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Abstract

The two central issues in China's accession to the World Trade Organization (WTO) were its economic size and the large role the state had played in economic decisions. The treatment of State-Owned Enterprises (SOEs) as central to addressing the latter point. While the Protocol of Accession imposed obligations on China that went beyond what was required of other WTO members, it has not been effective at resolving concerns about Chinese SOEs. This demonstrates, in part, the limitations of using the WTO as a vehicle to promote economic reform.

Keywords

China, Trade, WTO, SOE

I. Introduction

China's accession to the World Trade Organization (WTO) in 2001 was both momentous and pre-meditated. It was momentous both because of China's rapidly growing economic importance and because it marked the entry of an economy with a very large state sector into the multilateral trading system. The Protocol of Accession that described China's obligations as a new member was the product of 15 years of negotiation. This paper examines the way that Protocol handled Chinese state-owned enterprises (SOEs).

SOEs were recognized at the time as central to Chinese state control over the economy. The issues that this control raised were not entirely novel for the WTO. There had been long-standing discussions of restrictions on subsidies, for example, and there had been earlier accessions of transition economies. But China presented an extreme version of these pre-existing issues. As such, the episode offers insight into the development of WTO rules and jurisprudence in some key areas as well.

The accession issue is interesting not only because of the prominence of China in the world trading system, but also because it offers lessons about the possibilities and limitations of the WTO as a vehicle for furthering economic reform. The desire to pursue reform was a major reason China sought WTO membership. Privatization or restructuring of the SOE sector was central to Chinese economic reform.

The paper argues that the issue of Chinese SOEs was not handled particularly well in the Protocol of Accession. The treatment in the text of the Protocol was very brief and essentially offered particular China-specific tweaks to existing WTO agreements, such as the Agreement on Subsidies and Countervailing Measures (SCM). Those agreements had often been inadequate to handle the issues faced by a pre-China WTO and the tweaks were insufficient to handle the additional problems posed by China. In many cases, foreseeable problems were simply not addressed at all in the Protocol.

In addition to this failure to meet *ex ante* expectations, the Protocol falls short by several *ex post* measures. It did not suffice to quell anxieties about the Chinese state sector. It did not provide the necessary clarity to allow ready enforcement through the WTO's Dispute Settlement Mechanism (DSM). And it did not serve as the lever to move Chinese reform forward in the way the Chinese leaders who oversaw accession had hoped.

These failings demonstrate the limitations of the use of the WTO as a means of compelling economic reform in a member country. At the time of China's accession, the WTO was to be a cooperative partner in furthering Chinese reform. Neither the accession Protocol nor the WTO's powers equipped it to foist reform upon a reluctant Chinese state.

The next section sets out the issues that faced negotiators as they tried to craft a Protocol of Accession governing Chinese SOEs. This list of issues can serve as a scorecard of sorts against which the ultimate agreement can be judged. Section 3 then describes the treatment of Chinese SOEs in the actual Protocol. Section 4 offers an *ex post* assessment as well as an interpretation of why the experience with the Protocol played out as it did. Section 5 concludes.

II. The SOE problem *ex ante*

This section sets the stage for a consideration of how China's Protocol of Accession to the WTO treated the question of SOEs by reviewing the problems the Protocol was meant to solve.

China's formal bid to join the global trading system presented the incumbent powers with a quandary. The GATT had largely maintained a structure in which there were developed nations with

large economies and developing nations with small economies. The large developed nations were subject to a fairly developed set of rules, while the smaller developing nations were granted leniency under the principle of “special and differential” treatment.¹

The People’s Republic of China did not fit comfortably in either of these categories. It was certainly not developed; in 2001 its per capita GDP just surpassed \$1,000 per person. Yet even then China was the sixth largest economy in the world, nestled right behind France and growing rapidly.² So which treatment was it supposed to receive? The problem was further complicated by China’s background as a centrally-planned economy.

One point is abundantly clear – contemporary analysts knew that China was important. More specifically, they knew that the treatment of Chinese SOEs was central. As the eminent trade analyst Gary Hufbauer (1998) wrote:

“Either China commits to privatize and liberalize its SOEs over the next decade, or the fabric of the WTO will be ripped. The operation of a giant state-owned sector, protected by numerous barriers and enjoying unusual privileges, functioning alongside private enterprise in the world trade and investment system, is bound to cause tremendous friction.”³

Blumental (1997), writing several years before the deal concluded, argues:

“Reform of bloated inefficient state-owned enterprises (SOEs), the traditional mainstay of the socialist economy, is at the crux of the issues concerning China’s accession to the WTO. The problem of SOEs...underlies negotiations on market access and elimination of non-tariff barriers.”⁴

He goes on to describe an SOE sector comprising, at the time, more than 300,000 enterprises, constituting more than one-third of China’s GDP, and providing employment or funds to over 200 million Chinese.

