

1998

## Future Challenges: The Proposed Accession of China, Russia, and Others - Presentation Summary and Comments China, Russia, and Others - Presentation Summary and Comments

Charles E. Roh Jr.

John Kingery

Greg Mastel

James D. Southwick

---

### Recommended Citation

Charles E. Roh et al., *Future Challenges: The Proposed Accession of China, Russia, and Others - Presentation Summary and Comments China, Russia, and Others - Presentation Summary and Comments*, 32 INT'L L. 883 (1998)

<https://scholar.smu.edu/til/vol32/iss3/20>

This Symposium is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in International Lawyer by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

# **FUTURE CHALLENGES: THE PROPOSED ACCESSION OF CHINA, RUSSIA, AND OTHERS**

## **Presentation Summary and Comments**

CHARLES E. ROH, JR.\* , John Kingery\*\* , GREG MASTEL\*\*\* ,  
AND JAMES D. SOUTHWICK\*\*\*\*

*CHARLES E. ROH, JR.* : Roh made three general observations about the eventual accession of China and Russia to the WTO. First, compared with the GATT, the WTO should reduce Member States' anxieties about enforcement of trade rules as to China and Russia. Unlike the GATT, the WTO will not allow China or Russia to block enforcement of adverse decisions or to block retaliation for failure to implement adverse decisions. Similarly, under the WTO, members need not be concerned about developing countries acting out of solidarity to block reports.

Second, China and Russia's accession to the WTO may, but need not, create additional strain on the WTO system. One source of strain is that by virtue of their size, these countries would generate more disputes to be brought before the DSB. China and Russia's accession also would likely exacerbate the problem of timely compliance with DSB reports. Roh suggested that big countries are more tempted to wait until the last minute to implement DSB decisions. Further, there is a risk that big countries will use their leverage to negotiate "three-quarters

---

\*Charles E. Roh, Jr. is a partner with Weil, Gotshal & Manges LLP in Washington, D.C.

\*\*John Kingery is Senior Legal Officer in the Legal Affairs Division of the World Trade Organization. The views expressed in this paper and during the seminar are exclusively those of the author and not of the World Trade Organization or any of its Members.

\*\*\*Greg Mastel is a vice president of the Economic Strategy Institute and author of *The Rise of the Chinese Economy* (Armonk, NY: M.E. Sharpe, 1997).

\*\*\*\*Prior to joining the international practice group at Dorsey & Whitney, James Southwick served in the Office of the United States Trade Representative as Assistant General Counsel, with responsibility for Japan and Latin America, and then as Deputy Assistant United States Trade Representative for Japan.

compliance," rather than full compliance with DSB decisions. Another possible source of strain is the advent of more complex cases, precisely the sort of cases with which the WTO deals least well. Big countries are liable to bring cases involving "fuzzy" rules and hard fact-finding.

Third, Roh observed that there is a tremendous burden on the negotiators who are developing terms of accession for China and Russia. The negotiators will do no favors to the Member States by papering over differences and leaving the DSB to fill in any gaps. This approach to handling differences may work well within a domestic system (as in the United States, where legislators sometimes leave statutes ambiguous, placing the burden of clarification on the judiciary), but in general, nations are not comfortable having arbitration panels engage in rulemaking. Further, China and Russia pose special problems when it comes to negotiating rules of accession: they are both huge countries; they are both developing countries (in the sense that they are growing and each possess some features of a powerhouse and some features of a developing country); and they both must deal with the phenomenon of state-owned enterprises and government control of large parts of their respective economies.

Roh stated that the most recent draft of a protocol of accession for China and Russia was dated March 1997. So far, the negotiators' approach has been to insert a "general safeguard" in the protocol, which gives any member the option of suspending the WTO rules as between itself and China or Russia (which suspension would apply reciprocally). Under the terms of the general safeguard, such suspension could not be disputed before the DSB. Roh posed the question whether it is worthwhile to have China and Russia become members of the WTO on such terms. The general safeguard casts doubt on whether the protocol of accession would be a permanent agreement. One alternative may be to wait until China and Russia, on the one hand, and the WTO, on the other, are more ready for one another. However, that solution may not be politically acceptable. Other alternatives would be to develop a more specific safeguard or to leave problems for dispute settlement. However, neither of these solutions is completely satisfactory.

\* \* \* \*

*JOHN KINGERY:* The commitment required for accession of transitional economies, such as China and the countries comprising the former Soviet Union, will be different from those required of developing countries under the broadened regime of the World Trade Organization Agreements. In both situations, countries will be required to put new systems in place. In the transitional economies, however, there is an additional need to dismantle old structures and change philosophical constructs. Russia and China have accomplished a considerable amount of transformation but still have some distance to go.

An increase in the number of noncompliance dispute settlement cases may be anticipated due to the vast changes required on the part of the transitional economies. Even with the best intentions and reasonable transition periods, it is hard

to see how additional strain on the dispute settlement system can be avoided. These difficulties will exist even if the relationship is strictly proportional to the size of the economies. If there is a greater than proportional increase due to structural differences in the acceding economies, then the strain will be even greater.

