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“REFORM” OR “OPENING”? REFORM OF CHINA’S STATE-OWNED ENTERPRISES AND WTO ACCESSION — THE DILEMMA OF APPLYING GATT TO MARKETIZING ECONOMIES

David Blumental*

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I. INTRODUCTION

In recent years, the dramatic shift in the international politico-economic structure, the explosion of information technology, and the resulting globalization of economic relations have provided the political will and impetus for the creation of the World Trade Organization (WTO). Unlike its precursor, the General Agreement on Tariffs and Trade of 1947 (GATT), the WTO is not merely the trade arm of a political and military treaty alliance. It enjoys a stronger institutional identity, broader scope and more diverse functions than its predecessor. Concurrently, however, the WTO faces problems largely unanticipated by the original Contracting Parties of the GATT. The WTO's ability to manage the integration of new members while preserving the integrity of WTO free trade principles, including resolution of inevitable disputes, will have a profound impact on the future of the WTO as a respected and effective world institution.

An important unresolved issue is how the WTO should deal with the potential conflict that arises between the sovereign right of a member state or an aspiring member state to implement its own domestic policies and the integrity of the international norms and law underlying states' WTO commitments. This problem is especially acute in integrating into WTO countries whose nonmarket economies (NMEs) have yet to fully implement the basic premises of the GATT — transparency, reciprocity, and the rule of law — notwithstanding ongoing market reforms.

The premises of a global economy — interdependence and transparency — have permanently altered notions of absolute sovereignty, escalating the natural tension between states' sovereignty over domestic policy and adherence to international norms. In effect, international law is now involved far more directly in matters that were formerly considered the strict realm of the sovereign.

Globalization has also expanded the interaction between international and domestic law. Particularly in rapidly developing and marketizing economies, like the People's Republic of China ("China"), international norms have played an unprecedented

role in guiding the remodeling of legal systems. Not only have GATT rules and principles served as a model for Chinese legal reform over the past two decades, but the requirements of integration into the international community and its primary trade institution have also lent impetus to domestic reform, providing reformers with important political leverage against domestic opponents. By focusing on meeting the conditions for accession first to GATT and, now the WTO, Chinese market-oriented reformers have promoted their country's domestic economic reform and opening, and have overcome political opposition at several crucial junctures during the 1980s and 1990s.

Because there is no single definitive roadmap for marketization, rapid transition from a centrally-planned to a market-oriented economy invariably produces dislocation and social stress. When these reach extremes, national leaders must retrench and slow down the reform process. Internationally, this may mean adopting policies inconsistent with WTO commitments. When a country seeking to accede does so, the WTO faces a difficult question: Should it make a temporary exception, allow the country to accede notwithstanding, and then work within the multilateral framework to help it adjust its policies? Or should it simply withhold accession until the country can meet the requirements for membership without condition? These questions reflect two different views of the role of international law that surround the debate over China's accession to the WTO.

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, which have continued to enjoy important preferential treatment, and the political and economic difficulties their restructuring entails, underlies negotiations on market access and elimination of non-tariff barriers. China's reform process has reached an important watershed. The failure of two decades of economic reform to solve the problems of inefficient, debt-ridden SOEs has reached crisis proportions. In light of this, at the 15th Congress of the Chinese Communist Party in September 1997, the Chinese leadership reaffirmed a broad plan to revamp the state sector.¹ Following the annual session of the National People's Congress (NPC) in March 1998, new Premier Zhu Rongji embarked on an aggressive course of no-holds

1. See Jiang Zemin's Report at the 15th Congress of the Chinese Communist Party, *Hold High the Great Banner of Deng Xiaoping Theory for a Comprehensive Advancement of the Cause of Building Socialism with Chinese Characteristics into the 21st Century*. BEIJING REV., Oct. 6, 1997 (1 of 6 installments).

barred reform targeting SOEs and redundant bureaucracy.² Zhu's leadership faces a political dilemma, however — acceding to WTO will bring tangible economic and political benefits, spurring Chinese exports, creating jobs and providing revenue, that will relieve some of the pressure of SOE reform. On the other hand, the scope and far-reaching consequences that restructuring ailing, heavily subsidized SOEs entails will require China to slow the opening of its economy. As a result, Zhu is hard-pressed to make the kind of market access and safeguards commitments needed to push the negotiations on China's WTO Protocol of Accession towards closure.

The state-owned sector currently comprises more than 300,000 SOEs, over one-third of the country's GDP, and is the provider of livelihood and social welfare for over 200 million employees, pensioners and their families.³ As struggling SOEs have continued to lay off more and more redundant workers, causing uncertainty and discontent, the possibility of renewed urban unrest has become very real political problem for the Chinese government.⁴ In the short term, lowering tariffs, eliminating all non-tariff barriers and cutting off subsidies to SOEs in order to meet the conditions for WTO accession will force many SOEs into insolvency, pushing up unemployment. This will aggravate the already acute strain on the country's inchoate financial and social security systems. As such, the political exigencies of massive restructuring temporarily preclude strict adherence to WTO principles of most favored nation and national treatment. For China to grant full market access, and allow foreign industry to compete on equal footing with domestic industry would arguably be fatal to newly restructured Chinese enterprises. Without a reasonable period to adjust, the severe social dislocation caused

2. See Erik Eckholm, *New China Leader Promises Reforms for Every Sector*, N.Y. TIMES, Mar. 20, 1998, at A1.

3. According to the Third National Industrial Census conducted by the State Statistical Bureau, there are currently 340,000 SOEs. They account for 34% of total industrial output and 57% of total fixed asset investment. Their debt ratio is 80% and total debt of those SOEs that are in arrears is RMB900 billion (US\$108.5 billion). See *A Major Test for State Enterprise Reform*, INSIDE CHINA MAINLAND (Institute of Current China Studies, Taiwan), January 1998, at 41.

4. In the summer of 1997, more than 500,000 workers in Hunan, Fujian and Jiangxi provinces protested when SOEs distributed IOUs instead of wages. See Gregory Fossedol, *Enlist the Masses to Solve China's Dilemma*, ASIAN WALL ST. J., Feb. 26, 1998, at 10. More recently, in Heilongjiang, a northeastern industrial province, unpaid miners, workers, and pensioners have blocked railways and roads in protest of continued economic hardships. See *id.* at 10. See also S. CHINA MORNING POST, Mar. 10, 1998, at 8. Since 1997 there have been a number of reports concerning unemployment and latent social unrest. There was even speculation that disgruntled workers were responsible for a recent explosion on a bus in Wuhan, an industrial city in central China.

by massive unemployment could have devastating political consequences for the Party.⁵

The immediate question for China is how to negotiate its “ticket of admission” to the WTO while avoiding domestic social and political unrest — clearly too high a price to pay. The answer depends on whether China can substantially complete SOE reform before the transitional “phase-in” period to be permitted under its Protocol of Accession expires and it must fully comply with GATT requirements. Chinese Premier Zhu Rongji has promised to complete the task of SOE reform within three years. Many analysts, however, believe it will take at least 8-10 years.⁶ The problem is that China does not want to wait another ten years or more to join the WTO.

For the WTO, China’s accession is an important test that will have significant consequences for the organization’s future. If the WTO is to be the third pillar of the international institutions,⁷ it must produce a resolution that accommodates a variety of interests, including its own institutional interest. Integrating China successfully will strengthen the WTO’s mandate; keeping China out will extract certain institutional costs in terms of its legitimacy as an organization representing the world’s trading states. The United States, which has taken the lead role in the WTO Working Group, negotiating China’s accession protocol, has somewhat different priorities. For the U.S. the key will be to reach an agreement that encourages Chinese reform and integration while addressing American concerns about access to China’s markets and the growing U.S. trade deficit with China. Although the European Union (E.U.) shares many similar concerns and

5. Note: In China, in theory the Party formulates general policy, which the government implements through legislating and enforcing laws and regulations, etc. The Supreme Party organ is the Standing Committee of the Politburo. In addition to their respective government posts, Zhu Rongji, Jiang Zemin and Li Peng are the leading members of the Politburo Standing Committee.

6. See Erik Eckholm, *New China Leader Promises Reforms for Every Sector*, N.Y. TIMES, Mar. 20, 1998, at A1; also, Michael S. Serrill, *Can This Man Fix China*, TIME, Mar. 16, 1998, at 38-39; Xu Xing, *Modernizing SOEs: Easier Said Than Done*, KAIFANG [OPEN MAGAZINE], Oct. 1997, at 29-31. Zhu Rongji was elected Premier at the Ninth Session of the National People’s Congress in March 1998. Zhu was formerly Vice Premier in charge of economy where he engineered the overheated economy’s “soft landing”. Touted by the international media and hated by officials in the localities, Zhu is widely known as China’s “economic czar” or “laoban” (the “Boss”).

7. See Frederick M. Abbott, *China’s Accession to the WTO*, ASIL INSIGHT, January 1998, at 1. The other two pillars are the United Nations and the International Monetary Fund.

position as the U.S., it has generally maintained a more positive tone regarding China's early accession.⁸

The WTO and its principal members should consider carefully the effect of their stance on Chinese domestic policymaking in determining the conditions under which they will admit China. In addition, the WTO should seek to develop a common strategy that both anticipates the international consequences of China's admission while also giving China's reformers the ability to continue domestic reforms and gradually ensure compliance with WTO norms. The WTO and its members face important questions in trying to strike this balance: Given the sheer size of China's economy and population, to what extent should a special case be made for China in order to protect its domestic stability and ease its integration into the international trading order? Or are the existing exceptions and phase-in transition periods provided by the GATT sufficient? As a matter of international law and norms, what would the consequences of granting China special dispensation be to the WTO/GATT regime? Would this undermine its integrity or are these modifications necessary for the WTO to incorporate former nonmarket (centrally-planned) economies like China and Russia into a truly global trading system?

This paper looks at these questions in light of China's ongoing SOE reforms and tries to offer some answers. It argues that existing GATT provisions do not provide sufficient relief and that, as the world's most populous country and second largest economy,⁹ and as one of the United States' most important long term trading partners and allies, there is a strong case for granting China special treatment. It further asserts that the policy aims motivating the U.S. stance are too narrowly focused and misunderstand many of the systemic obstacles to market reform and the rule of law that exist in China.

The paper does not advocate on behalf of the Chinese government. It does submit, however, that a world trade organization in which China plays no part is a contradiction in terms and

8. E.U. Vice President Sir Leon Brittan has from time to time acted as a mediator of sorts between China and the WTO Working Party and U.S. . See, e.g., *L'Europe Propose Un Sommet Annuel avec la Chine*, LE FIGARO, Feb. 18, 1998, at II B (reporting offer of E.U. Vice President, Sir Leon Brittan during meeting with Chinese Foreign Trade Minister, Wu Yi, on further opening of trade and investment in Beijing); also, *Sir Leon Plays the Role of Knight in Soft Armour*, S. CHINA MORNING POST, Feb. 18, 1998, at 4; and *WTO Expected to Make Breakthrough in China's Accession*, Xinhua English Newswire, Jan. 10, 1998, available on WESTLAW (WL 2782319).

9. China's total GDP ranks second in the world at \$2.323 trillion (1990 figures). EAST ASIA ANALYTICAL UNIT, AUSTRALIA DEP'T. OF FOREIGN AFFAIRS AND TRADE, CHINA EMBRACES THE MARKET , at 46, Table 1.4. (1997).

that the international norms that the WTO represents will not be fully accepted until the institution embraces all nations. In this sense, by granting China special dispensation the WTO is setting a positive example that conforms with, not undermines, its larger goal of promoting increased wealth and stability through free trade. Therefore, the issue that remains is how to bring China into the fold in a manner that causes the least disruption to all concerned.

Part II of this paper addresses the fundamental difficulty of reconciling domestic policy and adherence to WTO free trade norms in the context of China's SOE reform. Part III argues that amidst sweeping political, economic and legal reforms which have transformed China during the past two decades, the continuing lack of legal institutions and institutional transparency to support the rule of law remains a critical, and perhaps insurmountable, obstacle in the path of SOE reform and GATT compliance. Part IV analyzes specific GATT provisions, the difficulty of compliance with the requirements of most-favored nation and national treatment, and whether GATT provisions like the safeguard ("escape clause"), developing country, or national security exceptions are applicable and can offer relief to China's dilemma. It then looks at whether special dispensation for China's accession should be viewed as a necessary exception or as setting a dangerous precedent for other marketizing countries applying for WTO membership. Part V considers potential consequences of admitting China to the WTO and outlines possible solutions for policy makers.

II. THE ISSUE — RECONCILING DOMESTIC POLICY WITH ADHERENCE TO INTERNATIONAL NORMS

With the advent of its domestic economic reform policy in the late 1970s, China began to look outward to the international community. In 1980, China joined the International Monetary Fund (IMF) and the World Bank. Soon after, the spread of reform to urban areas prompted China's request for full participation in GATT. China was granted observer status in 1982, and applied for re-admission to the GATT in 1986.¹⁰ A working party was thereafter established in 1987. As the Uruguay Round drew to a close at the end of 1994, China made a concerted effort

10. China was one of the 23 original Contracting Parties to the GATT in 1948. In 1950, following its retreat to Taiwan, the Chinese government withdrew from the GATT system. Because the PRC holds that Taiwan is an inseparable part of its sovereign territory, and never recognized the Nationalist government's withdrawal, it initially framed its request to join the GATT as "re-admission." For a discussion of this issue, see generally Ya Qin, *China and GATT: Accession Instead of Resumption*, 27 J. WORLD TRADE 77 (1993)

to accede in time to become a founding member of the WTO, but was unsuccessful due to what the Chinese government contends was undue U.S. intervention.¹¹

In 1995, China began negotiating with a WTO Working Party on a broadened range of accession issues including trade in services, intellectual property and new rules on non-tariff measures. To date, the negotiation of China's protocol of accession and the annexes thereto has focused on difficult issues, including elimination of quantitative restrictions on trade, non-tariff barriers, transparency and protection of intellectual property. The most critical issue, however, concerns the length of the phase-in and adjustment period China will be allowed. As one of 28 countries currently seeking WTO accession, China has argued that it is a developing country and should thus receive special preferences pursuant to GATT Article XVIII and Part IV.

The major trading states, however, maintain that the size of China's economy and the rapid growth of its exports require stricter and shorter phase-in terms. According to WTO statistics, the value of Chinese exports increased from US\$44.43 billion in 1990 to US\$124.95 billion in 1995, making China the eleventh largest trading nation with 2.8% of world trade.¹² China is currently the U.S.' fifth largest trading partner,¹³ and enjoys a growing surplus that reached US\$45.88 billion in the first 11 months of 1997, a nearly 25% increase over the same period in 1996, according to U.S. Commerce Department figures.¹⁴ U.S. Secretary of Commerce William Daley has predicted the U.S. trade deficit with China could reach US\$60 billion in 1998, aggravating political tensions.¹⁵ Japan and the E.U., China's other major trading partners, have also faced growing trade imbalances. The E.U.'s

11. See *Interview with Assistant Minister of Foreign Trade and Economic Cooperation*, Long Yongtu, RENMIN RIBAO [PEOPLE'S DAILY], Dec. 20, 1994, at 2 (stating that China's re-entry to GATT required U.S. "political sincerity").

12. A. Neil Tait and Kui-Wai Li, *Trade Regimes and China's Accession to the World Trade Organization*, J. WORLD TRADE L. 93, 96.