The challenges can be divided into two bins: There are larger strategic questions about how to incorporate China into the WTO, which tap into issues of principle and precedent; and there are more specific questions which concern the interplay between SOEs and more traditional issues on the GATT and WTO agenda. Each is discussed in turn.

Broader strategic choices on handling China’s accession

At the broadest level, the negotiators of China’s accession faced a choice between trying to lodge the enormous new member comfortably in established precedent or whether to treat the country as *sui generis*. In hindsight, this choice would have been easier had the GATT been less lenient toward developing countries in the preceding decades. The precedents available, however, were designed for countries that were seen as posing a minimal competitive threat. That was certainly not the case with China.

A number of authors decry the extent to which China was treated differently. Blumental (1997), anticipating the additional leniency for safeguard measures that ultimately appeared in the Protocol, wrote:

¹ For one review of the role of developing nations in the multilateral trading system, see Srinivasan (1998).

² <http://en.classora.com/reports/t24369/ranking-of-the-worlds-richest-countries-by-gdp?edition=2001>

³ Qin 2004, p. 863. Gary Hufbauer 1998, p. 50.

⁴ Blumental (1997) p. 201.

“...this unrestricted safety valve, however, runs counter to the notion of a trading system bound by the rule of law. The integrity of the WTO institution and all its members' long term interests should lie in equal application and compliance with WTO norms.”⁵

Qin (2004) argues against that the special treatment of China that shaped the Protocol was a mistake. She notes that there had been transition economies before China and that they had been extended more generous periods in which they could privatize and introduce market forces. There was also more lenience in allowing for government subsidies to facilitate privatization. She attributes this differential treatment to fear of the ‘China threat,’ based on its size, and concerns over state ownership.⁶

Just as the multilateral trading system had provided for transition economies in the past – though none as big as China – the issue of state ownership had arisen as well. Qin (2004) argues that “Although the WTO system is legally ownership-neutral, its norms and rules assume the conditions of a market economy that is typically dominated by private ownership.”⁷ She ultimately concludes that the treatment China received in its Protocol of accession, to be described below, “appears to be an unjustified departure from the ownership neutrality of the WTO legal system and the fundamental WTO principle of non-discrimination.”⁸

Both authors are effectively criticizing China's treatment in its accession as excessively political and arbitrary. They want the WTO legal system to operate with the impartiality we would expect in a domestic setting. Everyone should be equal before the law. Principles should be observed and deviations require evidence and justification. When they find arbitrariness in China's treatment, they treat this as a stain on the WTO legal system.

One can argue, however, that at a broader level, the WTO system operated just as it was supposed to. There was no fundamental conflict between a political and a legal approach because the legal structure of the WTO created a system that recognized and accommodated political exigencies. The GATT system could have described an accession protocol in which new members could enter simply with a unanimous vote, or even a majority vote. This would be the full parallel to a domestic legal system in which a new citizen, whether born or naturalized, gains complete access to the legal rights available to existing citizens. It is unlikely, however, that such a system would have won the requisite support among the initial GATT membership, particularly if it featured simple majority voting.⁹

Instead, accession of a new country to the GATT or WTO requires negotiation and action by national legislatures. This requirement was presumably in recognition that the existing rules and norms could not be expected to cover all potential future concerns that might accompany new members.¹⁰ Thus, while political concerns about competition from China absolutely shaped the terms of the Protocol of Accession, this was completely in keeping with the legal design of the GATT and WTO. As events played out, most subsequent criticism of the terms of accession took the opposite position from that of Blumental and Qin – later commentators believed the terms were too lenient, rather than too harsh. This will be addressed in Section IV below.

⁵ Blumental (1997) p. 249

⁶ Qin (2004), p. 917.

⁷ Qin (2004), p. 915.

⁸ Qin (2004), p. 916.

⁹ Note that the political limitations on the creators of the GATT system are not purely a matter of speculation. Shortly after the GATT's creation, there was an attempt to erect an International Trade Organization. The attempt failed when the United States Congress refused to ratify it. Drache (2000). It is also worth noting that the most recent example of a large, plurilateral trade agreement, the Trans-Pacific Partnership, also requires unanimous agreement to accept new members.

