The enterprise acquires the legal rights to dispose of the assets of the enterprise, which it must manage independently and assume sole responsibility for profits and losses. Shareholders are only responsible for the liabilities to the extent of their investment. See also Dodds, *supra* note 129, at 710–11.
  163. For a clear picture of initial bureaucratic involvement and communist party involvement in these enterprises, see Zheng, *supra* note 155, at 559.
  164. PRC, Company Law, adopted at the 5th Session of the Standing Committee of the 8th NPC, on Dec. 29, 1993, effective 1 July 1994. See Art & Gu, *supra* note 130, at 280; Anna M. Han, *China's Company Law: Practising Capitalism in a Transitional Economy*, 5 PAC. RIM L. & POL'Y J. 457 (1996).
  165. These economies together with the former Soviet Union experienced shock treatment economic programs in which transfer of ownership stood central. To date, some members of the Chinese leadership are still convinced that expanding the autonomy of SOEs without changing ownership is the way to solve the current problems in SOEs. For a comparative view with China, see Dodds, *supra* note 129, at 746. See also Woo et al., *supra* note 134. It is generally argued that China has achieved its economic boom by applying a policy of gradual reform, rather than large-scale privatisation. Gradual reforms have provided a stable environment for investment and allow time for the development of laws and institutions
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or *stockification*, which entails the restructuring of enterprises, adopting the corporate form, and instituting stock ownership and consequently stock trading without necessarily relinquishing the state's controlling interest in the means of production.<sup>166</sup> The idea is still that the state continues to regulate the economy, but as a sovereign implementing policies of general application rather than as an owner micro-managing individual enterprises.<sup>167</sup> China's stock markets, however, have not replaced the role of the state with a capital market system.<sup>168</sup> They are mainly there to facilitate financing by channelling consumer savings into productive enterprises.

Since the 1993 Decision, the Chinese government has encouraged breakups and mergers to reshuffle enterprises to conform them to required norms.<sup>169</sup> This was done in the first place to avoid major bankruptcies. Other SOEs have been put together to form groups to organise strategic alliances meant to create economies of scale.<sup>170</sup>

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essential to both a properly functioning market economy and a privatisation program. On the importance of institution building, see Grzegorz W. Kolodko, *Ten Years of Postsocialist Transition: Lessons for Policy Reforms*, World Bank Policy Research Working Paper 2095, April 1999. According to Cao et al., five factors generated growth in China: (1) initial economic structures, (2) integration into the global economy, (3) saving behaviour, (4) two disastrous leftist campaigns, and (5) overseas investment. See Cao et al., *supra* note 134, at 28.

166. The opening of securities exchanges in Shanghai in December 1990 and Shenzhen in June 1991 may have created a structure whereby state agencies no longer manage the details of day-to-day operations, but government administrative agencies have retained controlling rights through ownership of key state and legal person shares. See Blumental, *supra* note 132, at 223. See also Dodds, *supra* note 129, at 712. He calls the Chinese strategy a strategy of marketisation, introducing markets and competition without relinquishing control over SOEs. On the explanation of corporatisation, see also p. 727.

167. See Clarke (1992), *supra* note 129, at 289.

168. See Dodds, *supra* note 129, at 709. He writes that already in the mid 1980s local authorities and entrepreneurs set up small, unofficial securities markets in a number of cities around the country. On capital markets in China, see also Jay Zhe Zhang, *Securities Markets and Securities Regulation in China*, 22 N.C.J. INT'L L. COM. REG. 557 (1997). See also Brian Daly, *Of Shares, Securities, and Stakes: The Chinese Insider Trading Law and The Stakeholder Theory of Legal Analysis*, 11 AM. U.J. INT'L L. & POL'Y 971 (1996); Andrew X. Qian, *Why Does Not the Rising Water Lift the Boat? Internationalization of the Stock Markets and the Securities Regulatory Regime in China*, 29 INT'L LAW. 615 (1995); William D. Holmes, *China's Financial Reforms in the Global Market*, 28 L. & POL'Y INT'L BUS. 715 (1997); Kevin T. S. Kong, *Prospects for Asset Securitization within China's Legal Framework: The Two-Tiered Model*, 32 CORNELL INT'L L.J. 237 (1998); C. YAO, CHINA'S FINANCIAL SYSTEM UNDER TRANSITION (1998). PRC, Securities Law, adopted by the Sixth Session of the Ninth National People's Congress Standing Committee on Dec. 29, 1998.

169. See, e.g., *International Mergers and Acquisitions Will Attract Foreign Capital*, says MOFTEC, CHINAONLINE NEWS, Oct. 11, 2000, at <http://www.chinaonline.com> (noting that M&A has been an important focus of research).

170. See Dodds, *supra* note 128, at 735-37.

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## e. Social Costs

Despite these reforms, the state-run system has suffered chronically from losses, inefficiency, and insufficient productivity. A substantial portion of workers is *xia gang*.<sup>171</sup> The government's use of state enterprises for both production and delivery of welfare services constitutes a further structural impediment.<sup>172</sup>

Many of the difficulties in creating a market economy by downsizing the SOE track are associated with accounting for the irrational debt liabilities, employees' support programmes, and extensive social commitments. Because the state's social security reform<sup>173</sup> lags behind enterprise reform, the insurance funds for retirement, unemployment,<sup>174</sup> medical care and labour casualties must be generated from diminishing enterprise resources and state funds.<sup>175</sup>

Eventually, the postponement of fundamental reforms has caused severe damage to the Chinese financial system as well.<sup>176</sup>

## 4. Compliance with Article XVII GATT

Let us now return to the main concern of Article XVII GATT, viz. that maintaining China's large state-owned economic presence could enable the country to evade the effective responsibilities and policies of GATT/WTO even though such an economy can be in complete conformity with the technical rules of GATT.<sup>177</sup>

171. See Art & Gu, *supra* note 130, at 277. *Xia gang* or off-post is a euphemism for workers who are employed on paper but are not expected to report for work and thus are paid only a fraction of their previous income.

172. Chinese enterprises routinely provide their workers with housing, medical care, pensions and a host of other social services as part of the "iron rice-bowl" or lifetime employment and social benefits. See Art & Gu, *supra* note 130, at 278. This is an important reason why bankruptcies of inefficient enterprises are so few.

173. See, e.g., Peter Nan-shong Lee, *Reforming the Social Security System in China*, in PUBLIC POLICY IN CHINA 53 (S. Nagel & M. Mills eds., 1993); G. Sun, *Health Care Administration in China*, *id.* at 53–62.

174. See, e.g., *Bank of China to Layoff 15,000 Employees*, CHINAONLINE NEWS, Oct. 19, 2000, at <http://www.chinaonline.com>. Nevertheless, the WTO is generally believed to create new jobs in the private sector. See Kitt Marlow, *WTO Deal to Bring China Jobs*, *Says Economist*, CHINAONLINE NEWS, Oct. 16, 2000, at <http://www.chinaonline.com>.