13. *Renewal of MFN Status for China*, Charlene Barshevsy, U.S. Trade Representative, *Testimony at House Ways and Means Subcommittee Regarding Renewal of MFN Status for China*, June 17, 1997.

14. See David Wessel, *Big Discrepancy Exists between Data from U.S. and China on Trade Deficit*, WALL ST. J., Jan. 22, 1998, at A2. Tabulating differences cause considerable discrepancy between official Chinese and U.S. government statistics. According to Chinese government statistics the trade deficit was only US\$10 billion in 1996. China points both to discrepancies in methods of calculation—the U.S. figures include all trade that passes through Hong Kong, and to politically-motivated U.S. government restrictions that limit many U.S. high tech exports to China. *On Sino-US Trade Balance: State Council Information Office*, BEIJING REV., Apr. 7, 1997, available on WESTLAW (WL10062747).

15. See *Daley Sees Political Peril in U.S. Trade Deficit with China*, ASIA PULSE, Oct. 1, 1998. 1998 WL 19975625.

overall deficit with China grew at more than 26% annually in 1994 and 1995, while Chinese exports to Japan soared 13% in 1996.¹⁶ In 1997, China's total imports and exports reached US\$325 billion.¹⁷ Hence the vocal opposition among U.S. policy-makers and commentators to granting China a long phase-in period as a buffer to protect its domestic industry as it undergoes difficult restructuring.¹⁸

Negotiation of a new member's protocol of accession progresses simultaneously on two tracks — multilateral and bilateral. The WTO Working Party oversees the negotiation of its "ticket of admission,"¹⁹ and all interested WTO members may take part. Many of the substantive issues, however, are addressed in bilateral negotiations with China's principal trading partners and major WTO members, including the U.S., Japan, Canada and the E.U. countries. The U.S. has taken the lead role in negotiating intellectual property rights, market access, non-tariff barriers and related non-trade issues.²⁰

The Protocol of Accession and the annexes together comprise a new member's "ticket of admission," while the concessions they contain are the "price of admission."²¹ Except as the Protocol of Accession adjusts the default obligations of WTO membership, once a state joins the WTO it automatically undertakes the full responsibilities and enjoys the privileges of membership. Bilateral negotiations focus specific trade-related areas. Upon accession to the WTO, all bilateral agreements that have been concluded automatically apply as between all WTO members and the acceding state by virtue of GATT Article I (most-favored nation treatment).

16. CHINA'S ECONOMY IN 1995-97, Central Intelligence Agency, Directorate of Intelligence, Dec. 1997, APLA 97-10008, at 28 (citing official U.S. and Chinese statistics).

17. WTO Statistics. Also published in RENMIN RIBAO (PEOPLE'S DAILY), Jan. 23, 1998, available in WESTLAW (WL 2785339).

18. U.S. Commerce Secretary William Daley told his Chinese counterparts in no uncertain terms, "There must be greater access for U.S. exports. . . [O]ur export performance in China is not due to any loss of U.S. competitiveness. Market access is the issue for China's entry in the WTO." Lorien Holland, Agence Fr.-Presse, Oct. 7, 1997, available on WESTLAW (WL 13409023). Some U.S. commentators argue that the trade imbalance is a serious long term problem and will continue to grow. See Gregory J. Mastel and Andrew Szamosszegi, *China's Growing Trade Imbalance*, THE INT'L ECONOMY, May/June 1997.

19. JOHN J. JACKSON, *THE WORLD TRADING SYSTEM* 45.

20. See generally A. Neil Tait and Kui-Wai Li, *Trade Regimes and China's Accession to the World Trade Organization*, J. WORLD TRADE L. 93. Also note, upon China's accession to the WTO, all bilateral agreements concluded with the U.S. will apply to all WTO members by virtue of GATT art. I (most-favored nation treatment).

21. JACKSON, *supra* note 18.

The U.S. has taken the primary role in bilateral negotiations on intellectual property rights, market access, non-tariff barriers and related non-trade issues,²² and since the early 1990s, has executed several Memoranda of Understanding (MOUs) with China on issues of intellectual property rights and market access. In the MOU of October 10, 1992, the PRC committed to reduce or eliminate many non-tariff barriers (NTB) such as licensing requirements and quotas as well as adopt measures to make its trade regime more transparent. In return, the U.S. agreed to reduce export controls on high tech equipment and to "staunchly support" China's GATT bid. U.S. Trade Representative Charlene Barshevsky noted in her statement to Congress in 1997, last year that China has made progress and followed through on many of its commitments under the MOU, but many issues remain.²³

For both the U.S. and China, bilateral negotiations on trade issues continue to be fraught with domestic and foreign policy concerns. On the U.S. side, the growing trade deficit with China and frustration with lack of equal market access have been driving a relatively hardline American approach to China's WTO bid. U.S. Trade Representative Charlene Barshevsky has stated that while China's accession is critical to an effective framework for Sino-U.S. trade relations, much more work is necessary on bilateral trade issues, and that China must take steps to balance its trade surplus with the U.S. and open its markets to foreign goods for the U.S. to support its accession.²⁴ U.S. Commerce Secretary William Daley stressed to his Chinese counterpart that "[m]arket access is the [key] issue for China's entry in the WTO."²⁵ He warned that China must "make a commensurate balance of concessions and obligations to WTO members."²⁶ American manufacturing and service industries as well as agricultural interests also remain anxious to gain access to the Chinese market.²⁷

22. See generally A. Neil Tait and Kui-Wai Li, *Trade Regimes and China's Accession to the World Trade Organization*, J. WORLD TRADE L. 93.

23. Hearings, *supra* note 13 (testimony of Charlene Barshevsky).

24. See *China Entry to WTO Critical to U.S. Trade Relations*, ASIA PULSE, Jan. 30, 1998, available in WESTLAW (WL 2946727); also *Japan Efforts in Asia "Woefully Inadequate"*, Agence Fr. Presse, Jan. 29, 1998, available in WESTLAW (WL2211056); *China's Assurances on Reform Please U.S.*, ASIAN WALL ST. J., Jan. 26, 1998, at 6.

25. Lorien Holland, Agence Fr.-Presse, Oct. 7, 1997, available on WESTLAW (WL 13409023).

26. Agence Fr.-Presse, Oct. 6, 1997, available on WESTLAW (WL 13408137).

27. See, e.g., *Grassley Seeks USDA Commitments to New Markets for Iowa Agriculture, Family Farmers*, Government Press Release, Fed. Doc. Clearing Hse., Jan. 29, 1998, available in WESTLAW WL7321334. (urging a tough agreement with China for WTO accession and opening of markets to U.S. pork exports). See also hearing, *supra* note 13 (testimony of Charlene Barshevsky).

A. CHINA'S POLITICAL DILEMMA

Despite warming relations with Washington following President Jiang Zemin's U.S. state visit in November 1997, and positive signs from both top E.U. and WTO officials concerning its accession status,²⁸ China faces a difficult political dilemma as it embarks on a course to reform its ailing SOEs.²⁹ Through two decades of economic reform, the combination of foreign direct investment and export-led growth has transformed China into an economic power. Legal and economic reforms have shaped the development of a market-oriented economy and the creation of new forms of business organization. Few SOEs, however, have successfully adjusted to the market without special preferences, and few operate under "hard" budget constraints.³⁰ Plagued by poor management, corruption, large debts and heavy social welfare burdens, SOEs are a massive remnant of the planned economy that even the most aggressive reformers have been reluctant to tackle. Instead, the government has dealt with the problem by throwing money at it in the form of various direct subsidies and soft loans. But the lack of political will to carry out painful reform of inefficient, unprofitable SOEs has left China's marketization effort in limbo.³¹ It is precisely because reformers have failed to devise a solution to the SOE problem that financial and social dislocation have now reached crisis proportions.³² Reform of the state-owned sector is the linchpin to financial and banking

28. See *Reforms Help Bring WTO Entry Closer*, S. CHINA MORNING POST, Feb. 7, 1998 (quoting WTO Deputy Director-General Kim Chul-su, "[T]he process [of China's accession to WTO] has entered its final phase.").

29. According to official Chinese figures, approximately 50% of SOEs operated at a loss during the first half of 1995. In the first 3 quarters of 1997, 47% incurred losses. See *Demand Crunch*, FAR EASTERN ECON. REV., Nov. 13, 1997, at 62. Slowing turnover, rising inventories and excess capacity in certain industries have also decreased SOE performance. See CHINA'S ECONOMY IN 1995-97, supra note 16, at 6.

30. Harvard economist Janos Kornai describes the socialist planned economy as one where firms have only "soft budget constraints". The life or death of the firm does not depend on profitability, efficiency and solvency. The measure of successful operations is merely fulfilling the plan. See generally J. KORNAI, ECONOMICS OF SHORTAGE (2 vols.) (1980). See also Donald Clarke, *What's Law Got To Do With It? Legal Institutions and Economic Reform in China*, 10 UCLA PAC. BASIN L.J. 1, 8-10 (1991).

31. Liaoning, a province in the heavily industrialized Northeast, is home to roughly 10% of China's large and medium-sized SOEs. 42% of these are in the red with average debt ratios of 75%. See S. CHINA MORNING POST, Nov. 25, 1997, at 10.

32. At a special meeting of the Party Central Committee and State Council leaders following the 15th Party Congress in late September 1997, in a lengthy report on SOE reform, Zhu Rongji stated, "State enterprise reform has been going on for 13 or 14 years now and is now at the point where lack of forward progress entails retreat and collapse." Luo Bing, *Zhu Rongji Tan Guoyou Qiye Gaige Wentu [Zhu Rongji Discusses SOE Reform]*, ZHENG MING (Hong Kong), Nov. 1997, at 25-26.

reform and to resolving the deep structural problems driving boom and bust cycles of high growth followed by retrenchment. SOE reform is also crucial to managing the country's labor and employment markets and the growing social tensions and disparity between those benefiting and those disadvantaged by urban reform. Without this solution, China can neither achieve sustainable growth nor the full shift of governmental function from direct economic intervention to macroeconomic management.³³

The state-owned sector comprises over one-third of the country's GDP and is the source of livelihood and social welfare for over 200 million employees, pensioners and their families.³⁴ The largest SOEs, like the mammoth Capital Steel, are literally small cities unto themselves, responsible for providing medical care, housing, child care and education benefits to over several hundred thousand employees, pensioners and dependents. According to official reports, however, only 20% of SOEs operate in the black, while in 1996 total losses in the state-owned industrial sector soared 39%,³⁵ totaling 1.3% of GDP. Government subsidies and bank loans to support these industries absorbed more than 75% of domestic credit in 1996.³⁶ Everyone agrees that the situation has become untenable, that the failure to carry out SOE reform will have disastrous consequences. But as always, there is a divergence of opinion as to how fast to push mergers, acquisitions and bankruptcies in different sectors.

To comply with GATT norms, China must suspend most subsidies to unprofitable SOEs and lower tariffs, and must eliminate NTBs. The tremendous domestic social and political impact of such a move, however, necessitates measured, gradual action — political risk management. The political risk inherent in the Party's SOE reform plan is two-fold. First, large scale layoffs and unemployment resulting from the "corporatization", mergers, sales, bankruptcy and closure of over 100,000 SOEs are likely to cause continued spread of discontent and disenfranchisement among the urban population.³⁷ Second, loans and subsidized inputs necessary to support SOEs have put China's state-run banks and entire financial system under tremendous strain. As China

33. See *infra* note 35, at 11.

34. See *supra* note 3.

35. Official Chinese economic indicators, cited in CHINA'S ECONOMY IN 1995-97, *supra* note 15.

36. See THE CHINESE ECONOMY: FIGHTING INFLATION, DEEPENING REFORMS, World Bank Group, 1996, at 15.

37. The official *China Daily* reported that a recent government survey of 2,430 Chinese families in 53 cities found that public acceptance of government reforms was down, apparently due to increasing unemployment and SOE layoffs. It warned that handling of groups disadvantaged by the reform process would be important to maintaining social stability. See S.CHINA MORNING POST, Feb. 2, 1998, at 8.

eliminates most subsidies to unprofitable SOEs to comply with GATT norms, the phase-in period will provide domestic reformers a critical buffer period. During this period, the reformers will be able to carry out re-employment programs, divert the burden of social welfare to newly-created national and municipal funds, and to diversify SOE ownership and restructure its debt through domestic and international public stock offerings, mergers, consolidations, and bankruptcies.

1. Social Welfare, Unemployment and Social Stability

Cutting off subsidies to SOEs to comply with GATT principles of most favored nation and national treatment will aggravate the already acute strain on the country's inchoate national social security system. The lesson to be taken from the devastating effects of Russia's failure to deal with this issue has not been lost on the Chinese leadership.³⁸ Since the mid-1950s, urban Chinese society has been organized around the "work unit" (*danwei*). Every government office, school, hospital and factory was a separate unit responsible for the "cradle to grave" social welfare provided to all its workers and their dependents. SOE reform means dismantling the mainstay of the urban social safety net. But a national system for providing medical care and other social services has yet to emerge in its place.³⁹ When Zhu Rongji announced in March 1998 that subsidized housing would be phased out, he noticeably did not discuss how workers making less than US\$150 per month would pay market prices for housing.⁴⁰

SOE distress has also resulted in a sharp increase in unemployment and urban poverty.⁴¹ For years SOEs suffered from underemployment: inefficient production meant workers often

38. At the East Asia Economic Summit in Hong Kong, Wang Zhongyu, minister of the State Economic and Trade Commission, in charge of SOE reform, stated that the most pressing issue of reform was to set up a social security system to replace that formerly provided to workers by SOEs directly. S. CHINA MORNING POST, Oct. 14, 1997, at 16. See also CHINA'S ECONOMY IN 1995-97, *supra* note 15, at 10.

39. See Joseph Kahn, *Welfare Wanes: Holes in China's Safety Net Open Way for Providers*, ASIAN WALL ST. J., Feb. 2, 1998, at 1. Eighteen cities have implemented trial programs providing only minimum protection. See Peng Weixiang, *Building the Last Line of Defense for Social Security*, CHINA L.Q., Sept. 15, 1996, at 54-55.

40. See Erik Eckholm, *New China Leader Promises Reforms for Every Sector*, *supra* note 2. Note long term loans to consumers secured home mortgages are theoretically available to individuals in China. In practice though, tight bank credit and poor mechanisms for credit risk assessment and managing security interests present considerable obstacles to the use of consumer credit to solve the housing subsidy problem. See also Pamela Yatsko and Matt Forney, *Demand Crunch*, FAR E. ECON. REV., Jan. 15, 1998, at 47 (quoting middle-aged Chinese worker, Bao Li, complaining about 40% hike in subsidized rents).

41. See Elizabeth Rosenthal, *Poverty Spreads and Deepens in China's Cities*, N.Y. Times News Serv., Oct. 4, 1998 at WL-NYT 1998 98276068-03. Chinese re-

had nothing to do, yet they were paid. In recent years, as the number of workers laid off from SOEs has continued to increase, renewed urban unrest and increased crime have become very real political problems for the Chinese government.⁴² In the first half of 1997 more than five million workers were furloughed as a result of SOE reform. At the NPC Session in March, 1998, Labor Minister Li Boyong reported that over 11.5 million people SOE employees lost their jobs in 1997, adding another burden to the already serious unemployment situation.⁴³ More recent official statistics put unemployment at 4%, but this figure does not reflect the rapidly increasing number of laid-off redundant workers, particularly in regions where heavy industry is concentrated.⁴⁴ Over the next three years, SOEs will dismiss 10 million more employees from their payrolls, according to Labor Minister Li.⁴⁵ In the state-run iron and steel industry alone, there are plans to cut the workforce by 28% by eliminating 500,000 jobs in the next two years.⁴⁶ State Councillor Wang Zhongyu, one of Zhu Rongji's cabinet members in charge of SOE restructuring, stated that the government expected that in 1998 alone over 600,000 workers in the hard-hit state-run textile industry would lose their jobs.⁴⁷ Creating new employment is therefore critical and the government is giving top priority to relief and reemploy-

searchers estimate that 12-20 million urban residents live in "absolute poverty," and 90% of those are working poor or laid off workers (xiagang).

