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# CHINA AND THE WORLD TRADE ORGANISATION: TOWARDS A BETTER FIT

PETROS C. MAVROIDIS AND ANDRÉ SAPIR

China's accession to the World Trade Organisation in 2001 was hailed as the natural conclusion of a long march that started with the reforms of Deng Xiaoping in the 1970s. However, China's participation in the WTO has been anything but smooth. Its self-proclaimed socialist market economy system has alienated its trading partners. Two diametrically opposite approaches have been proposed to deal with the emerging problems. One is to demand that China changes its economic regime. The other is to stay idle and accept that the WTO must accommodate different economic regimes, no matter how idiosyncratic. In this paper, we argue that there is a more promising third way. In our view, the problems posed by China arise from the fact that, while in the past the GATT/WTO had to address the accession of socialist countries or of big trading nations, it never had to deal with a big, socialist country like China. In order to retain its principles while accommodating China, the WTO needs to translate some of its implicit legal understanding into explicit treaty language. We advance specific proposals to this effect.

**JEL Classification:** F13, K40, P20

**Keywords:** WTO; China; Socialist market economy; Protocol of accession; Liberal understanding

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## 1. Introduction

On 11 November 2001, the day after the World Trade Organisation (WTO) membership unanimously approved the admission of China to the organisation, Mike Moore, the WTO Director General, said that the day would be remembered as *“one of the most significant events of the 21st century for China, the WTO, and the world.”*

This view was shared widely. In Washington, in a statement welcoming China into the international trading system, then US President George W. Bush said *“we look forward to the great benefits we know that greater trade will bring to all our peoples”*. In Beijing, the government newspaper, *The People’s Daily*, proclaimed in a front page editorial, that *“this is a historic moment in China’s reform and opening-up and the process of modernisation.”*

China’s achievements since it joined the WTO have been truly remarkable. In 2001, it was the sixth largest exporter of goods in the world (fourth, if the European Union is counted as one). By 2009, it had become the world’s largest exporter, surpassing the EU bloc as of 2014. China’s rapid export growth has been accompanied by rapid growth in production and income. Between 2001 and 2016, its GDP (gross domestic product) at PPP (purchasing power parity) in constant 2011 international dollars, multiplied by a factor of five, and, as a result, its economy, from being roughly the size of France and Germany combined, has now surpassed the United States. At the same time, it has moved rapidly up the ranks in per-capita income terms, from the level of Sudan in 2001 to the level of Brazil in 2016. And it is still growing, of course.

Accession to the WTO has certainly been a decisive factor in this success story. The rapid emergence of China as the world’s largest producer and exporter of (mainly manufactured) goods, though generally welcome, was also bound to create tensions with trading partners, and the trading system as whole. Tensions have been especially acute in the case of China, for three distinct reasons.

First, soon after China joined the WTO, the world economy was hit by a global financial crisis and a recession, which affected China and its main trading partners very differently. During 2008 and 2009, the European Union, Japan and the United States suffered cumulated GDP contractions of, respectively, 3.5, 6.5 and 2.6 percent, while China’s GDP expanded by 18.8 percent. And though many consider that China saved the world from a much deeper recession by expanding its internal demand, others see this period as a turning point, when China decisively overtook some advanced economies in terms of production and economic power.

The second reason is the state of the world trading system itself, and its difficulty in adapting to the new economic and political reality. At its creation, in 1947, the General Agreement on Tariffs and Trade (GATT) had 23 signatories, but two clearly dominated the system: the United States and the United Kingdom. These two countries were the dominant players until the Kennedy round. Over the years, the number and heterogeneity of signatories expanded a great deal, but the system remained dominated by a small group of like-minded Western countries, the ‘Quad’ – an informal group comprising of the trade ministers of Canada, the European Union, Japan and the United States, which met at least once a year starting in 1982. The Quad steered the world trading regime to the successful negotiation of the Tokyo and the Uruguay rounds. These two rounds completed the tariff agenda, by reducing tariffs to insignificance (almost), and laid the groundwork for negotiations on non-tariff barriers (NTBs). Soon after the WTO was established in 1995, and with the rise of emerging countries, the ‘old Quad’ was replaced by a ‘new Quad’, now comprising the European Union, the United States, Brazil and India. Later on, China joined the group, at least on some occasions, and has been increasingly involved in all important questions.

The GATT was remarkably successful in eliminating import and export quotas, and reducing tariffs. This success has also been its curse. Having lowered at-the-border measures, the GATT turned to behind-the-border measures (such as government procurement, subsidies or technical regulations), which now became the most visible forms of trade barriers. The GATT made some headway in taming behind-the-border measures, but their nature made them ill-suited to substantial progress among a large and increasingly heterogeneous group of countries. Unlike tariffs, NTBs (behind-the-border measures)<sup>1</sup> cannot be gradually removed, for very often they are necessary to address market failures. Non-discrimination is no guarantee of market access, since the latter is conditional upon satisfying requirements unilaterally set by the importing members.

The WTO has not given up, of course. It has continued to try and tackle behind-the-border measures, but the further increase in the number (currently 164) of members, their heterogeneity, plus the fact that the power to set the agenda has shifted from the old (homogeneous) Quad to the new (heterogeneous) Quad, have proved formidable difficulties. 'Deep integration' (eg mutual recognition, harmonisation) is not possible for such a heterogeneous group of countries, which have divergent preferences and capabilities.

Immediately before China's accession, the WTO scored some important victories, with the successful conclusion of the so-called extended negotiations under the General Agreement on Trade in Services or GATS (telecoms, financial services), and the ITA (Information Technology Agreement). At that moment, instead of wrapping up the unfinished business, it embarked on an ascent of Everest, so to speak, with the announcement of a comprehensive round. The Doha round was supposed to solve problems the WTO has neither the expertise nor the mandate to solve, namely, the wider development agenda. Resources were invested in the Doha round, and not in dealing with China's accession. The ongoing malaise surrounding the Doha round should, consequently, not come as a surprise. Worse, the challenges that China represented for the world trading system culminated in a crisis, with no institutional assessment of the situation. There is no WTO response so far to the question "*what is the problem with China?*" In fact, there is no WTO discussion on this subject at all.

In short, the world trading regime has struggled to cope with its new agenda. NTBs and heterogeneity of membership are a basic reason why this has been the case. China's entry has contributed to heterogeneity, making it even more difficult for the WTO to deliver on its goals. To cap it all, the WTO assigned itself an almost impossible task, and instead of moving the agenda forward, has stalled and created doubts that it can continue to accomplish its tasks.

Together, these two factors – the weak state of the WTO and the relative decline of advanced economies – would have been sufficient to create tensions in the trading system. But, as if these factors were not enough, there was another that was perhaps even more formidable.

The third and last reason why China has posed a challenge to the functioning of the trading system is the special nature of its domestic economic system, which the country's ruling Communist Party describes as a socialist market economy, but others (mainly, but not only outside China) call state capitalism. The special nature of China's economic system, together with the country's sheer size, explain why the negotiations on China's accession to the GATT/WTO were long and difficult.

China was one of the original contracting parties to the GATT in 1947, but its status was de-activated in 1950 after the formation of the People's Republic. For the next three decades, China had practically no contact with the GATT. The situation changed in the 1980s, following Chairman Deng's economic reforms. After seeking and obtaining observer status at the GATT, China informed the Director General in

<sup>1</sup> We use the terms NTBs (non-tariff barriers) and behind-the-border barriers as synonyms.

a communication dated 10 July 1986 that it had decided to “seek the resumption of its status as a contracting party to GATT” and to this end was prepared “to enter into negotiations with GATT contracting parties.”

In March 1987, GATT established a Working Party on China's Status as a Contracting Party, which met on 20 occasions between 1987 and 1995 without reaching an agreement. China then applied for accession to the WTO Agreement, and the GATT Working Party was converted into a Working Party on the Accession of China, which met on 18 occasions between 1995 and 2001, when it finally agreed on its Report, including a Draft Protocol on the Accession of the People's Republic of China.

The Report of the Working Party makes it clear that the main factor behind the protracted negotiations was the special nature of China's foreign trade regime compared to the regimes prevailing in most of the WTO members.

In introductory statements, the representative of China stated that:

*Since 1979, China had been progressively reforming its economic system, with the objective of establishing and improving the socialist market economy... State-owned enterprises had been reformed by a clear definition of property rights and responsibilities, a separation of government from enterprise, and scientific management. A modern enterprise system had been created for the state-owned sector, and the latter was gradually getting on the track of growth through independent operation, responsible for its own profits and losses. A nationwide unified and open market system had been developed. An improved macroeconomic regulatory system used indirect means and market forces to play a central role in economic management and the allocation of resources... Further liberalization of pricing policy had resulted in the majority of consumer and producer products being subject to market prices. The market now played a much more significant role in boosting supply and meeting demand.<sup>2</sup>*

Reviewing the situation of China, members of the Working Party expressed numerous concerns about specific aspects of its foreign trade regime, including

*... the application of the principle of non-discrimination in relation to foreign individuals and enterprises (whether wholly or partly foreign funded);<sup>3</sup>*

*the continuing governmental influence and guidance of the decisions and activities of [state-owned and state-invested] enterprises relating to the purchase and sale of goods and services... [and] about laws, regulations and measures in China affecting the transfer of technology, in particular in the context of investment decisions;<sup>4</sup>*

*the special features of China's economy, in its present state of reform, [which] still created the potential for a certain level of trade distorting subsidisation;<sup>5</sup>*

*the lack of transparency regarding the laws, regulations and other measures that applied to matters covered in the WTO Agreement and the Draft Protocol.<sup>6</sup>*

<sup>2</sup> WTO Doc. WT/ACC/CHN/49 at §6.

<sup>3</sup> WTO Doc. WT/ACC/CHN/49 at §15.

<sup>4</sup> WTO Doc. WT/ACC/CHN/49 at §§44 and 48.

<sup>5</sup> WTO Doc. WT/ACC/CHN/49 at §171.

<sup>6</sup> WTO Doc. WT/ACC/CHN/49 at §324.

Today, nearly 20 years after its accession to the WTO, China is still a socialist economy and its state continues to be a heavy presence in the country's trade regime. Coupled with the fact that China has become the world's largest or second largest country in the world in terms of GDP (depending on how GDP is compared across countries), this situation has irritated its main trading partners. After their trilateral meeting in September 2018, the trade ministers of the European Union, the United States and Japan (respectively China's first, second and third largest trading partners) issued a joint statement voicing their concern about "*third countries*" (without explicitly mentioning China) that maintain "*non-market oriented policies and practices*", develop "*State Owned Enterprises into national champions*" and "*require or pressure technology transfer from foreign companies to domestic companies*".<sup>7</sup> This came only a few weeks after the United States unilaterally imposed duties on Chinese products above and beyond what is permissible under WTO rules in order to pressure China to change its behaviour.

Against this background, the question we ask in this paper is how to address the concerns of the trading community about China nearly 20 years after its accession to the WTO. We take the concerns at face value, and do not advance our own. Some of the concerns about China can be taken care of within the four corners of the existing WTO regime, including through stricter enforcement of the Protocol of Accession for China. But many cannot be addressed within the multilateral trading regime, as it now stands. The GATT/WTO is an incomplete contract regulating trade transactions based on a 'liberal understanding' of the law and economy. It implicitly assumes that laws, contracts and property rights will be enforced; that the state will not undo contractual promises on trade liberalisation by favouring (through pecuniary means or otherwise) domestic agents; and that investment will be liberalised. None of this was ever translated into legal language in the GATT/WTO agreements, but it formed the essential background against which the multilateral trading rules have operated over the years. One might add that it was a quintessential reason why the multilateral rules have operated so smoothly, despite the increasing number and heterogeneity of GATT/WTO members.

China was not the first, and will most probably not be the last, country to join the GATT/WTO with an economic system different from the liberal systems of the main incumbent members. The GATT had to face a somewhat similar situation when socialist, non-market countries from central and eastern Europe wanted to join (and did join) the club. But these countries were small and it was relatively easy to facilitate their accession through the protocols of accession, which imposed specific obligations on the acceding countries. Even when Japan wanted to join – a much bigger economy, not centrally-planned but definitely an economy in which the state had a lot to say over its working – the GATT system managed, through a relatively straightforward protocol of accession, to find its way forward.

What helped, in our view at least, is that all the big players shared (or at least accepted) the liberal understanding of the law and economy. And those that did not (Hungary, Poland, Romania, Yugoslavia) were rather insignificant in terms of world trade. Japan, was an outlier, as we will see in more detail later on. But even Japan, was under the protective aegis of the United States when it joined the GATT, and joined the OECD (Organisation for Economic Cooperation and Development) relatively soon after it had joined the GATT. Through (or because of) its OECD membership, Japan aligned its regulatory regime to that of the Western countries. India and Brazil, two big and important original GATT signatories, which might have been a thorn in the side of the system, always accepted the basic tenets and gradually expanded their formal respect of the liberal understanding, thereby avoiding clashes with other GATT/WTO members as their economies grew. India first in 1991, with the economic reform put in place by prime ministers Rao and Singh, and Brazil with the adoption of Plano Real of 1994, steered by presidents Franco and Cardoso, abandoned the heavily interventionist policies of the past, and espoused the basics of market economics for good.

<sup>7</sup> Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the European Union, New York, 25 September 2018.

In short, until the accession of China, the multilateral trading system was able to cope with an increasing variety in economic systems among its members. This was either because new members were fairly small, or, if they were larger economies, because they shared (or accepted) the liberal understanding of the law and the economy that was implicit in the original GATT text, and which reflected the fact that its main architects were American and British<sup>8</sup>.

This time it is different. China is not small, nor is it willing to reform the one-party political system and everything it entails in terms of state participation in the working of the economy, as many of its partners had hoped it would within a relatively short period after joining the WTO. Two diametrically opposed views about the way the international trade community should react to this situation have so far seen the light of day.

One is the position of the US government, which was expressed in July 2018 by its ambassador to the WTO during the discussion about China's trade policy in the realm of the WTO's Trade Policy Review Body. We quote §§4.105 and 112 in full<sup>9</sup>:

*4.105. China's failure to fully embrace the open, market-oriented policies on which this institution is founded must be addressed, either within the WTO or outside the WTO. Given China's very large and growing role in international trade, and the serious harm that China's state-led, mercantilist approach to trade and investment causes to China's trading partners, this reckoning can no longer be put off. If the WTO is to remain relevant to the international trading system, change is necessary.*

*4.112. Going forward, the best solution is for China finally to take the initiative to fully and effectively embrace open, market-oriented policies. China knows what needs to be done, and we urge China to take that route.*

The view of the US government seems to be that China must accept a regime change and abandon its "state-led, mercantilist trade and investment regime"<sup>10</sup>, or risk the demise of the WTO system and/or further trade retribution.

The opposite view is that China must resist calls to become more 'Western' in the way it manages its economy, and that the WTO can and must accommodate a diversity of economic systems. A vocal proponent of this view is Dani Rodrik, the Harvard economist, who recently approved of the "fact that many of China's policies violate WTO rules", arguing that "[a]ny sensible international trade regime must start from the recognition that it is neither feasible nor desirable to restrict the policy space countries have to design their own economic and social models" (Rodrik, 2018).

