

Is China Playing By the Rules? Free Trade, Fair Trade, and WTO Compliance
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Written Testimony of
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Mr. Chairman, Mr. Co-Chairman, and Members of the Commission:

Thank you for the opportunity to testify before you today. I am a Professor in the Department of Government and Politics at the University of Maryland. I have been researching and teaching on China's politics and economy since the mid-1980s, first at Dartmouth College and now at the University of Maryland. One of my areas of expertise is China's participation in the World Trade Organization (WTO).

In my testimony today I wish to address two issues related to China's rule of law development, which is of course a core part of the Commission's mandate. The first half of my comments addresses the implementation of China's WTO-related rule-of-law commitments as they are carried out in *domestic* legal arena. The second part of my testimony addresses China's adherence to *international* standards in its participation in the WTO in Geneva and related meetings, with particular attention to the recent WTO Ministerial in Cancun.

I. Uneven Progress on China's WTO-Related Rule of Law Commitments

On the first topic – domestic rule of law commitments – I will focus my attention on two subjects: promulgation of rules required by China's WTO accession documents, and development of mechanisms and norms of transparency. I give some attention to where we are in “year two” of China's membership, but remain cognizant that the real and enduring processes the Commission is interested in require we think with a longer-term metric in mind.

My basic assessment, which I believe is consistent with that of many scholars and practitioners who follow legal developments as they relate to WTO, is that the trends in these areas have not changed much since the Commission issued its Annual Report for 2002. It remains the case that over the past decade China has made great strides in strengthening many aspects of its legal system, including as this system applies to WTO compliance. Despite substantial progress, however, there is no question that China has a long way to go toward fulfilling its commitment on rule-of-law related issues. Its ability to do so routinely will depend on continued evolution of the overall move toward rule of law in the legal system as a whole.

With regard to the promulgation of rules required by China's accession, as has frequently been noted, the Chinese government has established or revised many laws committed to in its WTO accession agreement.^[1] Still, we continue to await promulgation of many rules for specific industries. Even where broad laws have been promulgated, detailed implementing rules on market access for foreign firms have not appeared. For example, in year two (by December 11) China's WTO accession agreement mandates that several sets of regulations on services be promulgated, but it is not clear that they will be ready.^[2] More generally, the pace of law-making and revising has slowed substantially compared to two years ago. This slowing is in part because much already has been done, but it also reflects the fact that more difficult and controversial areas are being approached. As time passes, moreover, domestic economic constituencies have mobilized themselves, often in the form of industry associations, and have erected protectionist barriers. Furthermore, new rules that erect new trade barriers, such as on genetically-modified organisms (GMOs) and other sanitary and phytosanitary concerns, are being issued. Not all will be judged WTO non-compliant, but some certainly will.

The issue of transparency has received significant attention from the Commission. China's WTO commitments speak explicitly to the issue of transparency by requiring that all regulations related to its WTO commitments be published promptly and in official accessible venues, and that prior to promulgation they be published in draft form and subject to public comment (including by foreign interests).[3] In this realm of administrative law and procedure, the Chinese government has made progress in encouraging that laws are published, transparent, promulgated only after some public comment period, and so forth. Prompt publication of formally issued laws has proceeded especially well; one hears of fewer and fewer instances where foreign businesses are told of an internal (*neibu*) regulation or administrative circular that they must abide by yet may not see. There continue to be more instances where drafts have been circulated for public comment with sufficient (if still short) time to receive comment. Some regulatory agencies – notably the China Securities Regulatory Commission – seem quite committed to these procedures.

Nevertheless, many of the same gaps the Commission found in its 2002 Annual Report remain. In particular, the adherence to the public comment commitment is uneven.[4] Too often, binding rules that significantly affect market access are issued without opportunity for comment, as occurred this year with the 2003 Telecommunications Service Classification Catalog.[5] Draft rules continue to circulate without a mechanism for formal comment.[6] Sometimes drafts are circulated only among a few companies (foreign or domestic), often just those former government monopolies with close ties to the regulator. Public comment periods, even when offered to a broad range of Chinese and foreign companies, are often too short. Many observers had also hoped that the WTO-based requirements for transparency also would help open the policy formulating process to greater scrutiny, though this is not mandated by WTO. There continues to be disappointment on this front as well.