The presenter for this section, Mr. Roh, correctly identified the three areas of concern in regard to the ability of the dispute settlement system to cope with accession. The areas of concern include: (1) increased case load; (2) procedural maneuvering by parties to slow or stall the dispute settlement process; and, (3) the danger of ambiguous obligations resulting from the negotiations.

These are probabilities rather than mere possibilities. There will be more cases. Members are already maneuvering to slow down, divert, and frustrate the dispute settlement process. The procedural maneuvering, unfortunately, already seems to be on the increase. The negotiating process regarding the traditional economies of China and Russia is extensive and unlikely to result in clear commitments in all areas within the time politically available. The relevant question here concerns whether the ambiguities will be limited or whether the Understanding of Rules and Procedures Governing the Settlement of Disputes (DSU) will be circumvented in large portions through some type of general or specific safeguard provisions.

Nonetheless, instead of examining these three areas to see whether the present system can cope, it is a worthwhile exercise to see how these strains might present opportunities. For the moment, the present system is satisfactory and stable. The Members have clearly demonstrated that they will not attempt anything more than fine tuning in the 1998 review. They may be lucky to achieve even that. There are majority opinions on many minor changes that would be worthwhile, but there is presently no evident consensus.

For the system to move forward, strains on the present structure will require further pressure. I use the term "forward" purposely. That is, on this matter there most certainly is a "forward" and a "backward." We can move forward to a more transparent, certain, and judicial system, while backward will lead us to a more diplomatic, opaque, uncertain, and untrustworthy system.

With the Uruguay Round, the signatory countries to the Marrakesh Agreement Establishing the World Trade Organization took a decisive step in a particular direction. The step, of course, was mutual for these countries, but it was most important for the United States. An implicit part of the post-war Bretton Woods system was greater relative openness of the U.S. economy. A strong dollar, lower tariffs, an open market, and tolerance of a plethora of quotas, subsidies, and an assortment of other non-tariff barriers maintained by other countries were parts of the deal to promote reconstruction of the world economy and solidarity during the Cold War. The United States eliminated some of its own trade barriers during the various negotiating rounds. However, in the Uruguay Round, the United States did something differently. It traded away its *potential* for deals that rely for leverage on the threat of closing the U.S. market.

Prior to the Uruguay Round, there was a viable alternative—utilizing bilateral pressure and selective market closings as “crowbars” to pry open other markets. Used properly, this system was a means of using trade pressure to force openness on others and not simply a means to protect domestic markets. The decision during the Uruguay Round was to take a profound step away from an approach based on pressure and diplomacy and towards a system of the enforceable rules of law. This is not, of course, to say that the decision to adopt the DSU was that of the United States alone or that there were not many doubters elsewhere about the wisdom of moving towards a more judicial system. For instance, many within the European Union were deeply troubled by the prospect of taking any steps away from the diplomatic model of dispute settlement. The decision by these countries and persons was as profound as that taken by the United States, albeit from a different perspective.

The Rubicon has been crossed. The WTO Members are committed. It is success or nothing, since it is impossible to attempt to reverse this fundamental philosophical direction and retreat back across the river and live life as before. The element of trust underpinning the world's highly specialized and interdependent economies would be fractured. The risk of waves of protectionism and financial collapse should not be underestimated. Most likely, an attempt to go back will overshoot the final structure of the old GATT system. Furthermore, the opportunity to encourage developing and transitional countries to base their development on open and fair economies would be gone, possibly forever. There is a forward and a backward.

## **I. Where the Strains Will Show**

There are several actual and potential shortcomings in the system that will likely be exposed by the accession of China and Russia. Such weaknesses are numerous and of varying degree of importance. In the interest of brevity, this comment will focus on six points. The first four are primarily procedural while the last two are mainly substantive.

### **A. PANEL SELECTION**

One of the remnants of the old GATT system is that the parties choose their own judges. The difference is, of course, that the issue can now be forced by either party taking the question to the Director-General after twenty days following establishment of the panel.<sup>1</sup> However, the selection by the Director-General is not a pristine process. The parties make their views known as to what is acceptable and what is not and the Director-General makes his selection within those param-

---

1. Understanding on Rules & Procedures Governing the Settlement of Disputes art. 8.7, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, *LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND* vol. 31; 33 I.L.M. 1226 (1994) [hereinafter DSU].

ters. The bases for objection to panelists offered by Members are becoming increasingly weak and unsupportable, with broad categories of individuals routinely being eliminated.

The result of this process is that the system increasingly relies on a small pool of panelists. The burdens of being a panelist are increasing and the rewards are de minimis. Member delegates are not compensated and nondelegates receive about \$400 a day to cover their expenses. They do, however, get a lot of trouble and grief for their efforts.

There are two further items to note here. First, the mere fact that the system relies on delegates is troubling. Delegates sitting in judgment over parties on Monday could easily be spending Tuesday negotiating with those same countries and persons. No set of rules of conduct in the world could resolve this problem. Second, the increasing complexity of cases and the accompanying time burdens means that there will either be increasing reluctance on the part of individuals to serve or service will become pro forma and the decisionmaking will be hidden beneath the surface.