¹⁰ In fact, the accession of China to the WTO is still controversial in the United States in both political and academic discourse, fifteen years later. See, for example, Autor, Dorn and Hanson (2013) and Pierce and Schott (2016).

Specific areas of concern about Chinese SOEs

The previous section described some of the broader, China-specific anxieties that prompted strategic choices about how to bring China into the WTO. This section touches upon some of the traditional areas of WTO regulation and points to questions raised by China's substantial state sector. The intent is to demonstrate the scope of the issues posed by SOEs in China's accession.

i) Subsidies

Perhaps the most obvious issue is that of subsidies, a long-standing topic of interest under the GATT and WTO and subject of the Agreement on Subsidies and Countervailing Measures.¹¹ From that description:

“Unlike the Tokyo Round Subsidies Code, the WTO SCM Agreement contains a definition of the term “subsidy”. The definition contains three basic elements: (i) a financial contribution (ii) by a government or any public body within the territory of a Member (iii) which confers a benefit. All three of these elements must be satisfied in order for a subsidy to exist.”

A subsidy must also be “specific” to be actionable— a subtle concept meant to distinguish actionable subsidies from general government support in the form of infrastructure or education, for example.

In the case of a private business A, this definition is relatively clear. If a government wished to induce the production of X additional units of a product, it could offer the private business a certain sum of money for each unit it produced; this would be a clear subsidy. In the case of a state-owned enterprise B, there is the potential that the same economic result could be achieved through the appointment of a reliable manager who would then be tasked with expanding production by X units. If this has a negative financial effect on the state-owned enterprise, it could have access to state coffers.

Thus, state-owned enterprises could provide a ready means for providing subsidies in a non-transparent way. This is where the concept of ownership-neutrality becomes difficult. If A and B *behave* the same way, they could be treated similarly. But the different ownership structure means that the same behavior by B could be substantially more difficult to detect and respond to than if it were done by A.

ii) Non-Market Economies

A closely related problem involved non-market economies (NMEs). In our example above of Private Firm A, the presumption was that it set its production decision to maximize profits, taking into account market prices for inputs and outputs. The objectionable element of the subsidy was that it allowed the firm to excessively lower the price of the output. In an NME, by definition, allocations are not made primarily through market price signals. There is a presumption that those signals are distorted.

One could have an NME without SOEs, or an SOE in a market economy. The issue is raised here only because it was a longer-standing issue within the GATT and raises parallel issues of what will transpire when economic entities are not transparently responding to price signals.

iii) State-trading

In an analysis roughly contemporaneous with the latter stages of China's accession talks, Mavroidis and Cottier (1999) write: “State trading has been one of the most often recurring themes in the negotiations on accession of both China and Russia and it recently attracted a lot of attention among existing WTO members.” As with NMEs, there is an imperfect correspondence between SOEs and

¹¹ See World Trade Organization, “Agreement on Subsidies and Countervailing Measures (‘SCM Agreement’), https://www.wto.org/english/tratop_e/scm_e/subs_e.htm. Accessed 13 October 2016.

state trading enterprises, the latter defined as “governmental and non-governmental enterprises, including marketing boards, which deal with goods for export and/or import.”¹²

Although state trading is the subject of GATT Article XVII, Mavroidis and Cottier wrote at the time that such disciplines did not appear adequate to meet challenges such as those posed by China's accession.

iv) Government Procurement

If one compares trade with SOEs to an open market ideal, concerns cover not only SOEs as a supplier but also as a purchaser. To the extent that existing WTO members were seeking market access in China, the effects of removing border barriers would depend on whether Chinese purchasers were making decisions solely on standard commercial considerations, such as quality and price.

An obvious alternative is that state-owned firms could be influenced to ‘buy local.’ In fact, some years later when China made a push for ‘indigenous innovation,’ the large purchasing power of the state sector was explicitly wielded to try to spur domestic industries at the expense of imports.¹³

Unlike some of the issues listed above, the issue of government procurement resisted efforts to consolidate multilateral rulemaking through the Uruguay Round's Single Undertaking. The Agreement on Government Procurement remained a separate plurilateral, one which China has yet to join. The importance of the issue clearly varies in proportion with the size of the state sector in an economy, however, making it especially relevant in the case of Chinese SOEs.

v) Motivation – what is “commercial activity”?