42. Redundant workers at flagship steel conglomerate Capital Iron and Steelworks have not been receiving their subsistence wages. Its subsidiary, Tegang Specialty Steel, has reportedly laid off over 35% of its workforce. See S. CHINA MORNING POST, Dec. 2, 1997, at 6. China News Digest reported the results of a survey by the New York-based Human Rights in China which suggested that 38% of workers in Sichuan province were furloughed indefinitely. Of these, 73% did not receive promised welfare. CHINA NEWS DIGEST, Jan. 30, 1998. See, e.g., Jasper Becker, *Unpaid Miners Blocking Rail Lines*, S. CHINA MORNING POST, Mar. 10, 1998, at 8 (reporting on social unrest and worker protests).

43. See Daniel Kwan, *Insurance Fund Increased to Assist Jobless*, S. CHINA MORNING POST, March 9, 1998, at 8, (citing remarks by Minister Li Boyong at NPC Session); see also *Job Outlook Is Gloomy in China*, ASIAN WALL ST. J., April 2, 1998, at 4, (citing official statistics showing 2.5 workers compete for each available job in 1998).

44. The official *Renminribao* [People's Daily] reported 10% unemployment in the Northeast rust belt. Nov. 17, 1997. The World Bank estimates 11% urban unemployment. Mark Sharp, *Reforms Near Vital Juncture*, S. CHINA MORNING POST, Sept. 7, 1997, at 2.

45. See Vivian Pik-Kwan Chan, *10 Million Jobs To Go in State Firms; Re-employment A Priority To Ensure Stability, Says Minister*, S. CHINA MORNING POST, Feb. 10, 1998, at 7, (citing interview between Li and the official Xinhua News Agency).

46. Xinhua News Agency, Feb. 25, 1998, available on WESTLAW, ALLNEWSPLUS LIBRARY.

47. See *China Outlines Textile Industry Reforms*, ASIAN WALL ST. J., Dec. 19, 1997, at 7.

ment measures.⁴⁸ But with the slack employment market in non-state sectors, only half of the 12 million people laid off have found new jobs,⁴⁹ and according to one researcher at the Chinese Academy of Social Sciences, the Government will not be able to arrange re-employment for all redundant workers.⁵⁰ Over 100 million surplus rural laborers migrating to the cities in search of work add an additional dimension to the dilemma.⁵¹ One economist even predicted actual unemployment could hit 28% in coming years.⁵²

2. Subsidies, Policy Loans and Banking Reform

At the Party's direction, over the past few years state-run banks have replaced direct government subsidies to SOEs with soft loans, placing a severe strain on the banking system.⁵³ Estimates suggest that the amount of these loans, most of which are non-performing and are unlikely to be repaid, is enough to drive the banks into insolvency.⁵⁴ The continuing Asian financial crisis has underscored the need to restructure these loans and relieve

48. The State Council and other relevant ministries have recently promulgated a number of circulars, notices, and regulations addressing this problem. See, e.g., *State Council Supplementary Notice on the Acquisition of Enterprises, the Declaration of Bankruptcy and the Re-employment of Staff and Workers of State-owned Enterprises for Trial Implementation in Several Cities* (Guofa [1997] No. 10); *Notice Regarding Further Improvement of the Work of the Re-employment of Workers* (Laobu fa [1997] No. 166); *Notice on Establishing Re-employment Service Centers* (Laobu fa [1997] No. 252) (requiring all provinces to set up re-employment funds and service centers); *Notice Regarding Distribution of the "Investigative Report on Shanghai's Experience Implementing Re-employment Projects"* (Guojingmaoqi [1997] No. 549) (urging local governments to apply Shanghai's successful approach to local conditions). Available in Chinese and in translation on file with author. Also at China Law website <www.qis.net/chinalaw>.

49. State Statistics Bureau spokesman, Ye Zhen, cited in Pamela Yatsko and Matt Forney, *Demand Crunch*, FAR E. ECON. REV., Jan. 15, 1998, at 46.

50. See Jasper Becker, 'Bleak Outlook' for 30 Million Jobless, S. CHINA MORNING POST, Nov. 26, 1997, at 8.

51. See Ian Johnson, *Deploying Migrants: China Fights to Contain Emergence of Megacities*, ASIAN WALL ST. J., Dec. 12, 1997, at 1 (reporting on new city built 320 kilometers from Beijing to divert the flow of excess migrant labor to the capital).

52. See Daniel Kwan, *Economist Predicts 28% Jobless Figure by 2000*, S. CHINA MORNING POST, March 16, 1998, at 7, (citing interview with economist Feng Lanrui estimating 28% unemployment by 2000, including rural migrants, published in Guangzhou newspaper, [*Nanfeng Weekly*]).

53. See generally Greg Mastel, *A China the World Could Bank On*, WASH. POST, Dec. 29, 1997 at A17; also CHINA'S ECONOMY IN 1995-97, *supra* note 16, at 15-16.

54. Nicholas Lardy, an economist at the Brookings Institute, puts the figure at US\$600 billion. See Indira A.R. Lekshmanan, *Wary Chinese Edge Into Capitalism*, BOSTON GLOBE, Nov. 9, 1997, at A38. Thomas G. Rawski, an economist specializing in Chinese affairs, asserts, "China's four big banks have tiny capital, derisory reserves, and mountains of uncollectable debt. All four would fail any formal test of solvency." Thomas G. Rawski, *Is China Next?*, ASIAN WALL ST. J., Jan. 23, 1998, at 8.

the burden on China's banks. China has since moved to free its banks from policy loans and allow them to lend on sound financial criteria.⁵⁵ But this notably does not solve the problem of existing loans.⁵⁶

The use of subsidized credit and industrial inputs to support sluggish, unprofitable SOEs is inflationary and results in inefficient allocation of scarce resources, which in turn drives up the national deficit.⁵⁷ Not only do loans to SOEs account for 80% of all state-run bank debt, but according to People's Bank of China (PBOC) Governor Dai Xianglong and other central bank officials, "problem loans" more than one year in arrears to SOEs constitute 20% of all advances made by China's four largest commercial banks.⁵⁸ Inter-enterprise debt, often triangulated, adds to the fiscal burden by aggravating SOE cash flow and insolvency problems.⁵⁹ PBOC Governor Dai estimated that to turn the state sector around will require over RMB1 trillion (US\$120.5 billion).⁶⁰ With its banking sector so overextended, China must cut subsidized loans to SOEs or else face the risk of a large scale financial crisis that would jeopardize other vital areas of economic reform.

The upshot is that the political and economic exigencies of massive restructuring temporarily preclude strict adherence to

55. See, e.g., *Commercial Banks to be Allowed to Set Rates on Loans*, CHINA DAILY, Feb. 23, 1998; also CHINA'S ECONOMY IN 1995-97, *supra* note 15, at 15-16.

56. China has tried to shift some of the burden back to the state. Banks have issued bonds to the Ministry of Finance, but PBOC Deputy Governor Chen Yuan has admitted this is largely an accounting entry not a substantive reform. See Seth Faison, *China to Prime Economic Pump with Mammoth Building Outlay*, N.Y. TIMES, March 6, 1998, at A6; see also Steven Mufson, *China Announces Large Bond Issue to Bail Out Banks*, WASH. POST, March 1, 1998, at A21.

57. If policy-lending by state-owned banks is taken into account, the true budget deficit may be as high as 6% of GDP, according to Oxford Analytica, a research group based in Oxford, U.K. . See generally *Asia Pacific Daily Briefs*, <<http://www.oxford-analytica.com>>. Per World Bank figures, in 1994, budgetary and implicit financial subsidies equaled 4% of China's GDP, while SOE aggregate net financing was 7.8% of GDP. THE CHINESE ECONOMY, *supra* note 32, at 17.

58. See CHINA'S ECONOMY IN 1995-97, *supra* note 16, at 15-16. See also S. CHINA MORNING POST, Oct. 23, 1997 at 1.

59. "Triangular" debt refers to trading transactions between three or more enterprises which are not settled. This debt causes major cash flow problems for SOEs, pushing many into insolvency. According to the Asian Development Bank, nationwide SOE's outstanding liabilities increased from RMB100 billion in 1988 to over RMB700 billion in April 1995. See ASIAN DEVELOPMENT BANK, STATE ENTERPRISE INSOLVENCY REFORM, (People's Republic of China TA No. 2271, March, 1996) at 132-35. Huge outstanding accounts receivable in basic industries like coal mining evidence the serious fiscal problems industrial SOEs are facing just paying for production inputs. See Jasper Becker, *Unpaid Miners Blocking Rail Lines*, S. CHINA MORNING POST, Mar. 10, 1998, at 8 (state owned coal mines show a profit on the books, but many customers do not pay).

60. See S. CHINA MORNING POST, Oct. 23, 1997, at 1.

GATT principles of most favored nation and national treatment. To grant full market access and allow foreign industry to compete on equal footing with domestic industry would arguably be fatal to newly restructured enterprises, causing financial distress and mass unemployment. Together, these would almost inevitably lead to widespread social unrest and political crisis that would deal a sharp blow to an already fragile polity. The Party's track record in dealing with urban unrest, in particular striking independent workers' groups — for example, the events of May-June 1989 which ended in the violent military invasion of Tian'anmen Square by the People's Liberation Army⁶¹ — as well as the imperatives and attitudes of the current leaders,⁶² makes it reasonable to assume that the Party would forcibly protect its hold on power.⁶³ If not contained, the resulting loss of legitimacy combined with economic crisis would ultimately be political anathema to the Party.

B. CHINA'S PERSPECTIVE ON THE WTO AND ACCESSION

The immediate question for China is how to negotiate its "ticket of admission" to the WTO while steering clear of potential domestic social and political unrest. Notwithstanding their

61. The popular nationwide urban "democracy" movement in the spring of 1989 focused on complaints that the government was not doing enough to combat soaring inflation and official corruption. Urban subsidies were not keeping pace with double digit inflation and struggling SOEs were forced to lay off thousands of workers. The critical turning point for the Party in dealing with the unrest was the advent of the Independent Workers' Union (*Gongzilian*) headed by worker-turned-star dissident Han Dongfang. Workers' participation made Deng Xiaoping and other leaders fear they could lose control. That's when they mobilized the army. See Richard Baum, *The Road to Tiananmen: Chinese Politics in the 1980s*, in *THE POLITICS OF CHINA: 1949-1989*, (Roderick MacFarquhar ed.) (1993) at 456 (noting that the "decisive catalysts" of the Tian'anmen Massacre included the "rapid rise of a militant, autonomous workers' movement . . . proclaiming its solidarity with the students in opposition to the regime, bringing ever closer to reality Deng's recurrent Polish nightmare"). See also Gary H. Jefferson and Thomas G. Rawski, *Enterprise Reform in Chinese Industry*, 8 J. ECON. PERSP. 47, 52 (1994).

62. Of the current triumvirate, Li Peng, dubbed the "Butcher of Beijing" and other epithets by his many detractors, is the only one with a direct connection to Tian'anmen 1989. Zhu Rongji and Jiang Zemin, are by no means lightweights, however. Zhu has rejected the suggestion that the official verdict on June 4, 1989 events be overturned; and his reform platform notably contains no provision for democratic political change. Jiang is likewise no democrat. See generally *THE POLITICS OF CHINA*, *supra* note 61.

63. The Party under Jiang's leadership has also consolidated the means to exercise this force. After a publicized address by Jiang Zemin to People's Armed Police (PAP) the paramilitary force charged with maintaining domestic stability earlier in 1997, the 15th Party Congress decided to double its ranks to 1.2 million. The PAP, however, has purchased riot control equipment which might allow them to control civil unrest with fewer casualties. See Gregory Fossedal, *Enlist the Masses To Solve China's Dilemma*, *supra* note 4; also Bruce Gilley, *Opening the Gates to Tian'anmen*, *ASIAN WALL ST. J.*, Nov. 13, 1997, at 10.

commitment to reform and integration into the international economic community, Chinese leaders have made clear that maintaining domestic stability is of primary importance.⁶⁴ In his Report to the 15th Party Congress, Jiang Zemin emphasized, "[I]t is of the utmost importance to maintain a stable political environment and public order. . . . We must uphold the leadership of the Party. . . eliminate all factors jeopardizing stability, and guard against. . . subversive. . . domestic hostile forces."⁶⁵ China's concern is that it does not want to be excluded from the WTO for another decade.

The solution, therefore, turns on the issue of timing: whether the WTO will allow China a transition period long enough for it substantially to complete SOE reform before it must fully comply with GATT requirements. More liberal "phase-ins" would allow the Government to defuse the potential social time-bomb and buffer the shock of marketization by giving new reform policies a chance to take hold. How long is necessary is difficult to determine. Chinese Premier Zhu Rongji has promised to complete the Herculean task of SOE reform within three years.⁶⁶ Nonetheless many analysts believe it will take at least 8-10 years.⁶⁷ The chief Chinese negotiator in Geneva, Long Yongtu, vice minister for foreign trade, argued that Beijing's reforms are progressing as quickly as the country's domestic situation will allow, and that Chinese membership in the WTO is necessary to ensure the success of domestic reforms.⁶⁸ In an important speech on China's economy and development delivered at an IMF conference in Hong Kong, Zhu Rongji stressed that China cannot achieve economic growth in isolation from the world, that the country "will continue to follow unswervingly the opening-up policy and march towards the world. . . ."⁶⁹ In the same speech, however, he described the urgency of SOE reform, and urged the WTO not to "make excessive demands on China, which is a developing country."⁷⁰ State Councillor and former Minister of Foreign Trade and Economic Cooperation, Madame Wu Yi,

64. See, e.g., Report at the 15th Congress of the Chinese Communist Party, *supra* note 1, at 17; also Premier Li Signals Caution on Reforms, S. CHINA MORNING POST, Feb. 5, 1998, at 7.

65. Report at the 15th Congress of the Chinese Communist Party, *supra* note 1, at 17.

66. Zhu Optimistic as Reforms Pay Economic Dividends, S. CHINA MORNING POST, Sept. 23, 1997, at 2.

67. See Erik Eckholm, *New China Leader Promises Reforms for Every Sector*, *supra* note 2; see also Luo Bing, *A Major Test for State Enterprise Reform*, *supra* note 3; and ZHENG MING (Hong Kong), Nov. 1997, at 25-26 (reporting on conference of Chinese economic leaders discussing SOE reform).