This bizarre and unaesthetic process of litigants choosing their own judges is not unique to the WTO, but the added burden of cases, the increasingly difficult nature of the cases due to ambiguous accession negotiations, and the temptation to use the selection process to either slow down or skew the results will make it increasingly untenable. At the moment, it is fundamental to the politics of the dispute settlement system. The politics should be removed.

## B. EVIDENCE

The evidentiary nature of the cases is becoming more complex. The *Japanese Film* case<sup>2</sup> has resulted in a 526-page opinion and file cabinets full of submissions. Increasingly technical regulations are at issue as in the *EC Hormones* decision.<sup>3</sup> One only needs to recall that one of the primary areas of the China negotiations has been the service sector where the old state controlled system is well entrenched. The General Agreement on Trade in Services has barely been touched in dispute settlement and it is full of ambiguities and definitional problems due to its novel nature.

How can these evidentiary issues be handled within a system of inexperienced, part-time judges taking a day or two off from their full time jobs? How can they be handled when the evidence is difficult to discover, located far away, and written in Chinese or Cyrillic? How can they be handled if the rules to be applied are ambiguous or full of gaps? The answer can only be, "not well."

2. *Japan—Measures Affecting Consumer Photographic Film and Paper*, WT/DS44 (visited May 31, 1998) <<http://www.wto.org/wto/online/ddf.htm>> [hereinafter WTO Website].

3. *European Communities—Measures Affecting Meat and Meat Products (Hormones)*, WT/DS26 & WT/DS48, at WTO Website, *supra* note 2.

### C. TIMING

The system is off schedule—a problem which will get worse in the future. The parties demand more time for briefing. Expert testimony is required more often.<sup>4</sup> Enormously lengthy briefs and hundreds of thousands of pages of evidence cannot be adequately summarized and analyzed in short periods of time. In addition, there are problems with translation of materials. Starved for resources, the WTO Secretariat is experiencing increasing delays in issuing final decisions to the Members within the specified time frame due to the difficulties of translating the huge amount of materials into the three official languages. In addition to the post-decision translation problems, the litigation itself will slow down due to the needs of the parties to translate materials for submission or rebuttal, especially when non-Western languages are involved. Translation was an issue in the *Japanese Film* case where the parties argued about the accuracy of certain translations from Japanese to English. This problem will increase significantly when China and Russia are involved.

One can always attempt to address these issues by incorporating more time into the dispute settlement system. However, it must be remembered that the remedies available within the DSU are prospective in nature. Justice delayed is justice partially foregone. Timeliness can be particularly important for a smaller country involved in a dispute where a proportionally greater part of their economy may be involved.

### D. MEASURE SHIFTING AND MULTIPLE CASES

Complaining parties in WTO litigation can easily find themselves in a difficult situation. They can find out during the dispute that they were unaware of certain measures applied by the defending Member to the goods or services in question. Also, the defending Member can remove a measure and replace it with a different one that may be partially if not equally as restrictive. The answer in such situations has been increasingly “tough luck,” there is no process for amending the complaint.<sup>5</sup>

4. See *id.*; *Japan—Measures Affecting Consumer Photographic Film and Paper*, WT/DS44 (regarding translation issues); *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58, DS61; *Australia—Measures Affecting the Importation of Salmon*, WT/DS18; and *Japan—Measures Affecting Agricultural Products*, WT/DS76, at WTO Website, *supra* note 2.

5. See *e.g.*, *India—Patent Protection for Pharmaceutical and Agricultural Products*, WT/DS50/AB/R, para. 85-96 (Dec. 19, 1997), at WTO Website, *supra* note 2. The United States claimed that it learned of certain Indian measures only in the course of the proceedings. Therefore, they were not included in the original panel request and, hence, the Terms of Reference. The panel dealt with the issue by ruling at the outset of the first substantive meeting that certain issues would be included. The panel noted that the ruling was accepted by both parties.

The Appellate Body overruled the panel and noted that there was no procedure in the DSU for adding new measures to the case during the course of the proceedings, regardless of the agreement of the parties.

The DSU retains a significant element of the old diplomatic-based negotiating process, a fact that is often overlooked when people celebrate the undeniable improvements in the system. Part of the old system was the consultation period. Consultation is still a required first step. While it is appropriate to encourage negotiations, the inability to manage the scope of a case through some sort of amendment process once negotiations have failed, is a serious problem. Most of the time, it will be a good faith question of new developments or changes in legislation that result in new measures appearing in a case—good faith, but a problem nonetheless. However, it does not require much imagination to see how a defending litigant could manipulate the system and string out the process by hiding measures through the consultations or dropping one set of measures and replacing them with new ones having the same or similar effect.

The difficulty for the system is twofold. First, it can result in a series of cases, one trailing along after another, dealing with the same or similar issues. The system can become clogged dealing with the same essential disputes over and over again.<sup>6</sup> Second, cynicism and disrepute can undermine the support for the system if realistic remedies cannot be achieved in a reasonable amount of time.