Toward the end of this list, we move away from the well-defined categories of WTO discourse and touch on some of the more vague but still relevant themes. One such is the motivation of an entity operating in the multilateral trading system. The general presumption is that privately owned firms will be engaged in ‘commercial activity.’ This presumably means that firms are attempting to maximize the present discounted stream of returns to their shareholders.¹⁴ Thus, for a given level of quality, the commercially-motivated firm will purchase the least expensive input, no matter the source. It will set prices so as to maximize its profit.¹⁵

Part of the argument for ownership-neutrality in the GATT and the WTO is that it is only this motivation and behavior that matters. If a state-owned firm behaves in a commercial manner, the argument might go, its ownership structure would be irrelevant. The difficulty is that there is no easy economic test to determine whether a firm's buying or selling behavior is commercially sound. Actions such as selling at very low prices to hook customers can be practiced by commercially-motivated firms and those with ulterior motives alike.¹⁶

¹² World Trade Organization, “State trading enterprises,” https://www.wto.org/english/tratop_e/statra_e/statra_e.htm, accessed 13 October 2016.

¹³ See, for example, MacGregor (2010).

¹⁴ While this is the economic textbook motivation for private firm behavior, note that even without any ownership concerns there are arguments that even private firms should have additional motivations, including patriotism or ‘corporate social responsibility.’

¹⁵ Again, the seeming simplicity of commercial motivation falters a bit here. If a firm sets prices below costs through predatory pricing, this is seen as objectionable and subject to antidumping measures, even though it may well be profit-maximizing.

¹⁶ Think, for example, of retail stores offering very low prices as ‘loss leaders’ to draw in customers. They hope to recoup any losses on the cheap products by pitching more lucrative goods to those same customers.

It would be easier to test between motivations if there were a clear alternative hypothesis. What, exactly, is it that state-owned enterprises might do if they do not act commercially? The answer is likely to vary depending upon the state in question – one reason why transition rules crafted to handle Poland’s accession might not suffice for handling China’s accession. The concern could range from an enhanced willingness to suffer losses so as to maintain politically-important employment to a desire to dominate certain industries for geostrategic purposes. In the case of China, there has been abundant disquiet about motives, but little consensus on a specific alternative motivation.

vi) Investment?

One question that became more salient across China’s first decade in the WTO was the treatment of investment. For WTO members such as the United States who harbored concerns about the motivations of Chinese SOEs, those concerns intensified when the state-owned or state-affiliated organizations began acquiring or creating businesses within the concerned country.¹⁷

This is generally a concern about outbound Chinese investment. Much of the WTO approach to regulating investment transactions – Trade Related Investment Measures – has, in contrast, focused on concerns about host country measures.

vii) Sovereign immunity?

A final concern, building in particular off the investment context, could concern sovereign immunity. Would SOEs enjoy any special degree of protection in standard commercial legal disputes?¹⁸

Conclusion – Points of Concern

This list of issues raised by China’s extensive network of SOEs is intended to provide some basis for assessing the obligations that were undertaken in its Protocol of Accession. It would have taken remarkable prescience to have adequately addressed all of the issues, since some only emerged as important considerations years after China’s accession. But trade agreements are supposed to be forward-looking, as they set the rules for commerce across decades to come.

The next section describes the way in which SOEs were treated in the Protocol of Accession. Section IV then offers an assessment.

III. China’s SOE treatment under the Protocol of Accession

For a process that lasted 15 years, on a subject that was seen to be centrally important, and one that touched on so many points of concern, it’s remarkable how brief the actual text devoted to Chinese SOEs is in the protocol of accession. Of course, if phrased correctly, it is possible to have powerful strictures embodied in short sentences.

The direct mentions of SOEs in the protocol fall into three categories: direct mention in the protocol; discussion in the Working Party Report, incorporated by reference; and transparency requirements. Each is described in turn.

¹⁷ This paper takes no stance on the cutoffs between state-owned, state-affiliated, or state-influenced, though it is clearly an important point. The appropriate distinction depends on the question being asked. Is the question whether the Chinese state would have access to information? If so, a small ownership stake could suffice. Is it whether major investment or production decisions can be determined by the state? If so, a larger stake might be required, though that would depend on the way decision-making occurs within the firm, which could be opaque. For one recent investment example in which this question arises, see Levy (2016).

¹⁸ See, for example, van Aaken (2013).

Direct reference

Paragraph 10.2, of the section on subsidies, reads:

“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.” (WTO 2001b)

On the face of it, this appears to be a very significant concession by China. A central question about the usage of countervailing measures has been the question of specificity. This is the principal objection, for example, to using countervailing duties (CVDs) against Chinese currency practices – the idea that they are a general government practice and not specific. Thus, by providing a relatively low hurdle for specificity, this paragraph would seem to have opened the door to extensive use of CVDs against Chinese SOEs.