175. Jiang, *supra* note 128, at 12–13. On the social costs of market reform, see Carol Graham, *Strategies for Addressing the Social Costs of Market Reforms: Lessons for Transition Economies in East Asia and Eastern Europe*, in ECONOMIES, *supra* note 134, at 325–55. China is apparently serious about beefing up its social security programme. See *China Earmarks US 652 Million for Social Security*, CHINAONLINE NEWS, Aug. 11, 2000, at <http://www.chinaonline.com>.

176. See Lardy, *supra* note 134, at 4–5. Unwilling to tolerate urban employment that would accompany the widespread bankruptcy of loss-making firms, the state assumed the burden of subsidising growing losses through fiscal subsidies and, increasingly, through so-called policy loans from the state-owned banks. This resulted in huge financial liabilities on the part of Chinese firms. The reason for borrowing such large sums is that they are obligated to provide a broad range of social services that should be financed from the government budget. On financial reform, see also HAIQUN YANG, *BANKING AND FINANCIAL CONTROL IN REFORMING PLANNED ECONOMIES* (1996).

177. Jackson, *supra* note 105, at 892.

On the surface China has formally revised its state-trading system by increasing the number of traditional FTCs through a profound decentralisation and by awarding FTR to a more diversified number of FTOs such as SOEs, and in doing so dismantling many of the trade monopolies. Yet on a deeper, structural level we are forced to believe that SOEs, which take up a large number of Chinese FTOs, do not live up to the expectations of the concerns indirectly addressed by Article XVII GATT. Below we explain that Chinese SOE reform does not cut deep enough. Firstly the decentralisation of trade monopolies raises serious concerns of transparency and secondly corporate governance in China is not adequate to preclude the (local) government from interfering in the day-to-day management of companies. Therefore, it is hard to say that state enterprises only operate in accordance with free market considerations to conform to Article XVII GATT. Finally, this section addresses the adverse use of subsidies in the Chinese state economy.

#### a. Defunct Decentralisation

A central feature of the reforms was the decentralisation of FTR beyond the handful of centrally controlled FTC.<sup>178</sup> Despite the large number of trading firms overall, there are still two broad groups of commodities for which the number of firms entitled to engage in trade is tightly restricted.<sup>179</sup> These products are typically handled by one or a few designated FTOs, making direct control of the quantities imported and exported very practical. This regime is an important special feature of the Chinese trade system, but very much a minority part of the overall system. The heavy reliance on it for major agricultural trade raises, however, concerns.<sup>180</sup>

But the manner of State trading goes beyond the classical use of FTCs and it involves other FTOs such as the SOE. Depending upon the manner in which these enterprises undertake business, State trading still could form a serious distortion.

Note that "State-owned" is deceptively difficult to define in a politically or economically meaningful sense. The enterprise is controlled by one or more units of government at or above the county level, the so-called Department in Charge.<sup>181</sup> The power of management and control rests with one or several bodies with divergent interests and goals. There is no monolithic Chinese state but only a fragmented one. This phenomenon is often labelled as "too many mothers-in-law" (*popo tai duo*).<sup>182</sup>

The decentralisation, in which also SOE reform has resulted, makes it difficult for the central reformers to implement liberal economic policies.<sup>183</sup> Only a few thousand of the

178. In mid 1999, MOFTEC reported that there were around 9,000 FTC. The number of SOEs and private firms with trading rights for their own products had risen to 12,000 and around 300,000 FIEs had trading rights for their own products. See Ianchovichina et al., *supra* note 96.

179. These involve on the one hand grain, vegetable oils, sugar, tobacco, crude oil, refined oil, chemical fertiliser, cotton and on the other hand rubber, timber, plywood, wool, acrylics, and steel products.

180. See generally W. Davey, *Article XVII GATT: An Overview, in OPERATIONS OF STATE TRADING ENTERPRISES AS THEY RELATE TO INTERNATIONAL TRADE* (1998).

181. See *supra* note 130.

182. See Clarke (1991), *supra* note 129, at 7; see also Dodds, *supra* note 129, at 715.

183. See Jun Ma, *Macroeconomic Management and Intergovernmental Relations in China*, World Bank Working Paper, January 1995 (noting that decentralization in China has been crucial in stimulating regional economic growth and reform, but local governments have attained

largest SOEs remain under direct central control.<sup>184</sup> At the local level, local bureaucrats tightly try to hold on to their privileges.<sup>185</sup>

Those ministries that traditionally wielded control over the allocation of resources and the management of large SOEs and industrial groups resist greatly.<sup>186</sup> The 9th National People's Congress (NPC), which concluded in mid-March 1998, implemented a plan to restructure this bureaucracy by cutting the number of ministries from forty-one to twenty-nine.<sup>187</sup> Despite the ambitions of reformers, there are problems that yet remain insurmountable.

While the government decentralised the economy and its bureaucracy it has had great difficulty in establishing mechanisms to ensure that enterprises respond to the prescribed policies as intended.<sup>188</sup> Hence, it is very difficult to police or control any grants of exclusive or special privileges, whether formal or in effect. Therefore, many local monopolies might exist and transparent notification becomes a very difficult task. This transparency is absolutely necessary for members to judge the extent to which state-trading enterprises serve as a substitute for other measures covered in GATT such as quantitative restrictions, tariffs and subsidies.

Furthermore, the administrative maze affects commercial decision making, because the bureaucracy holds the lifeline to whether SOEs have access to the international market. Second, the decentralisation has not substituted direct micro-control with indirect macro-control and hence does not guarantee a uniform application of foreign trade administration.

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*de facto* control over many policy instruments, seriously weakening the central government's ability to achieve and sustain macroeconomic stability. In areas where the division of regulatory power is vaguely defined, local governments' protectionist behaviour has led to a malfunction in resource allocation).

184. Dodds, *supra* note 129, at 700.

185. Local governments have significant power and local cadres are not interested to give up their patronage over SOEs or the revenue they gain through taxes and bribes. Corrupt officials often demand enterprises to pay various exactions (*tanpai*). See Blumental, *supra* note 132, at 234; see also Clarke (1991), *supra* note 129, at 37–42 (notes that local authorities tend to view successful enterprises as milk cows. From local governments down to the street committee, from the Department in Charge to the TV station, all come seeking money, usually with the threat to withhold vital goods or services such as housing, education for employees' children or police protection). See also Helena Lolenda, *One Party, Two Systems: Corruption in the People's Republic of China and Attempts to Control it*, 47 J. CHINESE L. 187 (1990).

186. See Clarke (1991), *supra* note 129, at 14 (noting that sub-central levels of the system are able to thwart and subvert the demands of the centre). The central government, despite efforts of recentralisation, has never regained the control it lost during the Cultural Revolution. The vast quantity of legislation produced by the central government cannot change the pre-reform legal institutions, which remain in many ways unchanged in the position they occupy in the Chinese polity.