68. See *China's Assurances on Reform Please U.S.*, *supra* note 23.

69. Zhu Optimistic as Reforms Pay Economic Dividends, *supra* note 64.

70. *Id.*

echoed this view eloquently, noting that it was unfair for Western countries to demand of China in a few years that which has taken them 200 years to achieve.⁷¹ President Jiang Zemin evinced a cautious tone in remarks to the National People's Congress (NPC), stressing that China must carefully assess and prepare for the risks and consequences of full opening to the global economy.⁷²

The Chinese leadership must carefully assess and balance the benefits of WTO membership with the potential harm to its fragile domestic situation. Eliminating subsidies to SOEs far in excess of WTO limits will endanger the jobs of over 100 million Chinese.⁷³ China plainly cannot afford to do this. Nor can it unilaterally lower tariffs, exposing restructuring industry to potentially fatal foreign competition.⁷⁴ Reform on this scale must be gradual. At the same time, China remains strong in its desire to join WTO, to gain the concomitant recognition and respect deserving of an international economic power, to become a full-fledged member of the international community, and to increase its wealth and develop its industry through the benefits of WTO membership. For domestic reformers, WTO accession will provide the critical economic and political leverage they need to guide the country through the tribulations of massive industrial restructuring.

C. WTO'S PERSPECTIVE ON CHINA'S ACCESSION: RECONCILING DOMESTIC POLICY WITH INTERNATIONAL NORMS

Despite positive statements by WTO Director-General Renato Ruggiero and others concerning China's accession critical areas remain unresolved, particularly after China's pledge not to devalue its currency in the wake of the Asian financial meltdown.⁷⁵ China has yet to convince the trading powers it can

71. See James Kynge, *China Agrees Framework for Talks on Services Trade*, FIN. TIMES, Feb. 18, 1998, at 7.

72. See *Wary Jiang Pledges More Open Market*, S. CHINA MORNING POST, Mar. 10, 1998, at 7.

73. See, e.g., Greg Mastel, *Clinton-Jiang Summit, Round Two*, J. COM., Dec. 3, 1997, at 7A; see also, Xu Xing, *China's Unemployment Problem and Solutions*, OPEN MAGAZINE (Kaifang), Nov. 1997, at 32-33; Xu Xing, *Modernizing SOEs: Easier Said Than Done*, *supra* note 6, at 29-31.

74. Shi Guangsheng, newly-promoted Minister of Foreign Trade and Economic Cooperation has stated, however, that China will decrease its overall trade surplus in 1998. See, *Trade: Big Push To Lower Surplus*, S. CHINA MORNING POST, Mar. 10, 1998, at 4.

75. At the World Economic Forum held in Davos, Switzerland in February 1998, Chinese Vice Premier Li Lanqing assured business and political leaders that China would not devalue the Renminbi in the wake of the Asian financial crisis. Many including WTO Director-General Ruggiero regard China's stability and WTO

make and uphold commitments to open its services sector to foreign investment, to further lower tariff bindings and to eliminate licensing requirements and other NTBs. There is considerable evidence to show that China has a long way yet to go towards ensuring institutional transparency and uniform application of relevant laws and regulations.⁷⁶ While WTO has expressed its commitment to integrate China and other countries into the world trade regime,⁷⁷ it must do so in a manner consistent with the basic principles of an open, rules-based system. Key WTO officials have acknowledged that managing China's accession in a way that reinforces rather than weakens the multilateral WTO regime is currently the biggest challenge confronting the institution.⁷⁸

1. *The Global Economy: From GATT to WTO*

Established in 1947 as part of the post-World War II Bretton Woods System,⁷⁹ GATT was conceived as a multilateral treaty framework governing trade in manufactured goods premised on the idea that free trade promotes transparency, openness and reciprocity. Its members, known as Contracting Parties, were for many years limited to the states of the non-communist world. GATT encouraged harmonization of tariffs and the elimination of all barriers to free trade. Replacing quotas, import licensing requirements, subsidies and tax benefits with tariffs improved trade efficiency and produced revenue for importing countries.⁸⁰

entry as crucial to Asia's recovery. See Tani Freedman, *China Pledges on Yuan Raises Payoff Questions*, Agence Fr.-Presse, Feb. 2, 1998, available in WESTLAW (WL2212886); Tani Freedman, *China WTO Entry a Stabilizing Factor in Asia Crisis: Ruggiero*, Agence Fr.-Presse, Feb. 1, 1998, available in WESTLAW (WL2212050); see also *Vice Premier Pledges Infrastructure Program*, S. CHINA MORNING POST, Feb. 2, 1998, at 1.

76. See, e.g., Stanley Lubman, *Making China a Nation of Laws, Not Whims*, L.A. Times, Sept. 6, 1998, at m2.

77. See WTO Singapore Ministerial Declaration, adopted on 13 December 1996.

78. See Jeffrey L. Gertler, *The Process of China's Accession to the World Trade Organization*, in CHINA IN THE WORLD TRADING SYSTEM: DEFINING THE PRINCIPLES OF ENGAGEMENT, (Frederick M. Abbott ed., 1998), at 67-68. Mr. Gertler is Senior Counselor, Legal Affairs Division and Secretary, Working Party on the Accession of China, World Trade Organization.

79. The "Bretton Woods system" takes its name from the series of conferences held at Bretton Woods, New Hampshire beginning in 1944 that developed the institutions and agreements that have regulated international economic, financial and development activity since. They comprise the IMF, the World Bank (formerly the International Bank for Reconstruction and Development), and GATT. See generally LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS, *infra* note 79, at 278-88.

80. A tariff or binding is an import tax which is calculated ad valorem or at a flat rate.

Tariffs also served GATT's geopolitical agenda, promoting transparency and aligning the economic interests of the non-communist world.

Between the 1964 and 1980, the Kennedy and Tokyo Rounds resulted in important agreements and understandings amending the original 1947 treaty. In addition to further tariff reduction procedures and non-tariff barriers, these Rounds addressed the issue of incorporating developing states into the trade regime. In 1964, Part IV on trade and development was added to the General Agreement. The Tokyo Round subsequently produced an Understanding on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries, expressing GATT's desire to embrace a broader international representation;⁸¹ however, as world trade and the number of states wishing to accede increased, GATT lacked the formal institutions and streamlined decision making procedures to meet the needs of new states wishing to accede and the application of GATT norms to new areas such as trade in services and intellectual property.

The Uruguay Round negotiations from 1986 to 1994, laid the groundwork for the establishment of the WTO in 1995. The Marrakesh Agreement of July 1994 created a permanent, formal organization headquartered in Geneva.⁸² The WTO embodies the original GATT as amended, but it modifies the GATT structure in several significant respects. It administers the negotiation, adjudication and enforcement of a broader scope of trade issues than GATT, incorporating over a dozen agreements relating trade in goods and services, including intellectual property, subsidies and countervailing measures, trade-related investment measures, safeguards, etc. It enjoys a stronger institutional identity manifested in decision-making and dispute resolution mechanisms that emphasize efficiency and adjudication, rather than ad hoc consensus and mediation as under GATT. The WTO decision making procedure amends the unanimous consensus formerly required under GATT. Most decisions, including the approval of the terms agreed on in a new member's protocol of

81. Such Understandings have an uncertain legal status and are not independent agreements under GATT. Nevertheless, they express general aims and intent. See JOHN H. JACKSON, *RESTRUCTURING THE GATT SYSTEM*, 26-29, *reprinted in* LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS, *infra* note 79, 315-18.

82. Agreement Establishing the World Trade Organization, reproduced in JOHN H. JACKSON, WILLIAM J. DAVEY, & ALAN O. SYKES, JR., *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS, DOCUMENTARY SUPPLEMENT* (3d ed., 1995).

accession, can be made by a 2/3 majority vote of the organization's Ministerial Conference.⁸³

2. *Change in the International Order: Creating a World Trade System*

For the WTO, China's accession is an important test of its mettle. The explosion of information technology and the globalization of economic relations that inspired the formation of the WTO represent new challenges that the original GATT Contracting Parties never contemplated. These challenges stem from a far broader definition of "world" than the international trading system that existed under GATT, particularly before the Uruguay Round. The WTO seeks to act as a broad-based institutional pillar of the international system, not merely the trade arm of a political and military treaty alliance.⁸⁴ Currently, of 130 WTO members, 80% are developing countries or economies in transition.⁸⁵ Its ability to balance the need to integrate new members with the integrity of its free trade principles will have a profound impact on the WTO's future as a respected and effective institution.

For the U.S., the negotiations with China are an important opportunity to shape the political and economic structure of the world in the coming century. The problem, however, is that the U.S. has overemphasized issues of market access, the growing U.S. trade deficit, and even non-trade issues such as human rights at the expense of an agreement that encourages Chinese reform and integration. This approach is shortsighted and overestimates the U.S.' ability to influence the course of events in China. Moreover, it fundamentally misunderstands the nature of ongoing reforms in China and the obstacles ahead. The other major actor in the accession process, the E.U., shares many similar concerns but has maintained a generally more positive position regarding China's early accession, and may from time to time act to mediate the tension between the PRC and the U.S.⁸⁶

83. *See id.*, art. XII. Exceptions are interpretation of WTO agreements and permission to waive certain requirements both of which require a 3/4 vote. Amendments may be passed by a 2/3 vote, but are not binding on dissenting member states unless passed by a 3/4 vote.

84. For fuller discussion on this topic, *see generally*, THE WTO AS AN INTERNATIONAL ORGANIZATION, Anne O. Krueger, ed. (1998).

85. *See China and the World Trading System*, speech delivered by WTO Director-General Renato Ruggiero at Beijing University, Apr. 21, 1997, visited March, 1998 <<http://www.wto.org/wto/speeches/china.htm>>.

86. *See, e.g., L'Europe Propose Un Sommet Annuel avec la Chine*, *supra* note 8 (reporting offer of E.U. Vice President, Sir Leon Brittan during meeting with Chinese Foreign Trade Minister, Wu Yi, on further opening of trade and investment in Beijing); *see also Sir Leon Plays the Role of Knight in Soft Armour*, *supra* note 8.

In determining the conditions under which they will admit China, the WTO and its principal members should carefully consider the effect of their stance on Chinese domestic policymaking. They should seek to develop a common strategy that both anticipates the international consequences of China's admission while also giving China's reformers the ability to continue domestic reforms and gradually ensure compliance with WTO norms.

III. ANALYSIS OF ONGOING REFORM OF CHINA'S STATE-OWNED ENTERPRISES

Sweeping economic and legal reforms since 1978 have transformed China from a centrally-planned, command-style economic and political structure to a largely decentralized "socialist market economy."⁸⁷ The terms "state-controlled" and "planned economy" as traditionally defined no longer accurately describe China. Since 1978, successive Party documents and a growing body of legislation have outlined the political theory and corresponding legal framework on which to "build socialism with Chinese characteristics."⁸⁸ Urban collectives, rural township collectives, Sino-foreign joint ventures, and private enterprise now figure prominently in China's overall GDP.⁸⁹ Where price controls and quotas existed, the market now governs the flow and prices of most goods and services,⁹⁰ yet despite the emergence of market mechanisms, the rules of a fully-developed market econ-

87. The principle of the "socialist market economy" was officially adopted by the Party in 1993 in *Zhonggongzhongyang Guanyu Jianli Shehuizhuyi Shichang Jingji Tizhi Ruogan Wenti De Jueding (Decision of the CPC Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economic Structure)* (adopted by the Third Plenary Session of the Fourteenth Central Committee of the Communist Party of China, Nov. 14, 1993), translated in KENNETH LIEBERTHAL, *GOVERNING CHINA*, at 419. It connotes the continued political commitment to socialism with "unique Chinese characteristics", i.e., market mechanisms.

88. "Building Socialism with Chinese Characteristics" is the political mantra embodying Deng Xiaoping Theory, which was officially adopted by amendment to the Party Constitution at the 15th Party Congress. Deng's ideology stresses pragmatism—experimenting and applying what works. See generally William H. Simon, *The Legal Structure of the Chinese "Socialist Market" Enterprise*, 21 J. CORP. L. 267 (1996).

89. The non-public sector—collectively-owned, private and Sino-foreign joint venture enterprises—accounted for nearly two-thirds of total industrial output in 1994. See *THE CHINESE ECONOMY*, *supra* note 35, at 16. Private enterprises accounted for less than one percent of total industrial production in 1978, two percent in 1985, five percent in 1989, and nine percent in 1993. See BARRY NAUGHTON, *GROWING OUT OF THE PLAN: CHINESE ECONOMIC REFORM, 1979-1993*, at 14 (1995). For a summary of different forms of business organization in China, see GUIGUO WANG, *BUSINESS LAW OF CHINA: CASES, TEXTS AND COMMENTARY* 145-76 (1993).

90. See NAUGHTON, *supra* note 85, at 289-291.

omy still do not apply. Rather, the Middle Kingdom has become a strange hybrid in which diverse forms of ownership coexist, often in tension with each other. Nevertheless, the recent 15th Party Congress and the Ninth National People's Congress (NPC) leadership reaffirmed its intent that public ownership remain the mainstay of the economy.⁹¹ In order to achieve this aim, however, SOE reform must succeed in replacing the traditional state-owned model with a modern enterprise system that encourages efficiency and growth while reconciling the conflict between management autonomy and public ownership.⁹²

Public ownership does not mean state-run enterprise in the conventional sense. China has skirted the ideological conflict inherent in adopting capitalist mechanisms to build socialism by creating a legal framework that separates ownership interest from management authority and financial interest.⁹³ Ownership remains vested in the "entire people"⁹⁴ but is exercised by the state on their behalf. Per constitutional amendment, formerly state-run industry (*guoying*) is now legally referred to as "state-owned" (*guoyou*), underscoring the official intent to separate government administration from enterprise operations.⁹⁵ Economic reform, in turn, has resulted in decentralization of this control over most SOEs to provincial and municipal govern-

91. See Jiang Zemin's Report at the 15th Party Congress, *supra* note 1, at 18.

92. The traditional state-owned enterprise was indivisible from its supervisory government agency. It remits all profits to the agency and had virtually no autonomy over its management and enterprise business functions and decision-making. See Daniel C.K. Chow, *An Analysis of the Political Economy of China's Enterprise Conglomerates: A Study of the Reform of the Electric Power Industry in China*, 28 LAW & POL'Y INT'L BUS. 383, 394 (1997).

93. The theoretical underpinning is found in Deng Xiaoping's famous "Cat Theory" (*maolun*), essentially an old Szechuanese adage: "It doesn't matter if it's a white cat or a black cat, as long as it catches mice it's a good cat." Former General Secretary Zhao Ziyang, a key engineer of reform in the 1980s, further resolved the theoretical conflict by proclaiming China in the "primary stage of socialism" during which diverse means could be employed to build industry and accumulate capital. Jiang Zemin has revived this theory to support his call for broad SOE restructuring. See *How to Understand Jiang's Important Speech*, BEIJING REV., Aug. 25, 1997 at 14, available in WESTLAW (WL 10063404).

94. See, e.g., XIANFA [PRC Constitution] (1982) art. 7 (amended 1988, 1993), reprinted and translated in [1 BUS. REG.] CHINA L. FOR FOREIGN BUS. (CCH) ¶ 4-500, ¶ 4-500(7) (1993); *Zhonghua Renmin Gongheguo Quanmin Suoyouzhong Gongye Qiye Fa [Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People]* art. 1 (1988), reprinted and translated in [2 BUS. REG.] CHINA L. FOR FOREIGN BUS. (CCH) ¶ 13-534, ¶ 13-534(1) (1993).