We disagree with both views. We neither support unilateral action by the United States to force China to change its economic system (or more likely, to reach a bilateral agreement to reduce its deficit, which will not be an action in the interest of all WTO members), nor do we agree that China should be allowed to violate WTO rules because it needs policy space. Both views fly directly against the quintessential elements of the multilateral trading regime as we know it. We value the rules-based multilateral system and worry that it will perish if its two biggest member countries look for short-term bilateral

<sup>8</sup> See Irwin *et al.* (2008) and Tumlin (1984). Japan presented the world trading regime with issues, even though complaints against it were raised not only at the moment it acceded to the GATT, but also a few years after it had joined the GATT, as a result of its monumental growth rates in the 1960s and the 1970s. Already at the moment of its accession, it managed to provoke a record number of invocations of the non-application clause. Eventually though, Japan became 'one of us', of which the best proof is its ascension to Quad status. We will discuss the Japanese problem in detail.

<sup>9</sup> WTO Doc. WT/TPR/M/375.

<sup>10</sup> WT/TPR/M/375 at §4.110.

solutions (patchwork, to be precise) outside the confines of the WTO, simply disregarding their WTO commitments. We believe that the only solution to durably address the problems posed by China's participation while avoiding the demise of the WTO, is to reform the WTO itself. The 'China issues', as we will show, might for now be predominantly, but are not in fact exclusively, China-specific.

The purpose of this paper is not to offer a complete blueprint to reform the WTO. We leave this much-needed but ambitious task to others. Our goal is more modest. We only seek to propose WTO reforms that we consider essential to reduce the tensions in the trading system that are likely to continue for a while given China's size and the nature of its economic system. Some of the concerns can be taken care of through more active enforcement of the current regime, and others can only be addressed if the current regime is reinforced with additional obligations.

The paper is organised as follows. In section 2, we begin by examining the claims against China presented by the US authorities (based on discussions in the Trilateral group, in which EU, Japanese and US officials participate), the most vehement critics of Chinese policies, and then focus on two of them: the claim about state-owned enterprises (SOEs) and the claim about forced technology transfer (TT). These two issues lie at the core of complaints against China's trade and investment regime. We then examine what China's WTO obligations are with respect to SOEs and TT, and ask whether the current WTO rules can adequately deal with the claims of the US and others. We conclude in the negative, and thus, the question arises: where did we get it wrong? To respond to this question, in section 3, we move to the past. We first compare the protocol of accession of China to the WTO with earlier GATT accession protocols for countries with significant state involvement in their trade regimes. We then focus on a comparison between Japan and China, because we find that recent complaints against the latter are strongly reminiscent of earlier complaints against the former. Almost identical arguments were raised against the destructive nature of the Japanese *"mercantilist trade and investment regime"*. We explore the differences and the similarities of the two situations and draw lessons, which inform the rest of our paper. Based on this discussion, section 4 offers proposals on how to improve WTO rules to deal with China and other countries with some similar features. Section 5 concludes.

## **2. Complaints against China**

There have been numerous complaints against China since it joined the WTO. Many concern policies and practices that overlap with the subject of complaints against other WTO members. Two of them, however, are more specific to China, and were at the centre of discussions in the trilateral meeting of the EU, Japanese and US trade ministers in September 2018: the behaviour of SOEs, and forced transfer of technology.

SOEs are present in many countries, not just in China. In fact, state trading enterprises (STEs), which have been regulated by the GATT since 1947, are a form of SOE, albeit SOEs with limited scope. Many of the countries that have acceded to the WTO, that is after the conclusion of the Uruguay round agreements, maintain SOEs that extend beyond state-trading. This is the case not only in centrally-planned economies like Vietnam, and to some extent China, but also in some Arab countries. Yet, the Agreement on Subsidies and Countervailing Measures (SCM) does not even mention SOEs. And since SOEs have greater scope than STEs (which are limited to trading activities), we believe, with others, that it is high time that the Agreement on Subsidies and Countervailing Measures (SCM Agreement) regulates this issue as well. It is simply inefficient to address it only through Protocols of Accession, as is the case today.



Transfer of technology (TT) is a different matter. The issue is partly addressed, directly and indirectly, by various WTO agreements. The GATT and other multilateral agreements do not cover investment for goods, nor do they therefore address transfer of technology. On the other hand, the GATS (General Agreement on Trade in Services) is the only multilateral agreement that covers investment. And the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement) has something to say on this score as well. So, TT can be addressed in part through more active enforcement of the existing framework, and in part necessitates reinforcement of the current regime. Trade and investment are, of course, both complements and substitutes, and a multilateral agreement on investment has been on the cards for some time, without materialising into anything concrete. China's practices, because of their consequential impact, make this issue a priority.

In this section, therefore, we focus on SOEs and forced technology transfer. We first examine China's WTO obligations under the WTO Agreement and the Protocol of Accession. We then discuss the formal WTO disputes initiated by the trilateral members against China and their outcome.

## 2.1 State-Owned Enterprises

SOEs have been a thorny issue in the relations with China. GATT, as briefly explained above, includes provisions on state trading enterprises (STEs), which it addresses head on, but no single provision explicitly deals with SOEs.

The original GATT Agreement (1947) was, and the WTO Agreement is still, silent about state ownership and more broadly about state involvement in the trading regime. This was a reflection of the fact that its main architects were American and British, the front-runners of market economies, and that its original participants shared (or at least accepted) a liberal understanding of law and democracy. As a result, there was no need to discuss this issue, since, anyway, their regimes were capitalist regimes built around the protection of private property.

The only exception, which confirms the rule, concerns STEs. Article XVII of the GATT permits contracting parties to maintain or establish STEs, but requires that they "*act in a manner consistent with the general principles of non-discriminatory treatment prescribed in [the GATT] Agreement for governmental measures affecting imports or exports by private traders.*" This rule was introduced in order to police milk and wheat marketing boards operated at the time (in 1947) by Australia, Canada, New Zealand and the United Kingdom, four of the original 23 GATT signatories<sup>11</sup>.

The provision on STEs might sound like a paradox and an oddity when viewed against the liberal understanding of the GATT. The explanation though, is quite intuitive: some countries, and most prominently the four countries mentioned above, had introduced STEs to ensure adequate supply of staples in the period following the 1929 financial crisis, and more so following the second world war.

When negotiations with China were initiated, WTO members had already concluded the SCM Agreement. By that time, they were aware that the term 'state-owned enterprise' did not even appear in the body of the SCM Agreement. Indeed, SOEs, an amplification of state involvement in the market when compared to STEs, were quite contrary to GATT's liberal understanding. If at all, the idea was to dismantle STEs, not to encourage and strengthen them. True, some states that acceded to the GATT/WTO knew of SOEs. They were a marginal concern for international trade (ex-communist countries; some African/Arab states) though, and presented the world trading regime with no real, pressing issues to handle. China's accession changed all this.

<sup>11</sup> See Kostecki (1978).

There was widespread recognition during the Chinese accession negotiations of the incompatibility of SOEs with a liberal trading system. Hufbauer (1998), for example, reflected the commonplace view that SOEs presented a clear and present danger, and, that unless something was done in the four corners of the Protocol of Accession, the world trading system could suffer as a result.

### 2.1.1 China's WTO Obligations

China's obligations with respect to SOEs originate in the WTO Agreements (especially, the SCM, even though it does not address SOEs in explicit manner), and its Protocol of Accession (which does address SOEs explicitly)<sup>12</sup>.

With respect to the SCM Agreement, China must not provide export or local content subsidies, otherwise it will be violating its obligations under Article 3 of SCM. Furthermore, assuming that it has subsidised (irrespective of whether its subsidy is illegal, as per Article 3 of SCM, or simply actionable, under Article 5 of SCM), it runs the risk of countervailing duties being imposed against it.

For either of these two provisions to kick in with respect to SOEs though, one thing is clear: SOEs must be acknowledged to be a "public body" in the sense of Article 1 of SCM<sup>13</sup>. If not, the only way to punish action by SOEs would be if complainants were to demonstrate that the Chinese government was using them as a conduit. The amount of evidence required for this latter demonstration is of course, greater than if SOEs were perceived to be public bodies.

So much for the SCM. What about the Protocol of Accession? There are various provisions, in different parts of the Protocol<sup>14</sup>, dealing with this issue.

§10.2 (Section on subsidies):

*For purposes of applying Articles 1.2 and 2 of the SCM Agreement, subsidies provided to state-owned enterprises will be viewed as specific if, inter alia, state-owned enterprises are the predominant recipients of such subsidies or state-owned enterprises receive disproportionately large amounts of such subsidies.*

This is a China-specific obligation. No such presumption exists for SOEs operating in other WTO members<sup>15</sup>.

§12.2 (Section on agriculture) on the other hand, reads:

*China shall, under the Transitional Review Mechanism, notify fiscal and other transfers between or among state-owned enterprises in the agricultural sector (whether national or sub-national) and other enterprises that operate as state trading enterprises in the agricultural sector.*

This is also a China-only obligation. Other WTO members need to notify only financial contributions that are specific subsidies (Article 25.2 of SCM).

<sup>12</sup> For a comprehensive discussion, see Qin (2004).

<sup>13</sup> SOEs can of course be the recipients of subsidies as well. This is not the question we ask here though, as with respect to this issue, there is no need to go beyond the existing regime.

<sup>14</sup> WTO Doc. WT/L/432 of 23 November 2001.

<sup>15</sup> See Christiansen and Kim (2014) for an extensive discussion of the importance of SOEs in the world. See also Garcia-Herrero and Xu (2017) and Lardy (2019) for contrasting views on the role of SOEs in China and how trading partners should deal with them.

In addition, the report of the Working Party on the Accession of China contains an entire section on SOEs and state-invested enterprises (SIEs)<sup>16,17</sup>. Section 6 of Chapter II comprises seven paragraphs (§§43–49), some of which (§§46-47, and 49) are explicitly mentioned in §342 as binding commitments given by China. Here we quote §§46-47 in full<sup>18</sup>:

*46. The representative of China further confirmed that China would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g., price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement. The Working Party took note of these commitments.*

*47. The representative of China confirmed that, without prejudice to China's rights in future negotiations in the Government Procurement Agreement, all laws, regulations and measures relating to the procurement by state-owned and state-invested enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale, or for nongovernmental purposes would not be considered to be laws, regulations and measures relating to government procurement. Thus, such purchases or sales would be subject to the provisions of Articles II, XVI and XVII of the GATS and Article III of the GATT 1994. The Working Party took note of this commitment.*

In fact, these provisions reproduce the obligations embedded in Article XVII of GATT. Interestingly, §46 refers to the two obligations included in Article XVII of GATT, without mentioning them as expressions of the non-discrimination obligation. Non-discrimination is separately mentioned in the same provision.

Case law has, in our view wrongly, understood these two obligations (afford adequate opportunities to compete; act in accordance with commercial considerations) as mere expressions of the obligation to not discriminate. This means that an STE that does not discriminate between foreign and domestic goods (sources of supply) is not violating Article XVII even when not acting, say, in accordance with commercial considerations. Thus, case law has made toothless Article XVII of GATT. Both the TPP (the Trans-Pacific Partnership), as well as its successor agreement, the CPTPP (the Comprehensive and Progressive Agreement for Trans-Pacific Partnership), have distinguished non-discrimination from these two obligations. This is the right approach, and we will return to this point later. We should note at this stage the absence of case law on §46.

To complete our discussion on this point, the reference to the Government Procurement Agreement (GPA) in §47, was deemed necessary since, from its accession days, China had promised to eventually join this agreement. This promise has yet to materialise, probably because many Chinese SOEs would have *ipso facto* lost an important market, had accession to the GPA taken place.

### **2.1.2 Complaints before the WTO**

Two disputes concerning Chinese SOEs have been brought to the WTO, but China was the complainant rather than the defendant. In the two cases, China complained against US measures affecting exports

<sup>16</sup> SIEs are entities over which the state has some but not majority control.

<sup>17</sup> WTO Doc. WT/ACC/CHN/49 of 1 October 2001.

<sup>18</sup> We quote §49 in the discussion on technology transfer.

by Chinese SOEs: *US-Antidumping and Countervailing Duties (China)*(DS379) and *US-Countervailing Measures (China)*(DS437). The only provision from the Protocol of Accession cited in the two disputes was Article 15, which concerns price comparability in subsidies and dumping investigations. For the rest, the disputes concerned consistency of the challenged practices with various provisions of the SCM Agreement.

Who won or lost overall in these two disputes is immaterial for our purposes. What matters is how the WTO adjudicating bodies understood the term “*public body*”, and, more precisely, whether SOEs qualify as such. To recall, Article 1.1(a)(1) of the SCM Agreement specifies that a subsidy exists if “*there is a financial contribution by a government or any public body within the territory of a Member*”.

The question before the WTO adjudicators was whether ownership as such is enough for an entity to be qualified as a “*public body*.” The response was identical in the two disputes [*US-Antidumping and Countervailing Duties (China)*; *US-Countervailing Measures (China)*], and it was a flat no. The US administration, when implementing the adverse report, adopted a measure by which it distinguished between three cases: SOEs being fully owned by the state, partially owned, or SOEs with no participation of the state as a shareholder. It then added a series of relevant factors (the number and importance of which increase as we move along the spectrum from full to no ownership) that must also be taken into account when deciding whether an SOE is a public body.

In light of the fact that the US administration was not equating government ownership with public body status, the panel report on *US-Countervailing Measures (China)* (Article 21.5-China) found that the United States had complied with its obligation to implement the adverse panel report. The issue is currently under appeal.

Is the outcome so far reasonable? There is, anyway, internal consistency between the two reports. Still, we believe that there is scope to improve the approach followed in these reports, and we discuss our proposals to this effect in section 4.

## **2.2 Forced transfer of technology**

Several WTO members, and in particular the European Union and the United States, have complained about various measures that ultimately lead to forced transfer of technology from their firms operating in China to Chinese (private) firms<sup>19</sup>.

In a nutshell, the complaint is as follows: China, through administrative guidance and licensing procedures, obliges foreign firms to transfer technology to Chinese firms if they want to operate in the country. China can credibly do that because, in the absence of a BIT (bilateral investment treaty) protecting foreign investment, foreign companies can face any sort of foreign ownership restrictions. China thus obliges foreign companies to enter into joint ventures with Chinese companies in order to obtain similar credit conditions as Chinese companies. Chinese companies thus become the bottleneck. When they receive requests to enter into a joint venture, they routinely agree to do so, but only if the foreign company first agrees to transfer technology to them.

<sup>19</sup> Update Concerning China’s Acts, Policies and Practices Related to Technology Transfer, Intellectual Property, and Innovation, office of the USTR, Executive Office of the President, November 20, 2018 (hereafter USTR 2018). USTR provides some numbers to substantiate the point that this practice is widespread and not necessarily targeted against US companies, see USTR 2018 at pp. 23 et seq. The names of companies including DuPont, General Electric, Advanced Micro Devices are explicitly mentioned.