Again, the addition of Russia and China will add a considerable amount of strain in this regard. The rules in these transitional economies are not as well-defined and formalized as they generally are in most Western countries. Even with the best intentions by all parties involved, a number of effectively redundant cases could be generated.

#### E. COMPLIANCE

It is too soon to tell, but compliance may be the weak point of the whole dispute settlement system. The period for compliance is now at least fifteen months as a practical matter, although there may be renewed challenges on this point. How will compliance be monitored and enforced in this Member-driven organization? Will major trading Members exploit every technicality available to circumvent the intent of the panel and Appellate Body? If so, how will it be enforced? Will the solution involve referral back to the original panel and at least a partial resetting of the whole process? Will a whole new consultation and panel process on the new measures be required? Without certainty of compliance, the temptation to remove disputes with the acceding countries from the DSU process

---

6. Even where there is no measure shifting, the multiplicity of similar disputes can also arise due to a multiplicity of complainants on substantially the same measures. See *India—Patent Protection for Pharmaceutical and Agricultural Products*, WT/DS79/1, (May 6, 1997) (complaint by the European Communities); *Argentina—Measures Affecting Textiles and Clothing and Footwear*, WT/DS77/1, (Apr. 28, 1997) (complaint by the European Communities), at WTO Website, *supra* note 2. These panels were established at a time when the earlier complaints by the United States on essentially the same measures were substantially further along in the dispute settlement process. The European Community stated that it was filing the cases to protect its position in negotiating resolutions and its right to compensation should such an eventuality arise.



will increase. Such removal could undermine the credibility of the dispute settlement system.

#### F. POLITICIZATION

The other substantive issue that will be brought into sharper focus by the accession of China and Russia involves concerns about the politicization of the process. So far, this issue has been remarkably contained. Indeed, the system has worked with a substantial insulation from the politics of trade. However, all three crucial institutions involved in the process are potentially subject to politicization.

The Secretariat has dual roles in the WTO. First, it assists and facilitates substantive negotiations resulting in treaty texts. However, the second role is then to assist in the enforcement of the rules once negotiated. This potential conflict is partially resolved by having the Legal Affairs Division primarily, but by no means exclusively, responsible for supporting the dispute settlement process. Legal Affairs has relatively less involvement in the major areas of substantive negotiations.<sup>7</sup> Nonetheless, there is no clear distinction between the processes of negotiation and adjudication.

This lack of clear separation of responsibility also applies to panelists to the extent they are also delegates of or otherwise employed by Member governments. Even the Appellate Body, with its part time members, must be a subject of concern in this regard, albeit at least one step further removed from conflicts than many panelists.

The mere appearance of political considerations in the dispute settlement process must be avoided at all cost. Again, the best intentioned rules of conduct and individuals cannot remove the appearance and possibly the reality of such a conflict if individuals are serving in dual roles. The acceding transitional economies have less experience than most western countries with independent judicial systems. Indeed, internal independent judicial review is itself a subject of negotiation. These countries will demand a great deal of credibility and evidence of objectivity from the dispute settlement system if they are expected to comply with the results or asked to agree to bring their complaints exclusively to that forum.

## II. The Way Forward

There is the potential for both forward and backward movement. We can move back from an independent arbitral system and return to a diplomatic-oriented structure. We can, but we must not. The way forward is to develop a true judicial system.

---

7. China, however, is something of an exception as Legal Affairs has a larger support role within the Secretariat than usual.

The United States and the other Members have made a decisive step towards the rule of law in international economic relations. It is an experiment that must be completed. The lessons of the twentieth century with its two horrific world wars clearly demonstrate the outcomes in a world without enforceable laws. Success is far from inevitable and a judicial system can fail just like diplomacy. However, a clear, transparent, fair, reliable, and independent system gives us our best chance.

The 1998 DSU review will not touch upon the broader issues concerning the fundamental structure of the system. There is no pressure to do so because the system is functioning adequately under present structure. In addition, the structure is new and needs to be further tested. However, it is obvious that the accession of large transitional economies will strain the present system. The fundamental philosophical inadequacies will be exposed. Therefore, now is the time to begin thinking about what the next step should be.

In my view, we should begin thinking about a structure for an independent judiciary. We should utilize judges rather than panelists. These judges should be employees exclusively of the WTO with their own independent staff. The Appellate Body is further down this road, but needs restructuring and changes to improve its functioning and ensure its objectivity. The judges may need the authority to "ride the circuit" and take their courts to places other than Geneva in order to be closer to the evidence and provide necessary transparency. A more complex set of litigation rules dealing with discovery and pleading will be required as well.

These possibilities themselves, however, raise a very fundamental question. How can an independent judiciary be brought into existence, reformed from time to time, and corrected when in error without a legislative body? The Member countries, and more importantly, their populations are not about to contemplate surrender of sovereignty to any supranational legislative entity. Therefore, a streamlined system of intergovernmental negotiation and agreement would probably be required to go along with reinforced rule enforcement.