95. The Constitution was amended in 1993 to conform with the goal of pursuing a socialist market economy. See NATALIE LICHTENSTEIN, ENTERPRISE REFORM IN CHINA: THE EVOLVING LEGAL FRAMEWORK 5 (World Bank Policy Research Working Paper WPS 1198, Sept. 1993).

ments;⁹⁶ only a few thousand of the largest SOEs remain under direct central control.⁹⁷ Even at the local level, state control over management of SOEs has gradually developed into a “weak owners, strong managers” corporate structure. The result is that now SOE managers generally enjoy greater authority and have full responsibility for business operations.

A. SOE “STOCKIFICATION” NOT PRIVATIZATION; CONTINUED GOVERNMENT INTERVENTION

The opening of stock markets in Shanghai in December 1990 and Shenzhen in June 1991 has played an important role in creating a structure whereby state agencies no longer manage the details of day-to-day operations. Many SOEs have changed their legal and financial structure to sell equity securities on those markets. These markets have seen rapid expansion over the past two years,⁹⁸ and it is expected they will continue to grow substantially as the government places importance on public equity offerings as a means to raise capital for SOE restructuring.

China’s stock markets, however, differ significantly from their counterparts in New York and Hong Kong. Although they facilitate financing and managerial reform of SOEs, transferring consumers’ personal savings into productive enterprises,⁹⁹ Chinese securities exchanges have not replaced the role of the state with a capitalist market system. In fact, government administrative agencies have retained controlling rights through ownership of key state and legal person shares.¹⁰⁰ Publicly-traded compa-

96. See BARBARA LEE AND JOHN NELLIS, ENTERPRISE REFORM AND PRIVATIZATION IN SOCIALIST ECONOMIES 7 (World Bank Discussion Papers No. 104, 1990).

97. Over 104,700 industrial SOEs are controlled by sub-national government agencies. See HARRY G. BROADMAN, MEETING THE CHALLENGE OF CHINESE ENTERPRISE REFORM 6 (World Bank Discussion Papers No. 283, 1995)

98. See CHINA’S ECONOMY IN 1995-97, *supra* note 16, at 13.

99. Chinese citizens have huge aggregate personal savings which the government hopes to put to productive use. Chinese personal savings available for investment total s \$361 billion. See Michael Irl Nikkel, Note, “Chinese Characteristics” in *Corporate Clothing: Question of Fiduciary Duty in China’s Company Law*, 80 MINN. L. REV. 503, 505 n. 11 (1995).

100. Stock is classified in China according to the type of entity or person holding shares. The three principal classes of shares are state shares (*guojia gu*), legal person shares (*faren gu*), and individual shares (*geren gu*). State shares represent the rights of a government organization or designated holding company received in exchange for state-owned assets when an SOE issues equity securities. Legal person shares are owned by one of several types of juridical persons recognized under the General Principles of Civil Law, often other state-owned companies or institutional legal persons (*shiye faren*). Individual shares are held by individual Chinese citizens either “employee shares” (*neibu zhigong gu*) or public individual shares (*shehui geren gu*) offered to the general public. See Minkang Gu and Robert C. Art, *Securitization of State Ownership: Chinese Securities Law*, 18 MICH. J. INT’L L. 115, 126-27 (1996);

nies have not been "privatized" in the strict sense of the word. Rather, the process by which an SOE converts into a "company limited by shares" or a "shareholding cooperative company" and then sells shares on the market, *gufenhua* in Chinese, literally "stockification," is more properly understood as "corporatization" or "securitization," as distinguished from privatization.¹⁰¹ Such corporations retain a significant component of public ownership. Indeed, ideologically complete privatization is incompatible with Party policy because private ownership obviates the role of the state to act as the agent of the "entire people" in the ownership of the means of production.¹⁰² As such, use of the word "privatization" (*siyouhua*) with reference to SOEs remains taboo; Chinese officials in charge of economic reform have gone to great lengths to emphasize that "we resolutely oppose . . . privatization."¹⁰³

The stock markets have provided the basis for the current system of diverse ownership aimed at improving efficiency, separating government and business functions and to tap into nongovernment sources of capital, in particular foreign investment and consumer savings;¹⁰⁴ however, because the shares of the state and legal persons, which comprise the bulk of shares, cannot be freely traded on the market, they are in effect inaliena-

also Fang Liufang, *China's Corporatization Experiment*, 5 DUKE J. COMP. & INT'L L. 149, 208 (1995); Andrew Xuefeng Qian, *Riding Two Horses: Corporatizing Enterprises and the Emerging Securities Regulatory Regime in China*, 12 UCLA PAC. BASIN L.J. 62, 86-88 (1993).

101. The distinction turns primarily on the fact that the State through one or more of its administrative agencies retains controlling shareholding interest, thus preserving the principle of socialist public ownership. "Securitization" refers to the issuance of equity securities, not liens or other security interests. See Jianfu Chen, *Securitisation of State-owned Enterprises and the Ownership Controversy in the PRC*, 15 SYDNEY L. REV. 59 (1993); see also Andrei A. Baev, *Is There a Niche for the State in Corporate Governance? Securitization of State-Owned Enterprises and New Forms of State Ownership*, 18 HOUS. J. INT'L L. 1, 5-6 (1995); and see generally Simon, *The Legal Structure of the Chinese "Socialist Market" Enterprise*, *supra* note 88. Some have referred to *gufenhua* as "limited privatization". See Matthew D. Bersani, *Privatization and the Creation of State Companies in China*, 1993 COLUM. BUS. L. REV. 301, 306 (1993).

102. See XIANFA (PRC Constitution), art 6. (stipulating "socialist public ownership of the means of production, namely, ownership by the whole people").

103. Liu Hongru, Vice Minister of the State Commission for Restructuring the Economic System, qualifies this remark, "[B]ut we do not because of that oppose the stock market." See Liu Hongru, *Probe for A Correct Path—Questions on the Experiments in Joint Stock Companies and Stock Market*, ZHONGGUO JINGJI TIZHI GAIGE [CHINA'S ECONOMIC STRUCTURE REFORM], June 23, 1992, at 18, 18-25, translated in JPRS—CAR-92-079, Oct. 21, 1992, at 20.

104. In 1990, consumer bank deposits totaled RMB703.4 billion (approx. US\$850 million at current exchange rates). See Wang Pingxing, *A Glimpse of China's Securities Market*, XINHUA NEWS SERVICE, Feb. 11, 1991, available in FBIS DAILY REPORT—CHINA, Feb. 11, 1991, at 49-50.

ble, limiting the market's ability to grow through mergers, acquisitions, tender offers and corporate takeovers. Maintaining public ownership is thus in tension with the need to expand market mechanisms to restructure SOEs. The result is a lack of certainty in ascribing property rights between the state and the enterprise.¹⁰⁵

Continuing intervention by local governments in the business affairs of enterprises, combined with ambiguous property rights, has also impeded the development of more efficient, more competitive and better managed enterprises. Legal reform separating the state's ultimate ownership interest from management authority and rights to the enterprise's profits has so far failed to define property rights clearly between the enterprise and its administrative superior, or "department in charge."¹⁰⁶ Administrative agencies at local and national levels that invest in enterprises naturally want to maintain control over them.¹⁰⁷ Complex and often coextensive lines of horizontal and vertical administrative authority, however, mean enterprises are often subject to conflicting orders from other government agencies as well.¹⁰⁸ As a result, enterprises still do not have complete decision-making au-

105. See Wallace Wen-Yeu Wang, *Reforming State-Owned Enterprises in China: Redefining Enterprise Operating Rights*, 6 J. CHINESE L. 89, 102-20 (1992).

106. See Donald C. Clarke, *What's Law Got To Do With It?* supra note 30 at 25-37 (1991); also Deborah Kay Johns, *Comment, Reforming the State-enterprise Property Relationship in the People's Republic of China: the Corporatization of State-owned Enterprises*, 16 Mich. J. Int'l L. 911, 914 (1995) ("[C]orporatization . . . on paper helps delineate the respective property rights of the state and SOEs, but in the end effects little shift in the culture of state intervention underlying the state-enterprise relationship.").

107. An enterprise is usually controlled by a local government which has invested capital assets in it according to an informal policy: "shei jian, shei kong, sheiyong", which means he who "establishes, controls, and uses [the enterprise]". See James B. Stepanek, *China's Enduring State Factories: Why Ten Years of Reform Have Left Factories Unchanged*, in 2 JOINT ECON. COMM., 102D CONG., 1ST SESS., CHINA'S ECONOMIC DILEMMAS IN THE 1990s, at 440, 443 (1991).

108. The complex, overlapping web of vertical and horizontal administrative authority—the *tiao* (vertical line) and *kuai* (horizontal)—can be a quandary for enterprises. Chinese refer to this as having too many mothers-in-law" (*popo tai duo*). In fact, the *tiao* are often industrial administrative bodies while *kuai* are simply local people's governments or their subordinate agencies. For example, a local electric power company in Hainan province is subject to the industrial administration of the Ministry of Electric Power in Beijing (or its replacement following March 1998's bureaucratic haircut), while it is subject to the often more direct influence of the Hainan provincial government. Enterprises often resolve conflicting instructions from their various *popo* by tending toward the local authorities. See also Anna M. Han, *China's Company Law: Practicing Capitalism in a Transitional Economy*, 5 PAC. RIM L. & POL'Y J. 457, 489 (1996); see also Robert C. Hsu, *ECONOMIC THEORIES IN CHINA, 1979-1988*, at 88 (1991).

thority in the conduct of their business affairs; managers do not have sufficient incentives.¹⁰⁹

The fundamental legal issue is, however, systemic, caused by the fragmented polity of the state and the inability of the central government to ensure uniform application of the law. The structure of the institutions that administer, enforce and interpret the law compromises its implementation. This enforcement gap also reflects the separation of internal Party discipline from legality.¹¹⁰ Because the Party remains above the law (*dang da yu fa*), it subverts the normative force of legislation. The result is legal instrumentalism, not the rule of law.

B. LAYING THE POLITICAL FOUNDATION FOR ECONOMIC AND LEGAL REFORM SINCE 1978

After Mao Zedong's would-be successor, Hua Guofeng, arrested the ultra-leftist Gang of Four, ending the Cultural Revolution, he was left with a country in economic shambles, and a people psychologically torn asunder by over ten years of Maoist "class struggle."¹¹¹ Hua, however, having completed this service to the Chinese people, had little idea how to rebuild the nation. Nor did he have the strong political presence or credentials to fill Mao's shoes. In this vacuum, Deng Xiaoping returned to power quickly, promoting a policy of "reform and opening."¹¹² In an important speech just preceding the Third Plenary Session of the 11th Central Committee in early December 1978, Deng exhorted ranking Party members to "liberate [their] thinking," of

109. See Wang, *Reforming State-Owned Enterprises in China*, *supra* note 105, at 102-22; see also Donald C. Clarke, *Economic Regulation and Its Discontents: Understanding Economic Law in China*, 28 *STAN. J. INT'L L.* 283 (1992); see also Clarke, *What's Law Got to Do with It?*, *infra* note 153, at 36-44 (discussing rights of enterprises to resist exactions, and to hire and fire employees).

110. On the functions of law in China and the inherent structural problems of the Chinese legal system, see Stanley B. Lubman, *Introduction: The Future of Chinese Law*, in *CHINA'S LEGAL REFORMS*, (1996). See also Donald C. Clarke, *What's Law Got To Do With It?*, *supra* note 30.

111. The Great Proletarian Cultural Revolution which began in 1966 was a mass political and social movement in which millions were persecuted and killed. The Gang of Four included Mao's wife, Jiang Qing, as well as Yao Wenyuan, Zhang Chunqiao and Wang Hongwen. For a history of the Cultural Revolution, see RODERICK MACFARQUHAR, *ORIGINS OF THE CULTURAL REVOLUTION*; see also YAN JIAQI, *TURBULENT DECADE: A HISTORY OF THE CULTURAL REVOLUTION* (1996).

112. Deng held senior leadership positions since the 1950s, but was purged early in the Cultural Revolution. He later returned to the political scene in the mid-1970s only to be purged again following the Tian'anmen Incident of April 1976. In the summer of 1977, Hua Guofeng reluctantly permitted Deng to return. Deng resumed key posts as Vice Chairman of the Party and a member of the Politburo Standing Committee as well as Vice Chairman of the powerful Party Military Affairs Commission.

old ideology, "seek truth from facts" and "unite in looking ahead."¹¹³ The Communique of the Third Plenary Session adopted immediately following in late December 1978, by nearly 300 ranking Party members, was the groundbreaking document which set economic and legal reform into motion.¹¹⁴ The Communique bore the unmistakable mark of Deng's pragmatism, and put the Party's undeniable imprimatur on the removal of several fundamental ideological obstacles to reform.¹¹⁵ It stated, "Carrying out the four modernizations . . . requires changes in all methods of management, actions and thinking which stand in the way of growth [of productive forces]."¹¹⁶ Second, the Communique addressed the need for a rational division of authority:

[O]ne of the serious shortcomings in the structure of economic management in our country is the over-concentration of authority . . . [I]t is necessary boldly to shift [authority] . . . to lower levels so that the local authorities and industrial and agricultural enterprises will have greater power of decision in management. . . . [I]t is necessary . . . to tackle conscientiously the failure to make a distinction between the Party, the government and the enterprise and to put a stop to the substitution of government for enterprise administration.¹¹⁷

Finally, the Communique opened the way for the concurrent enhancement of the role of law — legalization — and the tremendous amount of economic legislation that China has promulgated since that time:

[I]t is imperative to strengthen the socialist legal system. . . . [T]here must be laws for people to follow, these laws must be observed, their enforcement must be strict and law breakers must be dealt with. . . . [L]egislative work should have an important place on the agenda of the National People's Congress and its Standing Committee. Procuratorial and judicial organizations must maintain their independence as is appropriate, . . . guarantee the equality of all people before the people's laws and deny anyone the privilege of being above the law.¹¹⁸

113. *Liberate Thinking, Seek Truth from Facts, Unite in Looking Ahead*, in DENG XIAOPING WENXUAN (1975-1982) (SELECTED WORKS OF DENG XIAOPING), People's Publishing House (1983).

114. *Communique of the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China*, adopted on Dec. 22, 1978. Translated in CHINESE POLITICS: DOCUMENTS AND ANALYSIS, 341-53.

115. In China, official Party documents generally have the normative force of law. For discussion on this topic, see PETER H. CORNE, FOREIGN INVESTMENT IN CHINA: THE ADMINISTRATIVE LEGAL SYSTEM, 51-90 (1997); see also KENNETH LIEBERTHAL, GOVERNING CHINA: FROM REVOLUTION THROUGH REFORM (1995); see also Donald C. Clarke, *What's Law Got To Do With It? Legal Institutions and Economic Reform in China*, 10 UCLA PAC. BASIN L.J. 1 (1991).

116. *Communique of the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China*, at 344.

117. *Id.* at 346.

118. *Id.* at 350.

Thereafter, reform began in rural China with the dismantling of the people's communes and the reallocation of land according to the "contract responsibility system." Replacing the agricultural "production teams" with labor and fixed production quotas organized by household noticeably increased efficiency and output. Based on this success, reform spread rapidly from the few areas in Anhui and Sichuan Provinces where it was first implemented.¹¹⁹ The Party leaders from those provinces, Wan Li and Zhao Ziyang, were promoted to central leadership positions soon thereafter.

