The WTO at the Crossroads: How to Avoid the China Syndrome?

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1. Knockin’ on the World Trading Regime’s Door (Again)

China was one of the original contracting parties to the GATT in 1947, but its status was deactivated 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 late 1970s and early 1980s, following Deng Xiaoping’s economic reforms. China formally sought the resumption of its status as a contracting party to the GATT in 1986, with accession negotiations starting the following year. Despite 20 rounds of negotiations, the two parties (China and the incumbent GATT members) failed to reach an agreement by 1995, when the WTO succeeded GATT. It then took another 18 rounds of negotiations for the two parties (China and the incumbent WTO members) to agree on China’s Protocol of Accession to the WTO. The exceptionally long accession negotiation reflected an exceptional situation of having a country with a socialist economic system and the largest population in the world join an organization conceived and operated on essentially liberal economic principles.

China’s accession to the WTO in 2001 was hailed as a magnificent achievement that would stay in history as the indelible etching on the wall commemorating the definitive victory of the liberal paradigm. Twenty years later, the mood has changed radically. Today, newspaper headlines concerning China, in the Western world at least, are consistently negative. Increasingly, there is a feeling that perhaps China and the WTO are mutually incompatible. What has changed during the past 20 years? China or the WTO? How can a seemingly happy marriage turn so sour...
so quickly? The answer is multi-faceted. China did not change. The problem is largely one of false expectations. It is further a case of sub-optimal contracting.

Inspired by our recent book (Mavroidis and Sapir, 2021), in this short paper we discuss China in the WTO, not China in the world economy, or China in the realm of international relations. We do not deny that there is an osmosis between the general and the specific. Allison (2017) offered a perspective in this context, when claiming that we are probably traversing yet another Thucydides’ trap. Nevertheless, while we take on board all these analytics, in what follows, we concentrate on China and the WTO.

1.1. The GATT Liberal Understanding

Economists and historians alike have described the GATT-think, both its explicit and its implicit dimension. In Baldwin’s (1970) classic account, the GATT is a tariff bargain, the value of which is insured through legal disciplines such as national treatment, and non-violation complaints. Tumlir (1984) and Zeiler (1999) focus on the pre-requisites for the agreed GATT-think to function: a liberal economy. This should not come as surprise at all: Irwin, Mavroidis, and Sykes (2008) have shown that a conscious decision was taken to restrict originally the number of seats around the GATT negotiating table to a homogenous nucleus of liberal market economies. This choice was consistent with the idea that GATT, besides being a trade agreement, was part of the arsenal of the West during the Cold War. Trade policy, after all, broadly defined, is national security policy, as Schelling (1971) has observed, since it allows trading nations to have access to goods that could be critical in advancing national security concerns.

The GATT entered the world of international relations as an interim organization that was meant to be eventually incorporated into the International Trade Organisation (ITO). The ITO was supposed to become a multilateral organization, and the GATT followed suit, even though the ITO never saw the light of day. In part hoping to persuade them to change course, in part in order to place a dent on the coherence of the Soviet bloc, the GATT gradually opened its doors to socialist countries: first, Poland and Yugoslavia (in the 1960s), and then, Hungary and Romania (in the 1970s). The incumbents did not find it necessary to translate the liberal understanding, implicit in the GATT, into explicit legal disciplines, since all four countries were very small in terms of international trade, and their policies could not affect its course.

The GATT had not been amended when Japan joined GATT in the 1950s either, although Japan was a bigger player, and the state played an important role in the Japanese economy. Add to that the fact that many GATT incumbents were reluctant to accept Japan in their midst for this reason. Japan was even then a large economy, and its export-led growth model was viewed as a threat. In fact, some of the reactions to China’s attempt to access the GATT and then the WTO were very reminiscent of the reactions to Japan’s own efforts to enter the GATT-world. Yet, there were also striking differences between the West’s reaction to Japan Inc. and China Inc., which had to do with economics but also, and primarily, with geopolitics. Given the military occupation of Japan by the United States at the time when it joined the GATT, there was little, if any doubt that it would eventually espouse the Western economic model. Its membership of the OECD, with its various ‘codes of conduct’ (in line with the principles of economic liberalism), a decade after joining the GATT, was the clearest sign that Japan had indeed joined the Western club.