187. See Blumental, *supra* note 132, at 235.

188. The vision that "the state regulates the market, and the market guides the enterprises" represents essentially repudiation by the state of its right as an owner to control enterprise behaviour directly, in favour of more detached and indirect control through legislation. See Clarke (1992), *supra* note 129, at 289. Thus, while granting more autonomy to enterprise managers, the State must develop a monitoring system to ensure that managers do not waste enterprise assets.

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Finally, it is noted here that the WTO has dealt with countries that at times maintained a complete monopoly of their foreign trade like Poland, Hungary, Romania, and Yugoslavia.<sup>189</sup> But of course China (and Russia) is a much larger economy to deal with and the economic stakes are much higher this time.

#### b. Defunct Corporate Governance

Getting the government out of business has proven to be a persistent problem from the outset of SOE reform.<sup>190</sup> The Company Law may be a legal milestone to corporatise SOEs by converting them into shareholding companies, but the changes it specifies are largely cosmetic. It falls short of providing enterprises and managers with the corporate tools they need to build modern companies and maximise efficiency, because administrative agencies holding controlling shares can still interfere directly in the day-to-day management and affairs of the company<sup>191</sup>—a feature earlier reforms already tried to bring to extinction without success.

Under the Company Law, the state and the company (with its investors) receive certain legal rights that are ambiguous and at odds. While enterprises obtain the right of autonomous operations, the state retains legal ownership of state-owned assets, and the tripartite internal governance system plays into the conflicting interests and rights of the state, the company, private shareholders and labour representatives. Of concern is the notion that enterprises must operate under government and CCP supervision.<sup>192</sup>

*Corporatisation* can only be called a success if it achieves two levels of separation, viz. first when the state's regulatory and administrative powers would be separated from its enterprise ownership rights; and second, when ownership and management rights would be separated.<sup>193</sup> However, these fundamental principles have been transferred on paper only.<sup>194</sup> The failure is attributed to the fact that the Berle and Means corporation cannot just be transplanted to China.<sup>195</sup> The State with its highly concentrated ownership

189. The principal documents can be found in GATT, *Basic Instruments and Selected Documents* (BISD). Yugoslavia 8 BISD 17, 18, 64ff; 9 BISD 56ff; 10 BISD 61ff; 11 BISD 52, 79, 50ff; 14 BISD 15, 16, 49ff; 15 BISD 53ff, 63. Poland 8 BISD 12, 61; 11 BISD 72ff; 12 BISD 62ff; 13 BISD 33ff; 14 BISD 46ff; 17 BISD 96ff; 18 BISD 188ff, 201ff; 19 BISD 109ff; 20 BISD 209; 21 BISD 112; 22 BISD 63ff; 24 BISD 139ff. Romania 18 BISD 5ff, 23, 94ff; 20 BISD 217ff; 24 BISD 149ff; 27 BISD 166ff; 30 BISD 194ff. Hungary 20 BISD 3, 17, 34ff; 22 BISD 54ff; 24 BISD 4; 25 BISD 155ff; 27 BISD 156ff; 29 BISD 129ff; 31 BISD 156ff. For parallels with China, see Yu-shu Feng, *China's Membership of GATT: A Practical Proposal*, 22 J. WORLD TRADE L. 60 (1988). See also Chung-Chou Li, *Resumption of China's GATT Membership*, 21 J. WORLD TRADE L. 34 (1987).

190. See Blumental, *supra* note 132, at 228.

191. PRC, Company Law, *supra* note 164, arts. 66, 67. It must be noted, however, that it concerns only wholly state-owned enterprises.

192. See (excellent study of the tension between the enterprise's right of autonomous operations and the government's right of supervision) Joaquin F. Matias, *From Work-Units to Corporations: The Role of Chinese Corporate Governance in a Transitional Market Economy*, 12 N.Y. INT'L L. REV. 1 (1999).

193. Dodds, *supra* note 129, at 730.

194. Corporate governance is still under construction in China. See Matias, *supra* note 192.

195. See Dodds, *supra* note 129, at 732.

is unlikely to play the role of a passive investor and with the fears of social unrest will continue to intervene in SOE operations. A proper separation and balance of ownership and control is by no means determined by law directly. It is, rather, achieved through the owner's voluntary avoidance of interfering in the exercise of ownership functions.<sup>196</sup>

Therefore, proprietary directions inhibiting foreign trade by the government are still easy to make. The country hides itself behind the protective structure of what it calls commercial decision-making according to its own market structure. It is true that some European countries maintained control over a large part of economic resources by government operation, but their corporate governance<sup>197</sup> and mature administrative laws tried to form a counterbalance to cabin possible risks.

Questions remain whether the latest Notice of the State Council "Basic Standard for Large and Medium-Size State-Owned Enterprises to Establish the Modern Enterprise System and Strengthen Management," will be able to separate the government functions from enterprise operation, reform through shareholding and establish standard structures of governance by legal authorities.<sup>198</sup>

### c. Subsidies

The provision of subsidies to SOEs, which are mainly involved in exporting, may run afoul of WTO subsidy disciplines. Although this concern is not directly raised in Article XVII, of which the disciplines are found in other Articles of GATT, such as Article VI. The connection between subsidies and SOE reform is nevertheless established here. The adverse use of subsidies, inherent to state economy, is yet another example that many Chinese enterprises may not be able to make decisions based on economic considerations alone.

To harden the budget constraint and make enterprises sensitive to the difference between costs and revenues, the government requires since 1981 that capital construction projects for SOEs must obtain their funds through interest-bearing bank loans instead of from government sponsored interest-free capital appropriations.<sup>199</sup>

Despite efforts to harden the budget constraint by making investment costly, any cost increase could easily be offset by negotiating concessions on taxes or profit turnovers

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196. As Dodds writes, many questions in the Company Law remain unanswered, like what percentage of ownership the state reserves, who will represent the State, or how will the ownership claims of multiple supervisory government units be handled. The law does not explain how a conflict between State and private shareholders must be handled, and does not protect minority shareholders. Few is known about fiduciary duties. See Dodds, *supra* note 129, at 731-33.

197. In this regard monitoring devices such as the takeover market, the managerial market, etc. are not yet sophisticated enough in China. See, e.g., G. Yu, *The Relevance of Comparative Corporate Governance Studies for China*, 8 AUST. J. CORP. L. 49 (1997).

198. See *New Regulations Lay Out Reform Plan for SOEs*, CHINAONLINE NEWS, Oct. 30, 2000, at <http://www.chinaonline.com>.

199. Clarke (1992), *supra* note 129, at 296.

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or by passing the increases on to buyers.<sup>200</sup> Finally, the government remains ready to pump money into failing enterprises if other remedies fail.<sup>201</sup>

Making a profit is not a question of life or death in China. If an enterprise can be funded free from outside sources, there is no incentive to accumulate capital internally for further growth. It takes note of prices if it feels like it by passing along cost increases or lobbying with the authorities to obtain a larger tax break or subsidy.<sup>202</sup> The system thus encourages SOEs to invest in influencing local bureaucracy rather than in improving efficiency.