Reform and opening began in urban China as Deng consolidated his power in the early 1980s, edging out Hua Guofeng. By 1981, Hua stepped down as Chairman of the Party and resigned all political posts. Deng was in control, supreme atop a broad coalition of Party leaders all of whom recognized the need for economic development and a cease to the excesses of Maoist "class struggle." They held different views, however, as to the pace at which reform should proceed. Throughout the 1980s and early 1990s, reform proceeded in alternating cycles of loosening (*fang*) and retrenchment and tightening (*shou*).¹²⁰

C. GETTING GOVERNMENT OUT OF BUSINESS: LAW AND POLICY OF SOE REFORM

The principal focus of Chinese urban reform has been to "invigorate" SOEs (*gaohuo guoyouqiye*) by granting them greater autonomy and concurrently developing a framework of legislation to define the enterprise, its legal rights and obligations.¹²¹ Getting the government out of business, however, has proven to be a persistent problem from the outset of SOE reform in the early 1980s.¹²²

119. See *Peasants' Initiative Unleashed by Contracts*, BEIJING REV., Oct. 29, 1984, at 18-21.

120. Of the Party elders, Deng promoted faster, fuller market reform. Chen Yun, a former state planning chief, advocated more limited market reform. However, this reform would be subordinate to the planned sector and within a "bird cage." See generally KENNETH LIEBERTHAL, *GOVERNING CHINA: FROM REVOLUTION THROUGH REFORM* 128-144 (1995).

121. Prior to economic reform beginning 1978, there was virtually no legal infrastructure to structure and enforce economic relations. Under the planned economy, all economic agreements were effectively between state agencies, and the state was ultimately responsible to make up any losses, thus obviating the need for enforceable contracts. Since 1979, most laws and regulations enacted govern economic activity. See Gu Ming, *Recent Developments in Chinese Economic Legislation*, 21 U.S.L. REV. 217 (1987).

122. In 1983, the Provisional Regulations of State-owned Industrial Enterprises provided SOEs with limited autonomy to engage in supplemental production beyond their planned quotas and retain profits therefrom. See NATALIE LICHTENSTEIN, *ENTERPRISE REFORM IN CHINA: THE EVOLVING LEGAL FRAME-*

At a plenary session in late 1984, the Party Central Committee launched full-scale urban reform with the adoption of its "Decision on Reform of the Economic Structure" ("1984 Decision").¹²³ The 1984 Decision noted the positive results of rural reform and outlined a parallel plan for the urban industrial sector that extended decision-making authority to the enterprises by separating ownership interest from operation. It defined principles for separating government administration from enterprise functions and decentralization of control: "As far as the relations between government and enterprises are concerned, from now on government departments at various levels will, in principle, not manage or operate enterprises directly."¹²⁴ Where enterprises formerly delivered any profits to their department in charge, the 1984 Decision adopted the responsibility system that worked so well in the countryside to redefine the economic relationship, allowing SOEs to retain after-tax profits.¹²⁵

Since the mid 1980s, there have been a number of important policy pronouncements and legislation defining the realm of SOE autonomy and governance.¹²⁶ The thrust of the reforms has been threefold: first, to recognize enterprises as independent legal entities separate from their departments in charge;¹²⁷ second, to grant enterprises independent operating rights; and third,

WORK 3 (World Bank Policy Research Working Paper WPS 1198, Sept. 1993); see also Robert F. Dodds, Note, *State Enterprise Reform in China: Managing the Transition to a Market Economy*, 27 LAW & POL'Y INT'L BUS. 695, 704-705 (1996).

123. *Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure*, translated in BEIJING REV., Oct. 29, 1984, at I.

124. *Id.* at X.

125. *Id.* at XII.

126. In China, legislation must first be approved in principle by the Party. Most legislation is the product of an iterative process where such approvals in principle are followed by trial implementation, which is, in turn, reviewed and incorporated into the legislation. See Kenneth T.K. Wong and Zhonglan Huang, *A Critical Analysis of the Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People*, 7 UCLA PAC. BASIN L.J. 180, 181-185 (1990); Yang Xiaobing, *Enterprise Law: A Milestone for Reform*, BEIJING REV., May 2-8, 1988, at 24.

127. The Economic Contract Law promulgated in 1981 first referred to SOEs as "legal persons" (*faren*). Subsequently, the General Principles of Civil Law promulgated in 1986 defined a legal person as an organization that has the capacity to have and independently enjoy civil rights and the competence to perform civil duties and bear civil liability for these duties. An enterprise legal person is liable in regard to the business activities of its statutory representative and "to the extent of the property the State has given it to operate and manage." See *General Principles of Civil Law of the People's Republic of China*, Art. 48, translated in THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA, Vol. 2, at 225. (1987) Foreign Languages Press Beijing. The 1988 Enterprise Law reinforced this: "An enterprise shall obtain the status of a legal person in accordance with the law and shall bear civil liability for property which the State has authorized it to operate and manage." See Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People, art. 2 (1988) China Ls for Foreign Bus. (CCH Austl.) ¶ 13-534 [hereinafter Enterprise Law].

to allow them to retain their profits, thus giving managers incentive to increase efficiency and competitiveness.¹²⁸ Tax reform aimed to decrease state agencies' control over SOEs by replacing the bargaining and discretion in the government-enterprise relationship with a uniform 55% tax on profits (*ligaishui*) for medium and large SOEs.¹²⁹

The 1988 Law on Industrial Enterprises owned by the Whole People ("Enterprise Law") was the first major legislation to codify the principles embodied in the 1984 Decision.¹³⁰ It focused on the separation of enterprise management from state ownership, explicitly granting the enterprise the right and duty to manage the enterprise and its property.¹³¹ The Enterprise Law conferred important rights and responsibilities on SOEs and factory directors, making them independently responsible in theory for their own profits and losses. It also formally restricted many of the powers of the department in charge over the enterprise.¹³² But it provided these rights only subject to "regulations of the State Council." This important proviso left the limits of SOE autonomy vague and open to official arbitrariness.¹³³

Although reforms gave management autonomy in pricing, production, marketing, and procurement, important areas — investment and disposal of large capital assets — remained under local government control. In July 1992, following Deng Xiaoping's much-heralded tour of southern China,¹³⁴ the State

128. The *Regulations on the Work of Directors of Industrial Enterprises Owned by the Whole People* promulgated in 1986, gave directors greater authority over the enterprise, allowing them greater leeway in fulfilling their contracts with their departments in charge. See Donald C. Clarke, *What's Law Got To Do With It? Legal Institutions and Economic Reform in China*, 10 UCLA PAC. BASIN L.J. 1, 46 (1991).

129. See NAUGHTON, *GROWING OUT OF THE PLAN*, *supra* note 85, at 183; and Lili Liu, *A Gradual Approach to China's State Enterprise Reforms Plots Slow But Steady Progress*, CHINA BUS. REV., May 1, 1996. See also CONSTRUCTING CHINA, (Kenneth Lieberthal, et al. eds., 1997).

130. The Enterprise Law was hailed among Chinese legal scholars as an important "legislative breakthrough". See Wang Baoshu, *Lun Quanmin Suoyouzhi Gongye Qiye Fa zai Qiye Lifa shang de Tupo (On Enterprise Law as a Major Breakthrough in China's Enterprise Legislative History)*, 4 ZHONGGUO FAXUE (CHINA LEGAL SCIENCE) 3 (1988); see also James V. Feinerman, *The Evolving Chinese Enterprise*, 15 SYRACUSE J. INT'L L. & COM. 203, 207 (1989).

131. See Enterprise Law, art. 2, *supra* note 123, ¶ 13-534(4).

132. See *id.*, art. 14, 56(4) (departments in charge may not encroach on enterprises' property rights); see also *id.*, art. 58 (departments in charge may not encroach on enterprises' management rights).

133. These provisos are embodied in the two chapters of the Enterprise Law stipulating the rights and liabilities of enterprises (Ch. III) and defining the relations between the enterprise and the government (Ch. VI), respectively. Almost every article in both chapters requires an SOE to exercise its rights "in accordance with State Council regulations". See *id.*, art. 22-34. ¶13-534(22)-(534).

134. Deng's tour of southern special economic zones, in particular, Shenzhen, on the tenth anniversary of its establishment, was widely interpreted as a sign that Deng

Council promulgated the Regulations on Transforming the Operation and Management Mechanisms of State-owned Industrial Enterprises (1992 Regulations).¹³⁵ These regulations detailed the specific management rights of SOEs over production, labor, investment and asset disposition,¹³⁶ and re-emphasized the separation of government and enterprise functions in three respects.¹³⁷ It specified standards and conditions for the enterprises' responsibility for its own profits and losses, circumscribed how the government may exercise its ownership rights and its market regulatory function, and finally, provided for civil liability for infringement on enterprise operating rights.¹³⁸

Over the next year, planned price control was cut even further as the government moved to allow the market to dictate commodity prices.¹³⁹ Further policy breakthrough came with the 14th Party Congress, which enshrined the principle of the "socialist market economy" as the goal of reform.¹⁴⁰ A year later the Decision of the CCP Central Committee on Certain Issues Concerning the Establishment of a Socialist Market Economic Structure put forward a 50-point plan to be implemented during the Ninth Five-Year Plan, to achieve a "modern enterprise system" by the year 2000.¹⁴¹ As part of this plan, it laid the political groundwork for SOE corporatization and reorganization, and the amelioration of the financial and legal underpinnings of a market economy. Soon thereafter the long-awaited Company Law was promulgated and took effect on January 1, 1994.¹⁴² The Company Law is important because it provides the legal basis

had won out over his more conservative colleagues and as a green light for economic reform. The few years following saw incredible double digit economic boom. See NAUGHTON, *GROWING OUT OF THE PLAN*, *supra* note 85, at 289. See also CHINA'S ECONOMY IN 1992 AND 1993: GRAPPLING WITH THE RISKS OF RAPID GROWTH 25 (1993) (noting renewed attention to enterprise reform following Deng's Southern Tour and important speech upon his return to Beijing). CENTRAL INTELLIGENCE AGENCY, DIRECTORATE OF INTELLIGENCE, No. EA 93-10016, at iii.

135. *Quanminsuoyouzhi Gongye Qiye Zhuanhuan Jingyingjizhi Tiaoli (Regulations on Transforming the Management Mechanisms of State-Owned Industrial Enterprises)*, promulgated July 23, 1992, published in GUOWUYUAN GONGBAO (GAZETTE OF THE STATE COUNCIL OF THE PEOPLE'S REPUBLIC OF CHINA) 1992, at 837 et seq., translated in BBC SUMMARY OF WORLD BROADCASTS, July 29, 1992, available in LEXIS, World Library, BBCSWB File.

136. See *id.*, ch. 2, art. 6-22; see also LICHTENSTEIN, *supra* note 118, at 6-8.

137. See LICHTENSTEIN, *supra* note 118, at 6-8.

138. See *id.*

139. See NAUGHTON, *supra* note 85, at 289-291.

140. See Report of the 14th Party Congress; see also NAUGHTON, *supra* note 85, at 289.

141. Decision of the CCP Central Committee on Certain Issues Concerning the Establishment of a Socialist Market Economic Structure, *supra* note 83, translated in Lieberthal, at 419.

142. The Company Law of the People's Republic of China, reprinted and translated in CHINA L. FOR FOREIGN BUS. (CCH) ¶ 13- 534 (1994).

and mechanism necessary for SOEs to convert into shareholding companies, to "corporatize".¹⁴³ But it is also problematic because it falls far short of providing enterprises and managers with the corporate structure and management tools they need to build modern companies and maximize efficiency.¹⁴⁴ Much of the changes it specifies are largely cosmetic and where affording enterprise autonomous decisionmaking authority imposes on political control, the Company Law errs on the side of political caution rather than corporate reform.¹⁴⁵ Most notably, the Company Law does not vest ultimate corporate control in the board of directors, which in turn could grant authority over operations to management. Rather, it vests ultimate control in the company's stockholders' board, which supervises the board of directors.¹⁴⁶ Where an administrative agency holds controlling shares in an enterprise, it can interfere directly in the day-to-day management and affairs of the company.¹⁴⁷ Finally, the Company Law allows for direct administrative supervision under Article 67 which stipulates that the assets of a company wholly owned by a state agency shall be under the supervision of the authorized government investment body or other agency.¹⁴⁸

Seven months after the Company Law came out, in July 1994, the State Council announced an industrial policy, establishing fifty-six enterprise groups in "pillar industries" — in automobile and automotive parts, petrochemicals, electronics and machinery, and construction — which will have priority access to policy bank loans and protection from foreign competition. Subsequently, at the Fourth Session of the Eighth NPC in March 1996, the government announced that it would concentrate on the development of 1,000 large SOEs and enterprise groups that will form the core of the modern enterprise system. Concurrently, the government planned to cut loose small, medium and some large SOEs to improve efficiency by diversifying ownership, restructuring debt, mergers, issuing equity securities, and in some cases, through liquidation bankruptcy.¹⁴⁹

143. See BROADMAN, *supra* note 92, at 10.

144. See Anna M. Han, *China's Company Law: Practicing Capitalism in a Transitional Economy*, 5 PAC. RIM L. & POL'Y J. 457, 466 (1996).

145. See *id.* "Reflected in . . . [the Company Law] is the delicate balance of allowing some independent decisionmaking on the enterprise level while . . . giving up the minimum amount of political control."

146. The board of stockholders can pass their own resolutions and approve the company's budget, etc. See Company Law, *supra* note 138, art. 37, 38.

147. See *id.* art. 66; see also Han, *China's Company Law*, *supra* note 140, at 485.

148. See Company Law, *supra* note 138, art. 67; see also Han, *China's Company Law*, *supra* note 140, at 487-88.

149. See generally THE CHINESE ECONOMY, *supra* note 32, 19-22.

D. 15TH PARTY CONGRESS — RENEWED
POLITICAL IMPRIMATUR

Jiang Zemin's keynote address at the 15th Congress of the Chinese Communist Party in September 1997 put the Party's seal of approval on the broad plan to revamp SOEs through mergers, acquisitions, public offerings, and in certain case, bankruptcies. The plan generally distinguishes its approach by the size of the enterprise. By "grasping hold of the large [SOEs] and letting the small ones go," (*zhua da fang xiao*) China hopes to realize its plan to establish enterprise groups in "pillar industries," while releasing the bulk of SOEs — mostly medium and small-sized — to fend for themselves.

Nonetheless, this apparent imprimatur raises two important questions. First, whether SOE reform will be any different this time; and second, whether the state enterprise group strategy is a viable one, particularly in light of the lessons of South Korea in the recent Asian financial meltdown. To date, China has taken a gradual, iterative approach to SOE reform — one that prizes stability and political concerns over total reform. If privatization is not possible, will the current proposed solution really work, and will the Party leaders have the political wherewithal and gumption to carry it through to completion when the going gets tough?

The idea to select the cream of the largest SOEs for transformation into internationally competitive, profit-oriented conglomerates closely tied to state banks reflects Chinese leaders' fascination with the "bigger is better" mentality and the *chaebol* (*keiretsu*) models that powered Japan and South Korea's economic miracles.¹⁵⁰ The problem is that in adopting the *chaebol* approach, China seems to be ignoring the inherent structural flaws of the *chaebol* that South Korea's financial crisis and Japan's economic downturn have underscored.¹⁵¹ Chinese officials have insisted that China's approach is different, but China's weak banking system in particular raises due cause for con-

150. China conceives of these enterprise groups as resembling keiretsu and chaebol federations of companies that enjoy monopoly power in certain segments of the economy. The principal differences are that state enterprise groups are formally organized, supported and dominated by the government. See Daniel C.K. Chow, *An Analysis of the Political Economy of China's Enterprise Conglomerates*, 28 *LAW & POL'Y INT'L BUS.* 383, 384 n. 3. See generally MICHAEL L. GERLACH, *THE KEIRETSU: A PRIMER* (1992); Gregory K. Bader, *The Keiretsu Distribution System of Japan: Its Steadfast Existence Despite Heightened Foreign and Domestic Pressure for Dissolution*, 27 *CORNELL INT'L L.J.* 365, 365-66 (1994).