1.2. This Time is Different

The GATT/WTO liberal understanding was still implicit when China knocked on its door, and eventually joined it in 2001. WTO incumbents assumed that, with Deng’s reforms, China had entered a one-way street with market economy being the end destination. Buoyed by Fukuyama’s (1992) pronouncement of the end of history, they seemed to espouse the view
that the definitive victory of liberalism had arrived, and the fall of the Berlin wall was only the beginning. Some US statesmen went so far as to publicly state that China would become not only a liberal market, but also a liberal democracy. Of course, there were sceptics as well, especially in the United States. But even sceptics bought into a simplistic narrative: the US keeps its tariffs at the same level after China’s accession; China greatly reduces and caps its tariffs (from 25% to 9% for industrial products, and from 31% to 14% for farm products); and therefore, the US was bound to gain more than China and obtain bilateral trade surpluses with China. Even those who did not buy into the ‘China changes’ story could see the huge potential economic benefits of accessing the world’s fastest growing market with the biggest population, which would also soon become the world’s biggest market. China was the biggest prize of the twenty-first century.

This economic dream has become reality, but so have the frictions with China. Even if China had, like Japan, turned into a Western-style economy by becoming an OECD member a decade after its accession to the WTO, frictions with incumbents would most likely have occurred, as they did occur with Japan. It is not so simple to incorporate into the trading system a very large and very fast-growing economy without frictions. But what is different with China is that it has retained substantial state involvement in the working of its economy, which is in direct contradiction with the WTO’s implicit liberal understanding. Furthermore, while exports can be addressed through protective measures irrespective of the choice of regime of the exporting country, it is access into the domestic market that is affected most depending on the choice of regime.

China describes its economic system as a ‘socialist market economy’. It is a mix of private initiative and state planning, where, unlike in Western economies, the state’s (or the Communist Party’s) role is paramount. Dominated by SOEs (state-owned enterprises), and omni-present industrial policies, the Chinese economy leaves room for the private sector, but, according to official Chinese statistics (stats.gov.cn), the public sector made up 63% of total employment in 2019. While some opening of the economy has clearly occurred over the years, and it is now possible to have ‘Wofers’ (wholly owned foreign enterprises), privatization has been slow, or at least slower than expected by China’s trade partners. No doubt, lots of assets have been corporatized, but corporatization does not mean privatization.

On 11 December 2001, China officially joined the WTO. Its achievements since then have been truly remarkable. In 2001, China was the sixth largest exporter of goods in the world (fourth, if the European Union is counted as one unit). Since 2009, it has been the world’s largest goods exporter, even surpassing the EU bloc from 2014 onwards. Fast export (and import) growth has boosted GDP growth and income levels. According to the IMF’s April 2021 WEO database, China’s GDP amounted to barely 13% of US GDP in 2001. Twenty years later, this ratio is likely to reach 73%. During the same period, China’s per capita income, measured at purchasing power parities, rose from the level of Sudan in 2001 to nearly the level of Mexico.1

2. Success for China Brings Frictions in the WTO
China’s integration in the world economy has created frictions, especially with the US, which has long had massive trade deficits with China. In 2019, US goods and services trade with China totalled an estimated $635 billion. Exports were $163 billion; imports were $472 billion. The US goods and services trade deficit with China was $309,2 a far cry from the forecast at the time when China joined the WTO. Economists rightly argue that bilateral trade balances reflect many other factors than trade policies, and that the WTO is about establishing competitive opportunities for nations to exploit their comparative advantage, not about having bilateral balanced trade. But the politics of trade are different.

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1See https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=CN-US
2See https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china
Critics of China’s trade policy, not only in the United States, but also in the European Union and elsewhere, often argue that China has done well by not respecting its WTO obligations. Has this been the case?

2.1 What Did China Agree to when It Joined the WTO?

When China joined the WTO, it negotiated three distinct layers of obligations: the multilateral framework that applies to all WTO members and consists of the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS), the agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), and the Dispute Settlement Understanding (DSU); a plurilateral framework that applies to only a subset of WTO members wishing to join the Government Procurement Agreement (GPA) and/or the Agreement on Trade in Civil Aircraft; and China’s Protocol of Accession. Only the first and third layers matter as China (promised to but) did not join the GPA.

The multilateral framework was negotiated during the Uruguay Round without China in mind. The most glaring evidence to this effect is the fact that the term ‘SOE’, a key feature of China’s economic system, though also present in many other countries, including EU member states, is totally absent in the WTO Agreements. A few years later, President Obama adopted the opposite strategy: he negotiated the TPP (Trans-Pacific Partnership) with China in mind, without implicating China in the negotiations. If China ever wished to accede to the TPP, it would have to adjust to a very demanding discipline regarding SOEs, as Viet Nam, a country where SOEs are also an important feature, had to do to join the CPTPP (the Comprehensive and Progressive TPP), the successor to the TPP, from which President Trump decided to bow out. The Obama approach gets our vote.