China has committed to these transparency norms and to the promulgation regulations that enshrine the principles of market access and national treatment. Difficulty in adhering to these commitments cannot be excused. But the difficulties can be explained. To what, then, can we attribute this continued slow implementation? At this point, substantial education of officials – funded by the Chinese government and foreign public and private sources - has been completed. It is no longer compelling to attribute the gaps to a lack of understanding.[7] Several explanations are more compelling at this juncture. First, there continue to be poor coordination mechanisms between the myriad agencies that often must be involved in the promulgation of any new rules. Indeed, while there is often a lead agency for drafting, another agency or set of agencies may do the issuing of the rule. Poor ability to coordinate internally can easily spill out to poor coordination on the external comment requirements. Bureaucracies may shy away from public comment and prior notice, even though they are not required to do anything with the comments, because they complicate the internal negotiations and bureaucratic wrangling that accompanies the promulgation of many new rules.

A second structural obstacle to implementation of rule of law obligations is the ongoing administrative reorganization. I refer not merely to the immediate past reorganization following the National People's Congress in March 2003,[8] but more generally the longer term establishment of new regulatory agencies and re-division of authority between existing ministries, bureaus, etc. The administrative lines of authority remain unclear and poorly institutionalized, and continue to make the rulemaking process quite contentious.

Finally, the norm of transparency, though gaining ground domestically, is not yet reflexive. Not until the norm is fully grounded in domestic law will it become an entrenched part of the domestic legal and administrative landscape. The promulgation of an Administrative Procedure Law, now in draft form, is expected to lay out detailed procedures that administrative units must follow, including procedures to enhance transparency.[9] A similar slow process appears to be underway with regard to establishment of independent judicial review of WTO-related administrative actions.[10]

Thus, while it is still possible to point in year 2 to progress in the rule-of-law domain, the unevenness that has been present throughout the compliance process remains. The continuing unevenness, deadline missing,

and so forth, is generating greater anxiety and disappointment in the foreign community than it was a year ago, as it appears that these problems are in danger of becoming a permanent part of the implementation process and not merely a reflection of first-year missteps or even leadership transition and SARS. Goodwill is dissipating among many foreign observers and business interests.

Amidst this frustration, it is worth repeating that deep and enduring progress on many of the rule of law issues of concern to the Commission – not just as regards China’s WTO compliance, but also more broadly reform of legal procedures and processes, improvement in transparency, establishment of an independent judiciary, and so forth – are, and will continue to be, driven foremost by internal processes. By internal processes I refer primarily to the development of domestic constituencies, either within or outside of the government, with an interest in seeing deep rule of law oriented reforms. Such reforms can be encouraged and fostered by WTO compliance efforts, but except insofar as they support the development of domestic constituencies, they will contribute primarily at the margins. I am optimistic that there will be improvement over the medium term on these issues, but as a result of domestic trends that both pre-dated and go much deeper than China’s WTO implementation.

II. China’s Adherence to International Standards in the WTO Process in Geneva

The second issue I wish to address brings a different perspective to rule of law issues than has been addressed previously in this forum. This perspective examines China’s activity in WTO in Geneva and at related international meetings, including the WTO Ministerial in Cancun two weeks ago.

Prior to China’s becoming a member of the WTO, the question was often raised in Washington and elsewhere as to whether China would become a “revisionist” power in the WTO, attempting to change the rules and challenge the norms by which it operated. At that time, I argued that based on China’s behavior in other multilateral economic institutions, China was unlikely to be a revisionist power but, rather, would in most cases “play by the rules.”^[11] Now that China has been a member for nearly two years, it is useful to evaluate its actual behavior in Geneva.

Prior to engaging in an assessment, however, it is important to highlight a distinction about the use of the term “cooperation” as applied to China’s WTO behavior. We must be careful not to conflate the notion of “cooperative behavior” with “adherence to the agenda of the United States.” We may strongly prefer that China’s agenda in the Doha Round decisions be aligned with those of the U.S. government. But cooperative behavior in the WTO must be measured in terms of whether a country abides by the rules and norms established by the organization as a whole. In other words, does China adhere to the “rules about rules” of the organization?^[12] It is useful to keep in mind, for example, that some of the closest political allies of the U.S. may pursue agendas in some areas of the WTO that are quite inconsistent with our own. Hence, a huge number of disputes brought to the Dispute Resolution Mechanism in Geneva involving the U.S. also involve many close political and trading partners. At the level of day-to-day negotiations, then, “cooperation” cannot be defined by an absence of conflict with other nations, since conflict over trade interests is assumed and built into the process. Moreover, coalitions shift from issue to issue.