Qin (2004, 891) gives an example of how this might apply. She imagines a program aimed at any firm that employs a certain percentage of laid-off workers each year. If broadly available, it should be *de jure* non-specific. “In the case of China, however, a separate inquiry would be made into the ownership of recipients pursuant to the Protocol. If most of the recipients happened to be state-owned, the program will be viewed automatically as *de facto* specific.”

Paragraph 12.2, of the section on agriculture, 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.” (WTO 2001b)

The paragraph on agricultural transfers demonstrates the particular sensitivity to subsidies in that sector, but appears relatively unremarkable and consistent with transparency requirements mentioned below.

Working Party Report

Qin (2004) describes how the text of the protocol is augmented by the inclusion of China-specific rules from the Report of the Working Party (WTO 2001a).

“Since the Protocol was made ‘an integral part of the WTO Agreement,’ all the China-specific rules have become part of a ‘covered agreement’ for the purpose of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), enforceable through the WTO dispute settlement procedure.”¹⁹

Even so, of the 7 paragraphs devoted to “State-Owned and State-Invested Enterprises” in the Working Party Report, only 3 are officially incorporated under paragraph 342 of that report. Those paragraphs are reproduced here in full, (emphasis added):²⁰

“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

¹⁹ Qin (2004), p. 883

²⁰ WTO (2001a), p. 9.

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.”

“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.”

One final incorporated paragraph, in the section on “Industrial Policy, including Subsidies,” addresses SOES:

“172. Some members of the Working Party, in view of the special characteristics of China's economy, sought to clarify that when state-owned enterprises (including banks) provided financial contributions, they were doing so as government actors within the scope of Article 1.1(a) of the SCM Agreement. The representative of China noted, however, that such financial contributions would not necessarily give rise to a benefit within the meaning of Article 1.1(b) of the SCM Agreement. He pointed out that China's objective was that state-owned enterprises, including banks, should be run on a commercial basis and be responsible for their own profits and losses. The Working Party took note of this commitment.”

Paragraphs 46 and 172 each talk about the permissible motivations for Chinese SOEs. They were to operate on a ‘commercial basis’ and ‘be responsible for their own profits and losses.’ If these commitments were diligently followed, it is difficult to see how an SOE would be any different from a private enterprise – or why China would bother to have SOEs in the first place. If there were no financial relationship and no possibility for direction or the introduction of additional behavioral directives, it is hard to see what the Chinese state would gain. Of course, the extensive discussion of subsidies elsewhere in the agreement and some of the required disclosures discussed below cast doubt on the commitments laid out above.

The problem, as noted in Section 2, is that there is no obvious test for operation on a commercial basis. Two CEOs might set very different courses for an enterprise, even if faced with identical circumstances and even if attempting to maximize profits.²¹ This potential variation would make it difficult to discern if another CEO, appointed by the Party, had ulterior motives.

Paragraph 47 directly addresses the issue noted in Section 2, in which SOE purchases could conceivably be classified as government procurement, which is treated separately under the Agreement on Government Procurement, to which China is not a party. The paragraph makes clear that discriminatory approaches could be challenge to subject under the GATS or GATT.

²¹ One point contributing to opacity – for shareholder interests, the CEO should attempt to maximize the present discounted value of the stream of future profits. Thus, it might be better to take a loss in the immediate quarter, perhaps as part of a restructuring, if there is sufficient payoffs in later periods. This complicates the assessment of performance as well as any deductions about motives.

Paragraph 49 addresses foreign direct investment into China and declares the applicability of restrictions on intellectual property and investment measures.

Transparency

As Qin (2004) describes, the Protocol requires China to notify the WTO of any subsidy within the meaning of Article 1 of the SCM Agreement.²² The first such notification was included as an annex to the Protocol. Noting the limitation of such notifications, Qin writes:

“Among other things, it does not identify subsidies provided to SOEs through the state-owned banks, such as policy loans, automatic rollover of unpaid principal and interest, forgiven loans and below-market low-interest loans. Citing difficulties involved in gathering information, China undertakes that it will ‘progressively work towards a full notification of subsidies...’”²³

Her list demonstrates the potentially intricate web of connections between the Chinese state and SOEs as well as the difficulty of monitoring, much less enforcing, promises of purely commercial behavior.