2.2 The Content of the Protocol of Accession

The Protocol of Accession reflects the Zeitgeist at the time when China was negotiating its accession: exuberance, probably irrational exuberance. Incumbents even set a date, 2015, by when they expected China to have become a market economy. The Protocol contains many best-endeavours clauses, which reflect the spirit of the negotiated contract but do not translate into legally enforceable obligations. Alas, only the latter matter. So, while we observe various best-endeavours clauses on privatization or pricing policies, there is precious little in the Protocol in terms of binding commitments in these areas. And, of course, the Protocol of Accession could never have been a perfect substitute for deficient legislative foresight. Both the statutory language and practice, discussed in an exemplary manner by Williams (2008), confirm this point. The extensive margin of obligations included in the multilateral agreements (and the plurilateral agreements, assuming the acceding country agrees to adhere to one or more of them) circumscribe the sum of obligations that a Protocol of Accession can include. The intensive margin (e.g., level of tariffs) is of course a matter of negotiation, and very much an item for inclusion in any protocol.

China joined the WTO when the Doha Round was initiated. The Doha Round mandate (negotiated before China’s accession) included renegotiation of various WTO Agreements, including the Agreement on Subsidies and Countervailing Measures (SCM), which could have been used to ‘complete’ the deficient SCM Agreement and add important details to explicitly acknowledge: for example, that SOEs are ‘public bodies’ in the SCM sense of the term. Abandoning the ‘Trade and Competition’ and ‘Trade and Investment’ initiatives at the WTO Ministerial Meeting in Cancun (in 2003) did not help either. Various investment-related practices have continued to plague market access for foreigners in China, though the EU recently tried to remedy this situation, but only for EU investors, with the bilateral EU–China Comprehensive Agreement on Investment

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3Johnson (2018) at pp. 528 et seq.
(CAI), which has been assessed by Dadush and Sapir (2021). Similarly, enforcement (or lack thereof) of competition law by the Chinese authorities continues to create uneasiness especially across Trans-Atlantic partners.

2.3 How Much Can Be Achieved through Litigation?

Dissatisfaction with China on the part of the US, the EU, and other Western countries has centred mainly around two issues: the manner in which SOEs have been operating, and the (lack of) enforcement of intellectual property rights, typified by the de jure or de facto obligation for foreign investors in China to enter into joint venture agreements with Chinese companies and transfer them their technology.\(^4\) Two WTO complaints have been raised so far implicating Chinese SOEs, and both have been raised by China. This is telling, in and of itself. If the membership complains about SOEs’ involvement in the Chinese economy, why not litigate more? There is a general claim that there has been under-enforcement against China by its trading partners, and there is probably some merit to this claim. If we use a country’s share of global trade as a predictor for the number of disputes it faces at the WTO as respondent, then China is definitely under-represented. Probably, various foreign investors prefer to ‘bite the bullet’ and stay in the Chinese market rather than provoke the wrath of the Chinese authorities by litigating their rights. There is evidence to this effect that we discuss in Mavroidis and Sapir (2021).

When litigation did occur, the outcome was not exhilarating for complainants. The WTO Appellate Body had already, before China’s accession, eviscerated the legal discipline imposed by GATT Article XVI on STEs (state-trading enterprises), a sub-set of SOEs, by narrowing the obligation imposed to non-discriminatory behaviour, making the obligation to act in accordance with commercial considerations de facto redundant. In a similar vein, the Appellate Body has held that SOEs, 100% owned by the Chinese state, are not even presumptively ‘public bodies’. Its eventual finding in a subsequent case that even private companies could be considered ‘public bodies’, a complete U-turn over the prior case law, was too little too late. By that time, the Trump Administration had pulled the rug under the Appellate Body condemning (provisionally at least) it into abeyance. Yes, legislators could have provided clearer legislative guidance, but WTO adjudicators failed miserably in this context as well.

What about the vexed issue of forced technology transfer that foreign companies wanting to invest in China routinely complain about? There has only been one litigation against China, by the European Union, in a WTO case that is still pending. Why nothing more? For one simple reason: the WTO does not punish the behaviour by private agents. Unless the obligation to transfer technology to a Chinese partner in a joint venture can be attributed to the Chinese state, which is rarely or never the case, foreign investors will not prevail in a WTO litigation.