These questions will not be answered easily, but the pressures that will require answers will become evident in the next few years as the present system, regardless of its virtues, is strained by the accession of another quarter of the world's population to the WTO. This is an opportunity not to be missed.

\* \* \* \*

*GREG MASTEL:* One of the little discussed challenges created by the end of the Cold War is integrating former communist economies into the global economic system they once shunned. Though these countries generally have recognized the need for economic and political reform, most are far from being Jeffersonian democracies with free market economies. Most do not even aspire to such a goal; they seek much more modest change.

China, the largest of these economies, has articulated a strategy of limited

reform, with very little political liberalization and economic reform aimed at creating a uniquely Chinese "socialist-market economy." Other leading former non-market economies, such as Russia, Vietnam, and many of the former Soviet Republics, are similarly reluctant to embrace market principles for organizing their economies.

Nonetheless, most of these reforming non-market economies are now seeking to join international economic institutions, some of which presuppose the existence of a functioning market economy. The most immediate challenge is posed by the effort of many of these countries, led by China and Russia, to enter the World Trade Organization (WTO)—the ultimate rule-based, market-oriented economic institution.

### **I. Non-Market Economies Enter the World Economy**

It has been clear for many years that communism failed to produce rising standards of living and to distribute resources efficiently. Thus, it is not surprising that as countries adopt market reforms they become more prosperous and, ultimately, become larger players in the world economy.

In the 1970s, China was the first non-market economy to begin systematic economic reform. Since that time, the Chinese economy has grown strongly. China is one of the five largest economies in the world and, if growth continues, could be the world's largest economy early in the 21st century. Russia, by some measures, is among the world's top ten economies and several other reforming communist economies, such as Vietnam, have also been growing well. Collectively, these economies are already significant, with a combined annual GDP of over \$5 trillion.

The reforming communist countries are also becoming a force in global commerce. China is one of the world's top ten exporters and its exports have grown at three times the world average for two decades. Vietnam is attempting with some success to emulate China. Russia lags behind, but its foreign trade is now increasing. In fact, all of the former communist countries have experienced foreign trade growth since the end of the Cold War. Already, in sectors from footwear to computers to aluminum production, former communist countries have become major competitive factors.

### **II. The Legacy of Communism**

Unfortunately for the WTO, most of the reforming non-market economies are neither rule-based nor fully market-oriented. Nonetheless, China has sought membership in the trading system for more than a decade and may be closing in on its objective. Russia won a pledge from President Clinton to press for Russian accession in 1998. The arrangements struck with these two will establish the template for WTO membership for other former non-market countries—more than a dozen of which now seek membership.

Both of the leading former communist countries have instituted reforms. Russia has done far more than China in adopting political reforms, but China has probably done more and certainly been more successful in implementing economic reforms. As noted, with regard to economic reform, however, the ultimate objective in the former communist world is not a free market economy and many of the economic policies still held dear directly violate the WTO.

A critical examination of existing economic structures in China and Russia demonstrate many troubling holdovers from the communist system. State-Owned Enterprises (SOEs) still play a prominent role in both countries. Despite several waves of reform rhetoric, China's SOEs account for about thirty percent of the economy. Most of these SOEs are poorly run and require heavy state subsidies far in excess of WTO prescribed limits to survive, but Beijing is unwilling to reduce these subsidies quickly. Beijing's reluctance is understandable, as SOEs employ between one and two hundred million Chinese and appear to provide the majority of jobs in several major Chinese cities. Recently, Russia seems to be inclined to move toward more state ownership, with the government speaking of re-nationalizing industries, such as aluminum production.

Further, in China, subsidies are not limited to SOEs. Other WTO inconsistent subsidies for energy, labor, and some raw materials are provided outside the SOE sector.

Economic planning also continues. China manages its economy through communist-style five-year plans. Chinese ministries are busy drafting industrial plans that rely upon WTO prohibited policies like subsidies, investment requirements, trade barriers, and technology transfer requirements. In recent years, China has issued major new industrial plans for pharmaceuticals and automobiles. Another plan for electronics is imminent and China's industrial ministries are said to be at work on still more plans.

Although it is not just confined to former communist countries, protectionism is also very much a tradition of communism and it is still rampant in China, Russia, and the rest of the former communist world. The Chinese market is protected by a web of trade barriers aimed at ensuring state control and dictating that those wishing to do business in the Chinese market must invest in China rather than export to China. Import demand in many sectors is still set by consultations between government ministries, not the marketplace. Although China has promised to make changes, the government must approve of all imports and exports. None of these policies are permitted under the WTO.

Protectionism in Russia seems to be increasing. Under pressure from the International Monetary Fund, Russia took some steps towards trade liberalization. Recently, however, the Yeltsin government reversed course by instituting a "buy Russian" campaign, launching broadsides at foreign investment, and erecting new non-tariff barriers. In an almost humorous move, the lead Russian negotiator on WTO accession demanded that Russia be allowed to *raise* tariffs upon entry to the WTO.