### 2.2.1 China's WTO obligations

To understand whether complaints about forced technology transfer from foreign companies wanting to operate in China can be handled through WTO litigation, we need to examine China's WTO obligations with respect to: (1) foreign direct investment (FDI) in goods, (2) FDI in services, and (3) forced transfer of technology.

With respect to FDI in goods, there is no multilateral discipline, neither within nor outside the WTO Agreement. There are only international investment agreements, typically BITs. China has BITs with Japan and many individual EU member states, but they contain no specific obligations relating to the issues we discuss here. The European Union and the United States are both negotiating BITs with China that they hope would include obligations on transfer of technology, but the negotiations are not progressing well.

With respect to FDI in services, China has assumed obligations under Mode 3 in its schedule of concessions under GATS. Its obligations are asymmetric. Sometimes national treatment has been afforded to foreign services suppliers, and sometimes not. Sometimes there has been recourse to the measures included in Article XVI of GATS (market access), and sometimes not. It is thus impossible to provide a generic statement regarding China's obligations in this respect. Its obligations are service-sector specific.

What is clear though, is the imperative of Article XVI.2(e) of GATS, which reads as follows:

*In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:*

*(e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service.*

This means that, without an indication to the opposite, China cannot subject foreign commercial presence in its market to the prior establishment of joint venture. Hence, for China to behave in the realm of services trade in the same manner it allegedly does in the realm of trade in goods, it will have to indicate its willingness to do so in its schedule of concessions. In the opposite scenario, foreign companies can go ahead and establish a commercial presence on their own in China (assuming of course, that China has made commitments to this effect).

With respect to technology transfer, the situation is more complicated. In a way, the whole of the TRIPs (Trade-related Intellectual Property Rights) Agreement is about counteracting forced transfer of technology. Forced transfer can only occur under the restrictive conditions of Article 31 of TRIPs (compulsory licensing). Furthermore, WTO members must put in place an effective system of enforcement. They must, by virtue of Article 40, control anti-competitive practices in contractual licences. Furthermore, Article 41.5 of TRIPs provides that parties do not have an obligation to establish a distinct judicial system for the enforcement of intellectual property (IP) rights. There is thus no need to establish specialised courts, as the assumption is that the existing judicial system in place within each member's sovereignty could be put to good use to this effect.

There was, however, widespread concern about China's ability and commitment to administer laws and regulations pertaining to trade in goods, services and IP rights. As a result, Part I of China's Protocol of Accession contains a number specific requirements. We list the three most important.

First, Section 2(A) (uniform administration) provides that:

*2. China shall apply and administer in a uniform, impartial and reasonable manner all its laws, regulations and other measures of the central government as well as local regulations, rules and other measures issued or applied at the sub-national level (collectively referred to as "laws, regulations and other measures") pertaining to or affecting trade in goods, services, trade-related aspects of intellectual property rights ("TRIPS") or the control of foreign exchange.*

Second, we read in Section 2(C) (transparency) that:

*1. China undertakes that only those laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange that are published and readily available to other WTO Members, individuals and enterprises, shall be enforced. In addition, China shall make available to WTO Members, upon request, all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange before such measures are implemented or enforced. In emergency situations, laws, regulations and other measures shall be made available at the latest when they are implemented or enforced.*

Third, Section 2(D) (judicial review) provides that:

*1. China shall establish, or designate, and maintain tribunals, contact points and procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application referred to in Article X:1 of the GATT 1994, Article VI of the GATS and the relevant provisions of the TRIPS Agreement. Such tribunals shall be impartial and independent of the agency entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter.*

*2. Review procedures shall include the opportunity for appeal, without penalty, by individuals or enterprises affected by any administrative action subject to review. If the initial right of appeal is to an administrative body, there shall in all cases be the opportunity to choose to appeal the decision to a judicial body. Notice of the decision on appeal shall be given to the appellant and the reasons for such decision shall be provided in writing. The appellant shall also be informed of any right to further appeal.*

These requirements are not specific to IP rights. They apply to the entire WTO Agreement, including the TRIPs Agreement. They are meant to impose greater discipline on China than on other WTO members for reasons that were clearly spelled out in §§76–79 of the report of the Working Party on the Accession of China<sup>20</sup>. There, members of the Working Party stated unambiguously that China needed to strengthen its judicial arsenal to ensure that their rights are effectively enforced. China accepted their demands. We quote §78 in full:

*The representative of China confirmed that it would revise its relevant laws and regulations so that its relevant domestic laws and regulations would be consistent with the requirements of the WTO Agreement and the Draft Protocol on procedures for judicial review of administrative actions. He further stated that the tribunals responsible for such reviews would be impartial*

<sup>20</sup> Qin (2010) agrees that Section 2(D) of the Protocol of Accession imposes on China an obligation that other WTO members have not assumed.

*and independent of the agency entrusted with administrative enforcement, and would not have any substantial interest in the outcome of the matter. The Working Party took note of these commitments.*

During the accession negotiations, there was particular unease with China's administrative practice in relation to technology transfer. Paragraphs 48 and 49 of the Working Party on the Accession of China, capture this point to perfection:

*48. Certain members of the Working Party expressed concern about laws, regulations and measures in China affecting the transfer of technology, in particular in the context of investment decisions. Moreover, these members expressed concern about measures conditioning the receipt of benefits, including investment approvals, upon technology transfer. In their view, the terms and conditions of technology transfer, particularly in the context of an investment, should be agreed between the parties to the investment without government interference. The government should not, for example, condition investment approval upon technology transfer.*

*49. The representative of China confirmed that China would only impose, apply or enforce laws, regulations or measures relating to the transfer of technology, production processes, or other proprietary knowledge to an individual or enterprise in its territory that were not inconsistent with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement") and the Agreement on Trade-Related Investment Measures ("TRIMs Agreement"). He confirmed that the terms and conditions of technology transfer, production processes or other proprietary knowledge, particularly in the context of an investment, would only require agreement between the parties to the investment. The Working Party took note of these commitments.*

Recalling that §48 (like §§46-47) is explicitly mentioned in §342 as constituting binding commitments, we conclude that China undertook a firm commitment to abstain from forcing technology transfers from foreign firms operating within its territory. We need to explain this point a bit. China would be, according to the Protocol of Accession, liable only if transfer of technology was attributed to her. If it is the expression of private behaviour, China would incur no obligation.

### **2.2.2 Complaints before the WTO**

On 1 June 2018, the European Union requested consultations with China on certain measures imposed by China pertaining to (forced) transfer of foreign technology. It was the first instance of a WTO member launching a formal complaint against China about technology transfer. This request was replaced by a new request circulated on 20 December 2018. The European Union claimed that certain Chinese measures adversely affected the protection of the intellectual property rights of foreign companies transferring technology to China, and appeared to be inconsistent with a number of China's WTO obligations: several articles of the TRIPs Agreement; Article X:3(a) of the GATT 1994, concerning the administration of trade regulations; and Paragraph 2(A)(2) of Part I of China's Protocol of Accession, which also relates to the administration of trade regulations.

The European Union, more specifically, claimed that<sup>21</sup>:

*Through its domestic legislation, China restricts the access and operation of foreign investment in its territory, by conditioning the approval of foreign investments upon*

<sup>21</sup> WTO Doc. WT/DS549/1/Rev.1 G/L/1244/Rev1. IP/D/39/Rev.1 of 8 January 2019.

*performance requirements, including requirements related to the transfer of technology and the conduct of research and development in China. In addition, China imposes measures that adversely affect the protection of intellectual property rights of foreign companies, which transfer technology into China, including in the context of joint ventures with Chinese companies. In this respect, China discriminates against foreign companies by imposing on them conditions, which are less favourable than those applicable to the transfer of technology between Chinese companies.*

It further claimed that:<sup>22</sup>

*Pursuant to Paragraph 7.3 of its Accession Protocol, China committed to eliminate and cease to enforce performance requirements made effective through laws, regulations or other measures. Moreover, China committed not to enforce provisions of contracts imposing such requirements. China also committed to ensure that the means of approval by national and sub-national authorities of the right of investment would not be conditioned on performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or the conduct of research and development in China. Pursuant to Paragraph 203 of its Working Party Report, China committed that the allocation, permission or rights for importation and investment would not be conditional upon performance requirements set by national or sub-national authorities, or subject to secondary conditions covering, for example, the transfer of technology.*

At this stage, we can only speculate about the outcome of this case, assuming that the consultations with China fail, and the European Union requests the establishment of a panel. We note nevertheless, the reliance of the complainant on provisions embedded in the Protocol of Accession, which is the most promising legal basis to attack China's practices in this respect.

### **3. Dealing with heterogeneity in the GATT/WTO: lessons from the past for China**

China was not the first country whose accession to the GATT/WTO posed a challenge to the system's liberal understanding.

Typically, the way the system handled this situation was by imposing specific conditions on the new GATT/WTO members in their protocols of accession. This approach worked well, and the system dealt effectively with the relatively small socialist countries from Central and Eastern Europe, which joined the GATT during the 1960s and 1970s. It was more problematic with Japan, a country where state involvement in the trading system was far less than in socialist countries, but with far bigger (potential) economic size already when it joined the GATT in 1955. Thus, the GATT managed to withstand challenges to the system arising either from state involvement, or because of size. With China's accession, as we have noted above, the WTO had to deal with both factors simultaneously. Could (would) it succeed?

To answer this question, this section is divided in two parts. The first (3.1) discusses the role of accession protocols and compares the protocols for the socialist countries that joined the GATT with the protocol for China. The second part (3.2) looks at the situation of Japan when and after it joined the GATT, and draws parallels with the situation of China when and after it joined the WTO.

<sup>22</sup> WTO Doc. WT/DS549/1/Rev.1 G/L/1244/Rev.1 IP/D/39/Rev.1 of 8 January 2019.



We kick off our discussion in sub-section 3.1, with a detailed explanation of the objective function of Protocols of Accession. This is necessary for our discussion regarding the former communist European countries and also for our subsequent discussion about Japan and China.

### 3.1 Protocols of Accession

Countries joining the WTO (or earlier the GATT) are potentially subject to more obligations than incumbents (the founding members). They have to abide by the WTO Agreement (or earlier the GATT Agreement), and they also must observe the specific commitments embedded in their Protocol of Accession.

#### 3.1.1 From GATT to GATT+

To understand the function of protocols of accession, the natural place to start is of course the relevant statutory provision. Article XXXIII of GATT states:

*A government not party to this Agreement, or a government acting on behalf of a separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement, may accede to this Agreement, on its own behalf or on behalf of that territory, on terms to be agreed between such government and the CONTRACTING PARTIES. Decisions of the CONTRACTING PARTIES under this paragraph shall be taken by a two-thirds majority.*

Article XII of the Agreement Establishing the WTO almost verbatim reproduces this provision:

*Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.*

Originally, “*terms to be agreed*” was understood as reference to the schedules of concessions, which list the specific tariff concessions and related commitments that members have agreed to in the context of GATT/WTO trade negotiations. All GATT/WTO members have signed a schedule of concessions, which is either annexed to the original GATT/WTO Agreement, or to a Protocol of Accession. In the GATT, schedules usually consist of maximum most-favoured nation (MFN) tariff levels often referred to as “*bound tariffs*” or “*tariff bindings*”<sup>23</sup>. The 1955 Protocol of Accession for Japan, which we discuss in greater detail in the next sub-section, is a very appropriate illustration.

Over the years, GATT+ obligations started creeping in. The reason for the change was the increasing heterogeneity of the membership. In particular, countries wishing to join the GATT that were state-trading countries (STCs) had to accept commitments that would run against the heart of the world trading regime: they would commit to importing well-specified trade volumes. Eventually, in the 1990s, GATT+ commitments would extend to cover a variety of issues.

Recall that the original GATT Agreement was silent on STCs, as it only contained rules on state trading enterprises (Article XVII), which, as we discussed in section 2, originated in market economies and not

<sup>23</sup> Williams (2008) provided the most comprehensive discussion of the accession negotiation record. Those participating in preferential schemes will of course also include the preferential rate. As of 2016, all WTO members participate in at least one preferential arrangement.

in STCs<sup>24</sup>. STEs thus, were operating in a context of respect for property rights, and within the constraints of national antitrust laws (and often, liberalised investment).

The issue of STCs came up in the GATT for the first time in the early 1950s, after one of its original signatories, Czechoslovakia, became a non-market economy (NME). This novel situation posed a problem for the GATT liberal order. The solution chosen was to do nothing initially. Eventually, at the request of Czechoslovakia, it was decided to adapt one of the GATT rules. Article VI was augmented with Interpretative Note ad Article VI in order to deal with the problem of finding comparable prices in anti-dumping and anti-subsidy investigations when trade is operated by a state monopoly.

The question of STCs and the GATT took on a new dimension in 1959, when Poland became the first socialist country to apply for full accession to the GATT. The solution this time was to avoid further modification of the GATT rules, but instead to use the process of accession to impose specific obligations on Poland. Since the country would not agree to abandon central planning or the state monopoly over foreign trade, which were incompatible with several GATT rules, the protocol of accession finally agreed in 1967 required Poland to accept a number of GATT+ obligations. The same approach was used later for the accessions of Yugoslavia (1966), Romania (1971) and Hungary (1973)<sup>25</sup>. The protocols of accession for these socialist countries contained a number of GATT+ obligations<sup>26</sup>:

- A minimum commitment to import from GATT members;
- An agreed annual increase for imports from GATT members (7% in the case of Poland)<sup>27</sup>;
- A commitment to address discriminatory quantitative restrictions;
- the Interpretative Note and Article VI of GATT were diluted, so not all prices had to be fixed by the state anymore in order for a GATT member to be treated as an NME;
- The possibility for GATT members to put in place safeguards on conditions less stringent than those embedded in Article XIX of GATT.

The protocols of accession for the socialist countries also included for the first time a discussion on trading rights, due to the fact that, with varying degrees, in none of these countries was it possible for private companies to act as international traders. Nevertheless, the protocols imposed no detailed obligations.

<sup>24</sup> The Suggested Charter for an International Trade Organisation of the United Nations, a document released by the US Government in September 1946, which served as the basis for the London draft of November 1946 of what became in March 1948 the Havana Charter for an ITO, contained rules on both STEs and STCs. Article 26 of the Suggested Charter deals with STEs and is similar to Article XVII of the final text of the GATT in 1947. Articles 27 and 28 deal with STCs but were not incorporated into the GATT when it became clear that the Soviet Union, for whom the two articles were designed, would not participate in the GATT.

<sup>25</sup> See Reuland (1975) and Grzybowski (1977).

<sup>26</sup> Yugoslavia was the first socialist country which joined GATT (in 1966), but it acceded as a market rather than a non-market economy.

<sup>27</sup> The notion that STCs should import over a period a minimum value of goods from GATT members, which would be adjusted periodically, finds its origin in Article 28 of the Suggested Charter discussed in footnote 9.

### 3.1.2 From GATT+ to WTO+ and WTOx<sup>28</sup>

Following the advent of the WTO, a number of non-Western countries joined. We divide them in four categories:

- Central and Eastern European countries (CEECs);
- Russia and other former Soviet republics;
- Arab countries;
- Vietnam and China.