Have complainants been pursuing the wrong legal strategy? Certainly, Charlene Barshefsky, a former US Trade Representative, thinks this way. In a recent (2019) speech at the US–China Business Council in Shanghai, she deplored the under-use of commitments made by China in its Protocol of Accession to litigate at the WTO.\(^5\) However, apart from the anti-surge clause, which protects against ‘excessive’ Chinese exports, she did not point to any provision that would have obliged China to open its closed market, which is the main problem faced by China’s trading partners, and certainly a far bigger one than slowing down the alarming pace of Chinese exports to their markets.

What can be done to further open up the Chinese market under the existing WTO regime? Not much is the simple answer. There is a lot in terms of ‘spirit’ but no binding language in

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\(^4\)Gao (2022) calls this phase of China–WTO relations as one of ‘alienation’, following the original ‘aspiration’ and the high hopes that the world community harboured about trade expansion when China joined the WTO, and the ensuing ‘assimilation’, the period during which for right or wrong reasons (as we believe was the case), the WTO membership believed that China would change and become integral part of the liberal trade order.

\(^5\)https://www.merckgroup.com/content/dam/web/corporate/images/country-specifics/china/research/AmChamChina.pdf
the Protocol of Accession. A former member of the Appellate Body, Jennifer Hillman (2018), has claimed that non-violation complaints could provide an adequate means to channel disputes against China. We disagree. For starters, this instrument can be of almost no help when it comes to litigating Chinese measures (and there are many) proceeding time-wise with China’s negotiation on tariff bindings. This is so because of the allocation of burden of proof under WTO law. But more to the point, prevailing in this context does not entail an obligation for China to amend its regime. It will simply have to part with a very small, infinitesimal indeed, portion of its huge surplus. The conclusion is that WTO adjudication is no substitute for deficient WTO legislation. Those who negotiated the terms of accession seem to have spent more time thinking ‘How can we block Chinese exports?’ than asking ‘How do we guarantee that China will open up?’

We have so far painted a rather bleak picture. Is there no light at the end of the tunnel? Maybe, yes, but to get there the world trading community, China included, will have to behave like ‘responsible stakeholders’, as Zoellick (2020), another ex-USTR, has recently asked them to do. We turn to this discussion in what follows.

3. Silver Linings, Only through the WTO

The China-story in the WTO is a case of cognitive dissonance. China never committed to become a ‘market economy’ when it joined the WTO. It only promised to become a ‘socialist market economy’. The Western countries and the WTO membership in general only paid attention to the words ‘market economy’, but for the Chinese the word ‘socialist’ was equally important. China’s constitution is very clear about this. Article 6 states that ‘The foundation of the socialist economic system of the People’s Republic of China is socialist public ownership of the means of production, that is, ownership by the whole people and collective ownership by the working people … In the primary stage of socialism, the state shall uphold a fundamental economic system under which public ownership is the mainstay and diverse forms of ownership develop together.’

3.1 President Xi, and China of Today

It was not really a surprise, therefore, that President Xi moved towards re-invigorating the role of the state, rather than retracting it, in the workings of the economy. And he had, and still has, little incentive to do otherwise. As it is, China has been outperforming other big advanced and emerging economies for some time now. And not only that, China weathered the Great Financial Crisis much better than others. The same holds for the Covid-19 crisis. According to the IMF’s April 2021 WEO database, China’s GDP will reach 117% of its 2019 level in 2022, while the US will only reach 106% and the EU 102% of their 2019 levels. Why change then?

Not that a serious regime change was ever in the cards. Chairman Deng excoriated Gorbachev’s decision to dissolve the communist party, since he always thought that its role was crucial in directing state affairs. And of course, the reduction of the role of the state was more a question of corporatization than privatization of state assets. As a result, the world trading community is now stuck with a legal framework that is hardly appropriate to take care of the concerns that emerge. Yet, as we argue in Mavroidis and Sapir (2021), this does not necessarily mean that no progress is possible in trying to bridge the gap between the Chinese and the WTO systems.

The word trading community should be under no illusions as to what can be achieved. China will not change its economic regime and overall approach by legislative fiat, through an edict decided in Geneva.