Piracy of intellectual property is also a widespread problem, which some trace back to communism's refusal to recognize ideas as property. The U.S.-China disputes over protection of intellectual property are well known. Despite some Chinese efforts at better enforcement, industry sources argue that piracy is still a multi-billion dollar industry in China. Less well known is that Russia and several of its former Eastern European satellites appear to be nearly as tolerant of piracy as China.

### III. The Rule of Law

As thorny as these trade barriers will be to address, there is a still more difficult problem: the lack of a rule of law. As the head of China's National Peoples' Congress has argued, China is still a country ruled by strong leaders, not by laws. As many western companies operating in China have found, this means that contracts are not secure, bribery is rampant, and regulation promulgation a mystery. Russia may be even worse, with prominent observers arguing that the Mafia may actually control much of the economy.

The lack of a rule of law has direct implications for the WTO. The experience with China on intellectual property protection is instructive. In 1992, after a heated dispute with the United States, China implemented sweeping legal changes that brought its intellectual property protection laws up to a world standard. The laws simply were not enforced, however, and the piracy industry actually grew manifold after the legal changes were passed. Worse, the Peoples' Liberation Army and provincial government officials appear to be directly involved in the piracy. If a member government cannot enforce its laws upon itself or its citizens, how can it possibly live by WTO rules?

Just as troubling, the WTO's quasi-judicial process is not equipped to enforce rules on a lawless country. Given the enormous system-wide reforms necessary to achieve WTO consistency and the poor record of implementing international trade agreements in China and Russia, numerous dispute settlement actions are likely in the short-term. The sheer volume of these complaints could pose a serious burden to the WTO dispute settlement process.

But there are other serious concerns related to dispute settlement. In both China and Russia, policy often is not set through clearly established laws and procedures. Informal ministry decisions, the practices of corrupt officials, and even Mafia decisions have a more direct impact on business and commerce. Lacking a "paper trail," these practices probably could not be proven before a WTO panel and, even if a case was established and won, the government could well be powerless or unwilling to enforce the decision. If China's recent behavior in responding to human rights complaints in the United Nations is any guide, it could well respond to any effort to force its hand through trade sanctions with the threat of counter-sanctions. The WTO thus might well be unable to apply its rules to these proposed new members.

#### IV. Non-Market Economies in the WTO?

The WTO could gain in power and influence by integrating former non-market economies into its membership. If the WTO could discipline these countries' trade practices and related industrial policies, membership would be a boon to the WTO and its member countries.

If, on the other hand, these countries were allowed to join the WTO with liberal waivers or long phase-ins, the reforming non-market world could become free riders on the trading system. Especially given that China is an extraordinarily successful participant in international trade, these free riders could break the system. Other WTO members would justifiably complain about being held to standards from which China and Russia are exempt; the consensus in support of the WTO and mutual free trade would likely suffer. As the U.S. political process has recently demonstrated, protectionism could easily rear its head in even the core WTO members.

Perhaps even worse, if these countries were brought into the WTO and the WTO proved unable to police international trade with them, its credibility could suffer still more. All of the world's aspiring protectionists would be provided a case study in how to break the rules with impunity.

In the longer term there are other serious worries. China has made it clear that it wants to join the WTO to have a role in writing the rules for the future. Given that China and other former non-market economies do not seem to share western assumptions about the desirability of the market and free trade, they are likely to oppose stronger trading rules on investment, services, or the other areas where the WTO hopes to make further progress. History has demonstrated that individual countries that wish to slow progress can halt trade liberalization for years. India and Malaysia provide strong recent cases in point. Injecting another dozen or so potential foot-draggers could indefinitely stymie the WTO.

Of course, the world trading system has been dealing with difficult countries for many years, but the creation of the WTO was a major step forward. Many of the special treatments for these outliers have been eliminated. At the same time, economic reform has become more popular in domestic politics in India and other trade laggards. At this point, attempting to integrate a group of countries into the WTO that does not aspire to free trade and that the WTO is ill-equipped to deal with would, at best, multiply existing problems and, at worst, erase much of the hard won trade progress.

#### V. Associate Membership

The choice, however, need not be so stark. It may be possible to integrate the one-time communist world into the WTO in a way that will strengthen, not weaken the WTO. This would require an innovative accession process, rather than a simple phase-in or a set of waivers.

There are some precedents for such an innovative process. At the height of the Cold War the GATT attempted to integrate several non-market economies—Poland, Romania, and Hungary—into its membership, but faced many of the same seeming incompatibilities discussed above. The problem was addressed through a combination of special measures enabling other countries to protect against state-subsidized competition, special guarantees of export access for other WTO members, and a general safeguard provision to allow the withdrawal of trade benefits if the non-market economies failed to reform.

Many of these same provisions, notably the general safeguard, could appropriately be applied to China, Russia, and other reforming economies while they reformed SOEs and took other steps over a period of perhaps many years to make their economies fully consistent with the WTO. These countries' participation in ongoing negotiations also would be limited until economic reform was completed. Except for the just listed limitations, the transitional economies would gain all other benefits of membership. This approach would strike a balance between compliance and benefit levels, and encourage further reform to gain further benefits.