In the PRC’s first year of membership in WTO, we can conclude that it did not pursue a revisionist agenda.^[13] There are two major exceptions, discussed below, that cut at core issues of Chinese sovereignty. Yet the answer to whether China has been a “cooperative” power in the WTO is, by and large, “yes.” The Chinese delegation has made no effort to change the conservative consensus rules of the WTO. The informal processes to which the consensus rules give life are also accepted, notably the norm of non-interference in issues where a country’s core interests are not involved. (In this, China’s behavior can be contrasted with that of India.) China has welcomed the expectation of other countries, including the U.S., that it should be – must be – an active participant in major WTO decisions, whether made formally or informally. China has made several moves to help give developing countries more voice, but except in the case of the meetings earlier

this month in Cancun, these moves have not been particularly disruptive. And in all these moves China has been much more a follower than a leader.

China for the most part has not made its presence strongly felt in Geneva, moreover. The PRC delegation has spent considerable energy coming up to speed on the rules and norms of the organization, as well as on the TRM process, as discussed below. The delegation remains small and understaffed, and thus lacks capacity to pursue an aggressive agenda across. Moreover, domestic consultative arrangements have not been established to allow for the formulation of a cohesive trade policy, further hindering the ability to act aggressively within the WTO.

Despite this overall pattern of cooperation, there are two issues on which China can be judged as conflicting fundamentally with WTO rules, norms, and expectations: Taiwan's membership, and the TRM. These issues are perceived in China as impinging on the PRC definition of a sovereign concern, and as a result China treats them in more rigidly category.

Taiwan became a WTO member just following China's accession. The PRC's treatment of Taiwan's membership echoes its behavior in other multilateral institutions, although it is perhaps in some ways less rigid. At times members of the PRC delegation have been willing to meet informally with their Taiwanese counterparts (as in APEC, for example), and has dealt with the Taiwanese delegation in formal settings (such as responding to questions from Taiwan in the TRM context. More routinely, though, the PRC has broken the WTO norms for dealing with other members, notably using Chinese in communications rather than one of the official languages of the WTO, insisting on meeting in hotels rather than in the Geneva organization's buildings, and frequently refusing or canceling scheduled consultations on trade issues. The PRC delegation also has conflicted with the Taiwanese delegation with regard to issues of nomenclature and the status of the Taiwan mission. The effort is to ensure that reference to Taiwan's membership in the WTO not imply sovereignty for Taiwan. Most recently, in the spring of 2003, the WTO Director-General Supachai Panitchpakdi approached the head of the Taiwan delegation and, in essence, requested Taiwan to accept a downgrading of its status from "permanent mission" to "office of permanent representative," and to affirm that the actions regarding WTO representation of Taiwan have no implications for sovereignty. The PRC appears to have been working through the lead agents of the WTO in an attempt to lend legitimacy to its pressure.

The Transitional Review Mechanism (TRM) is a process established in China's accession protocol (and is unique to China) to review annually China's progress in implementation for the first eight years of membership.^[14] The TRM is enormously unpopular in China. It is a focus point for PRC concerns about national humiliation and sovereignty, all the more aggravating because Chinese leaders agreed to submit to it. It also is evocative of the annual most favored nation status debate in the U.S. Congress during the decade prior to China's WTO admission. However, unlike the MFN debate, China has a direct role in the TRM process and is therefore positioned to be much more defiant.

It was in this context that the first TRM review occurred a year ago, in the fall of 2002. Under pressure particularly from the U.S., discussion of problems with PRC compliance was initiated several months prior to the formal review scheduled to take place in December. The PRC's formal response was threefold: compliance issues should not be brought up significantly before the formal date of the review; China would respond to the issues raised, but only to the letter of the law and as such would only provide oral answers; and other discussions about compliance should take place in informal and/or bilateral settings. The debate was acrimonious. As China resisted giving full answers it became subject to much criticism. This left a bitter taste in the mouths of many in the foreign trade bureaucracy. It is likely that the PRC will explore ways to minimize the impact of the TRM in the current and coming years. I will come back to this point subsequently.

With the exception of these two sovereignty-regarding situations, though, the PRC's behavior in Geneva cannot be judged to be revisionist or uncooperative. Indeed, U.S. officials were hopeful for cooperation on a range of issues. With regard to one major issue on the Doha agenda, agriculture, Chinese trade officials had expressed publicly and privately that cooperation with the US was quite possible on the proposal Ambassador Zoellick and Secretary Veneman put forward last year.

It was thus contrary to expectation that China might join what is now known as the Group of 22 developing countries in putting forth a counterproposal to that of the EU and the U.S. at China's first ministerial meeting in Cancun earlier this month.^[15] In large part as a result of the stalemate between the two blocs, the meetings failed to produce an agreement on modalities for further agricultural negotiations. The main complaint of developing countries was that the working draft did not go far enough to commit to cuts in agricultural subsidies by developing countries, while at the same time asking for tariff reductions by (and with only a modicum of "special and differential treatment" for) developing countries. Developed countries have argued that the developing countries cannot expect the developed countries to make all the compromises, and that a breakdown in negotiations does not further the agenda of the developing countries, which need progress on agricultural negotiations more than the wealthier agricultural nations.