IV. Analysis

This section attempts to pass judgment on the treatment of Chinese SOEs in the Protocol of Accession. There are at least two ways this could be done. First, one could look at the text and see whether there are any glaring deficiencies. Such an analysis could compare the issues that could be anticipated, as described in Section 2, to those that were actually dealt with. A second approach is to take advantage of 15 years experience and ask how well the Protocol functioned in practice. Each approach is taken up in turn.

Textual analysis

A first point to note is how brief the references are to SOEs in the Protocol, given the broad range of issues raised by their prominence in the Chinese economy and the obvious significance of both China and that particular sector. Of course, the text need not make explicit reference to SOEs in order to handle the issues they raise. The Protocol can and does draw in well-developed agreements, such as the Agreement on Subsidies and Countervailing Measures (SCM).

But to believe that such brief references and terse modifications – such as the concession on specificity in 10. 2 – would suffice is to presume either that the problems posed by Chinese SOEs were relatively straightforward extensions of existing issues handled by the WTO, or that whatever vagaries popped up because of the inclusion of SOEs in the multilateral trading system could be addressed through the WTO’s dispute settlement mechanism (DSM).

Neither presumption seems justified. The questions described in Section 2 are extensive and in areas such as ‘state trading,’ there was a sense that GATT strictures (Article XVII in that case) were already too vague and inadequate. Extending them to cover the Chinese state sector was inevitably going to exacerbate the problem. Further, given the politically-charged atmosphere surrounding trade with China, asking the DSM to fill in the blanks in the rules threatened to pose undue strains on the system. Nor, with its odd treatment of precedent, is the DSM well-constructed for the extensive development of case law.²⁴

²² Qin (2004), p. 888.

²³ Qin (2004), p. 888.

²⁴ For this economist, the development of case law through the DSM, in the formal absence of *stare decisis*, remains perplexing. See WTO (2016c).

The brevity of the Protocol's treatment seems, instead, like a failure to grapple with a serious issue.

A second textual point to note is the one that preoccupied two contemporary critics. Blumental, writing before the conclusion of China's accession talks, and Qin, writing a few years after, both note the lack of any reasonable plan for China's transition away from a large SOE sector in the Protocol.

Qin notes that transition economies are often granted a certain indulgence in using subsidies to facilitate the privatization of SOEs, but that China's Protocol did not provide the leniency that had been the norm. She focused on China's exclusion from Article 27.13 of the SCM Agreement and also warns of a likely strain on the DSM.

"Due to the transitional nature of the Chinese economy, situations involved in a pre-privatization subsidy in China can be far more complex and of a much larger scale than those identified by the Appellate Body... From an institutional perspective, how to treat subsidy issues arising in connection with privatization in transition economies should be a matter of WTO policy. Such policy issues are better dealt with by the 'legislative' process than left to the adjudicatory procedure for resolution on a case-by-case basis."²⁵

She notes that most other transition economies gained lenient treatment because of their developing status, but that the Protocol effectively denied this to China.

Beyond the transitional points, Blumental and Qin conclude that the treatment of the Chinese SOE sector in the Protocol is excessively harsh. This prospective assessment offers a contrast with the way the deal appears in retrospect.

The Protocol in practice – judging effectiveness

If the first means of judging the Protocol was to see how it did against a checklist of issues that required attention, a second means is to ask whether it met the broader challenge of governing the commercial relationship in a satisfactory way. The answer here, as well, appears to be no.

There are several ways a legal agreement of this sort might be deemed effective. The most straightforward would be if the understanding embodied in the agreement precluded any subsequent controversies. In this instance, that would mean a prescribed treatment of SOEs, such as a transition path, that left all (or most) parties satisfied. This has not been the subsequent experience at all. Trade with China continues to be highly contentious and the role of the Chinese state in the economy is at the core of the concerns. In the United States, concerns about commercial relations with China have been prominent in the 2016 presidential campaign. In Europe, there are ongoing debates about whether China should still be treated as a non-market economy (NME). In one recent commentary on the NME dispute, Chad Brown of the Peterson Institute predicted, "the EU, WTO and US are all likely to attempt to push China to continue to reduce the influence of state-owned enterprises in its economy through privatization, and to provide additional transparency about these firms."²⁶ In broad outline, these seem like the same challenges that the Protocol was intended to address 15 years before.

An alternative measure of effectiveness would have been if issues had persisted, but if the Protocol had established a framework whereby the issues could be satisfactorily addressed. This does not seem to be the case, either. Ideally, one would consider the number of DSM cases brought citing the SOE provisions in the Protocol. However, as noted above, the actual provisions directly concerning SOEs

²⁵ Qin (2004) p. 909.