3.2 Multilateral Rules are Needed, Preferential Rules Can Inspire

What the multilateral trading regime can potentially achieve in China, in addition to what it has already done over the past 20 years, is to ‘tweak’ a few key institutions, which would facilitate access to China’s market and increase the relevance of the WTO framework in Beijing.
In doing this, however, the trading community should not repeat the mistakes of the past. Non bis peccatur, or the cat should not sit on the hot stove twice, as the saying goes. There is no reason to believe, if there ever was one, that a relational contract, full of gaps, will function as expected. The WTO membership’s heterogeneity would argue against such expectations. Now is the time for explicit contracting. Wu (2016) correctly underscores the capacity of China to evade its commitments. It is equally true, though, that the biggest victories against China were scored in areas where contractual expression is quite clear. And now is also the time of action. Contrary to Rodrik’s (2018) suggestion, the world trading community cannot stay idle. The ‘do-nothing’ approach implies that problems perpetuate. It is also a-historical. The GATT/WTO was not designed to accommodate each and every state on earth irrespective of its regime choice. The liberal understanding permeated the agreed text. Indeed, its key institutions cannot function properly absent acknowledgement of the liberal understanding. At the same time, it is true that neither the GATT nor the WTO agreements ever made explicit their implicit liberal understanding. Unlike the European Union, which added accession criteria (the Copenhagen criteria) to prepare for the accession of the former socialist countries of central and eastern Europe, the GATT/WTO agreements contain no such criteria.

The world trading community would be well-advised to avoid repeating unilateral reactions à la Trump Administration. We now know, thanks to the work of Amiti, Redding, and Weinstein (2019) and Bown (2021) that not only China did not flinch, but that it is the US economy that suffered the bulk of the cost of the unilateral increase in tariffs. And of course, the Phase One US–China agreement did not solve the ‘China problem’, or even reduce the US trade deficit with China, and risks being outlawed by a WTO panel, if/when litigation occurs.

The world trading community needs to come together and ‘complete’ some of the contract. Bilateral solutions, such as the US–China deal or the EU–China Comprehensive Agreement on Investment (CAI) may help a bit but will not solve the problem because of the nature of what is at stake: subsidies involving SOEs require multilateral discipline. In doing this, the world trading community would be well-advised to mimic existing successful examples. Both the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP, the successor to the TPP signed under Obama but rejected by Trump) as well as the US–Mexico–Canada Agreement (USMCA, the successor to the North-America Free Trade Agreement, NAFTA) contain detailed chapters regarding the disciplining of state-owned enterprises (SOEs) and forced technology transfers, the two biggest irritants to trade and investment relations with China.

For Realpolitik reasons as well, this is a commendable approach: why attempt to re-invent the wheel, when solutions that meet the approval of a substantial percentage of the WTO membership already exist? And the good news is that China has already agreed on some of this discipline in its bilateral investment agreement (the CAI) with the EU, as Dadush and Sapir (2021) explain.

With this in mind, we would like to advance two proposals for WTO reforms. The first concerns SOEs, of which only a small subset, state-trading enterprises (STEs), are covered by the WTO Agreement, under GATT Article XVI. The new text should make it clear that all SOEs (including, but not exclusively STEs) are presumptively ‘public bodies’ (reversing thus, the burden of proof in subsidies disputes), and must anyway act in accordance with ‘commercial considerations’. Second, for foreign direct investment involving joint ventures, WTO signatories (China included) should be constrained not to enforce contracts between domestic and foreign firms that oblige the foreign investor to transfer technology to its domestic partner against its wishes. If agreed at the multilateral level, a substantial part of today’s complaints against China would subside.

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6The EU has adopted Commission regulation 2020/870 of 24 June 2020 to counteract “One Belt One Road” subsidies, but there are doubts as to the legality of this approach, and even bigger doubts as to their effectiveness, if they remain a tool in EU hands only.
For all this to happen, of course, all the main WTO players, China included, must agree to participate in new WTO negotiations. The question is how to bring this about politically. The January 2020 Joint Statement of the Trilateral (Japan, the US, and the EU) showed that trade distorting policies and practices by China pose challenges to many nations, and that cooperation is possible. As argued by Baldwin et al. (2020), call for a structured dialogue with China will be required down the road. China has benefitted enormously from its participation in the WTO. The cost of non-WTO, as may happen if the ‘China problem’ continues to poison the atmosphere at the WTO, would be felt in Beijing probably even more than elsewhere. China should have an incentive, therefore, to act as a ‘responsible stakeholder’, as already argued by the then US Deputy Secretary of State, Robert Zoellick (2005). Crises usually go in tandem with opportunities. And the current crisis, which comes on top of the Covid and climate crises, is no exception. The new Director-General of the WTO has her hands already full for her entire mandate.

References