Hopefully, once economic reforms were fully adopted, these countries may also become more open to further trade liberalization—though this is admittedly an open question.

Under the best of circumstances, however, the road to full integration will be bumpy. The remnants of communism and the lack of a reliable rule of law will pose numerous problems that defy easy solutions. In addition to the associate member status just described, attention must be given to implementation, if the integrity of the WTO is to be protected. To ensure attention, the WTO should establish special accession working groups to continuously monitor trade reforms and trade flows with the transitional economies. Hopefully, this monitoring could head off problems before they become crises. This approach is far preferable to using the normal complaint-dispute settlement process, which is unlikely to be practical or effective.

## VI. Conclusion

The claim that the Cold War is over has been repeated so often that it is accepted without much debate. The reality, however, is that although the Cold War as a potential military conflict is over, many of the issues raised by the decades long struggle between communism and capitalism remain unresolved. The most important problem remaining is how to integrate these former communists into a global, market-based economy. The most complex step in that integration is accession to the WTO.

To accomplish this, a balance must be struck between the desire to bring these countries into the WTO and the need to enhance the WTO's status as an effective policeman of global trade. This balance can be struck, but it is only possible if

a creative approach, like that described herein, is used to integrate former non-market economies into the WTO.

\* \* \* \*

*JAMES D. SOUTHWICK:* In considering the future challenges for the WTO, the challenge of addressing trade barriers arising from non-transparent, restrictive government-industry cooperation, as occurs in many sectors in Japan, stands out as a particular problem. Clashes between the United States and Japan over this type of barrier in recent years have already put the WTO under strain. Unfortunately, there appears little prospect for avoiding disputes over this type of issue in the future, and, after the result of the WTO film case, little prospect for resolving this type of dispute in the WTO.

Of course, the film case was but one of many GATT and WTO disputes between the United States and Japan, many of which have ended favorably for the United States. For example, the U.S. prevailed in the two alcoholic beverages cases against Japan, and in cases on a variety of primary products, such as beef and citrus, and leather. The barriers involved in these successful cases, however, were easily identifiable border measures or internal taxation. In contrast, in numerous industrial sectors giving rise to U.S.-Japan trade tensions, the barriers consist of restrictive market structures and business practices, often fostered or sheltered by facially neutral Japanese government measures, actions, or inaction, and rarely if ever recorded in a manner allowing easy proof of their existence before a panel.

Difficulty in gaining access to Japan's distribution system is a common example of this problem, and the basis of many U.S.-Japan trade disputes this decade.

For example, in 1992 the United States and Japan went through a contentious dispute over the paper and paperboard sector, in which the key issue was access to the distribution system. The two governments reached an agreement that aimed to help foreign industry bypass the distribution system. The Japanese government agreed to give "administrative guidance" to major purchaser groups to purchase directly from foreign firms. Tension arose again in 1995, when it appeared that the agreement was bringing little headway in the market for foreign firms. Although the U.S. government listed this sector as a priority area of concern with Japan, the United States in the end took no further action, and the agreement expired in 1997 having achieved little.

A similar case arose in the flat glass sector in 1994. Here again, the basic problem was lack of access to the distribution system for foreign flat glass suppliers. After the United States threatened sanctions, the United States and Japan reached an agreement in 1995, under which the Japanese government issued formal notices to the distributors of their rights to deal with competing suppliers. The two governments agreed to detailed data gathering to closely monitor and bring pressure for a more open distribution system. The results of this agreement have been largely unsatisfactory.



Later in 1995, tensions between the United States and Japan approached a boiling point in yet another sector where distribution issues were a central concern: the automotive sector. One of the key U.S. concerns in these talks was access to Japanese dealerships for foreign cars. Dealerships, of course, are the distributors for cars. A second issue involved access to the Japanese market for replacement auto parts, the so-called "after-market". The problem in the after-market was, again, gaining access to the primary distributors for after-market parts. Also, restrictive regulations on inspections and certification of repair garages suppressed the developments of large automotive repair service store chains that could be an economical alternative route to market for foreign parts suppliers. The United States threatened Japan with \$6 billion in sanctions over these issues, which were averted when the U.S. government reached agreement in June 1995. Results under the agreement have been mixed.

The film case was the next in the series of these distribution disputes. Here, the main issue was access for foreign suppliers to the primary distributors of photographic film and paper. In addition, parallel to the auto parts after-market case, restrictive laws and regulations in the retail sector suppressed the best alternative to market and source of competition for the distributors: large-scale retail stores. In the film case, of course, the United States brought the matter to the WTO, rather than pursuing a bilateral action.

In each of these cases, the Japanese government took the view that access to the distribution system was not a matter of Japanese government responsibility, but rather a case of private market structures in which it would be inappropriate to intervene. In several of the cases, the U.S. government pressed Japan's competition authority, the Japan Fair Trade Commission (JFTC), to look into the matter.