²⁶ Quoted in Bailey (2016).|

are sparse in the text. The most recent case, *United States — Countervailing Duty Measures on Certain Products from China*²⁷ reveals the unresolved nature of the issue.

The Protocol of Accession essentially placed heavy weight on the SCM and made certain additional provisions for using it to challenge Chinese subsidies to SOEs through countervailing duty procedures. In *US-Countervailing Measures* China challenged the U.S. Department of Commerce's treatment of certain Chinese SOEs as "public bodies" within the meaning of the SCM Agreement. While it is beyond the scope of this paper to analyze the panel and appellate decisions in that case, the tenor of the discussion and the reversals of key points on appeal would seem to indicate that over a dozen years later, the Protocol has failed to provide the requisite clarity.²⁸ This appears to be exactly the sort of awkward development of case law that the Protocol should have aimed to avoid.

Given the lack of clarity about what China's SOE obligations were under the Protocol, it is difficult to render judgment about whether or not China complied. On certain facets, however, it is easier to report that China has not complied. Qin reported that "although China is required to notify the WTO of any subsidy granted or maintained within its territory, and did submit its first notification upon accession, it has since failed to provide any further subsidy notification as required." She goes on to note that this became a focal point during the second annual review of China's WTO compliance under the Transitional Review Mechanism.²⁹

The *US-Countervailing Measures* case notwithstanding, it is interesting to note that the prediction of a flood of DSM cases concerning Chinese SOEs has not been realized. There have been strikingly few. The issue was as important and contentious as ever. There were ample unresolved issues to be settled. The puzzle requires a different explanation.

Interpretation

A major motivation for China's push to enter the WTO, under Zhu Rongji, was to use membership as a lever to promote domestic economic reform.³⁰ This attempt put the WTO in a particular, delicate position. On the one hand, WTO commitments were to provide a justification for undertaking extensive reforms that the Chinese leadership wanted to undertake anyway. It was clear that addressing the sprawling and inefficient SOE sector would be central to such efforts. Such reforms were inevitably controversial; in part the inefficiency of SOEs could be traced to their large employment rolls without commensurate output. Opposition came from those threatened with new competition, from those who held patronage positions in SOEs, as well as from those who preferred a larger role for the state in the economy. Zhu evidently concluded that counterbalancing these pressures with pro-reform pressure from international commitments at the WTO.

While the Chinese leadership was eager to have this counterbalance, there was no such eagerness for external micromanagement of a politically-delicate reform process. If this hypothesis is correct, it would explain why China made substantial commitments, but those commitments remained disappointingly vague.

From the perspective of the existing WTO membership, the idea of Chinese reform was welcome, while the idea of competing with a growing Chinese economy and a still-large state sector almost

²⁷ DS437, *United States — Countervailing Duty Measures on Certain Products from China*, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds437_e.htm

²⁸ Among the issues, for example, was how members could identify a subsidy programme – a central issue in describing the relationship between the State and SOEs.

²⁹ Qin (2004) p. 897.

³⁰ Lardy (2001), Bajona (2004)

certainly was not. Even though Chinese accession commitments were inadequate by an absolute standard, they were still extensive and seen as unusually strict by contemporary analysts. It would be hard to argue that the membership conceded easily to Chinese demands; the accession negotiations lasted 15 years. They were confronted with a choice: either keep China out of the WTO; or allow China in with at least notional commitments to reform. The former was becoming ever more uncomfortable as China rapidly became a more significant player in the global trading system. The latter might well have seemed viable, so long as China was committed to reform.

The key question concerns the enforceability of Chinese commitments. Not only does enforcement require a commitment that can be enforced, but under the WTO DSM it requires a complainant. That was a particularly challenging issue in the case of China, since few businesses were eager to take a public stance challenging the Chinese government. This reluctance was most apparent when it came to another section of China's Protocol, Part 1, Paragraph 16, the "Transitional Product-Specific Safeguard Mechanism."³¹ That established a particularly lenient safeguard standard ("market disruption") in which the complainant did not even need to show wrong-doing on the part of the Chinese, thereby sidestepping difficult questions of interpretation of commitments. For the purposes of this argument, the salient point was the infrequency with which the safeguard was used. In the United States, where the safeguard was applied under Section 421 of the Trade Act of 1974, there were only seven cases filed through late 2009 as trade concerns about China peaked. The last filing in this stretch, concerning Chinese tires, was not even made by the industry; it came from the steelworkers' union.