### 5. Note on Article VIII GATS<sup>203</sup>

The problems that can arise in the domain of services are to a certain extent different from those in the domain of goods. In services, there is much greater concern about the monopoly (or non-competing oligopoly) control over essential facilities in the relevant market. Article VIII GATS, therefore, takes a market-based view as opposed to the ownership-based view of Article XVII GATT.<sup>204</sup>

200. The tax system remains remarkably soft and subject to bargaining, enterprises often negotiate over tax payments in the same way they bargain over output and profit targets. *Id.*

201. If a Chinese enterprise does not have enough money to cover its obligations, either the State pays or the creditors are left without recourse because in practice it is very difficult to attach the property of SOEs. The Bankruptcy Law (*see supra* note 154) tries to address problems related to enterprise insolvency where insolvency is perceived to mean that managers are running an enterprise inefficiently. The law attempts to protect enterprises whose losses result from, among other things, an irrational structure of prices, production quotas, or labour allocation. Unfortunately it is almost impossible to distinguish between these types of losses. The law's goal of preserving socially valuable, but economically inefficient enterprises puts the whole procedure back in the realm of bargaining and negotiation. Thus the law fails to make enterprises sensitive to market signals. See the discussion in Clarke (1992), *supra* note 129, at 298–300. See also Clarke (1991), *supra* note 129, at 51; *supra* note 176.

202. See also Clarke (1991), *supra* note 129, at 9–11 (lists five conditions by Kornai each sufficient to render the budget constraint soft: (1) the firm is a price maker, not a price taker; (2) the tax system is soft; (3) the enterprise receives free state grants; (4) the credit system is soft (*see supra* note 201); and (5) external financial investment is made on soft conditions). For a similar discussion, see Dodds, *supra* note 129, at 717.

203. For further reference on GATS, see B. HOEKMAN & M. KOSTECKI, *THE POLITICAL ECONOMY OF THE WORLD TRADING SYSTEM—FROM GATT TO WTO* 127 (1995) B. Hoekman, *Market Access through Multilateral Agreement: From Goods to Services*, 15 *WORLD ECONOMY* 707–28 (1992); B. Hoekman, *Tentative First Steps: An Assessment of the Uruguay Round*, World Bank, May 1995; John H. Jackson, *Constructing a Constitution for Trade in Services*, 11 *WORLD ECONOMY* 187–202 (1988); F. Weiss, *The General Agreement on Trade in Services* 1994, 32 *COMMON MARKET L. REV.* 1177–1225 (1995); P. Nicolaides, *Economic Aspects of Services: Implications for a GATT Agreement*, 23 *J. WORLD TRADE* 125–36 (1989); P. Sauve, *Assessing the General Agreement on Trade in Services, Half-Full or Half-Empty?* 29 *J. WORLD TRADE* 125–45 (1995); R. Frid, *Multilateral Liberalization of Trade in Services under the GATS*, 11 *SEW* 410–16 (November 1998). On Article VIII GATS in particular see Aaditya Mattoo, *Dealing with Monopolies and State Enterprises: WTO Rules for Goods and Services*, WTO, January 1997.

204. Some form of government involvement is a necessary condition insofar as it is required that the monopoly or non-competing oligopoly be “authorised or established formally or in

The disciplines of Article XVII resemble the disciplines of Article VIII. The supplier of the monopoly service should not act in a manner inconsistent with a member's MFN obligation and specific commitments. The scope, however, depends on the extent to which members have made liberalising specific commitments<sup>205</sup> under GATS on both market access and national treatment.<sup>206</sup>

Likewise Article VIII GATS, as Article XVIII GATT, does not create an obligation to change either the pattern of ownership or the market structure, but recognises the possible distortion of trade and the importance of negotiations. Changes in ownership and market structure, however, have been central to accession negotiations. China has committed to eliminate most foreign equity restrictions in all major service categories.<sup>207</sup>

Most commonly localised services like transport, telecommunications<sup>208</sup> and energy distribution are among the monopolies whose supply behaviour merits concern. In this regard, the electric power industry in China is being organised into conglomerates composed of both corporate and government entities clustered around certain industrial sectors. Therefore, the same transparency and ownership-management concerns exist as in the goods SOEs, because identical *corporatisation* has taken place in the service SOEs.<sup>209</sup>

#### 6. Observations

The Uruguay Round has not provided us with a separate treaty on State trading. To induce countries to accept such a treaty without appropriate *quid pro quo* is infeasible. Furthermore, Articles XVII GATT and VIII GATS are not rigorous enough in addressing the structural problems regarding Chinese State trading. Therefore, the possible disruption caused by Chinese SOEs must be effectively addressed in the accession negotiations. Members' fact finding in this regard has caused considerable delay in the swift accession of China.

China has agreed that it will not influence commercial decisions except in a WTO consistent manner and will allow SOEs to make purchases and sales solely based on commercial considerations. Both Article XVII GATT and XIII GATS have the unusual

effect" by a member (art. XXVIII (h) GATS). Therefore one can say that natural monopolies and oligopolies which exist without any facilitating government action are outside the scope of article VIII GATS. See Mattoo, *supra* note 203.

205. China has made commitments in all major service categories with reasonable transitions. They involve *inter alia* services auxiliary to distribution, telecommunications, insurance, banking, securities, professional services, the audio-visual sector, and travel and tourism.

206. As we noted earlier national treatment does not seem to apply in GATT at all. See *supra* note 99.

207. U.S.-China Bilateral WTO Agreement, Nov. 15, 1999.

208. Telecommunications take a special place regarding the application of article VIII GATS through the GATS Annex on Telecommunications and The Reference Paper: Ensuring Competition in the Supply of Telecom Services. Particularly useful in this regard is Mattoo, *supra* note 203.

209. See Daniel C. K. Chow, *An Analysis of the Political Economy of China's Enterprise Conglomerates: A Study of the Reform of the Electric Power Industry in China*, 28 L. & POL'Y INT'L BUS. 383 (1997).

aspect in the WTO context that they apply to the behaviour of enterprises, not to government rules of general application.<sup>210</sup> In this regard, we have demonstrated that the SOE reform does not cut deep enough and that it takes more than above government's commitment to convince mature WTO members. Therefore, the European Community and the United States have developed a longer-term strategy to deal with non-market economies, which will not be discussed here. Basically, it involves special antidumping and anti-subsidy measures, and a relaxed safeguard clause modelled on Article XIX GATT.

SOE reform in China makes us wiser about the difficulties to 'interface' the different economic systems into one universal WTO. The WTO, however, should continue to protect market economies from non-market economies as far as they try to enable the responsibilities and policies of WTO. Chinese SOEs definitely have the potential to evade these responsibilities and policies by, for example, proprietary directions due to a defunct decentralisation and the lack of effective corporate governance. By consequence, China undermines the access to its market for other members.

