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China Inc. in the WTO Dock

Tales from a System under Fire

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Executive Summary

For all of US President Donald Trump's misconceptions about trade, many economists share his administration's concern about the World Trade Organization's (WTO's) ineffectiveness in dealing with China's economic policies. Trade experts across the political spectrum agree that the role of the Communist party-state in the Chinese economy has become so pervasive and opaque that key elements are beyond the scope of WTO rules. But the trade body is by no means impotent in this regard. Many countries have obtained redress by bringing complaints against China to WTO tribunals, and Beijing generally complies when it loses.

To shed light on this issue, this paper examines two WTO cases involving China in detail — one a Chinese loss, the other a Chinese victory.

The purpose is to show how the system works, and highlight its strengths and weaknesses, especially with regard to China. The second case is a landmark, and is especially troubling because Beijing won on a crucial point — where does China's truly private sector end and the party-state begin? This case also illuminates another worrisome problem facing the WTO, namely US actions that threaten to undermine the trade body's dispute settlement system.

Taken together, these two cases illustrate why the WTO should be viewed as well-suited in many respects to fulfilling its mission — and well worth preserving — but far from perfect regarding the quandaries posed by China, and sorely in need of other improvements as well.

Introduction

For those who believe in strong multilateral institutions to manage global problems, it

would be hard to imagine a more disheartening message than the one delivered on September 18, 2017, by Robert Lighthizer, the United States Trade Representative (USTR). Speaking before a Washington audience, Lighthizer disparaged the WTO, depicting it as ineffectual on an issue crucial to its mission — China's economic juggernaut.

The WTO, Lighthizer (2017) contended, “is not equipped to deal” with the policies that China has adopted to foster its industrial advancement. “The sheer scale of [China's] coordinated efforts to develop [its] economy, to subsidize, to create national champions, to force technology transfer, and to distort markets in China and throughout the world is a threat to the world trading system that is unprecedented,” he said. “The WTO and its predecessor, the General Agreement on Tariffs and Trade, were not designed to successfully manage mercantilism on this scale. We must find other ways to defend our companies, workers, farmers, and indeed our economic system.”

Lighthizer's comments were a grave omen for the WTO, which stands out among multilateral institutions for its widely accepted and enforceable rules. Of all the trade agreements menaced by the Trump administration, none looms larger. Based in Geneva, the 164-member WTO is the current embodiment of the system established after World War II to prevent a reversion to the protectionist horrors of the 1930s. WTO rules keep a lid on countries' import barriers, and members take their disputes to WTO tribunals for adjudication rather than engage in tit-for-tat trade wars. In addition, the WTO is the guardian of the “most-favoured-nation” principle, under which member countries pledge to treat each other's products on a nondiscriminatory basis — a valuable bulwark against the formation of hostile trade blocs.

For all the WTO's virtues, the concern expressed by Lighthizer about its handling of China-related issues is legitimate. China's policies are bedeviling the trade body in ways that were unforeseen at the time Beijing joined and are increasingly glaring now — all the more given the immensity of the Chinese economy. But the WTO's impotence in dealing with China should not be exaggerated. In numerous instances, countries have brought complaints against Beijing to the trade body's tribunals and gotten satisfaction.

To elucidate this subject, this paper will examine two WTO disputes involving China in detail.¹ The

¹ Sources for this paper, which will be incorporated in a forthcoming book, include scores of people interviewed in Beijing, Brussels, Geneva, Tokyo and Washington, as well as a review of thousands of pages of documents in the public record. Nearly all interviews were conducted on a “deep background” basis, the purpose being to elicit the maximum amount of candour. To the extent sources of information can be identified, footnotes are provided, but full attribution would be impossible without compromising interviewees' confidentiality.

first case involves allegations that Beijing took unfair competitive advantage of its control over rare earths — minerals with names such as cerium, neodymium, praseodymium and samarium — which are crucial in the manufacturing of high-tech products, including hybrid cars, smart phones, guided missiles, low-energy light bulbs and camera lenses.

The second case involves a clash between China and the United States over whether Beijing was subsidizing certain products, such as tires for tractors and construction vehicles, that Chinese companies were exporting to the US market. This case is considered a landmark because WTO jurists confronted a central question about the Chinese economy: where is the line between private enterprise and the Communist party-state?