One would have expected that such an easy-to-claim safeguard would have attracted much more interest, given the rapidly growing body of complaints about Chinese economic behavior. A plausible explanation – and one that was given privately to government officials – was that few businesses operating in China were eager to incur the wrath of the Chinese government by publicly lodging complaints.³² If this was true for the relatively innocuous Sec. 421 safeguards, it should have been even more true for the sensitive question of how China was reforming its SOEs.

Thus, the loose approach to SOE reform regulation in the Protocol of Accession was unlikely to function as a source of strict discipline through the DSM, but could suffice if there was a reformist government in China that wished to point to international obligations as a justification for politically-difficult reforms. That made the efficacy of the Protocol subject to the reformist zeal of the Chinese government.

That zeal seemed to wane somewhat under the administrations of both Hu Jintao and Xi Jinping. While there are still calls for reform, there have also been statements from Xi Jinping that describe a continuing, central role for SOEs. The persistent domestic Chinese conflict over reform was described this past summer by the *Wall Street Journal*:

"On July 4, officials of the State Council, China's cabinet, were read remarks by Mr. Xi (Jinping) calling for 'stronger, better, bigger' state juggernauts, with a central role for the Communist Party in their management. Mr. Li (Keqiang)'s prepared comments stressed the need to 'slim down' state companies and to 'follow market rules' in remaking them."³³

Given the dominant role of Xi Jinping in Chinese governance, this would nevertheless suggest that SOEs are not receding.

³¹ See Grimmett (2011) p. 7

³² For some of the period in question, the author was Senior Economist for Trade on President George W. Bush's Council of Economic Advisers.

³³ Wei and Page (2016). Most observers describe Xi Jinping as China's most powerful leader at least since Deng Xiaoping.

V. Conclusion

One indicator of the inadequacy of the Protocol of Accession's treatment of Chinese SOEs is the excitement that has surrounded the treatment of SOEs in the Trans-Pacific Partnership (TPP). China was not a member of those negotiations, which concluded in November 2015, but a frequently-expressed objective of the negotiations was to establish new rules to address neglected issues in the global trading system. SOEs clearly made the list of neglected issues, along with more novel topics such as electronic commerce. The strong implication is that the strictures that were adopted to govern Chinese SOEs when it joined the WTO were inadequate.

The experience in these more recent negotiations may also offer some retrospective insight into why stricter conditions were not imposed on China. A major preoccupation of the TPP negotiators was "defensive interests" – the possibility that rules intended to ban Chinese practices might be turned against cherished U.S. practices, for example. Such considerations would also be expected to concern multilateral negotiators in talks such as the Uruguay Round or Doha negotiations. It has limited explanatory power for Chinese accession talks, however, since the Protocol would *only* apply to China.

The extent to which the Protocol applied only to China drew the disapproval of some commentators. It was described as undermining the integrity of the system to apply rules inconsistently. In fact, it is a feature of the *realpolitik* that inevitably determines outcomes at such high-level negotiations. Further, as argued in this paper, that argument worked both for and against China. It meant a more onerous set of accession obligations than had been applied to other developing countries. It also meant, however, that these onerous obligations were not vigorously enforced against China. This was not due to a lack of enthusiasm on the part of other governments, but rather on the necessity of building DSM cases around a complainant – a business that is willing to provide the requisite data. As a matter of *realpolitik*, few multinational businesses have been eager to play that role.

One of the lessons of the Chinese experience has been the difficulty of using the WTO as a vehicle to compel economic reform. For many developing countries, the WTO has been inadequate for this purpose because of the limited obligations imposed under the principle of special and differential treatment. The controversial higher standards applied to China offered the potential to meet this need. The idea of an external lever to advance reform was clearly a principal attraction to Chinese leadership when they sought out WTO accession.

This could have worked, had China maintained the same level of commitment to economic reform throughout the period following accession. Instead, there has been substantial wavering in the commitment to privatizing SOEs and limiting the state sector, a debate that continues to the present day. With strong clear requirements placed on reforming countries, the WTO could play an important facilitating role. However, the WTO DSM will not be adequate to prompt reform in the face of committed opposition. This will be more true the more powerful the reforming country in question.

Finally, the experience with the treatment of China's SOEs in its Protocol of Accession demonstrates the unfortunate imbalance between the legislative and judicial functions of the WTO. The sparse description of how Chinese SOEs should be treated in the actual language of the Protocol left substantial blanks to be filled in, presumably through DSM panels and appellate bodies. The DSM is ill-equipped to fill in holes of such magnitude. That is a problem that extends well beyond China's accession, as the WTO moves into its third decade without a major new agreement.

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