### C. ESTABLISHING A RULE OF LAW AND WTO COMPLIANCE

It has become clear from previous sections that law is the main instrument to accomplish China's economic reforms. China takes an instrumental approach towards the rule of law. Chinese imperial legal history and Marxism influence this approach.<sup>211</sup> For socio-historical and political reasons, however, the Western rule of law concept has become the standard, by which the institutions of Chinese society, from which Westerners are culturally removed, are evaluated to satisfy WTO compliance.

Further, state-owned enterprise (SOE) reform and Articles XVII GATT, VIII GATS have already hinted at the possible lack of transparency. This concern is addressed mainly in Article X GATT and the transparency issue has been a subject in both the U.S.-China Memorandum on Market Access<sup>212</sup> and the Draft Protocol on China.<sup>213</sup> The core of transparency as it is addressed in Article X GATT and the documents mentioned goes to the very heart of China's legal infrastructure, and more precisely to the nature and enforcement of its administrative law regime.<sup>214</sup>

At the time Article X was drafted, transparency did not have the 'veil dropping' meaning it has in the present WTO, but replicated very much the American approach to emerging administrative law in the 1920s and 1930s.<sup>215</sup> Since the establishment of the WTO, however, transparency of the legal system has become a vastly expanded concept

210. See Mattoo, *supra* note 203.

211. See, e.g., J. Wang, *The Role of Law in Contemporary China: Theory and Practice*, Ph.D. Thesis, Department of Government, Cornell University. On Marxism and Law, see H. COLLINS, *MARXISM AND LAW* (Oxford, Clarendon, 1982).

212. See art. 1, Memorandum of Understanding Concerning Market Access, 10 October 1992, 31 I.L.M. 1274. For completeness' sake there is also a Memorandum of Understanding on the Protection of Intellectual Property, 17 January 1992, which is not our focus here.

213. See art. 2 (C) and (D) Draft Protocol on China, 6 March 1996, on file with author.

214. See Sylvia Ostry, *China and the WTO: The Transparency Issue*, 3 UCLA J. INT'L L. & FOR. AFF. 1, 2 (1998).

215. *Id.* at 4-5.

and now requires, for example, the publication of laws, regulations, and the mode of administration in tradable services or, to a more limited extent, investment regimes.<sup>216</sup>

To satisfy the transparency requirement, China's accession to the WTO obliges the Chinese government to make China a more rule-based society than it has ever been. Tremendous efforts in the last decade have improved China's situation greatly,<sup>217</sup> yet a number of concerns still exist.

These concerns comprise the unpredictability of the legal system through policy laws, the lack of transparency due to the bureaucratic heavy hand, and the problems surrounding judicial review and lack of enforcement. These shortcomings undermine Chinese market access obligations because foreign traders and investors must struggle their way through a forest of administrative regulations and find it hard to seek legal redress.

### 1. Policy versus Law

To understand the position of the law in China, it is necessary to understand the position of the Chinese Communist Party (CCP).<sup>218</sup> Despite the erosion of the ruling ideology, which caused the discipline and the cohesion of the CCP to decline,<sup>219</sup> legislation remains dependent on the CCP's formulation of specific policies.<sup>220</sup> Sometimes important policies are announced in laws that are accompanied by statements by the

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216. *Id.* at 9–10.

217. The 1992 MOU substantially improved the transparency of China's foreign trade regime and the full implementation of it should bring China in conformity with GATT Article X. See Patrick H. Hu, *The China 301 on Market Access: A Prelude to GATT Membership?* 3 MINN. J. GLOBAL TRADE 132, 144–45 (1994). One of the major improvements was the adoption of the PRC, Foreign Trade Law (FTL), enacted by the 8th NPC on 12 May 1994. This law prescribes that foreign trade policy and regulations must be published freely and bans or restrictions on imports and exports must conform to GATT rules and be transparent. The FTL addresses the issues of unified national trade policy, transparency and conformity with GATT principles and international practices with respect to NTBs, market access, anti-dumping, subsidies and safeguard issues. On these improvements, see Man, *supra* note 110, at 493; Wang, *supra* note 111.

218. On the role of the CCP in law and society, see generally A. Chen, *An Introduction to Chinese Law*, Hong Kong, Hong Kong UP.

219. See S. ZHENG, *PARTY VS. STATE IN POST-1949 CHINA* (1997), at 4 (noting that China is facing a deep institutional crisis because of the disarray in the CCP and that the country is faced with the challenge of providing an alternative). On the erosion of Party control over lawmaking, see M. TANNER, *THE POLITICS OF LAWMAKING IN POST-MAO CHINA: INSTITUTIONS, PROCESSES, AND DEMOCRATIC PROSPECTS* (1999), at 51ff.

220. See Stanley Lubman, *Dispute Resolution in China after Deng Xiaoping: 'Mao and Mediation' Revisited*, 11 COLUM. J. ASIAN L. 229, 257 (1997). Or more extensively, see the same author's book, *BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO* (1999). See Clarke (1991), *supra* note 129, at 17–18. Although the National People's Congress (NPC) is a weak parliamentary body, it is no longer a rubber stamp and is constitutionally the supreme sovereign body of the PRC. The NPC elects a Standing Committee, which exercises the authority of the NPC when the NPC is not in session. However, major pieces of legislation must still receive prior Party approval and much of their content is decided before the NPC becomes involved. On the rise of the NPC system, see Tanner, *supra* note 219, at 72.

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CCP and CCP directives are still used to modify policies, previously given legislative expression.<sup>221</sup> Therefore, the distinction between law and policy is blurred and the result is a gap between the law on its face and the norms that are actually applied.

The perception that the Chinese have been ruled for decades by arbitrary and frequently hypocritical cadres has led some Chinese to think that government by objective rules is desirable and that under such government certain rights ought to be recognised and protected by the uniform application of rules.<sup>222</sup> But President Jiang's four-character slogan "rule the country according to law" emphasises only the need to protect long-term peace and stability.<sup>223</sup> Political stability is shorthand for regime survival and important to attract foreign direct investment (FDI) to serve export policy goals. Hence, the law is and must stay secondary to policy.<sup>224</sup>

The Party regime can thus revise legal policy anytime according to practical experience and can still intervene and resume total control whenever it deems the foundation of the regime as under threat.<sup>225</sup> There is even a darker side to this "flexibility." Officials in the right position can easily legalise their illegal profits by quoting and practising flexibility in the productive process and silence their critics by also applying flexibility in politics.<sup>226</sup>

However, the supremacy of party policy over the law cannot guarantee a stable legislative environment to deal with foreign trade issues involving investment, banking, finance, tax, etc., as long as foreign investors and China traders remain exposed to the legendary arbitrariness of Chinese policy makers. Moreover, laws are drafted in such vague terms that their interpretation can change overnight to suit any sudden policy change.<sup>227</sup>

The importance attached to underlying policies thus creates a legal system that is fluid and very changeable and hence unreliable. It allows the current regime to maintain the appearance of a viable legal system while retaining within its actual operation many facets of policy implementation, namely, changeability and adaptation to local normative structures and conditions.<sup>228</sup> These characteristics are reinforced by the administrative nature of the legal system as explained below.