151. See Seth Faison, *N.Y. TIMES*, *North China Pharmaceuticals a Model for Chinese Business*, Feb. 20, 1998 at 1998 WL-NYT 9805100400. Also Jim Mann, *China follows flawed Economic Model*, *L.A. TIMES*, Jan. 21, 1998, at A5 (1998 WL 2390637). See also *CHINA'S ECONOMY IN 1995-97*, *supra* note 15, at 8.

cern.¹⁵² Indeed China's approach does differ from the traditional *chaebol*, principally in that there is direct, overt government control over its enterprise groups — a move away from privatization or corporatization. It is an open question, however, whether this model will succeed and what impact it will have on China's WTO accession.

E. THE TROUBLE WITH THE RULE OF LAW IN CHINA — LACK OF TRANSPARENCY & FRAGMENTED ENFORCEMENT

GATT Article X requires WTO member states to ensure the publication and uniform application of all laws and regulations relating to foreign trade. In China, however, the central government's mere commitment in its Protocol of Accession cannot resolve the problems caused by persistent lack of transparency and fragmented enforcement. The inherent structural problems of the Chinese legal and political system that challenge the establishment of the rule of law underlie, and have an important effect on, both SOE reform and China's accession to WTO in general. While I cannot in this paper address this topic in detail, a brief discussion is warranted.¹⁵³

The obstacles to building the rule of law in China largely result from the decentralization of power from the center to the provinces over the past two decades. If China is to integrate into the world trading system Beijing must build a legal structure that equalizes the power relationship with the regions. One of the critical obstacles to enforcement lies ironically in the government bureaucracy itself. Local government has significant power, and local cadres are not interested to give up their patronage over SOEs or the revenue they gain through taxes and bribes.¹⁵⁴ As reforms have shifted power to localities,¹⁵⁵ corrupt officials often demand enterprises pay various exactions (*tanpai*), usually termed "fees" of one kind or another.¹⁵⁶

152. *See id.* (both)

153. A fuller analysis of the inherent structural problems of the Chinese legal system and the rule of law is a topic for a separate article or monograph. It has been addressed in fuller detail by several prominent scholars of Chinese law. *See, e.g.*, Stanley B. Lubman, *Introduction: The Future of Chinese Law*, in CHINA'S LEGAL REFORMS 1, 1-22 (1996); *see also* Perry Keller, *Sources of Order in Chinese Law*, 42 AM. J. COMP. L. 711 (1994).

154. For an interesting illustration of the corrupt ties between local Party and government authorities and large SOEs, see Seth Faison, *China's Paragon of Corruption*, N.Y. TIMES, Mar. 6, 1998, at C1.

155. *See* STAFF OF JOINT ECON. COMM., 102d CONG., CHINA'S ECONOMIC DILEMMAS IN THE 1990s: THE PROBLEMS OF REFORMS, MODERNIZATION, AND INTERDEPENDENCE 452 (1991).

156. *See* Clarke, *supra* note 29, at 37.

Even at the central government level there has been great resistance to change, particularly from those ministries that have traditionally wielded control over the allocation of resources and the management of large SOEs and industrial groups. Inter-agency conflict has been rife. MOFTEC's battle to get China into the WTO is only in part with its counterparts in Geneva at the WTO negotiating table. At home, entrenched bureaucracy in domestically-oriented administrative organs like the State Planning Commission and the Ministry of Machine Building Industry have been recalcitrant in adhering to transparent sets of rules and in eliminating both overt and disguised nontariff barriers—quotas, local content requirements. In many areas outright restrictions on foreign participation in sales and service distributorships persist.¹⁵⁷ The Ninth NPC, which concluded in mid-March 1998, implemented a broad plan to restructure this bureaucracy, cutting the number of ministries from 41 to 29. As part of his bold game plan, new Premier Zhu Rongji will cut the jobs of several million civil servants. A streamlined government structure with Zhu at the helm may alleviate administrative inertia, but it must do so as part of an overall plan to address the root of the problem: inefficient, poorly-managed SOEs. Despite his clear objective and no-nonsense approach, Zhu faces obstacles that even he may find insuperable.

The underlying problem is systemic. The fragmented polity of the state, the separation of internal Party discipline from legality and inconsistent administrative enforcement of often vaguely drafted laws cause legal and normative dislocation. The structure of the institutions that administer, enforce and interpret the law compromises its implementation. This enforcement gap reflects the lack of an overarching legal system based on the supremacy of law. Although the policy of reform and opening (*gaige kaifang*) promotes the development of the legal system (*fazhi jianshe*),¹⁵⁸ the Four Basic Principles place the leadership of the Party supreme in the Preamble to the Constitution.¹⁵⁹ This

157. The new *Catalog of Industrial Guidelines for Foreign Investment*, effective Jan. 1, 1998, stipulates those industries in which foreign investment is encouraged, restricted or outright prohibited. The regulation contains many WTO inconsistent provisions. Even for those industries in which foreign investment is permitted there are often significant restrictions on shareholding and scope of business that effectively preserve market advantage for domestic companies through governmental action. See *Waishang Touzi Chanye Zhidaomulu* [*Catalog of Industrial Guidelines for Foreign Investment*], reprinted in *GUOJI SHANGBAO* [INT'L BUS. NEWS], Jan. 9, 1998, at 2; see also Jerome A. Cohen, *Reforming China's Civil Procedure: Judging the Courts*, 45 AM. L. COMP. L. 793 (1997).

158. See, e.g., *Communique of the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China*, *supra* note 110, at 341-53.

159. The Four Basic Principles announced by Deng Xiaoping in 1979, are adherence to the socialist road, the dictatorship of the proletariat, the leadership of the

seeming contradiction in fact reduces the stature of the law. Because the Party remains above the law (*dang da yu fa*), it subverts the normative force of legislation. The result is legal instrumentalism, not the rule of law.

1. *The Chinese Court System — Inherent Problems Stemming from Lack of Separation of Powers*

The Chinese court system cannot effectively resolve disputes and enforce its judgments nationwide.¹⁶⁰ At base, it cannot do so because there is no functional separation of judicial and administrative or executive powers inherent in the Chinese system.¹⁶¹ Although the Supreme People's Court and its subordinates in each province, autonomous region, city and district are theoretically independent of the State Council and its subsidiary ministries and administrative organs, the courts, in practice, generally defer to the relevant department competent to interpret matters of law or administrative regulation pertinent to a particular case. A court will, for example, in matters of foreign trade or investment, ask MOFTEC for advice on how to interpret joint venture laws and regulations. Although termed a "request for advice" (*qingshi*), MOFTEC's opinion will very often be dispositive on the issue. Because most laws promulgated by the NPC provide only overarching principles to guide administrative bodies, many important issues underlying disputes are only addressed by detailed implementing regulations or other administrative regulations issued by the relevant administrative agency with the approval of the State Council.¹⁶² In addition to these functional matters, Chinese judicial system is limited by a general lack of professional legal training among its judges and serious corruption concerns.¹⁶³

Chinese Communist Party, and Marxism-Leninism and Mao Zedong Thought. See CONST. P.R.C., preamble (promulgated 1982), translated in KENNETH LIEBERTHAL, GOVERNING CHINA 355.

160. See Donald C. Clarke, *The Execution of Civil Judgments in China*, in CHINA'S LEGAL REFORMS 65-81 (Stanley Lubman ed., 1996).

161. Vincent Yang of the International Centre for Criminal Law Reform at the University of British Columbia has suggested that the 1996 Criminal Procedure Law gives judges a somewhat greater degree of independence in adjudication of criminal cases. (electronic communication on China Law Net).

162. An example of such administrative regulations are the *Detailed Rules for the Implementation of the Law of the PRC on Sino-foreign Cooperative Enterprises*, approved by the State Council on August 7, 1995, and promulgated by MOFTEC on September 4, 1995.

163. See Wang Chenguang, *Introduction: An Emerging Legal System*, in INTRODUCTION TO CHINESE LAW 23-26 (Wang Chenguang & Zhang Xianchu, eds., 1997) (citing interference with judicial functions from Party and governmental organs and officials as well as interference exerted by corruption). On lack of legal training and expertise see Clarke, *What's Law Got to Do with It?*, *supra* note 29, at 58-59; see also

2. Policy Distortion —Decentralized Interpretation and Administrative Enforcement

Decentralized interpretation and enforcement of laws and regulations by diffuse administrative agencies leads to policy distortion. Because there are few curbs on administrative discretion, the rights and certainty legislation is supposed to create are by no means certain. Most legislation, in fact, provides only vague instructions to administrative agencies, rather than instilling legal rights in natural and corporate citizens.¹⁶⁴ Agencies are left to fill the gaps with their own enactments. These are not subject to any centralized administrative code. As a matter of Chinese administrative law, courts have no jurisdiction to interpret administrative rules and regulations or to monitor the exercise of discretion by administrative agencies in applying them.¹⁶⁵ The Administrative Procedure Law and State Compensation Law, as well as the Regulations on Administrative Reconsideration, all attempt to exercise supervision and put some check on administrative organs. But the scope and frequency of their application remains limited.¹⁶⁶

On its face, development of a legal system is a matter of domestic policy over which any state's sovereignty naturally extends. The international community's ability directly to influence the outcome would seem to be limited. In fact, however, acting through WTO and other pillar international institutions, it can have a formative influence on domestic development. As Michel Oksenberg and Harold Jacobson noted nearly a decade ago, interaction with international institutions has had a marked effect on the Chinese institutional landscape.¹⁶⁷ China's significant and ever-growing body of legislation concerning foreign trade and investment reflects this nexus with the world. Because building a rule of law is a long, gradual process, engagement with other countries and international institutions has had and will continue

Irene So, *Disparities in Expertise of Judges*, S. CHINA MORNING POST, Oct. 4, 1995, at 10, available in LEXIS, World Library, TXPRIM File.

164. Vaguely drafted legislation allows administrative agencies discretion. They may apply different normative standards than intended. The result is legal dislocation. See PETER HOWARD CORNE, *FOREIGN INVESTMENT IN CHINA* 287 (1997).

165. SEE ZHONGYANG ZHENGFU ZUZHI JIGOU (ORGANIZATION AND INSTITUTIONS OF THE CENTRAL GOVERNMENT) China Dev. Publishers (1994).

166. Chinese lawyers and others report that these are implemented most often to redress minor claims by individuals. Strong local protectionism by local government officials often serves to frighten or discourage parties from bringing complaints. Especially for enterprise managers, there is a general lack of confidence that action under these laws will be effective and bring anything more than trouble at the hands of local cadres (*ganbu*).

167. See HAROLD K. JACOBSON & MICHEL OKSENBERG, *CHINA'S PARTICIPATION IN THE IMF, WORLD BANK, AND GATT* 146 (1990).

to have a tremendous impact on the course of Chinese economic and legal reform.

The preconditions for true SOE reform are the full separation of government and enterprise — at a minimum, fuller clarification and protection of enterprise operating rights — and the institutionalization of management incentives that reward profitability and efficient operation. This reform is vital for Chinese enterprises to be able to compete against foreign competitors. Once they can, China will be a step closer to full compliance with WTO/GATT requirements.

IV. ANALYSIS — EXISTING GATT PROVISIONS AND APPLICABLE EXCEPTIONS

SOE reform and the fundamental legal reform necessary to achieve it are intimately related to critical issues in China's WTO accession — equal market access to foreign goods and services, lower tariffs, and transparent rules and regulations. In considering whether China should be granted special dispensation in the interest of protecting its domestic stability, it is important to analyze how existing GATT provisions and exceptions will affect China once it is admitted, what its obligations will be, and how well it will live up to them.

A. REQUIREMENTS: MOST FAVORED NATION AND NATIONAL TREATMENT: ELIMINATION OF NTBS

The basic premise of GATT is that free trade promotes increased wealth, which in turn means that people will live better and in peace. By replacing all non-tariff barriers to trade with tariffs GATT seeks to minimize government interference in trade. This laissez-faire regime assumes each member state possesses a domestic economic system based on the rule of law that limits official arbitrariness, a system in which legislation must be transparent and uniformly enforced. The basic framework of GATT comprises the twin principles of most favored nation treatment and national treatment, each of which are subject to limited exceptions.

Most favored nation treatment (MFN) extends broadly to require all rules and formalities relating to import and export and all charges and methods of levying them conform to substantive standards of fairness and equality as between all WTO member states. GATT Article I stipulates, "*Any advantage, favor, privilege or immunity [any contracting party] grant[s] . . . to any product. . . shall be accorded immediately and unconditionally to the*

like product originating in . . . all other contracting parties.”¹⁶⁸ Uniformly applied, MFN is easy to administer and efficient and promotes equality by benefiting smaller, less economically developed countries. The principal cost of MFN is the “free rider effect”: new members may enjoy the benefit of all previously negotiated trade agreements without having made equal concessions. The U.S., in particular, is extremely concerned that WTO accession will give China an unfair advantage and allow its products to flood the American market. The real problem for the U.S., however, will be resolving the conflict between U.S. law, which requires annual renewal of China’s MFN status, and compliance with GATT Article I.¹⁶⁹ In fact, as I show below, the effects of Chinese exports can likely be regulated through GATT safeguards measures.

The other pillar of GATT, national treatment, guarantees equal treatment as between domestic and imported goods and prevents evasion of tariff bindings. Article III requires that imported products “shall be accorded treatment *no less favourable* than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”¹⁷⁰ National treatment ensures that no governmental action — internal tax, charge, law, or regulation affecting internal sale — is applied to either imported or domestic products in a way that protects domestic production. In addition, it also ensures that imported products are not subject to direct or indirect internal taxes or other internal charges of any kind in excess of those applied to like domestic products.¹⁷¹ The purpose of Article II, the WTO Appellate Body has reasoned, is to protect members’ expectations of equal competition and opportunity. It thus held that Japan’s higher tax rate for imported liquor was a violation of national treatment.¹⁷²

Nor is national treatment confined to affirmative charges, taxes, laws and regulations. Certain subsidies or policies encour-

168. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, art. I, para.1, *LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND* vol.1 (1994), 33 I.L.M. 1125 (1994) (emphasis added) [hereinafter GATT].

169. 19 U.S.C. §2432 (1998), the Jackson-Vanik Amendment to the U.S. Trade Act of 1974, granting of MFN treatment to countries that do not comply with that section’s freedom of emigration requirements is conditioned on an annual Presidential waiver, which is subject to Congressional disapproval. Congress’ annual debate concerning renewal traditionally surrounds human rights issues, not emigration strictly. GATT Article I, however, requires unconditional MFN.

170. GATT art. III, ¶ 4.

171. *See id.*, ¶¶ 1, 2.