The rationale for our taxonomy has to do with the innate characteristics of each group. The first two were part of the Soviet bloc. CEECs joined the European Union, whereas Russia and the remaining former Soviet republics did not. Arab countries exhibit characteristics of state-trading, but are typically ruled by royal families, and not necessarily in a manner reminiscent of communist countries. Vietnam and China are one-party, communist countries.

#### 3.1.2.1 CEECs

The accession of these countries was mostly a non-issue because when they joined the WTO, either as founding members (the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, and Slovenia) or acceding members (Bulgaria, Croatia, Estonia, Latvia and Lithuania), CEECs were already negotiating (or had already decided to negotiate) their accession to the European Union. It was clear, therefore, that all of them would be taking over the EU schedule of concessions.

What matters most though, for the purposes of our discussion, is that, to become EU members, CEECs had to completely amend their legal regimes. They had to implement, not only the GATT liberal understanding, but a lot more. The EU integration process requests that only well-functioning democracies can apply to join in. Once they accede, new members incur several legal obligations in order to ensure that their market economies are up to speed with those of the incumbents.

#### 3.1.2.2 Former Soviet Republics

This grouping deserves an extensive discussion, because their economies are not that different from China's. Several former Soviet republics applied to join the WTO. We focus on three that cover the whole spectrum of situations: Russia, by far the biggest country; Kazakhstan, a member of the Eurasian Economic Union (EAEU), and thus with close trade links with Russia; and Ukraine, which has distanced itself from Russia by signing a free-trade agreement (FTA) with the European Union.

The Protocols of Accession for these three countries are terse, and refer to specific paragraphs in the corresponding Working Party reports, where specific obligations have been assumed<sup>29</sup>. The structure of the reports is quite similar. For the purposes of our study, there are four themes that permeate these reports: SOEs/privatisation; pricing policies; trading rights; and investment.

<sup>28</sup> In Horn *et al* (2010), where this distinction originally appeared, we understood WTO+ as cases where trade partners liberalise further an area where WTO obligations already exist. For example, reducing the MFN tariff by x% is WTO+. Conversely, WTOx covers areas where trade partners agree to take on commitments in areas not covered in the WTO agreements currently in place.

<sup>29</sup> Kazakhstan's Protocol of Accession is reflected in WTO Doc. WT/L/357, of July 30, 2015, and the Working Party report for its accession, in WTO Doc. WT/ACC/KAZ/93, of June 23, 2015; the corresponding documents for Russia are WT/L/39, of December 17, 2011, and WT/ACC/RUS/70, of November 17, 2011, and for Ukraine, WT/L/718, of February 13, 2008, and WT/ACC/UKR/152, of January 25, 2008.

### 3.1.2.2.1 SOEs/privatisation

All three acceding countries have embarked on privatisation programmes. This was not at the request of the WTO. In fact, the Working Party reports make it clear that all three had embarked on privatisation programmes before they initiated their accession proceedings, probably anticipating accession to the organisation. The privatisation programmes in all three countries had wideranging content, covering farm, industrial and services industries. All three left aside key, strategic (in the view of the three countries) sectors, which do not necessarily overlap.

The number of SOEs had been reduced as a result of privatisation, of course. Nevertheless, in all three countries the share of the economy in the hands of SOEs was substantial at the time of accession<sup>30</sup>. The countries committed to ensure that their SOEs would behave in a WTO-compliant manner, which in practice meant that they would observe the obligations assumed under the SCM Agreement.

To the extent that SOEs are also traders, all three countries agreed, through commitments made during the accession process, that they would observe Article XVII of GATT (on state-trading enterprises).

In our view, the Protocols of Accession are characterised by a number of omissions regarding SOEs and privatisation. Let us start with the latter. Privatisation is welcome, but recall it was taking place irrespective of WTO accession. As a result, no one could guarantee that privatisation would take place under competitive conditions, with interested buyers (domestic and/or foreign) able to bid for state property. Of course, for foreigners to bid, a commitment on investment is a prerequisite. As we have already stated, there is no multilateral agreement in this respect, and acceding countries did not accept any WTOx obligations to this effect during the accession process.

The problem is of course, that state property could be transferred to state cronies, and thus state control could continue to exist under the guise of privatisation. This is very much a concern that has been expressed about Russian privatisation. The absence of meaningful competition law exacerbates the problems caused by phony privatisation.

SOEs must observe the SCM Agreement, but the problem is that the SCM Agreement does not even mention the term 'SOE'. There is thus, no presumption that SOEs for example, have access to money markets at preferential rates. There is further no presumption that their actions result in subsidies. Under the circumstances, our conclusions on the need to bring the disciplines embedded in the TPP into the WTO become all the more relevant.

With respect to STEs and/or SOEs that operate as STEs, observing Article XVII of GATT is a toothless proposition. Case law has managed to eviscerate this provision. It understood that the obligations to act on commercial considerations, and afford adequate opportunity to all interested parties are mere expressions of the non-discrimination obligation, and not (as they should be) self-standing obligations. As a result, to the extent that a WTO member (Russia, China or any other country) does not discriminate between foreign suppliers, it can be presumed to act on commercial considerations (even if this is manifestly not the case)<sup>31</sup>.

<sup>30</sup> For instance, according to statistics supplied by the Ukrainian delegation during the accession negotiations, in 2006, 19.5 percent of the Ukrainian economy was in state hands.

<sup>31</sup> In Mavroidis (2016) volume 1, pp. 399 et seq., we discussed all relevant case law on this score.

### 3.1.2.2.2 Pricing policies

In all three countries, prices are regulated in specific markets, typically, in energy, alcoholic beverages and some farm products such as fertilisers. A state entity, such as for example, the Ukrainian State Inspectorate on Price Control, is in charge of ensuring that minimum prices are respected<sup>32</sup>.

The membership expressed its discontent with similar policies. Nevertheless, to the extent that they observe the legislative framework of Articles III/XX of GATT, there is not much that can be done about them within the current WTO regime.

Again we believe that the Protocols include a number of omissions. Pricing policies are an issue that has not been adequately explored in GATT/WTO law, most likely because it was not an issue for the original members. Minimum import prices have been sanctioned both for farm and for non-farm goods. The Agreement on Agriculture, in Article 4.2, leaves us in no doubt that minimum import prices are inconsistent with the Agreement. Consistent case law has also outlawed minimum import prices for non-farm goods, for violating Article XI of GATT. In this case, recourse to Article XX of GATT will be necessary.

What about minimum sale prices, a pricing policy which is a behind-the-border measure? In this case, assuming the question were brought before a panel, we believe that similar measures, when concerning imported goods, would have to be found inconsistent with Article III of GATT, if they afford protection to domestic production. Assume that an imported good, following the relevant customs valuation procedures and the payment of customs duties, enters the market of Home at price {x}. Assume further that Home has a domestic law obliging this good to be sold at price {2x}. The complainant would have to show that the seemingly non-discriminatory price violates national treatment. This would be the case, if, for example, the cost of production of the domestic good were to be anywhere in the continuum between {x} and {2x}. In this case, the measure would *de facto* impose a higher burden on imported goods. There is no case law on this score, and maybe (as Ukraine has argued), justification for similar measures could be sought through recourse to Article XX of GATT (even though we fail to see how this could be the case). At any rate, maybe the incumbents did not insist very much on this point, thinking that they could enforce their rights through subsequent adjudication.

### 3.1.2.2.3 Trading Rights

Governments frequently adopt laws and regulations requiring traders to register the fact that they engage in the business of importing and exporting. However, conditions attached to the right to trade in goods might be inconsistent with GATT rules.

Trading rights exist in all WTO members. Nevertheless, what is the exception in most members was the rule in centrally-planned economies. All three countries agreed to increase the number of individuals (physical or legal persons) who would hold trading rights, but subjected them to some requirements of a bureaucratic nature.

There are some glaring omissions in this context as well. There is not enough detail about the conditions that must be satisfied in relation to the manner in which trading rights are allocated.

<sup>32</sup> Minimum prices have routinely been judged inconsistent with the GATT. All three countries nevertheless argued that an eventual inconsistency with Article XI of GATT (on the elimination of quantitative restrictions) could be justified through recourse to Article XX of GATT (which provides for exceptions to GATT obligations). Ukraine for example, advanced the argument that its minimum prices were meant to fight illegal production and trade of alcoholic drinks. Some aspects of this law have been disputed. In particular, Moldova has initiated a dispute to this effect, and, at the time of writing, the dispute is still at the stage of consultations (DS423, Ukraine-Taxes on Distilled Spirits).

Arguably, some of the concerns can be taken care of within the four corners of the existing regime (national treatment). The recent Appellate Body report on Brazil-Taxation could offer some help here. But restrictions could be justified under Article XX of GATT, and one would have expected negotiators to insist on this latter point. The problem is that, if trading rights are allocated to cronies of the regime, and because of the *de-facto* absence of competition law (and competition culture), the trade outcome could be manipulated in favour of domestic production.

#### **3.1.2.2.4 Investment**

All three countries maintain restrictions on investment. During their accession processes, they explained their preferences for investment in new technologies and in areas of strategic interest to them. WTO rules contain no obligations as far as investment in goods is concerned, so WTO members are free to act as they wish in this area.

On the other hand, WTO members might be bound by obligations with respect to services (Mode 3).

There are some omissions here too. Because (at least in some sectors) foreign ownership is capped and joint venture with local firms is compulsory, forced transfer of technology becomes a likely outcome of foreign direct investment.

#### **3.1.2.3 Arab Countries**

These countries presented some issues with respect to SOEs. The promise, for example, of Saudi Arabia to privatise and reduce the size of state-owned enterprises was enough to defuse the attention given to this issue<sup>33</sup>. Other countries, like Oman, made similar promises. No complaint has been raised against them before a WTO panel so far.

#### **3.1.2.4 Vietnam and China**

These two countries joined the WTO as NMEs. We discuss briefly Vietnam here and delay our discussion of China until Section 3.2.2.2. Vietnam accepted various WTO+ obligations as a result of its accession process. We highlight two. First, it accepted to provide that, not only nationals, but also foreigners could enjoy trading rights. This will be the default scenario. For goods listed in Table 8(c) of the Working Party report<sup>34</sup>, the default scenario will not apply. Second, Vietnam agreed to ban all state-mandated transfer of technology<sup>35</sup>. Once again, the ban covers behaviour attributed to government, and not private behaviour.

We conclude our discussion on protocols of accession for the GATT/WTO members that we have reviewed so far, by noting that the increasing heterogeneity in GATT/WTO membership did not lead to new GATT/WTO multilateral rules, but to lengthier protocols of accession. We observe thus, the opposite trend of what we noted with Czechoslovakia's passage behind the Iron Curtain, when an Interpretative Note was added to Article VI that was applicable to all GATT members.

<sup>33</sup> WTO Doc. WT/ACC/SAU/61 of January 1, 2005 at §§38 et seq.

<sup>34</sup> WTO Doc. WT/L/662 of November 11, 2006 (Protocol of Accession for Vietnam); the Working Party report has been published as WT/ACC/VNM/48 of October 27, 2006. Table 8(c) is reflected in pp. 161 et seq. of the report, and contains items such as cigarettes and tobacco, oil, newspapers. The relevant discussion about trading rights is included in §§137 et seq.

<sup>35</sup> *Idem* at §§125 et seq.

*Prima facie* this makes sense. Idiosyncratic situations require customised responses. The downside is of course that what is idiosyncratic is often an element of judgement, and MFN issues might arise. The trade-off here is not easy to solve.

### **3.2 The very special case of Japan**

Nearly 20 years after its accession to the WTO, China continues to be accused by some countries continue of long, discretionary procedures, transfer of technology and administrative guidance. In short, they accuse China of disproportionate state involvement in the economy. This is precisely the language some GATT members used to castigate Japan's accession to the GATT. *China Inc.*, the title of Wu's excellent paper (Wu, 2016), is reminiscent of Japan Inc., which is how some trading nations, especially the United States, baptised Japan after its adherence to the multilateral trading regime. Some European states were thinking along these lines already before Japan's accession to the GATT

We are not the first to draw a parallel between the Chinese and Japanese accessions. Forsberg (1998) investigated the same question. Forsberg's analysis though, insightful as it is, was done before China acceded.

#### **3.2.1 Japan and the GATT**

For three decades, Japan had a difficult economic relationship with some of its main trading partners. In the 1950s, it had problems becoming a member of GATT and had to wait until the mid-1960s to enjoy the full rights of membership, which (mainly) European countries had been withholding. In the 1970s and 1980s, after becoming an economic powerhouse, Japan was accused, mainly but not only by the United States, of unfair trade practices and found itself on the receiving end of various trade measures. Today, the European Union, Japan and the United States are the best of trade partners and hold trilateral meetings on how to deal with the new economic powerhouse, China. Today's reality is a far cry from yesterday's belligerent, almost pugilistic relationship, that these trading partners experienced.

##### **3.2.1.1 Japan's accession process**

Japan's accession to the GATT was unique in the history of accessions to the GATT. Japan is the only acceding member that had to wait for two years before joining the club. A number of future members have spent time first as observers. Japan spent it in a different way. It provisionally applied the GATT, undergoing some sort of probation period aimed at persuading incumbents that its economic model could fit with the GATT system.

In 1953, the GATT had 33 members, of which 23 agreed to provisionally apply the GATT to Japan during its probation period. The other ten refused. After its formal accession on 10 September 1955, only 19 members agreed to continue applying the GATT to Japan. The other 14 members invoked Article XXXV of GATT, the non-application clause<sup>36</sup>. This is an idiosyncratic GATT provision. When invoking it against an acceding country, an incumbent does not prevent it from acceding but refuses to abide by the GATT obligations in its bilateral relations with the new member.

The 14 members that invoked non-application were: Australia, Austria, Belgium, Brazil, Cuba, France, Haiti, India, Luxembourg, the Netherlands, New Zealand, Rhodesia, South Africa and the United

<sup>36</sup> GATT Doc. L/420 of 11 October 1955

Kingdom<sup>37</sup>. To add insult to injury, some of these 14 countries were applying MFN to non-members, but refused to do to Japan, a new member.

In contrast, only one WTO member invoked Article XIII of the Agreement Establishing the WTO – the successor provision to Article XXXV of GATT – vis-à-vis China: El Salvador<sup>38</sup>. This is probably because of the great success that the GATT/WTO regime has had in de-politicising trade, and bringing yesterday's enemies around the negotiating table.