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221. Lubman, *supra* note 220, at 244.

222. *Id.* at 246. See also the discussion in Chapter I about the rule of law in China.

223. *Id.* at 245; see also Chih-Yu Shih, *China's Socialist Law Under Reform: The Class Nature Reconsidered*, 44 AM. J. COMP. L. 642 (1996). Socialist legality must meet two demands. First it must meet stability, in order to promote the productive force; and secondly, flexibility, in order to cope with the complexities involved. On political stability, see also note 147.

224. See Lubman, *supra* note 220, at 245; see also M. Tanner, *The Erosion of Communist Party Control over Lawmaking in China*, CHINA Q. 381 (1994); M. Tanner, *How a Bill Becomes Law in China: Stages and Processes in Lawmaking*, CHINA Q. 39 (1995).

225. *Id.*

226. See Shih, *supra* note 223, at 643.

227. See Peter Howard Corne, *Lateral Movements: Legal Flexibility and Foreign Investment Regulation in China*, 27 CASE W. RES. J. INT'L L. 247 (1995). On legislative drafting, see LEGISLATIVE DRAFTING FOR MARKET REFORM: SOME LESSONS FROM CHINA (A. Seidman & R. Seidman eds., 1997).

228. See Corne, *supra* note 227, at 263.

## 2. Administrative System

The executive centered state apparatus headed by the State Council<sup>229</sup> supervises many departments including ministries, commissions, administrations and offices.<sup>230</sup> These central administrative agencies all possess authority to issue regulations to implement specific legislation under a grant of such power by a legislative body, and also a technically distinct type of authority to execute their general administrative responsibilities to issue any rule that is necessary to carry out their functions.<sup>231</sup> Until recently no procedural rules existed to govern the enactment of these important rules.<sup>232</sup> Although a formal hierarchy of norms exists,<sup>233</sup> the confusing range of documents and the blurred distinction between primary and secondary, implementing, legislation create a disorderly hierarchy of rules.<sup>234</sup>

In this disorder administrative agencies wield law-making powers to protect or increase their jurisdiction and to advance their policies, helped by the fact that these bureaucracies alone possess the power to interpret the rules they issue.<sup>235</sup> This gives rise

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229. The State Council is considered to be an administrative organ, not a legislative, and hence can pass only administrative rules (*xingzheng fagui*). See Clarke (1991), *supra* note 129, at 18.

230. See Lubman, *supra* note 220, at 254, 257. Most legislation originates in the State Council and those ministries, commissions and bureaux that are subordinate to it. The boundary between administrative legislation that is the proper subject of the executive branch, the State Council, and the pure legislative activity that is reserved to the NPC is often obscured. In its legally mandated role, the State Council enjoys too much power.

231. On the State Council lawmaking system, see Tanner, *supra* note 219, at 120.

232. This has recently changed somewhat under the PRC, Lawmaking Law, Mar. 15, 2000, enacted by the 3rd plenary meeting of the 9th NPC. See also Yahong Li, *The Law-Making Law: A Solution to the Problems in the Chinese Legislative System?* 30 H.K.L.J. 120 (2000).

233. Clarke (1991), *supra* note 129, at 26, notes that rules promulgated by hierarchical bodies have corresponding degrees of authority, but the Chinese legal system still has to come up with a definitive hierarchy that would enable rules to be ranked according to such features as label and promulgating body. See also note 234.

234. Lubman, *supra* note 220, at 258; see also Clarke (1991), *supra* note 129, at 26–27 (noting that regulations issued by the State Council or one of its ministries may be given greater weight than laws issued by the NPC because the latter are often vague statements of general principle that explicitly contemplate subsequent implementing rules). Li, *supra* note 232, at 122. Corne, *supra* note 227, at 252 (according to whom the hierarchy goes as follows: The NPC and its standing committee issues various enactments that can loosely be categorised as 'law'; the State Council issues administrative regulations (*xingzheng fagui*), the organs under the State Council, on the other hand, issue what are known as administrative rules (*xingzheng guizhang*); local people's congresses issue local administrative regulations (*difang xingzheng fagui*) and local people's government of provinces, municipalities, and quite big cities may issue local administrative rules (*difang xingzheng guizhang*); other normative documents (*qita de guifangxing wenjian*) formulated by national or local administrative organs for the purpose of regulation are not enforceable as law).

235. The legislature is viewed as the sole source of law in China where the courts may only "apply" laws. This means that the Court's interpretive function is limited to clarifying and strengthening the laws without changing their original meaning. Only the Supreme People's Court issues official interpretations and opinions either on entire laws or on specific sections and may in practice establish new rules or even contradict NPC legislation. See Lubman,

to all kinds of policy statements, administrative regulations, meetings, notices, instructions and speeches that are given legal effectiveness because they emanate from authoritative government and Party bodies.<sup>236</sup> These practices worsen the disorder because these "policy laws" do not set precise limits on legal and illegal behaviour nor define the legal consequences of failure to comply and are procedurally unclear.<sup>237</sup>

Although progress has been made in publishing collections of laws, many ministerial regulations and much provincial and local legislation remains internal or difficult to obtain, even when it is technically public.<sup>238</sup> Even if transparent sets of rules exist, the entrenched bureaucracy has been recalcitrant in adhering to them.<sup>239</sup> Apart from finding the applicable norm, however, it is crucial to find legal redress and enforce the rights that come under the law.

### 3. Legal Redress and Law Enforcement

Article X GATT, which, as mentioned above, goes to the heart of a country's legal infrastructure,<sup>240</sup> as well as the above-mentioned Sino-U.S. Bilateral WTO Agreement and China's Draft Protocol, mention the importance of legal redress and law enforcement. This is particularly relevant in the Chinese context where 'bureaucratic overreaching' often causes administrative interference with foreign investors' business.<sup>241</sup>

#### a. Legal Redress

The principles set forth in Article 41 of the PRC Constitution<sup>242</sup> as reaffirmed in Article 121 of the PRC General Principles of Civil Law (GPCL),<sup>243</sup> as well as the 1989 Administrative Litigation Law (ALL),<sup>244</sup> are among the legal milestones dealing with this

*supra* note 220, at 349–52; Li, *supra* note 232, at 137; see also Nanping Liu, *Judicial Interpretation in China: Opinions of the SPC*, Hong Kong, Sweet & Maxwell, 1997.

236. See Lubman, *supra* note 220, at 261–62.

237. Lubman, *supra* note 220, at 372 (notes that foreign investors commonly experience this problem as one of the more troubling features of the Chinese investment environment and that it is a fact of life for the Chinese to deal with it); see also Jerome A. Cohen & John E. Lange, *The Chinese Legal System: A Primer for Investors*, 17 N.Y.L. SCH. J. INT'L & COMP. L. 345 (1997).

238. Lubman, *supra* note 220, at 260. In October 1988, it was announced that "all administrative laws and regulations issued by the State Council" would be signed by the Premier, published in the Bulletin of the State Council and in the People's Daily, and distributed by the New China News Agency.