While the internal PRC dynamic leading up to China's participation in the coalition is not yet fully clear, greater clarity can be shed on what occurred from the PRC point of view. China, which agreed in its own WTO accession agreement to lower tariffs, subsidies and supports than virtually any other country, is in the process of defining its own agricultural trade interests.^[16] The Chinese government is pinning increasing hopes on agricultural exports – primarily to its Asian neighbors that maintain high agricultural tariffs – to help ease rural poverty and unemployment. In this, it shares interests with the U.S. and Cairns Group, as well as a number of developing countries (but not India). It also has an interest in leveling the playing field in subsidies, which it claims it cannot afford. Its concrete interests therefore are split between a developing and developed country agenda.

How, then, should we assess China's membership in the Group of 22? First, China's willingness to join with developing countries on this issue is an important stand, and does lend weight to the developing agenda. Previous efforts to solidify a development agenda in agriculture did not get far, and China's entry into the fray is certainly part of the reason for the greater hearing to the development agenda in WTO. Having said that, China's role in this coalition was to lend support, but not to lead it or attempt, in rhetoric, to make the discussion more vituperative. The initiative for the coalition lay clearly with Brazil and India, notwithstanding the fact that China's name appeared routinely in articles on the coalition. Indeed, it has appeared quite aloof. China's delegation to Cancun, led by Minister of Commerce Lu Fuyuan, did not seek headlines. Lu's comments to the media conference where the G22 made its major statements were much more conciliatory than those of other participants, saying China "*hoped* the Ministers would *consider* the G21 text even as they are considering the Chairman's draft" (emphasis added). In contrast, for example, the Argentinean Minister said the paper "must" be accorded the same basis as the chair's text, while the Brazilian Foreign Minister stated that it was essential that the group's paper be taken as a basis for negotiations.^[17] As discussions among ministers were becoming particularly fractious, moreover, Lu intervened to point out that stalemate (which of course eventually occurred) was in nobody's interest.^[18]

Moreover, China's media has barely reported the activities of China in the G22. The reports that have appeared have been descriptive and factual. No major analysis of the coalition and China's concrete role in Cancun has appeared in the press. No effort is being made to undermine the legitimacy of WTO processes, or to promote the idea that China is a developing country and working against the interests of the U.S. and EU^[19]. The key message is that China hopes to play a cooperative role in moving negotiations along in the future.

China therefore has positioned itself, as in past statements in the WTO, to serve as a “bridge” between the developing and developed country agenda. Such behavior has more than a diplomatic function; it also allows China to maneuver in the future within the complex agenda, not having burned any bridges, to best meet its evolving view of its agricultural trade interests. Its doors are still open to diplomacy from *all* sides. In other words, it allows the government maximum flexibility in its ability to form coalitions. This is quite consistent with China’s behavior across a range of multilateral institutions. In addition, there is a bilateral function to be served. Despite substantial bilateral tensions with India, both countries are trying to move ahead with international cooperation. Brazil and China, too, have made efforts to shore up their relationship in recent years. China’s responsiveness to their initiatives is likely to have played a part in the PRC receptiveness to the coalition. Moreover, as China faces another TRM round in the fall, it can perhaps leverage its support for the cause of the developing world into support for its own efforts to shape the TRM process.

Returning to the fundamental question of this portion of my testimony, while China’s behavior was inconsistent with the position the U.S. took at Cancun, its actions were well within the scope of legitimate actions in the WTO – they did not breach dominant accepted norms. China’s position reflects the complexity of the situation and its own evolving interests. Rather than closing the door to cooperation with any side, it remains open to conciliation.

[1] In 2000-2002, China’s governmental agencies went through a massive review process aimed at determining which of China’s regulations were WTO-compliant. In May 2002 China’s Ministry of Foreign Trade and Economic Cooperation (now part of the Ministry of Commerce) announced that more than 2,300 laws and regulations had been amended to comply with WTO rules, and 830 additional laws and regulations had been abolished.

[2] For example, the WTO mandates the promulgation of regulations on direct selling services by December 11, 2003.

[3] The Commission ably summarized these requirements in its 2002 Annual Report (p. 47).

[4] One recent example that has received much attention is that when China revised its auto policy regulations it did not issue the drafts publicly or provide foreign companies an opportunity to comment.