Back in the 1950s, Japanese officials were outraged by actions of the GATT incumbents<sup>39</sup>. Japan retaliated by refusing to apply the GATT to those who had invoked non-application against it. It was not all stick though. Japan tried carrot as well. It promised not to export too much. It argued that the GATT should be able to fit under its umbrella countries with different economic structures. Japan repeatedly pleaded with those that invoked non-application to stop doing so, but its trading partners took their time to change their views. For a long time, Brazil was the only partner that withdrew its non-application letter<sup>40</sup>. Not all of its remaining partners were uncompromising, though. The United Kingdom definitely was. The rest of the membership was prepared to make concessions. Belgium, Netherlands and Luxembourg (the Benelux countries) went on record stating that their non-application was temporary, and justified by the lack of adequate safeguards in the GATT to deal with Japanese competition. At that time, no antidumping agreement had been concluded, and still these countries applied MFN to Japan with respect to number of goods. France and Austria, echoing the attitude of the Benelux countries, blamed the lack of safeguards to justify their invocation. France especially, claimed it was doing what was necessary to protect its textiles industry<sup>41</sup>. India insisted that it was not acting the way it did because it had coordinated with others, but simply in order to address Japanese competition.

In November 1964 the representative of Japan *“drew attention to the fact that, through the invocation of Article XXXV, nearly half of the contracting parties were not applying the General Agreement to Japan”*<sup>42</sup>. That year, Japan became the first country outside Europe and North America to join the Organisation for Economic Cooperation and Development (OECD), a club of advanced nations committed to the liberal understanding. Nearly all European countries withdrew their letters of non-application.

Against this background, a few observations are in order. Since so many refused to accept Japan into the GATT family, why did they allow it to join in the first place? One might still wonder when Japan would have eventually joined the GATT if the US administration had not been such an ardent supporter of its accession. All historical accounts unanimously conclude on this point<sup>43</sup>. President Eisenhower adopted an unflinching attitude. He ignored important statesmen, such as Chairman of the House Ways and Means Committee Daniel Reed, who urged the establishment of a tariff wall to protect the US market from Japanese exported goods<sup>44</sup>.

<sup>37</sup> GATT Doc. L/405 of 13 September 1955. Furthermore, some countries that joined the GATT after Japan also invoked non-application.

<sup>38</sup> WTO Doc. WT/L/429 of 5 November 2001.

<sup>39</sup> See, for example the angry reaction of Minister Takaseki. Press Release, GATT/247 of 28 October 1955.

<sup>40</sup> GATT Doc. L/670 of 28 August 1957.

<sup>41</sup> Press Release, GATT/249 of 1 November 1955. On the hostile UK attitude, see Forsberg (1988) at pp. 186 and seq.

<sup>42</sup> GATT Doc. 2SS/SR.2 p.7. The countries that continued to invoke Article XXXV after 1964 were mainly developing countries, which had acceded to the GATT in the early 1960s.

<sup>43</sup> See, for instance, Johnson (1982), Kaufman (1982), Forsberg (1996 and 1998) and Irwin (2017).

<sup>44</sup> See Forsberg (1998) at pp. 187 and seq.



There were of course, geopolitical considerations that had led the US administration to adopt this attitude<sup>45</sup>. The United States was the occupying force in Japan in the years after the second world war. Because General Marshall had failed in his China mission, as Kurz-Phelan (2018) has persuasively argued, Japan became all the more important for US interests in that region.

There was also some optimism, even exuberance, to the effect that Japan, following its integration into the multilateral institutions (the GATT being a key step in this endeavour), would resemble and eventually emulate the US economic paradigm, and quite quickly. Japan's accession to the OECD in 1964 proved the optimists right.

Adherence to the liberal paradigm though, proved both a blessing and a curse. Japan transformed its economy quite rapidly, and proved the original critics – those denying Japan its rights under the GATT – right when predicting an influx of Japanese imports of unprecedented proportions into their national markets. Forsberg (1998) provided evidence to this effect (pp. 187 et seq.). Johnson (1982) was right when noting that no one in the 1950s foresaw the future Japanese miracle. Japanese export-led growth at the moment of Japan's accession in 1955 was more of an issue for the European countries than it was for the US administration, which was guided more by geopolitical concerns. The tables turned later. It became more of an issue for the United States, which did not hesitate to look for solutions outside the GATT, in an effort to solve its problems with Japan. Worse, the US actions created problems for other economies, like the European Union, which had to pay the price (literally) for the US-Japan Semi-conductor Pact of 1985.

### **3.2.1.2 Complaints and measures against Japan**

For 15 years immediately after joining the GATT, Japan enjoyed exceptional economic growth. During this period, which is often referred to as the period of the "Japanese miracle", it achieved average annual growth of GDP of nearly ten percent. During the same period, US GDP growth averaged 'only' four percent. As a result, the size of the Japanese economy significantly increased relative to the US economy. In 1955, Japan's GDP amounted to barely 12 percent of US GDP measured at purchasing power parities (PPP); by 1970 this ratio had reached 29 percent.

During the 1970s and 1980s, Japan's economic growth significantly slowed, but it still averaged nearly five percent, more than one percentage higher than the US. Consequently, the ratio between Japanese and US GDP continued to increase and reached an all-time high of 40 percent in 1991.

The rapid increase of Japanese production and exports created a backlash in other countries, especially the United States, which imposed anti-dumping and countervailing duties on various imports from Japan. During the 1970s and 1980s, the United States and to some extent the European Union, also convinced Japan to 'voluntarily' restrain its exports of various products. In the 1980s, Japan agreed to voluntary export restraints (VERs) that the United States had requested on a range of products, including steel, colour television sets and automobiles.

Eventually, Japan's partners also grew increasingly irritated by the difficulty of penetrating the Japanese market. Grievances in this respect focused on two issues:

- The lengthy approval procedures to accept only investment that was deemed profitable to Japan, involving, for example, technology that could be transferred to Japanese companies, as described by Mason (1992, p.151);

<sup>45</sup> Eckes (1995) provides substantial evidence to this effect. Davis and Wilf (2017) also discuss and analyse the role of geo-politics in GATT/WTO accessions.

- The omnipresent administrative guidance, whereby the Japanese government would dictate behaviour to Japanese economic agents.

'Japan Inc.' became Japan's *de-facto* name in trade circles. Through this sobriquet, its trading partners wanted to denote that private agents played second fiddle to the idiosyncratic (if not whimsical, echoing *folie de grandeur*) aspirations of the Japanese government to dominate international economic relations. Japan's trading partners adopted multilateral and bilateral measures to try to change Japan's practices.

### 3.2.1.2.1 Multilateral measures

The United States, Canada and the European Union litigated what could be litigated under the GATT multilateral rules. Japan was a defendant in nine cases between the time of its accession in 1955 and 1994, before the advent of the WTO. Table 1 lists the cases.

**Table 1: Japan GATT disputes (in chronological order)**

Subject	Complainant	Adoption date	Document code
Silk Yarn	US	17/05/1978	L/4637
Leather (US I)	US	06/11/1979	L/4849
Leather (Canada)	Canada	10/11/1980	L/5042
Tobacco	US	11/06/1981	L/5140
Leather (US II)	US	15/05/1984	L/5623
Alcoholic Beverages I	EU	10/11/1987	L/6216
Agricultural Products I	US	02/03/1988	L/6259
Semi-conductors	EU	04/05/1988	L/6309
SPF Dimension Lumber	Canada	19/07/1989	L/6470

Japan prevailed only once (SPF Dimension Lumber), and implemented all reports where its measures were found to be inconsistent with the GATT. Actually, it formally adopted only six reports, since twice (in Silk Yarn and Tobacco) it settled with the complainant (the United States) before the report was issued. The two instances in which Japan settled concerned state trading enterprises with monopolies over imports of silk yarn and tobacco. Note also that seven of the eight cases lost by Japan concerned its import regime. The other case concerned its export prices for semi-conductors.

In a Communication to the GATT membership in 1983<sup>46</sup>, the European Community (EC), the forerunner to the European Union, complained about what it viewed as *"a serious problem: the difficulty of penetrating the Japanese market."* It requested the establishment of a working party under Article XXIII:2 of the GATT (Nullification and Impairment), on the basis that *"benefits of successive GATT negotiations with Japan have not been realised owing to a series of factors peculiar to the Japanese economy which have resulted in a lower level of imports, especially of manufactured products, as compared with other industrial countries."* While acknowledging that Japan had recently taken some measures to alleviate the situation, the EC noted *"that the impact of these measures as a whole is limited and not commensurate with the magnitude of the problem."* Consequently, the EC demanded:

*[a] solution... which requires a co-ordinated series of general and specific measures, which go beyond the formal barriers at the border, and which are designed to bring about a definitive*

<sup>46</sup> GATT Doc. L/5479, of 8 April 1983.

*and substantial improvement in the present situation. In this context, the European Community reiterates that it is not seeking a fundamental change in the Japanese socio-economic system. It is interested in results: a situation in future where Japan offers equal opportunities of trade expansion to its trading partners, in conformity with the overall objectives of the General Agreement.*

*The European Community is of the view that the present situation constitutes a nullification or impairment by Japan, of the benefits otherwise accruing to the European Community under the GATT, and an impediment to the attainment of GATT's objectives. In particular the general GATT objective of 'reciprocal and mutually advantageous arrangements' has not been achieved<sup>47</sup>.*

The complaint was ultimately not pursued<sup>48</sup>.

### **3.2.1.2.2 Bilateral measures**

The United States overwhelmingly opted to deal bilaterally with Japan, using Section 301 of the Trade Act of 1974 and the threat of trade sanctions, in order to enlarge the scope of obligations that Japan should accept, given its newly acquired status of an economic giant. In a way, the 1980s negotiation between the United States and Japan, called the Structural Impediments Initiative (SII), was the accession negotiation of Japan that the United States had not wanted to conduct thirty years earlier because of the geopolitical circumstances.

Section 301 authorised, and in some instances required, the US Government to act against foreign countries that violate trade agreements or engage in unfair trade practices. It was originally adopted by the US Congress in 1974 but has been amended on several occasions since<sup>49</sup>.

The US Government's negotiating leverage with its trading partners was significantly increased when Congress amended Section 301 in the Omnibus Trade and Competitiveness Act of 1988. The new 'Super 301' provision mandated the US Government to implement trade retaliation when a country was named as an unfair trading partner and negotiations on specific products failed to produce satisfactory results.

The enactment of Super 301 was motivated by Congressional concern *"that certain foreign countries, most notably Japan, engage in broad and consistent patterns of unfair practices that serve to keep their home markets free of significant competition from US- and other foreign firms"*<sup>50</sup>. The new provision came out in a context of what some in Washington were referring to as *"Japan bashing"*<sup>51</sup>.

As Hugh Patrick, the famous American academic Japan specialist noted at the time, the US attitude was not surprising:

*After all, Japan had emerged in the 1980's as the most important economic and technological challenge (some would say threat) to the United States. Japan is by far the world's second largest economy... [and] with the United States, is at the frontiers of a far wider range of civilian goods technologies than any of the Western European countries. It has demonstrated*

<sup>47</sup> GATT Doc. L/5479, of 8 April 1983, p. 3.

<sup>48</sup> See GATT Analytical Index, p. 671.

<sup>49</sup> See Bhagwati and Patrick (1990) for an extensive discussion of Section 301.

<sup>50</sup> SENATE FINANCE COMMITTEE REPORT ON OMNIBUS TRADE ACT OF 1987, S. REP. No. 71, 100th Cong., 1<sup>st</sup> Sess., 77 (1987), cited by Grier (1992) at p. 6.

<sup>51</sup> See, for instance, Tolchin's (1988) article in the *New York Times* titled "'Japan-Bashing' Becomes a Trade Bill Issue'.

*immense competitive strength in a number of industries important to the United States - including automobiles, steel, consumer electronics, office equipment, semiconductors*<sup>52</sup>.

In 1989, Japan was named an unfair trading nation, and negotiations began on three products: supercomputers, telecommunications satellites and wood products<sup>53</sup>. In all three areas, the Government of Japan made commitments to remove the relevant barriers and the US Government dropped its threat of sanctions. That same year, US President George H.W. Bush and Japan's Prime Minister Uno initiated the SII talks, which focused on structural impediments that hinder imports into Japan, though it also addressed a number of US problems. The final report, issued in June 1990, listed six areas, on which the Japanese government was urged to act and rectify the situation: saving and investment patterns, land policy, the system of production distribution, exclusionary business practices, keiretsu relationships and pricing mechanisms.

Some issues raised in the SII were closely related to the GATT mandate, though not actually covered by it, albeit in oblique and minimalist manner: distribution of goods, and the treatment of restrictive business practices (RBPs) belong to this category. All that GATT requires is that the same distribution channels be available to both domestic and foreign goods, and that competition law, no matter whether efficient or inefficient, be applied in a non-discriminatory manner. The US administration wanted to go further than that.

Other issues, although quite remote from the GATT mandate, were nonetheless important for the trade outcome: public expenditure, land use policy and the notoriously close inter-corporate relationship across Japanese behemoths (keiretsu)<sup>54</sup>.

In the early 1990s, at a time when Japan was at the peak of its economic success and emerged as threat to the US economic supremacy, it was difficult to predict how the US-Japan relationship would evolve as a result of the SII agreement. Quoting from Hugh Patrick (1990) once again:

*... how the United States and Japan move from where they are today is unclear. The path certainly is difficult. Indeed, the United States - Japan economic relationship is fraught with danger. Both nations lack vision; both are beclouded by emotionalism and misperceptions. But beyond that, both nations have severe problems both in managing the relationship and in managing themselves. The great challenge in the relationship for the United States is whether it can learn how to share power as well as burdens with Japan. The respective national interests overlap but will not be identical; compromise will be necessary, but will be difficult for the United States. For Japan the crucial issue is what sort of vision it will develop of itself and the world; and how it will exercise power responsibly*<sup>55</sup>.

How effective was SII? SII was negotiated a few years after the Plaza agreement (1985), which had led to a rapid appreciation of the yen after 1985, the consequence of which was that imports were more attractive in Japan, while Japanese exports slowed. So, by the time the SII talks were concluded in June 1990, trade frictions between Japan and the United States had started to decline. Nonetheless, frictions continued for a while in some areas, especially in high-technology sectors, as discussed in *Who's Bashing Whom*, published in 1992 by Laura d'Andrea Tyson (1991), who served as Chair of

<sup>52</sup> Patrick (1990), p. 3.

<sup>53</sup> See, for instance, Grier (1992).

<sup>54</sup> See, for instance, Matsushita (1990) and Saxonhouse (1991). Matsushita mentions a widespread discomfort with SII in both sides of the Atlantic. We quote from p. 436: "Not surprisingly, the SII was criticized both in the United States and Japan. Japanese critics felt that the U.S. government was trying to interfere with Japanese domestic matters. In the United States, some critics believed that the SII would have a minimal effect, if any, on the trade imbalance."

<sup>55</sup> Patrick (1990), p. 12.

President Clinton's Council of Economic Advisors and then as Director of his National Economic Council during his first term in office (1993-1996).

The collapse of the Japanese asset price bubble in the early 1990s and the ensuing 'Lost Decade' helped to reduce trade tensions. Between 1990 and 2018, Japan's economic growth averaged less than two percent, a full percentage point lower than in the United States. As a result, the ratio between Japanese and US GDP continuously declined from its peak of 40 percent in 1991 to 27 percent in 2018, the lowest level since 1970. Similarly, Japan's share of international trade never returned to its peak level in 1990. Japan was not a threat anymore. Various contributions in Hamada *et al* (2010) lend ample support to the view that trade frictions disappeared after the burst of the asset price bubble.