239. Blumental, *supra* note 132, at 235.

240. See Ostry, *supra* note 214, at 2.

241. See David L. Weller, *The Bureaucratic Heavy Hand in China: Legal Means for Foreign Investors to Challenge Agency Action*, 98 COLUM. L. REV. 1238 (1998).

242. See PRC, Constitution, 1982, Art. 41.

243. See General Principles of the Civil Law of the PRC (GPCL), 12 July 1986, effective 1 January 1987, Art. 121.

244. See PRC, Administrative Litigation Law, 1989, effective 1 October 1990. On Administrative Law in China, see generally L. Feng, *Administrative Law—Procedures and Remedies in China*, Hong Kong, Sweet & Maxwell, 1996. See also Xixin Wang, *Administrative Procedure Reforms in China's Rule of Law Context*, 12 COLUM. J. ASIAN L. 251 (1998).

requirement. Moreover, many Chinese laws and regulations specifically provide for the right to appeal against administrative agencies to appeal to People's Courts.<sup>245</sup>

The GPCL asserts the basic tenet that the State can incur liability to citizens or entities as is recognised in the PRC Constitution.<sup>246</sup> But it is the passage of the ALL that rendered these rights more concrete. It both strengthens general checks against governmental control in China and offers foreign investors a legal means to challenge intrusive agency action.<sup>247</sup>

The ALL imposes two explicit limits. First, it does not permit a plaintiff to challenge the inherent validity of abstract regulations and rules under which a particular administrative act is implemented. Instead, it only allows a review of the lawfulness of concrete acts.<sup>248</sup> For example, a court can only refuse to apply a conflicting lower-level regulation if it conflicts with the Constitution, national law, or a State Council regulation. The court may not strike down such an abstract rule, but will refer the matter for resolution to the State Council. Alternatively, an injured party may seek administrative reconsideration, through which the applicable agency may modify or declare void a concrete administrative act. However, the agency reconsidering the administrative act and relevant regulation may be in the same hierarchy as the original deciding agency and may have drafted the regulation itself.<sup>249</sup>

The second limitation on causes of action in Article 12 ALL permits certain concrete acts to be immunised from judicial challenge.<sup>250</sup> This limitation is understandable, because it immunises laws and regulations promulgated by the legislative branch of the government only as distinct from the administrative branch.

Notwithstanding these limits, an injured party's frustration is more likely to arise from other deficiencies in the Chinese legal system, such as insufficiently developed procedural law and the general inefficacy of the courts.<sup>251</sup>

Although the law permits a challenge of administrative actions, its effectiveness is limited by constraints on the power of the courts. Chinese courts are viewed as bureaucratic institutions.<sup>252</sup> Traditional practice treats judges as cadres whose functions are not distinct from those of other officials.<sup>253</sup> For the first thirty years of the PRC, Chinese

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245. This is, for example, the case in the PRC, Customs Law.

246. See Weller, *supra* note 241, at 1255–56.

247. *Id.* at 1257.

248. Article 12, ALL. "Concrete acts" have been construed by the Supreme People's Court as "unilateral acts or conduct, relating to specific matters and the rights and interests of specific citizens or legal persons." The general regulation itself, however, may not be struck down. See Weller, *supra* note 241, at 1259–60.

249. See *id.* at 1260–61.

250. *Id.* at 1261.

251. *Id.* at 1262.

252. Courts are no powerful arbiters like they are expected to be in Western jurisdictions. They are just part of the bureaucratic system and are therefore no more important than the post office or a public utility.

253. See Lubman, *supra* note 220, at 311, 362. Most of China's judges came to their positions through transfer from Party and military posts throughout the 1980. Most lacked university education, and very few have received formal legal instruction. There are special training efforts but overall educational levels remain low. See also Clarke (1991), *supra* note 129, at 21–22.

courts only existed essentially in form but not in substance and were eradicated during the Cultural Revolution. Since 1979, the system has been extensively rebuilt.<sup>254</sup> The usefulness of the law is thus restrained by the systemic weaknesses of the Chinese legal system, as we shall further explore below.

#### b. Law Enforcement

Apart from the intrusions of policy into the daily work of the courts,<sup>255</sup> the most serious problem is enforcement.<sup>256</sup> It is estimated that twenty percent to thirty percent of the economic dispute cases on which courts make decisions are not enforced.<sup>257</sup>

A variety of reasons exist that explain why judgements may be unenforceable. Factors within the judicial system itself make enforcement of decisions unlikely. Chinese courts are, in general, reluctant to use coercive means towards enforcement. Instead, Chinese culture favours mediation.<sup>258</sup> Another societal and judicial factor is that courts

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254. On the Chinese judicial system, see, e.g., Clarke (1991), *supra* note 129, at 19; See also Lubman, *supra* note 220, at 306. There exist courts of general jurisdiction as well as specialised courts like railway, forestry, maritime and military courts. The latter type's jurisdiction is not limited by administrative territorial boundaries like the former type. General jurisdiction courts are organised hierarchically. At the top stands the Supreme People's Court, followed by Higher Level People's Courts (Provincially and in Municipals directly under the Central Government, as well as in Autonomous Regions like Tibet), Intermediate Level People's Courts (Prefectural Levels, as well as provincially larger cities directly beneath the Provincial Government) and Basic Level People's Courts (rural and urban counties or districts). The pyramid is not very neat, because higher courts sometimes exercise primary jurisdiction over cases that would have an "influence" on their territory. Courts of general jurisdiction have separate divisions for criminal, administrative, civil and economic matters and enforcement.

255. Not only is it possible that local power holders will interfere with the decision making process of a court, but also decision making by the Chinese Communist Party is still allowed in specific cases. This is done by the so-called Party's Political-Legal Committees.

256. See Donald C. Clarke, *Power and Politics in the Chinese Court System: The Enforcement of Civil Judgements*, 10 COL. J. ASIAN L. 1 (1996); see also Donald C. Clarke, *The Execution of Civil Judgements in China*, CHINA Q. 65 (1995).

257. "At present, the most prominent problem in economic adjudication is the difficulty of executing judgements" Zheng Tianxiang, President of the Supreme People's Court, 1988 in Supreme People's Work Report, April 1, 1988. In this report for the NPC he said that 20 percent of judgements in economic cases went unenforced in 1985 and 1986, while about 30 percent in 1987. Good statistics are however not available. It is also unclear how many of these cases involve foreigners or FIEs.

258. See Stanley Lubman, *International Commercial Dispute Resolution in China: A Practical Assessment*, 4 AM. REV. INT'L ARB. 107 (1993). Among the masses education and persuasion is to be used whereas coercion in Maoist view is reserved for the enemy. See excerpts from "Analysis of the Classes in Chinese Society," "On the People's Democratic Dictatorship," and "On the Correct Handling of Contradictions Among the People," in Z. MAO, *SELECTED WORKS*, Vol. 1, 4 and 5, Beijing, Langs Press, 1965, 1969, and 1977.