[5] The catalog was posted on the Ministry of Information Industry website with an effective date two weeks following release and no vehicle for soliciting comment. This catalog is crucial because it classifies telecommunications services into basic services and value-added services, a distinction of great importance to foreign firms because, for example, the former category is much more protected than the latter.

[6] This has been reported with regard to draft laws on retail, franchise and direct selling. See US-China Business Council, “China’s WTO-Implementation: A Mid-Year Assessment” (US-China Business Council, 2003).

[7] This is not to say that much can be done to build capacity in important areas – notably in the areas of judicial review and enforcement of regulations.

[8] The most pertinent example is the combination of the Ministry of Foreign Trade and Economic Relations (MOFTEC), which has lead responsibility for many aspects of WTO implementation, with the State Economic and Trade Commission (SETC) into a new Ministry of Commerce.

[9] On the importance of incorporating China's WTO obligations in domestic law to be fully authoritative, see Donald C. Clarke, "China's Legal System and the WTO: Prospects for Compliance," *Global Studies Law Review*, 2003.

[10] On independent judicial review of WTO-related administrative actions, I refer the Commissioners to the study by Veron Mei-Ying Hung, "China's WTO Commitment on Independent Judicial Review: An Opportunity for Political Reform," Working Paper Number 32 (Washington D.C.: Carnegie Endowment for International Peace, November 2002). Hung discusses the moves made toward establishing independent judicial review by basing it on the Administrative Litigation Law, but also notes the political constraints in achieving such *independent* review that can only be solved in the longer term and as a result of broader political reforms.

[11] Margaret M. Pearson, "China's Track Record in the Global Economy," in *China Business Review*, 27:1 (January-February, 2000): 48-53.

[12] A classic statement of this metric is Abram Chayes and Antonia Handler Chayes (1993), "On Compliance," *International Organization*, Vol. 47, Issue 2 (Spring), pp. 175-205.

[13] A longer version of this analysis, for the period up to June 2003, is Margaret M. Pearson, "China's Multiple Personalities in the WTO," in *New Trends in the Study of Chinese Foreign Policy*, edited by Alastair Iain Johnston and Robert Ross (manuscript pending review).

[14] All members are subject to a periodic "Trade Policy Review" (TPR) of their trading practices, a review that takes place within the Secretariat office. Reviews of China are not only more frequent than for other governments (compared for example to biannually for the U.S. and EU) but also involve multiple functional councils. This "WTO-plus" commitment was established as a response to the fact that China was to be admitted prior to its full compliance with the terms of membership set for it. See Paragraph 18 of the accession protocol.

[15] The WTO's Fifth Ministerial Conference was held September 9-14, 2003, in Cancun Mexico. The major substantive item on the agenda was decision on the framework for modalities for agriculture negotiations in the Doha Round. The working draft to be considered as the basis negotiations was the text submitted by the General Council chairman, Uruguay Ambassador Carlos Perez del Castillo. This draft was seen by the G22 as too close to the draft the U.S. and EU had agreed to several weeks earlier, and ignored concerns raised in a draft paper submitted in response by the group in August.

[16] China agreed in its accession agreement to reduce average tariffs on agricultural imports to 15% by January 2004, to domestic supports of no greater than 8.5%, and a reduction of export subsidies to zero upon WTO entry. These agreements are summarized in Nicholas Lardy, *Integrating China Into the World Economy* (Brookings Press: 2002).

[17] Statements given at the September 8, 2003 media event are reported in Martin Khor, "Developing Countries Prepare for Agricultural Battle at Cancun Ministerial," TWN Report, September 9, 2003. The number of countries in the coalition changed over the course of the meetings from 20, to 21, to 22 – hence the differing monikers (G20, G21, and G22).

[18] Peter Wonacott and Neil King, "China Moves Quietly to Push Trade Goals: Beijing, Balancing Needs to Its Farmers, Factories, Treads Softly at WTO Talks," *Wall Street Journal*, September 15, 2003.

[19] See for example reports appearing at:

www.people.com.cn/GB/jingji/1037/2085439.html;

www.chinanews.com.cn/n/2003-09-12/26/345847.html;

www.chinanews.com.cn/n/2003-09-04/26/342800.html;

www.china.org.cn/chinese/EC-c/401659.htm;

www.china.org.cn/chinese/2003/Sep/403738.htm;

finance.sina.com.cn/g/20030917/0753448722.shtml; PRC to Support Future WTO Talks; Promote Interests of Developing, New Member Nations," Xinhua (English), Sunday, September 14,2003.