Nonetheless, the United States did score some victories with the SII negotiations, which had an impact on trade relationships. For instance, Japan changed its large-scale retail law. As a result, conditions for opening up large stores in Japan were relaxed, though the subsequent emergence of e-commerce reduced the importance of this change.

### **3.2.2 Comparing China with Japan**

Some of the current complaints and measures against China are very similar to those against Japan decades ago, but others are quite different. The reason is two-fold: first, China and Japan are similar in some respects, but different in others; second the current WTO system is similar in some ways to the GATT system that existed earlier, but different in others.

We begin by examining the similarities and differences between China and Japan, and then examine how they have translated into differences and similarities between the complaints and trade measures against China and Japan.

#### **3.2.2.1 Similarities and differences between China and Japan**

Both countries shared at the moment of their accession the belief that export-led growth was the way forward. This was the outcome of strategic policy decisions: the domestic market would remain closed, and through a mix of the ensuing gains from economies of scale and generous government help, domestic companies would be in position to conquer export markets.

Japan, like China, was not living in a Melitz world (2003), where winners are the outcome of international competition. It was all about strategic policy. The success of such strategies depends in part on global demand and on the willingness of foreign partners to play the game. Japan practiced it at the right time. When it joined the GATT in 1955 and for the next 15-20 years, the US economy was booming, and many European economies were enjoying *les trentes glorieuses*, the 30 years after the second world war when everything went right, with exceptionally high growth and low unemployment. Moreover, the integration of the EU market provided Japanese exporters with fewer barriers to implement their export-led growth strategy.

The global environment, especially in the trilateral economies (European Union, Japan and the United States) has been less favourable since China joined the WTO in December 2001. Did it make sense therefore for China to pursue an export-led strategy similar to Japan's despite the changed global conditions? Yes, responded Haddad and Shepherd (2011), quite persuasively. Writing after the unprecedented, at least since the second world war, 2008 crisis, they explained why, because of the resilience that some key features of the WTO regime have exhibited, export-led growth could still pay off in today's world. Bown (2018) has provided sufficient evidence to this effect.

Notwithstanding the difference in the global environment between then and now, the two Asian countries enjoyed a similar export-led economic miracle during the first 15 years after their accession to the GATT/WTO, with GDP growing at an average annual rate of close to 10 percent.

There are, however, three important economic differences between China and Japan that have a bearing on the reaction by their main trading partners to their highly successful export-led growth strategy.

The first is economic size. As we already mentioned, Japan's GDP was barely 12 percent of the US GDP in 1955 and, although it grew rapidly during the next 15 years, it was equivalent to only 29 percent of the US GDP in 1970. By contrast, China's GDP (measured at PPP) was already equal to 43 percent of the US GP in 2001 and surpassed US GDP 15 years later.

The second difference is *per-capita* income. In 1955, Japan's *per-capita* income (measured at PPP) was equal to only 22 percent of the US level; in 1970, it reached 56 percent. And it continued growing. In fact, Thurow (1992), an MIT economist, saw Japan rivalling the European Union and the United States before long. His prediction did not materialise, but China is anyway much poorer. In 2001, its *per-capita* income was barely 10 percent of the US level; 15 years later, it was still at only 24 percent.

The third difference is the role of the state in the economy and the extent of the rule of law. China joined the WTO as an NME and, although there are discussions as to whether it is still an NME or not today, China certainly considers itself to be a "*socialist market economy*", thus acknowledging the importance of the state in the functioning of the economy. In addition, China has been a country where the rule of law has been patchy. By contrast Japan was never an NME nor a socialist economy, and the rule of law was never a problem. The Japanese domestic legal regime was never a cause of concern. Private rights were acknowledged in the Japanese constitution, and enforcement was quite meticulous. As a result, the country integrated into the 'Western club' quite rapidly after joining the GATT. It even became a certified member of the club in 1964, when it joined the OECD.

There is, finally, a geopolitical difference between the two countries, which is crucial for their trade relationship with one of their main trading partners, the United States. Since the second world war, Japan has been dependant on the United States for its security, with a large presence of US military personnel and weapons on its soil. China, on the contrary is increasingly becoming a military rival to the United States, especially in the South China Sea. Hence, while both Japan and China have been labelled at times economic rivals by the United States, China is also considered a strategic rival.

### **3.2.2.2 The Protocol of Accession for China: unfulfilled promise**

China made all the right noises on the economic front before it initiated its accession process. The Deng reforms were almost a dozen years old by the time accession negotiations were launched. They spoke loudly enough to the ears of trade negotiators who conveniently forgot the events of 1989 on Tiananmen Square. And yet the events revealed a lot about the extent to which China was a *Rechtsstaat*. In an ever-more globalised world, was it reasonable for the incumbents to overlook as much?

The issue is this: the implicit liberal compromise ensured the policy relevance of the GATT (and now WTO) in the domestic sphere. Disrespecting the liberal compromise entails to a large extent the policy irrelevance of the WTO. WTO members might be behaving like good citizens by respecting reports if and when caught and brought to justice.

China's Protocol of Accession was meant to bridge the gap between the place where China was, and the place where China should be when acceding to the WTO, in light of the acknowledgement that the implicit liberal understanding had long lost its GATT-wide acknowledgement. As on previous occasions, instead of embedding the liberal understanding in the multilateral context, incumbents preferred to introduce it in a protocol of accession. There is an upside and a downside to this approach: the downside is that the liberal understanding is customised, and this might eviscerate its functionality. The upside is that protocols of accession can better adjust to idiosyncratic elements of particular members. But it has to be enforced for some, when for others it can be taken for granted.

There is no evidence of coordination between the incumbents when negotiating with China. The negotiation was not between China and the WTO. The negotiating record suggests that, as in the past, a series of bilateral negotiations was conducted instead<sup>56</sup>. And yet this was no ordinary concession: China was not only a behemoth in terms of trade potential. China was also a country with a lot to be desired in terms of respect of basic human rights, state interference, independence of justice, etc<sup>57</sup>. Even though a WTO-wide coordination might have been difficult if not impossible in light of the membership's heterogeneity, the European Union and the United States, the then big two of the system, might have wished in retrospect that they had better coordinated their bilateral negotiations with China.

China's Protocol of Accession contains obligations that are both similar and different to the obligations contained in the protocols of accession to GATT for the European socialist countries. What is similar is the possibility for WTO members to (1) treat China as a NME for the purpose of Article VI of GATT, and (2) apply safeguards on conditions less stringent than those embedded in Article XIX of GATT. Both possibilities however were limited in time: 15 years after the accession of China to the WTO, expiring in December 2016<sup>58</sup>.

The difference is two-fold. On the one hand, China was not obliged to meet certain import targets from WTO members. On the other hand, China had to accept WTO+ obligations regarding SOEs, IP protection and technology transfer. In this realm, we notice that government interference was addressed. There was awareness, widespread awareness, about the role that SASAC (State-Owned Assets and Supervision Commission) was playing in the Chinese economy, and the ensuing need to discipline it. The SASAC operates under the State Council, and essentially administers SOEs (that have not been privatised) by appointing directors, etc. Alignment with international prices was explicitly inserted. IP rights needed to be protected (as we have seen above).

Carefully crafted obligations exist in various other areas as well, and also in the realm of transfer of technology, one of the focuses of our study. In §48 of the report of the Working Party on the Accession of China, we read an unambiguous promise by the government of China to stop any state-mandated WTO-inconsistent transfer of technology. The working assumption must have been that, if state involvement was totally absent, then it would have been quite hard for private operators to collude and request transfer of technology. The meaningfulness of this provision depends of course, on the manner in which China would implement its obligations regarding state interference with respect to

<sup>56</sup> Stewart (1993) has supplied a public good by putting it together in very comprehensive manner.

<sup>57</sup> Long Yongtu was China's chief negotiator, and later member of the Shanghai Forum. Anecdotal evidence suggests that Premier Zhu Rongji confided to WTO Director-General Mike Moore that the accession process was dominated by disagreements between the Beijing (government) conservatives, and the Shanghai (private sector) progressives.

<sup>58</sup> This deadline was imported verbatim from the US-China Bilateral WTO Agreement of November 16, 1999. A number of influential people in the United States believed that this was a realistic deadline for China to transform into a full-fledged market economy, see <https://clintonwhitehouse4.archives.gov/textonly/WH/New/WTO-Conf-1999/factsheets/fs-006.html>, and also <http://images.mofcom.gov.cn/wto2/201712/20171213174424357.pdf>.

SASAC. Nevertheless, China has accepted a firm commitment to stay away from interfering for the purposes of helping domestic producers.

What is puzzling then, since most of the time the accusation is that China interferes too much in the marketplace, is why have we seen the Protocol of Accession litigated on so few occasions? Was not China, for example, considered to be the champion of violations of IP rights? If the number of TRIPs-related disputes is an appropriate benchmark, then China has fared pretty well in the WTO<sup>59</sup>. The hypothesis that China has delivered must be excluded, since otherwise, why all the fuss?

It is also true that it is practically impossible to know the reasons for non-enforcement. The reasons lie in the realm of private information, and those possessing it obviously have no incentive at this stage to divulge. We are facing a classic prisoner's dilemma.

One could only speculate why enforcement has not occurred. Contract incompleteness could be a reason: what is the level of independence for domestic tribunals sought through the TRIPs+ provisions in the Protocol of Accession? It could also be that some might think that risk-averse panels might find their arguments a long shot: the disciplines on transfer of technology do not bind private parties. What are, for example, the evidential requirements that must be met for a complainant to show that collective refusal to enter into joint ventures without transfer of technology is the brain child of state interference that China promised to eradicate? Inaction could also be down to more mundane reasons. Western companies participating in global value chains might, in the name of the surprisingly cheap Chinese inputs they incorporate, be willing to turn a blind eye to business-unfriendly behaviour<sup>60</sup>. Or some companies might feel that by alerting their sovereigns to infractions, they risk their places on the lucrative Chinese market. Or even China might through carrots (preferential entry in their investment market) incite similar behaviour. There is no shortage of explanations of lack of enforcement.

So, what should be done under the circumstances? How can we correct the enforcement deficit? We do not subscribe to the view that the Protocol of Accession is first best. A few things could have been done better, and we will refer to some issues, which in our view were dealt with more efficiently in the TPP Agreement (Trans-Pacific Partnership), renamed CPTPP (Comprehensive and Progressive Agreement on Trans-Pacific Partnership) after the US withdrawal from TPP. In this realm, negotiators had of course, the luxury of agreeing on issues that could eventually influence China, without China being in position to influence the negotiation itself, since it had not been invited to participate.

### **3.2.2.3 Complaints and measures against China and Japan by their main trading partners**

The highly successful Japanese and Chinese export-led growth strategies were both met by a backlash from their leading trading partners. In part, this was because GATT/WTO contains a large arsenal of rules permitting countries to adopt trade defence measures such as anti-dumping, anti-subsidy and safeguard duties.

In the case of Japan, its exports were initially limited by the fact that European and other countries invoked non-application for about 10 years after it joined the GATT. Nonetheless, Japan's share of world merchandise exports grew rapidly. From 1.5 percent in 1955, it increased to 6 percent in 1970 and reached a peak of 10 around 1990. The result, as we have seen, was the imposition of measures to limit Japan's exports by its trading partners, including through voluntary export restraint (VER) measures that were clearly in violation of GATT rules but were nonetheless tolerated by the GATT

<sup>59</sup> There is the sporadic reason to even feel optimistic that things have changed, as the recent dispute between Huawei and Samsung adjudicated before a Chinese court shows, see the summary of the dispute in <https://www.theglobeandmail.com/business/article-huawei-patent-case-shows-chinese-courts-rising-clout-2/>.

<sup>60</sup> Blanchard *et al.* (2017) have expressed views on this score.



membership. The WTO Agreement on Safeguards (SG Agreement) banned the use of VERs and similar other 'grey area' measures (such as orderly market arrangements) that had become widespread in some GATT members to limit imports from Japan and other countries.

In the case of China, non-application was not an option. Recall, only one WTO member, and not one of the leading trading nations, invoked Article XIII of the Agreement Establishing the WTO – the successor provision to Article XXXV of GATT – vis-à-vis China: El Salvador<sup>61</sup>. The other members were divided into three distinct groups, with some in more than one group. Some wanted to avoid a clash with the most populated country in the world at the time when it was regaining its seat in the multilateral trading system. Some saw huge trading opportunities for their companies on the Chinese market. And some, as already stated, genuinely believed that China would transform fast, maybe sub-consciously thinking of the prior Japanese experience.

GATT/WTO contains adequate disciplines to address the rise of Chinese exports with trade defence measures. Furthermore, until 2015, because of a clause inserted to this effect in the Protocol of Accession, WTO members could presume that China was an NME, and use surrogate countries or constructed costs when imposing anti-dumping duties. The 2015 deadline inserted in the Protocol of Accession should be understood as a presumption, and nothing more. Consequently, siding with Mavroidis and Janow (2017), WTO members can lawfully continue to treat China as an NME even after 2015, but, if they want to avail themselves of this possibility, the onus is on them to show why China is an NME. They cannot presume that this is the case anymore.

WTO members can further impose countervailing duties if they can show that Chinese SOEs (or private companies) have received subsidies from the state. Case law might have made it more difficult to impose duties on imports originating from SOEs, but this is a matter of interpretation. Similar issues can be avoided in the future by pre-empting judicial discretion, as we suggest in our recommendations.

Safeguards can always be imposed against an influx of imports, assuming the statutory conditions have been met.

The fact that trade remedies in the WTO are *de-facto* prospective (which means, that the losing party in a panel simply has to stop the illegality from the end of the compliance period, roughly four years from the initiation of the dispute, assuming an appeal has been launched) entails that importers have a comprehensive arsenal at their disposal to address unfair (dumped, subsidised) or even fair trade to the extent that it has caused damage to their domestic industry (injury to competitors, not to competition). Like earlier with Japan, China's main trading partners are therefore able to deal with its exports in a satisfactory manner using the WTO arsenal.

The situation is different when it comes to China's domestic market, as it was at the time with Japan's domestic market, because here GATT/WTO disciplines are not as effective. In essence WTO members, such as the European Union or the United States, can always prevent the entry of foreign products into their market by putting up anti-dumping, anti-subsidy or safeguard tariffs against these products – though in the case of a large country like China they have to worry about possible retaliation. On the other hand, WTO members cannot simply force access to a foreign market especially if it is protected by behind-the-border measures rather than by tariffs. That was the problem GATT members faced with Japan in the 1980s, and which led the European Union to threaten nullification and impairment and the United States to use Section 301 to impose the SII bilateral negotiations. And it is the problem that WTO members face today with China.

<sup>61</sup> WTO Doc. WT/L/429 of 5 November 2001.