Case number one was a Chinese defeat; case number two was a Chinese victory. The purpose of chronicling them is not to belabour the obvious point that “you win some, you lose some” at the WTO, just as in tribunals elsewhere. Rather, it is to show how the system functions, and where its strengths and weaknesses lie — especially with regard to China.

An in-depth examination of these cases also provides insight into the importance of preserving the WTO, its defects notwithstanding. But before delving into the cases, it is necessary to put them in historical context, by reviewing the upheaval that China has perpetrated on the trading system and how the system has responded.

Developments in the years subsequent to these two cases have exacerbated the woes afflicting the WTO, which is already struggling to maintain its centrality in the trading system in the aftermath of its long, painful failure to modernize its rules in the Doha Round of global negotiations.

During the presidency of Xi Jinping, which began in 2012, China has moved even *further away from the market-opening reforms of the early 2000s toward a statist approach* aimed at attaining domination for Chinese firms in nearly every industrial sector. Among Western economists and other experts who fervently backed China’s admission to the

Conclusions

Two WTO cases: one shows that the tribunals in Geneva can readily handle the China Inc. problem; the other raises disconcerting questions about whether the trade body’s rules apply to the most problematic aspects of the Chinese system as it has evolved in the years since WTO entry. Taken together, they illustrate that the WTO is far from perfect regarding the quandaries posed by China’s rise, and in need of improvements on other issues as well, but well-suited in many respects to fulfilling a mission that is essential to global stability.

WTO, it has become commonplace to ruefully acknowledge that Beijing adheres to the letter of the trade body's rules, but not the spirit.

American deprecation of the Appellate Body, meanwhile, has reached new levels of intensity.

In 2016, Washington publicly vetoed the reappointment of another member, South Korea's Seung Wha Chang, charging that some of his decisions egregiously deviated from acceptable boundaries of jurisprudence. The United States was totally isolated in taking this action, and plowed ahead despite scant evidence that it had reaped much benefit from removing Hillman. The American who replaced her, Thomas Graham, is well regarded in Geneva, but has dashed the hopes of Washington trade hawks for an aggressive advocate. More recently, the Trump administration has held up the filling of two Appellate Body vacancies at a time when a heavy backlog of cases has accumulated. As *The Economist* (2017) put it, the administration is "hold[ing] the WTO hostage" in an apparent effort to ensure that future Appellate Body rulings are more to Washington's liking.

This is the sort of browbeating that could destroy the WTO's value. If member countries lose faith that they will get fair hearings in Geneva, it will be only a matter of time before they resort to other approaches for resolving disputes, including taking matters into their own hands.

Complaints about the Appellate Body are not wholly misplaced, as this paper has shown. Any court makes mistakes, and if Werner Zdouc is keeping the WTO's top judges from squarely facing theirs, he should find a different job — not because he has acted dishonourably (he has not), but because concerns about his loss of perspective are apt. However, it would be the ultimate loss of perspective — indeed, the ultimate throwing out of the baby with the bathwater — if the United States were to wreck the WTO out of pique over Appellate Body rulings on trade remedies.

The much thornier and more consequential question is whether the WTO can survive the continued rise of China Inc. and the US response.

For all its flaws, the WTO constrains Chinese policy within certain bounds — recall the respect for WTO rules that impels large delegations from Beijing to attend dispute settlement hearings in Geneva. Is this degree of constraint sufficient? Making the affirmative case has become increasingly difficult in recent years. Trump and his trade team clearly

believe in the need for other tools, including the possibility of unilateral sanctions against unfair trade practices, which Washington imposed during the pre-WTO era of the 1970s and 1980s and are of uncertain legality under WTO rules.

It is pleasant to contemplate a scenario in which the United States and China both exercise the leadership necessary to keep the WTO relevant, credible and effective. In view of the Doha Round's collapse, the prospect of negotiations at the global level is probably a pipe dream at this juncture. Short of that, Beijing could take measures on its own to give foreign companies more access to the Chinese market without imposing unreasonable conditions, and Washington could eschew unilateral sanctions while also adopting a more hands-off attitude toward the Appellate Body.

But most signs point in the other direction, toward China maintaining heavy-handed industrial policies that the WTO cannot or will not deem illegal, and the Trump administration going ballistic — perhaps to the point of WTO withdrawal — as soon as the United States loses a major case in the Appellate Body, which could easily happen in the next year or two. For those assessing the merits and demerits of such outcomes, the stories of *China — Rare Earths* and *US — AD/CVD* may provide little comfort, but hopefully some enlightenment.