The JFTC's reaction was, first, to resist the pressure as an inappropriate intrusion on its prosecutorial discretion. Second, when it finally took action, the JFTC chose to use voluntary surveys, rather than formal investigations utilizing its compulsory powers for gathering evidence. Not surprisingly, in each case, the JFTC found no clear antitrust violations. On the other hand, in each case it did find some practices of concern. However, it addressed these concerns by issuing weak advisory suggestions to industry. The result was a perfect defense against foreign pressure: there was no antitrust violation and therefore no basis for the U.S. to complain; but, to the extent there perhaps were some problems in the market, those problems had been addressed through the nonbinding administrative guidance, and it would take time to see the resulting changes in the market. Unfortunately, time has brought little change in any of these markets.

It might be tempting for a skeptic to argue that if there is no proof of an antitrust violation, perhaps there is no barrier in the distribution system. However, any experienced observer of Japan knows that even the Japanese government admits to inefficiencies, multiple layers, and other difficulties in its distribution system. Lack of access to that system has been a central thrust of U.S. policy toward Japan since the 1970s, and it currently is a main theme of Europe's trade policy

with Japan. It defies credulity that the rest of the industrialized world could have been wrong for over two decades about the market access barriers in the Japanese distribution system.

The WTO film case presented the argument that the Japanese government actively worked to create and maintain these restrictive distribution structures. The case did not rest on antitrust theory, or on the failure of Japan to enforce its antitrust laws. Rather, the United States argued that the Japanese government worked closely with Japanese industry, through formal and informal means, to establish and protect restrictive market structures. The panel did not find the U.S. evidence sufficient.

The film case leaves a dilemma in dealing with market access barriers in Japan. Perhaps in another case, a complaining party would do better to convince a panel of the Japanese governments' responsibility for helping to create informal or nontransparent market access barriers. However, the difficulties of researching and proving such a case are formidable, especially since the evidence may not involve the type of clear and formal government measure that WTO panels are used to. Moreover, distribution barriers are not the only type of informal, nontransparent barrier in Japan. Other types of market structures, industry practices, and government-industry interactions are likely to continue limiting market access, and these barriers will be difficult to address in the WTO.

At the same time, bringing increased attention to competition policy in the WTO will do little to address the distribution problems and similar market access barriers in Japan. Japan's anti-monopoly law has adequate rules on vertical restraints, but applying those rules in Japan—as in the United States—involves subtle analysis of economic and market conditions that are not easily reduced to simple and clear international rules. The need for discretion by each national antitrust authority will continue to be essential, and foreign companies and governments are likely to continue being frustrated at the JFTC's unwillingness to aggressively pursue distribution cases or other types of cases limiting foreign market access to Japan.

In short, the world trading community faces a dilemma in Japan. One may hope that the current economic challenges will lead to new thinking about the need for structural change toward more open and competitive markets. But if that hope fails, it may be difficult to find other means to address the fundamental imbalances that have existed for decades as a result of barriers in one of the largest markets in the world trading system.

\* \* \* \*

**QUESTION AND ANSWER SUMMARY:** James Southwick commented that the *Japan—Film* case exemplifies an important future challenge to the WTO concerning *keiretsu* and other similar relationships between government and industry. Access to distribution networks in Japan is a subset of this larger problem. Structural problems concerning access to Japan's distribution networks have been a

major issue for years and have been at the heart of disputes between the United States and Japan as well as between the European Union and Japan. This issue is a central theme in current bilateral discussions between the European Union and Japan. Disputes over automobiles and automobile parts, flat glass, and paper and paper board all were essentially about access to distribution networks. Further, disputes over access to distribution networks in Japan are not going away.

What makes access-to-distribution disputes so difficult is the inability to pinpoint actual trade barriers. In the wake of the *Japan—Film* case, Southwick is skeptical that other countries will confront Japan on this issue in the near future. Challenging Japan's distribution system in the WTO requires a great expenditure of funds and human resources.

Southwick discussed two possible options for dealing with Japan's distribution network system. One option is to resort to the traditional approach of imposing unilateral sanctions. However, Southwick described that option as problematic. A second option is to put trade and competition policy on the WTO agenda. However, Southwick was equally skeptical about the prospects for this option. Southwick observed that during the Bush Administration, the Japan Fair Trade Commission had agreed to study foreign producers' lack of access to markets in certain sectors, including flat glass, automobiles and auto parts, and paper and paper board. The Commission studied these areas and issued reports, but failed to come up with any solutions. Southwick noted that a very high threshold must be overcome before the Commission will act.

Brian Murphy agreed with comments concerning built-in opposition to rule of law in Russia. He observed that in his experience working for USAID, Russian officials pay a good deal of lip service to rule of law, but do not observe rule-of-law principles in practice. Greg Mastel responded that development of a rules-based system in the WTO is a key goal for the future, but in approaching that goal, it is important to appreciate the size of the obstacles ahead, including those noted by Murphy.

It was observed that both the European Union and Japan have stated publicly that they favor China's early accession to the WTO. That position appears to differ with the official position adopted by the Quad. The questioner asked for an explanation of this apparent gap. Charles Roh responded that there probably is not a true gap. In fact, all the major WTO players say that they are enthused about China's eventual accession, as long as it is done on "the right terms."