The situation with China today is however somewhat different from the situation with Japan 25-30 years ago. WTO disciplines on behind-the-border measures are stricter than earlier GATT disciplines. Hence, in principle China (like any other WTO member) should have less opportunity to restrict access to its market than Japan (or any other GATT member at the time). Moreover, the Protocol of Accession for China contains binding obligations to respect China-specific WTO+ commitments, whereas no specific obligations were present in the Protocol of Accession for Japan. At the same time, however, the involvement of the state in the Chinese economy and the extent to which China abides by the rule of law make it more difficult to enforce WTO commitments in China, especially when it comes to behind-the-border measures that are by nature difficult to enforce for a member-driven organisation like the WTO, which has no investigative or enforcement powers on its own initiative.

This, together with the fact that Chinese imports have grown less rapidly than Chinese exports, explains why China's trading partners have grown frustrated with its import policy in recent years and have taken a host of measures to try and remedy the situation.

### 3.2.2.3.1 Multilateral measures (WTO)

Since its accession to the WTO, China has been a defendant in 43 cases, of which six have been settled or terminated and 11 are still in consultations, some for a long time. Of the remaining 26 cases, 19 have been adjudicated while seven are pending at time of writing<sup>62</sup>.

Among the 19 adjudicated cases: seven concern trade defence measures by China against imports of various products (from the EU, the US, Canada and Japan); six concern duties on exports of various basic products (to the EU, the US, Japan and Mexico); three concern measures affecting imports of auto parts (from the EU, the US and Canada); one concerns measures affecting electronic payment services; one concerns the protection and enforcement of IP rights; and one concerns trading rights and distribution services for certain media products. We will not discuss these cases further since none involved SOEs or technology transfer, on which this paper focuses. Suffice it to say that China lost in all the 19 cases and has complied with the Dispute Settlement Body (DSB) recommendations in all cases.

Although the United States has been the most active complainant against China (with 23 out of 43 total cases and 8 out of the 19 adjudicated cases) and has been very successful in its disputes (with a victory in every adjudicated case), it has also been extremely frustrated with the DSB process.

According to the statement by the US Ambassador to the WTO during the 2018 Trade Policy Review of China:

*The WTO's dispute settlement mechanism is not designed to address a situation in which a WTO Member has opted for state-led trade and investment policies that prevail over market forces and that pursues policies guided by mercantilism rather than global economic cooperation. Rather, it is narrowly targeted at disputes where one Member believes that another Member has adopted a measure or taken an action that violates a WTO obligation. While some Chinese measures have been found by WTO panels or the Appellate Body to run afoul of China's WTO obligations, fundamental problems remain unaddressed as many of the most significant Chinese policies and practices are not directly disciplined by WTO rules or the additional commitments that China made in its Protocol of Accession<sup>63</sup>.*

<sup>62</sup> Of these seven cases, panels have been established but not yet composed at time of writing in five cases and panels composed in two other cases.

<sup>63</sup> WTO Doc. WT/TPR/M/375 at §4.109.

Given this situation the United States has looked for alternative ways to deal with its two main complaints about China: the role of SOEs and forced technology transfer. The first alternative, imagined by President Obama, was the Trans-Pacific Partnership Agreement. The second is Section 301, revived by President Trump.

### **3.2.2.3.2 Regional measures (TPP)**

One attempt to find an alternative, or perhaps a complement, to the multilateral track was the Trans-Pacific Partnership negotiated during the Obama presidency. The TPP agreement between the United States, Japan and ten other Pacific Rim countries (Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam) signed on 4 February 2016 was an important strategic and political success for President Obama and Japanese Prime Minister Abe.

The deal, which was still awaiting ratification by the US Congress at the end of President Obama's presidency in order to enter into force, was meant to cover 40 percent of the global economy and create an economic bloc with reduced trade barriers to the flow of goods, services and data, and with new standards and rules for investment, the environment, labour, IP right protection and state-owned enterprises.

The TPP agreement was the economic centrepiece of the President Obama's pivot to Asia, which was designed to counter the rise of China in the Pacific and beyond. As the president stated on the signing of the agreement, *"TPP allows America — and not countries like China — to write the rules of the road in the 21st century, which is especially important in a region as dynamic as the Asia-Pacific"*<sup>64</sup>.

### **3.2.2.3.3 Bilateral measures (Section 301)**

One of the first acts in office of President Trump in January 2017 was to fulfil his campaign promise to withdraw the United States from the TTP Agreement. During the campaign, candidate Trump also pledged to label China a *"currency manipulator"* on his first day in office. But in an interview with the *Wall Street Journal* in April 2017, President Trump changed his mind. *"They're not currency manipulators"*, he said, reflecting the latest US Treasury Department's finding in its annual report on foreign exchange policies of major trading partners.

At the time of writing, President Trump's position on the yuan-dollar exchange rate has not altered. It seems unlikely therefore that he will seek an agreement with China similar to the 1985 Plaza agreement with Japan, which together with the 1991 SII agreement, resulted in a significant reduction in Japan's exports to, and increase in its imports from, the United States.

What President Trump has done, however, has been to revive the use of Section 301 as a lever to try and force domestic changes in China, as President George H.W. Bush did in 1989, when he named Japan an unfair trading nation, thus paving the way for the SII negotiations.

Section 301 was used extensively during the 1980s and 1990s, not only against Japan but also against other US trading partners in order to open up their markets and force them to better enforce US IP rights holders. With the conclusion of the Uruguay Round negotiations in 1994 and the establishment of the WTO, Section 301 remained on the statute books but was downgraded to an instrument of diplomatic protection<sup>65</sup>. The reason, as discussed by Chad Bown (2017), is two-fold.

<sup>64</sup> Statement by the President on the Signing of the Trans-Pacific Partnership, 3 February 2016.

<sup>65</sup> Nonetheless, Section 301 has continued to serve as an instrument at the disposal of private parties, which have no standing before the WTO courts, to alert the US government of foreign trade practice that hurt them. It serves the same purpose, therefore, as the EU Trade Barriers Regulation.

First, the WTO brought in new multilateral discipline in areas of huge commercial interest for the United States, with the GATS Agreement for services and the TRIPS Agreement for IP rights. Second, the new dispute settlement system, with the creation of the Appellate Body and the introduction of remedies in case of non-compliance with DSB rulings, became far more constraining than the relatively toothless GATT system that the United States had long complained about. But the main reason, we believe, is that the WTO DSU (Dispute Settlement Understanding) has copied the deadlines of Section 301.

Although Washington made a number of criticisms about the functioning of the WTO dispute settlement system, on the whole it seemed to provide a satisfactory (from the US viewpoint) alternative to the unilateral Section 301 process. In fact, according to Bown (2017), Section 301 was never used by the US administration after the start of the WTO and before the Trump presidency. The decision in August 2017 of President Trump to ask the US Trade Representative to launch a Section 301 investigation into “China’s acts, policies, and practices related to technology transfer, intellectual property, and innovation” was therefore momentous. In March 2018, the Trade Representative advised President Trump that the investigation supports the following findings<sup>66</sup>:

*First, China uses foreign ownership restrictions, including joint venture requirements, equity limitations, and other investment restrictions, to require or pressure technology transfer from U.S. companies to Chinese entities. China also uses administrative review and licensing procedures to require or pressure technology transfer, which, inter alia, undermines the value of U.S. investments and technology and weakens the global competitiveness of U.S. firms.*

*Second, China imposes substantial restrictions on, and intervenes in, U.S. firms’ investments and activities, including through restrictions on technology licensing terms. These restrictions deprive U.S. technology owners of the ability to bargain and set market-based terms for technology transfer. As a result, U.S. companies seeking to license technologies must do so on terms that unfairly favour Chinese recipients.*

*Third, China directs and facilitates the systematic investment in, and acquisition of, U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and to generate large-scale technology transfer in industries deemed important by Chinese government industrial plans.*

*Fourth, China conducts and supports unauthorized intrusions into, and theft from, the computer networks of U.S. companies. These actions provide the Chinese government with unauthorized access to intellectual property, trade secrets, or confidential business information, including technical data, negotiating positions, and sensitive and proprietary internal business communications, and they also support China’s strategic development goals, including its science and technology advancement, military modernization, and economic development.*

Based on the threat to US competitiveness and to national security that these findings implied, President Trump directed the USTR to take appropriate action, including increased tariffs on goods from China. The amount of Chinese imports facing additional duties initially set at \$60 billion was later raised to \$260 billion. In retaliation the Chinese Government initially announced additional duties on US imports worth \$60, an amount later raised to \$120 billion.

<sup>66</sup> Presidential Memorandum on the Actions by the United States Related to the Section 301 Investigation, issued on 22 March 2018.

Remember that after Japan was named an unfair trading nation, President George H.W. Bush decided not to impose additional duties, but instead launched the SII talks. Clearly US-China relations today are very different from US-Japan relations 30 years ago. At the time the United States and Japan were simply trading accusations that each was bashing the other. Today, the United States and China are in a trade war affecting more than fifty percent of their bilateral goods trade<sup>67</sup>.

#### 4. The way forward

As was anticipated, the accession of China to the WTO has been highly significant for China, the WTO and the world. But nearly 20 years after the event, our analysis in this paper shows that the fit between China and the WTO is not seamless. Dangerous tensions for the world trading system have not been avoided. At least in the eyes of her main trading partners, including the European Union, Japan and the United States, China has not become the type of market economy they envisaged back in 2001. This situation has added to the woes of the WTO.

The question is what to do now. How can the WTO regime better accommodate a behemoth socialist market economy, as China characterises itself? Should we look for a Protocol of Accession 2.0, or is it time for a WTO 2.0?

During the GATT era, the trading system was able to deal successfully with the accession of new members that were either socialist (like Poland) or large (like Japan), but it never had to deal with a country like China, which is both socialist and large. The way GATT handled the accession of these new members was through protocols of accession that were, during this era, nothing more than tariff commitments, plus, in the case of socialist countries, promises to import more. In the case of Japan, a large market economy, but with a significant state involvement, the protocol of accession proved however insufficient to avoid tensions after its economy rose to second in the world, behind the United States. The European Union and the United States, the country's main trading partners, took umbrage at Japan's behaviour and demanded changes. The European Union acted within the GATT but mostly failed. The United States acted outside the GATT and succeeded.

The WTO-era is different from the GATT-era on two accounts: depth and width. GATT agreements and commitments essentially concerned tariffs. WTO agreements go far deeper, with disciplines on behind-the-border issues left unregulated by the GATT, such as intellectual property protection, technical barriers to trade and trade in services, which all require adherence to the liberal understanding of the law in order for commitments to be meaningfully enforced.

Furthermore, except for a handful of socialist countries of small to insignificant size (including Poland, Hungary and Romania, who anyway joined after the advent of the GATT and thus, did not influence its design and GATT-Think), GATT members were mainly Western countries, including Japan, which joined the Western club (the OECD) within ten years after it had joined the GATT. By joining the OECD, Japan adhered to all soft law initiatives adopted by the Paris organisation regarding the role of the state in regulating economic policies, the behaviour of private agents, etc. From soft law, it was a short walk to binding regulation. This means that all GATT members that mattered in terms of international trade, basically shared or accepted the liberal understanding of the law and the economy.

<sup>67</sup> In 2017, the US imported \$520 billion of Chinese goods and exported \$190 of goods to China. The trade measures announced in 2018 cover therefore 50 percent of US imports from China and more than 50 percent of Chinese imports from the US.

With the end of the Cold War, the WTO has become a truly global organisation. Its members now include countries in transition from planned to market economies and which fall into three categories: some that have formally abandoned socialism, but where the state continues to play an important role (such as Russia and many other former Soviet republics); others that have fully endorsed the market economy system (such as the countries of Central and Eastern Europe, including some former Soviet republics, which have become members of the European Union); and still a few others that remain socialist economies, including China and Vietnam.

China's Protocol of Accession to the WTO was an attempt to use an old instrument (the protocol of accession) to deal with a totally new challenge: the accession of a very large and socialist country, in transition towards a market economy, to a rules-based international trading order designed by and for liberal-minded countries and encompassing not only tariffs but also behind-the-border measures.

Protocols of accession, as we have seen, originally included only the level of tariffs on which acceding countries and incumbents had agreed upon. Eventually, protocols contained language to the effect that certain volumes of trade should be guaranteed. This approach was satisfactory for the accession of countries with no bargaining power, which could not affect terms of trade. The situation was different with China. The Protocol of Accession was extended, and protracted, but the question was how much can you include in a Protocol of Accession without being accused of going overboard? After all, how much more could China accept beyond what others had signed up to? And since the liberal understanding is just this, an understanding, since the GATT/WTO does not explicitly condition accession upon prior democratic and market-friendly transformation, as the European Union does, what was the moral justification for imposing on China obligations that no other country had accepted?

All this argued in favour of under-including rather than over-including obligations in the Protocol of Accession. And this is what happened.

The Protocol went some way to help China fit with the WTO, but in other ways it was, as we discussed in section 3, a missed opportunity. Partly China did not keep to some of its commitments (on interference with market mechanisms or using SOEs to undo some of its obligations) and partly the Protocol has been under-enforced.

In section 1 we discussed three potential options for the future relationship between China and the WTO: forcing China to change its economic regime through economic and political pressure; doing nothing, that is keeping the status quo as far as China and the WTO are concerned; and using the WTO framework to bring about a better fit between China and the WTO.

The first option, chosen by the Trump administration, is a mixture of unilateral measures and bilateral negotiations with China that bear a strong resemblance to the successful actions of earlier US administrations in relation to Japan. However, as we have argued, China is very different from Japan in geopolitical terms and is unlikely therefore to give in to US pressure, which will only increase the frustration of the Trump administration towards China and the WTO.

A variant of the first option was the TPP approach pursued by the Obama administration, and elegantly argued for by Mark Wu (2016). This consisted of putting pressure on China to change its economic system by creating a grouping of Pacific countries led by the United States and excluding China.

Another variant of this first option is to pursue bilateral trade and investment agreements with China that contain some new discipline. Both the United States (since 2008) and the European Union (since 2013) have been negotiating (separately) bilateral investment treaties with China, but little progress

has been achieved so far. And both have announced that they will not envisage negotiating bilateral trade agreements with China before signing investment deals.

As far as the European Union is concerned, one clear source of inspiration for the bilateral discussion with China is the EU-Vietnam Free Trade Agreement and the EU-Vietnam Investment Protection Agreement, which were both completed in July 2018, but are still awaiting signature and ratification.

The second option, discussed by Dani Rodrik (2018), would be to essentially do nothing and consider that neither China nor the WTO need to change in order to accommodate better one another.

Our analysis in sections 2 and 3 of this paper leads us to the conclusion that neither of two options is realistic nor desirable. A third option must therefore be pursued in the collective interest of the WTO membership to preserve the rules-based multilateral trading system. This option relies squarely on WTO mechanisms.

There are, however, two different avenues that can be pursued within the WTO framework: a China-specific avenue, or a WTO-wide avenue.

The most obvious China-specific avenue within the WTO framework is to litigate against China on the basis of its Protocol of Accession. This avenue has clearly borne fruits in the past, when the cases concerned clear-cut commitments by China. This is what happened with several cases about export taxes, which were all won by the European Union, Japan or the United States. Similarly, the European Union is likely to win its ongoing dispute with China on forced technology transfer, which we discussed in Section 2, because it is based on clear commitments made in China's Protocol of Accession.