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are concerned only with criminal adjudication and sentencing.<sup>259</sup> Another important factor is the lack of finality of judgements.<sup>260</sup>

The most important reason for judgements being unenforceable, however, is local protectionism, which testifies so strongly to the fragmentation of the legal system.<sup>261</sup> Courts are extremely reluctant to enforce judgements against local enterprises, local citizens, or authorities because local governments, on which the court depends, depend on local enterprises and local banks for income and employment. They are all part of the same bureaucratic family and every member must respect its local relatives.

The basic question remains whether it makes sense to define legal relationships and transactions created by economic reforms, or to adopt an enormous amount of legislation in view of WTO membership, if legislative enforcement cannot be guaranteed. To overcome this problem the courts must be insulated from the pressures generated by the Chinese Party-state. This can only happen if a more rigorous form of separation of powers is respected. So far, dispute resolution is handed back to the administrative domain by promoting arbitration and mediation.

#### 4. Observations

Article X GATT is not just a question of piling up and publishing laws, but also about how to administer a uniform, reasonable, and impartial legal system. It must be seen as part of an expanded WTO concept of transparency. This section has demonstrated that

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259. See Clarke, *supra* note 256, at 37. Apart from divorces there was not much civil work to do in a planned economy. This is still reflected clearly in the court's hierarchy where the president is involved in criminal adjudication, the vice-president in civil adjudication and the assistant vice-presidents monitor the execution.

260. See also Clarke, *supra* note 256, at 38. A judgement should be final to be legally effective; defendants have in fact numerous opportunities to re-litigate the merits of the case, or at least to pose further procedural obstacles in the way of execution. See also Nanping Lui, *A Vulnerable Justice: Finality of Civil Judgments in China*, 13 COLUM. J. ASIAN L. 35 (1999).

261. See Clarke, *supra* note 256, at 41–42 on local protectionism or *difang boahuzhuyi*. But not only courts reason that way, also other institutions in Chinese society such as local banks think in the same pattern. If an outside court demands a bank to freeze an account it is very likely the bank will refuse to do so until a local court has authorised it to do so. An often-secret contact between local courts and the debtor make it possible for that party to shift funds and property because it was warned. In Shenzhen internal rules of the bank may require this, although such requirements are prohibited in notices by the Supreme People's Court and the People's Bank of China (Supreme People's Court, People's Bank of China, Joint Notice on Investigating, Freezing and Levying on Bank Accounts of Enterprises, Institutions, Organs and Organisations, Dec. 28, 1983 and Supreme People's Court, People's Bank of China, Supreme People's Procuratorate and Ministry of Public Security, Notice on Investigation, Freezing, and Levying on Bank Accounts of Enterprises, Institutions, Organs and Organization, Dec. 11, 1993). Banks are forbidden to transfer or unfreeze frozen funds or to warn the depositor in advance of freezing, while courts for their part are told that when there is a difference of opinion with a bank, the matter should be resolved through consultation between the superiors of both court and bank instead of *detaining bank personnel*. In one case a judge entrusted with enforcement replied that the government would not let him finish the construction of his house if he executed what was demanded. In another case the daughter of a judge was transferred to a remote place after her father executed a judgement.

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still many Chinese practices and habits exist, which are adverse to Article X GATT and thus WTO transparency. All of which will not change overnight once China is admitted to the WTO.

Therefore, policy changes are likely to continue to create uncertainties, with practice contradicting policies. Further, there remain inconsistencies between national and local legislation due to a lack of proper hierarchy of legal norms. Finally, Chinese courts have discretion when administering the overall policy of regulation.

Stanley Lubman sees the only solution in thorough "institutional innovations that can only be part of a political solution to the current fragmentation of authority."<sup>262</sup> Donald Clarke agrees, stating that "[P]assing laws is not enough. Statutes can be effective only within an appropriate institutional framework."<sup>263</sup> In China, the administration is not restrained by its own rules.<sup>264</sup> Democratic political institutions, however, do not necessarily make the economic process less complex and painful.<sup>265</sup> Neither will the Rule of Law be won in a single day, even if the regime becomes liberal democratic or capitalist.<sup>266</sup>

Finally, transparency in Article X GATT encompasses the uniform application of law. If China cannot live up to this requirement, an undeniable element of the *rechtsstaat*, the country may deny benefits under the WTO framework to other members.

#### D. CONCLUSION

In order to join the WTO, it is generally accepted that China must comply with rules formulated with a particular politico-economic structure in mind and which make sense only in the context of that structure.<sup>267</sup> China's economic, legal, and political structures do not operate within the paradigm the WTO contemplates.<sup>268</sup>

International norms, like those created in the WTO framework, have played a tremendously important role in guiding the remodelling of the legal and economic system in China. Furthermore, a successful integration of China will certainly strengthen the WTO's mandate. If the WTO persists in excluding China, its legitimacy as an organisation would suffer.

The principles underlying the WTO were identified as the rule of law and the market economy. These fundamental premises were closely examined and applied to China's economic and legal reform process. Measured to compliance with Articles X (transparent legal system) and XVII GATT and VIII GATS (state economy), it has been demonstrated

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262. Lubman, *supra* note 220, at 259.

263. Clarke (1991), *supra* note 129, at 3. While law is often in principle the most appropriate vehicle for reform, the effectiveness of it is compromised by the institutional environment in which they must operate.

264. At least the Administrative Procedure Law, the State Compensation Law and the Regulations on Administrative Reconsideration are only bleak attempts to exercise supervision and check on administrative organs.

265. For example, Eastern European non-market economies and Russia. See Clarke (1991), *supra* note 129, at 2.

266. See Ronald C. Keith, *China's Struggle for the Rule of Law* 5 (Macmillan, 1994).

267. See Donald C. Clarke, *GATT Membership for China?*, 17 U. PUGET SOUND L. REV. 518 (1994).

268. Clarke, *supra* note 267, at 517.

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that Chinese reform is still unfinished, bringing about the transitional character of the Chinese economy and legal system.

The politico-historical framework in which China's accession takes place raises concerns about China's position as a constructive member of the multilateral trading system. On a deeper level, this concern is rooted in the demand for reciprocity. The benefit to China of WTO membership is rule-based, non-discriminatory market access at levels that currently apply between WTO member nations. In exchange, however, WTO members expect China to make commitments of equivalent value.<sup>269</sup> Being a constructive member of the international community is China's credit test, to see whether it can pay the equivalent value.

Both the transitional character and the credit test must be adequately dealt with in the accession negotiations, and explain why Chinese accession has dragged on for so many years. However, the process of integrating the Chinese socialist economy will stretch into the next decade or two. The main challenge ahead is for the WTO to ensure that China's large state-owned economy does not enable the country to evade the effective responsibilities and policies of GATT/WTO, even though the socialist market economy can be in complete conformity with the technical rules of the WTO.

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269. Eglin, *supra* note 1.

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