However, complaints about China in cases regarding requests for technology transfer by private Chinese companies as a condition to enter into joint ventures with foreign firms, and/or in cases involving SOEs, cannot be easily litigated at the WTO on the basis of China's Protocol of Accession because there is either no commitment or the existing commitments are not sufficiently clear cut. The broader point is that we do not think it is helpful to litigate at the WTO in cases where the rules and commitments are not sufficiently clear and where there is therefore a risk of error by panels and by the Appellate Body.

An alternative China-specific avenue within the WTO framework was proposed by Jennifer Hillmann, a former member of the Appellate Body. Her proposal is to initiate non-violation complaints (NVCs)<sup>68</sup> against China. We disagree with this proposal on two grounds. First, NVCs do not lead to obligations to remove the challenged measures since they are not deemed illegal in the first place. China has always the option to simply offer compensation to the litigant, without incurring the obligation to change its policies. Second, China has always the option of settling before the judgement, which avoids condemnation of its practices.

For all these reasons, we favour clarifying the WTO rules, when the commitments by China in its Protocol of Accession are either absent or fuzzy. Within the third option, therefore, we favour a WTO-wide solution, which consists of reinforcing the WTO by amending it, when litigation based on the Protocol of Accession is not feasible. In this case, we propose a five-pronged strategy that would build partly on the European Union-Vietnam proposed FTA, and on the Comprehensive and Progressive

<sup>68</sup> Briefly, an NVC allows WTO members to request compensation even for legal measures, which nevertheless nullify or impair the benefits accruing to them. What matters is that benefits have been impaired, irrespective of whether the action complained against is legal or not. To this effect, they will have to show that their benefits have been impaired as a result of a measure by a WTO member, which they could not have reasonably anticipated. For a detailed discussion, see Bagwell and Staiger (2001).

Agreement for Trans-Pacific Partnership (CPTPP), the successor to the TPP agreement, from which the United States withdrew in January 2017, a few days after President Trump's inauguration.

#### 4.1 Transfer of technology

In this area, the key issue is the Chinese law on joint ventures and the related regulations that impose the creation of joint ventures with Chinese partners on foreign firms wanting to invest in China.

With respect to investment, Chapter 9, Article 9.10 of CPTPP contains the following understanding of performance requirements:

*1. No Party shall, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any requirement, or enforce any commitment or undertaking:*

*(f) to transfer a particular technology, a production process or other proprietary knowledge to a person in its territory<sup>69</sup>;*

The carefully drafted provision creates an obligation not to impose or enforce the forced transfer of technology. By outlawing enforcement, this provision drastically reduces the incentive to request (non-voluntary) transfer of technology in the first place. Furthermore, those who could potentially request it will find it hard to collude and request transfers.

WTO law has no provision like this. Imaginative provisions will not suffice, however. But this is a provision that could find its way in a new agreement on investment. As the WTO has already started discussions on investment facilitation, and the voices arguing for a comprehensive agreement on trade and investment multiply, this is something to think about.

China has adopted a Technology Import Export Regulation (TIER), which does not force technology transfer in the sense that 'forced transfer of technology' is done in practice. This, of course, in and of itself does not amount to proof that transfer of technology does not happen at all. Complainants, however, cannot base themselves on TIER when mounting similar claims. They have to produce other (circumstantial) evidence in order to prevail, if they wish to pursue litigation (leaving aside the question about the appropriate forum).

TIER nevertheless, contains two clauses that both the EU Regulation Technology Transfer Block and the US Transfer Guidelines have included among the nine clauses that no enterprise/state should ever request/enforce. These are:

- The regulation mandates, irrespective of the willingness of licensors and licensees that the foreign licensor surrenders ownership of any improvement, that is there is no forced grantback to the licensor;
- Under the same circumstances, TIER prohibits licensing agreements that unreasonably restrict the export channels (marketing rights) of Chinese licensees.

These two conditions have been embedded in TIER, and the Chinese Ministry of Commerce (MOFCOM) aims to ensure that they are being observed in practice.

<sup>69</sup> The full text of CPTPP is available at <https://www.mfat.govt.nz/assets/Trans-Pacific-Partnership/Text/9.-Investment-Chapter.pdf>



These two clauses are problematic for a number of reasons. A licensor might never be willing, for example, to lower royalty payments for licensees, unless there is some sharing of improvements on the original license. What is worse is that the licensor is excluded from improvements. Under the circumstances, it might be unwilling to conclude a deal with a Chinese company, or be forced to accept deals for short-term gains, putting in danger its own mid- to long-term position in the market, and anyway, providing Chinese companies with a considerable advantage.

Furthermore, assuming challenges against the license, TIER requests the licensor to bear all responsibility, even if the challenge is directed against the manner in which the licensee has been utilising the license.

With respect to marketing rights, we should note that, without flexibility, both licensor and licensee might have to forego their licensing agreement in the first place.

We should note in this respect, Article 40 of TRIPs which reads as follows:

*1. Members agree that some licensing practices or conditions pertaining to intellectual property rights which restrain competition may have adverse effects on trade and may impede the transfer and dissemination of technology.*

*2. Nothing in this Agreement shall prevent Members from specifying in their legislation licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market. As provided above, a Member may adopt, consistently with the other provisions of this Agreement, appropriate measures to prevent or control such practices, which may include for example exclusive grantback conditions, conditions preventing challenges to validity and coercive package licensing, in the light of the relevant laws and regulations of that Member.*

*3. Each Member shall enter, upon request, into consultations with any other Member which has cause to believe that an intellectual property right owner that is a national or domiciliary of the Member to which the request for consultations has been addressed is undertaking practices in violation of the requesting Member's laws and regulations on the subject matter of this Section, and which wishes to secure compliance with such legislation, without prejudice to any action under the law and to the full freedom of an ultimate decision of either Member. The Member addressed shall accord full and sympathetic consideration to, and shall afford adequate opportunity for, consultations with the requesting Member, and shall cooperate through supply of publicly available non-confidential information of relevance to the matter in question and of other information available to the Member, subject to domestic law and to the conclusion of mutually satisfactory agreements concerning the safeguarding of its confidentiality by the requesting Member.*

*4. A Member whose nationals or domiciliaries are subject to proceedings in another Member concerning alleged violation of that other Member's laws and regulations on the subject matter of this Section shall, upon request, be granted an opportunity for consultations by the other Member under the same conditions as those foreseen in paragraph 3.*

It follows that WTO members, China included, allow competition law to have a role in technology-transfer agreements, if such agreements are injurious to competition and to future innovation. This

seems to us like a promising avenue, but to our knowledge so far no complaint has been raised to the effect that China has violated Article 40 of TRIPs through its technology transfer practices<sup>70</sup>.

We should add here a remark to avoid misunderstanding. The European Union's formal complaint against China about forced technology transfer discussed above concerns a very clear obligation assumed by China (in Paragraph 7.3 of its Accession Protocol) to avoid enforcing performance requirements. Here, we discuss transfer of technology in other areas as well, where current rules are far from creating an unambiguous obligation (like that imposed through Paragraph 7.3). This is why we favour, in this respect, and in light of the fact that transfer of technology is a major concern for technology-exporting countries, a clarification of the rules.

## 4.2 SOEs

Some progress can be achieved through a less-formalistic understanding of the Agreement on Subsidies and Countervailing Measures (SCM). The US administration had, wrongly, decided to simply equate state ownership with market-unlike behaviour, without checking whether or not a given state-owned company behaves like a private company. The WTO Appellate Body was equally wrong to see nothing in state ownership. And we ended up with an outcome in which the Appellate Body would not see anything wrong with state ownership, and would find against the United States routinely, each time the United States equated state-owned companies with subsidising agents. A crisis erupted as a result, and it was not China-specific. It helped ignite the fire that threatened the very existence of the Appellate Body and compulsory third-party adjudication at the WTO-level. The Trump Administration is carrying the torch.

At the very least, the Appellate Body should have asked the question: why would a state intervene, if the market would have done so anyway? Is not the purpose of the Agreement to compare an actual behaviour with a counterfactual where the state has not intervened?

What to do? We believe that emulating Chapter 17 of CPTPP (and previously of TPP) is the model we aspire to see in the WTO as well<sup>71</sup>. What does this Chapter do? It does precisely what a series of GATT/WTO panels should have done. Article XVII of GATT deals with state-trading enterprises (STEs), and some SOEs are STEs as well. This provision requires WTO members to ensure that their STEs behave in accordance with commercial considerations, to give interested parties adequate opportunities to compete, and to avoid discriminatory behaviour. A series of GATT/WTO panels turned the test on its head, when understanding the first two obligations as a sub-set of non-discrimination<sup>72</sup>. We can return to orthodoxy by simply reversing case law. We can ensure that this is the case by pre-empting judicial discretion through adopting an Understanding of Article XVII of GATT.

Another approach, though probably more demanding, would be to add language to the new understanding on SOEs, similar to the language in Chapter 11 of the EU-Vietnam FTA, which recognises the right of both parties to decide on its system of state ownership, but requires SOEs to act in accordance with commercial considerations in respect of their commercial activities.

## 4.3 Connecting SOEs to technology transfer

Often technology transfer is requested by SOEs. Sometimes, this is not the case. If SOEs were to be viewed as public bodies, then all requests would be attributable to China anyway. In this scenario,

<sup>70</sup> The WTO in early 2019 embarked on a discussion (not formal negotiation) regarding transfer of technology, see [https://www.wto.org/english/news\\_e/news19\\_e/trip\\_13feb19\\_e.htm](https://www.wto.org/english/news_e/news19_e/trip_13feb19_e.htm).

<sup>71</sup> Hufbauer and Cimino-Isaacs (2015) discuss this point.

<sup>72</sup> The case law is discussed in detail in Mavroidis (2016), volume 1, pp. 397 et seq.

there is no need to amend anything, as China would be violating commitments it has already accepted in its process of accession, as we have explained above. If not, then the two instances (SOEs, private parties) have to be treated in a symmetric manner. The question will be to what extent the challenged measure (forced technology transfer) should be attributed to China or not.

We assume that all the law states is that investment in China is possible only through a joint venture with a Chinese company, and nothing more.

In this case, the definition of public body in SCM case law will almost certainly influence attribution. Assuming SOEs are viewed as public bodies, then it will be a short move for any panel to attribute technology transfer to China. If not, the evidential requirements would be quite substantial. Siding with Wu (2016), who points to the inexhaustible potential for China to evade its obligations, we believe that, even though an informed judge could still reach the optimal result, it would be even better if a CPTPP-inspired solution were to find its way into the WTO as well.

#### **4.4 Enforcement**

Challenge procedures of the Agreement on Government Procurement could provide an inspiration for disputes over IP rights. To some extent this provision, which provides private parties with a direct voice without having to pass through government channels or filters, is echoed in Article X.3 of GATT and Article 41.5 of TRIPs. The difference is timing, and timing is crucial in protection of IP rights. Challenge procedures are geared towards providing fast relief. The WTO membership should think about the possibility of introducing multilateral review of decisions rendered by similar instances. This way the WTO contract will be interpreted harmoniously by the membership.

Obviously, challenge procedures will not solve the deeper issue of the liberal understanding and the rule of law in China. In this respect, one must acknowledge that the country has come a long way since the days of Chairman Mao and that it is moving in the right direction toward establishing a system, where political decisions are accountable to courts rather than the other way round. The inflection point would be the establishment of a *Rechtsstaat*, a decision which rests with China alone.

Efficient challenge procedures will be at best a nudge. But sometimes, a nudge is all you need to better evaluate the shortcomings of inertia, and rethink the merits of change. Establishing fora where private agents can invoke and enforce their rights under international agreements will provide the citizenry with possibilities in an increasingly privatised economy.

But we should not be blind to the fact that the WTO suffers from a general problem of transparency as far as trade measures are concerned. As long as long this problem remains, it will be difficult to enforce WTO rules, whether in SCM, TRIPs or in some other domains relevant to the subject of this paper<sup>73</sup>.

#### **4.5 A plurilateral Silk Road ahead**

Negotiating new agreements is an intimidating task. The fact that WTO members have not managed to add anything to the multilateral arsenal since 1995 other than the Agreement on Trade Facilitation is proof enough of the difficulties associated with such endeavours.

Yet it is absolutely essential to add new rules to the WTO in order to make it fit to today's reality. In particular there is a need to translate the liberal understanding of the law, which was implicit in the

<sup>73</sup> See, for instance, Mavroidis and Wolfe (2015), for the need to expand the role of the WTO Secretariat in this area.

GATT era and remains implicit today in the WTO, into operational rules to ensure that China and WTO members that belong to a different tradition of the law fit better with the WTO than currently.

Given the heterogeneity of the WTO membership, we believe, along with Hoekman and Mavroidis (2015), that plurilateral agreements are the way forward to preserve and reinforce the WTO.

The leading nations of the WTO must get together and design new rules in the domains we have discussed and probably in others. China, undeniably is a leading nation. It has to pull its weight. It belongs to the hard core of countries, along with Brazil, the European Union, India, Japan, the United States and eventually Russia, that should take the lead. In a context of variable geometry, China should be at the forefront. This is a must for the endeavour to succeed and ensure the sustainability of the rules-based multilateral trading system.

## 5. Concluding remarks

China has come a long way since Deng Xiaoping became the country's leader. China's WTO accession was hailed as the apex of a long transformation process. Its transformation though, has stopped short of espousing market economics, the way they are typically understood in the Western world. Its self-proclaimed "*socialist market economy*" system has alienated its trading partners, and ultimately represents a threat, even though this word might sound an exaggeration, to the multilateral trading regime. The WTO regime cannot stay idle, and China-only solutions are simply ineffectual.

The current crisis can partly be addressed through better enforcement of existing rules, including commitments taken by China in its Protocol of Accession. But, in our view, successful enforcement of WTO rules through litigation also requires changing some of the rules themselves in order to translate (some of) the implicit GATT/WTO liberal understanding into explicit treaty language. In this paper, we propose functionalist solutions in line with the objectives and targets of the WTO. Realistically, a re-working of the WTO, inspired by solutions that already exist in preferential and plurilateral agreements can help the regime move out of the current crisis and head into a new era of smoother trade relations.

Staying idle is no option, as the problems will continue to haunt the world trading system, and might even become more entrenched. But forced unilateral or bilateral solutions, as was the case with Japan, would never work with China.

The most promising avenue is the re-negotiation (multilateral ideally, or plurilaterally, if need be, but with the participation of the key players secured) of the WTO contract. The role of the state needs to be curtailed in order to unleash the potential for liberalisation and to help the world community reap the resulting gains. SOEs and transfer of technology are the prime candidates in this realm.

A legitimate question is whether China would accept participation in a multilateral or even plurilateral negotiation that would modify WTO rules on SOEs and technology transfer. We are fully aware that this not only a legitimate but also a very important and difficult question. At the same time, we strongly believe China is committed to a rules-based multilateral trading system and is willing therefore to sit at the table in Geneva to rethink some of the existing WTO rules. China should come forward with proposals in other domains that, together with SOEs and technology transfer, could form a package for future multilateral or plurilateral negotiations.

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