172. *Id.*

aging the purchase and use of domestic goods over like imported products may violate GATT norms. Although Article III specifically permits the payment of subsidies exclusively to domestic producers,¹⁷³ continued Chinese government subsidies to SOEs, regardless whether direct or indirect, will be subject to the restrictions imposed by Article XVI and the Agreement on Subsidies and Countervailing Measures. Moreover, because national treatment is interpreted expansively, this exception under Article III applies only very narrowly. In one important case, a GATT panel held that special credit facilities for Italian farmers buying domestic agricultural equipment violated national treatment on grounds that the government subsidies exception applies only to producers, not purchasers of goods.¹⁷⁴

To what degree then is a sovereign state precluded under GATT from formulating and implementing domestic economic policies? Because the few exceptions have been drawn so closely, both China's inability to assert central control over local enforcement and the need to give restructured SOEs a boost will likely create difficulties in complying. In fact, this is an area in which China has generally not complied with GATT norms. Not only are many imported goods subject to licensing and inspection requirements and charges, Chinese government policy frequently encourages various forms of import substitution in the procurement of equipment and other capital goods. For example, in a speech on China's energy policy, published in the Party journal, *Seeking Truth*, then-incumbent Premier Li Peng stressed that Chinese-made equipment should be used whenever possible in foreign-invested electric power projects.¹⁷⁵ The *Far Eastern Economic Review* has reported that central authorities in Beijing approved labor safety inspection regulations giving local officials in charge of procurement and import management even greater discretion which they have used aggressively in putting up barriers to foreign products, in particular capital goods and equipment.¹⁷⁶

These practices no doubt violate Article III. The issue, however, is whether it is realistic to expect China to guarantee foreign competitors equal treatment and opportunity in its domestic

173. GATT art. III, ¶ 4.

174. Italian Discrimination Against Imported Agricultural Machinery, Oct. 23, 1958, GATT B.I.S.D. (7th Supp.) at 60 (1959).

175. See *Zhongguo Nengyuan Zhengce (China's Energy Policy)*, QIUSHI XUEKAN [SEEKING TRUTH], May 1997. Li Peng completed the end of his second term as Premier in March 1998, and was subsequently elected Chairman of the NPC Standing Committee, China's highest legislative post.

176. See Matt Forney & Nigel Holloway, *In Two Minds*, FAR E. ECON. REV., June, 19, 1997, at 66.

market when the success of its economic and legal reforms depends, in large part, on first strengthening restructured domestic enterprises. Without continued legal reform and a concomitant equalization of the power relationship, even such a guarantee will mean little. Local protectionism is endemic throughout the country. Fragmented enforcement or flagrant violation of central directives and discriminatory internal taxes imposed by local Chinese provincial and county authorities defy central enforcement. GATT Ad Article III seems to temper strict national treatment by requiring a contracting party to take only "reasonable measures" to ensure that regional and local governments and authorities within its territory observe GATT provisions.¹⁷⁷ Nevertheless, the general provisions of Article X requiring uniform, impartial application of law and prompt judicial review counterweigh the notion that China can freely violate Article III by claiming it has fulfilled its duty by merely taking "reasonable measures" that are ineffectual against local protectionism.

1. National Treatment & Disguised Discrimination

An important qualification to Article III national treatment is found in Article XX, which provides exceptions for governmental measures necessary to protect public morals, human, animal or plant life or health, national treasures, and relating to the conservation of exhaustible natural resources, among others. It is unlikely, however, that China will be able to invoke any of the listed reasons to justify its violation of Article III. Prior Panel and DSB Appellate Body decisions have construed the protection of human life and conservation of natural resources uncompromisingly. Article XX(d) has likewise been subordinated to the overarching principle of Article III. This exception would allow China to adopt certain GATT-inconsistent measures to secure compliance with laws and regulations necessary to reform SOEs. Such measures would have to meet certain limited conditions. The laws or regulations themselves must be "not inconsistent" with GATT; the measures must be necessary to secure compliance, and "not applied in a manner which would

177. GATT Ad Art. III, ¶ 1 states that by virtue of the final paragraph of Article XXIV, the contracting party must take "reasonable measures" to ensure that regional and local governments and authorities within its territory observe GATT provisions. Where local taxation is inconsistent with the letter and the spirit of Article III, and abrupt action would cause "serious administrative and financial difficulties", the contracting party may eliminate the taxes gradually. This assumes that the central government can, in fact, eliminate GATT-inconsistent local protectionism, which is not evident in China's case.

constitute a means of arbitrary or unjustifiable discrimination . . . or a disguised restriction on international trade."¹⁷⁸

2. *Quotas & NTBs*

GATT Article XI prohibits quantitative restrictions (QRs), including all import and export restricting measures other than duties, tariffs and other charges. GATT proscribes disguised discrimination by channeling import restraints into tariffs. Because tariffs are visible, states are able to base their expectations on negotiated maximum tariffs subject only to several limited exceptions.¹⁷⁹

GATT essentially rules out the use of import quotas to protect domestic industry. The few exceptions are conditioned by prohibition against discriminatory application, and where import licenses are issued in connection with import restrictions, a further requirement that all relevant information be provided to any interested contract party.¹⁸⁰ This is yet another area, related to national treatment, where China has maintained protectionist measures. These are partly a political response to U.S. textile quotas, partly vestiges of the planned state foreign trade system, and partly disguised devices to protect homegrown industry.¹⁸¹ China has made commitments to eliminate QRs, but it is not clear they will do so to the detriment of reforming SOEs. This is also related to the issue of transparency. Many de facto quotas are set in internal government circulars and industry policies and "administrative guidance".

3. *Violation and Nonviolation Nullification or Impairment*

Violation nullification or impairment occurs when the failure of a WTO member to carry out a GATT obligation impedes another member's attainment of any GATT objective or impairs any benefit accruing to it directly or indirectly under GATT.¹⁸² Article XXIII provides WTO members with direct recourse against nullification or impairment of benefits that could prove a powerful tool against China in the event the measures or policies it adopts to effect SOE reform violate its GATT obligations. The

178. GATT, art. XX, (d). See also United States—Section 337 of the Tariff Act of 1930, Nov. 7, 1989, GATT B.I.S.D. (36th Supp.) at 345 (1989).

179. The Understanding on Balance of Payments requires WTO members to use balance of payments measures that are the least trade-disruptive and as temporary as possible. A contracting party may use import restrictions to guarantee sufficient foreign exchange reserves to maintain its external financial position.

180. GATT, art. XIII.

181. See Matt Forney & Nigel Holloway, *In Two Minds*, FAR E. ECON. REV., June, 19, 1997, at 66.

182. GATT, art. XXIII, ¶ 1.

complaining WTO member state(s) need only show that a measure or policy is inconsistent with GATT, a very low threshold, to raise an irrefutable presumption of *prima facie* nullification or impairment. This strict test ignores the actual effects on trade of the measures. A showing that a measure inconsistent with the national treatment requirements of Article III has no significant impact on trade will not rebut the presumption of nullification.¹⁸³ The remedy is somewhat tempered. The U.S. or other WTO member must first make proposals for China to adjust the offending policy or measures. Failing this, however, the U.S. could be authorized under Article XXIII to suspend certain GATT concessions or obligations applied to China.

Restrictions on the breadth of claims and available remedies for nonviolation nullification require WTO member countries cooperatively resolve impairment of benefits or harmed expectations through mutually satisfactory adjustment.¹⁸⁴ In so doing, the WTO Dispute Settlement Understanding (DSU) has created a model that may serve more generally to ease the pressure on China's entry into the WTO. Nonviolation nullification arises from the implementation of measures not inconsistent with GATT obligations or the existence of any other situation that likewise impair or nullify another WTO member's benefits or harm its reasonable expectations of benefit.¹⁸⁵ Under the DSU, were a Chinese reform measure found to nullify or impair U.S. benefits, China would not be obliged to remove it, only to make a mutually satisfactory adjustment. "Mutually satisfactory" by definition requires parties to work together to manage the challenges of international economic integration.

4. *Subsidies and Countervailing Measures*

The difficulty of distinguishing between those benefits to domestic industry that are the prerogative of the sovereign and those subsidies that distort trade and violate the norms of fairness and equality underlying the WTO has historically been a source of contention between China and its major trading partners. There is due concern that even as China continues to reform its SOEs, cutting many loose to face market forces, it will not phase out various direct and indirect subsidies for fear of the broad political consequences of rushing reform.

183. See United States—Taxes on Petroleum and Certain Imported Substances, June 17, 1987, GATT B.I.S.D. (34th Supp.) at 136 (1988).

184. GATT, annex 2, art. 26, ¶ 1(b).

185. See generally *EEC—Payments and Subsidies Paid to Processors and Producers of Oilseeds*, BISD 37S/86 (1991).

In recent years, China's hybrid "socialist market economy" has defied strict categorization, making it difficult for the U.S. and others to determine when to adopt countervailing measures. In response, the Clinton Administration has made proposals on adjusting U.S. policy to deal with NMEs in transition.¹⁸⁶ The U.S. Department of Commerce has also developed two tests that it applies to Chinese SOEs to determine whether they operate within a market mechanism or enjoy direct or indirect government preferences such as subsidized inputs.¹⁸⁷ Both the "bubbles of capitalism" and the "market oriented industry" approaches attempt, through different analyses, to calculate the degree of government involvement in various factors of production.¹⁸⁸

A subsidy is defined as a "payment by the government which forms a wedge between the price consumers pay and the costs incurred by producers, such that price is less than marginal cost."¹⁸⁹ Subsidies allow a country's industry to compete more effectively in the domestic and international marketplaces. For China, competitiveness in a number of industries, including high technology, is an important policy goal. More important in the short term, it is crucial to successfully restructuring SOEs, implementing fundamental government policies, and maintaining social stability. Any market advantage the government can supply is likely to be exploited, be it export subsidies or other benefits that ensure domestic companies maintain a certain share of the Chinese domestic market. At base the question then becomes how quickly and to what extent must China phase out SOE subsidies in order to comply with GATT requirements. The shorter the transition period the U.S. permits China to phase in compliance, the more it increases the strain on the Chinese government to provide social welfare to its underemployed urban workforce, finance the restructuring of the 1,000 enterprises in "pillar" industries, as well as guide the refinancing of the rest of the state industrial sector.

186. See *Special Report*, INSIDE U.S. TRADE, July 15, 1994, at S-5 (outlining the Clinton Administration's "economies in transition" proposal).

187. See Robert H. Lantz, *The Search for Consistency: Treatment of Nonmarket Economies in Transition Under United States Antidumping and Countervailing Duty Laws*, 10 AM. U. J. INT'L L. & POL'Y 993, 1030-48 (1995); see also Susan H. Kuhbach, *L'Etat, Ce N'est Pas Moi*, in THE COMMERCE DEPARTMENT SPEAKS 1992: DEVELOPMENTS IN IMPORT ADMINISTRATION; EXPORT AND INVESTMENT ABROAD, 789 PLI/Corp.169 (1992), available in WESTLAW, JLR database (describing the Commerce Department's position regarding investigations of trade from nonmarket economy countries).

188. See Lantz, *The Search for Consistency*, *supra* note 187, at 1030-40.

189. THE MIT DICTIONARY OF MODERN ECONOMICS 413 (David W. Pearce ed., 1986).

B. TRADITIONAL GATT TREATMENT OF NONMARKET ECONOMIES (NMEs)

Reform has not been limited to the state owned industrial sector. China has disassembled much of its formerly centralized state trading machinery. Import and export companies have a much greater degree of autonomy in their operations. MOFTEC has assumed the role of an administrative organ regulating foreign trade and foreign direct investment, drafting and enforcing a broad range of legislation. New legislation, particularly during the 1990s, has focused on creating a relatively transparent framework of laws and regulations. The Foreign Trade Law (1994) and the Regulation on Antidumping and Countervailing Duties (1997),¹⁹⁰ are notable examples of the efforts China has made to "get on the international track" (*yu guoji jiegui*).

In dealing with nonmarket economies, GATT has traditionally regulated state trading enterprises and other forms of government involvement in trade under Article XVII. The 1994 Understanding on Article XVII defined state trading enterprises as "governmental and non-governmental enterprises . . . , which have been granted exclusive or special rights or privileges, that when exercised through purchases and sales, affect imports and exports."¹⁹¹ GATT requires notice of the existence of state trading enterprises. The enterprises themselves must operate in non-discriminatory manner subject to QR restrictions and apply only commercial considerations in purchases and sales.¹⁹²

Beginning with the accession of Romania and Poland to GATT in the 1960s and early 1970s, respectively, GATT has had to deal with the problems of interfacing nonmarket economies into a market-based trade system. Provisional annual review of their protocols and compliance, as well as selective safeguards and commitments to increase imports, sufficed to facilitate their entry because the total volume of trade of those states was relatively small in proportion to overall world trade and because those countries were not undergoing the uncertainties and stresses of rapid marketization at the time of their accession. During the Uruguay Round (1986-1994) there was more discus-

190. See Thomas Yunlong Man, *National Legal Restructuring in Accordance with International Norms: GATT/WTO and China's Foreign Trade Reform*, 4 IND. J. GLOBAL LEGAL STUD. 471 (1997); Bing Wang, *China's New Foreign Trade Law: Analysis and Implications for China's GATT Bid*, 28 J. MARSHALL L. REV. 495 (1995); Jianming Shen, *A Critical Analysis of China's First Regulation on Foreign Dumping and Subsidies and Its Consistency with WTO Agreements*, 15 BERK. J. INT'L L. 295 (1997).

191. GATT, art. XVII.

192. Significantly, Article XVII does not contain a national treatment requirement.

sion among policymakers, negotiators and scholars concerning NMEs and economies in transition.¹⁹³

China's accession to the WTO presents a separate issue. Rote application of Article XVII is not a feasible solution. The duality and paradox of its anomalous "market socialism" hybrid, its rapidly developing coastal regions and poor, underdeveloped hinterland,¹⁹⁴ its 1.3 billion population, and its annual trade volume of \$US345 billion,¹⁹⁵ all require a unique solution. Indeed, the WTO itself is a far different institution, operating in a far different world, than was GATT in 1971, when Romania acceded. Perhaps the only common thread is that special dispensation was granted those East European countries for broader geopolitical reasons. In China's case broader reasons also justify special dispensation. The reasons, however, are not grounded in geopolitical concerns so much as in the integrity of a world trading institution.

C. RELIEF? GATT EXCEPTIONS: ESCAPE CLAUSE, DEVELOPING COUNTRIES

As a whole, GATT provides only very few exceptions to deal with special circumstances. Because they are so narrowly construed in their scope and length of application, these exceptions effectively reinforce GATT's systematic commitment to free trade. They are at most safety valves, not designed to function as devices to manage the integration of marketizing economies. Just as GATT channels all government intervention in trade into tariffs, it channels temporary relief from its regime into safeguards. Article XIX's "escape clause" authorizes temporary emergency relief measures on imports of particular products, and lists the requirements a member state must meet to invoke the exception. The Uruguay Round Agreement on Safeguards details actual measures that may be taken once the exception is properly invoked. Safeguards measures are intended to serve as a political expedient, easing domestic tension, and giving a new WTO member temporary respite to allow the industrial adjustment necessary to maintain competitiveness. In effect, the

193. See, e.g., John H. Jackson, *State Trading and Nonmarket Economies*, 23 INT'L LAW. 891 (1989); see also Eliza R. Patterson, *Improving GATT Rules for Nonmarket Economies*, 20 J. WORLD TRADE L. 185 (1986).

194. Per capita income of the residents of Guangzhou, capital of the rapidly developing Guangdong province, for the first time exceeded 10,000 yuan (about \$1,204) in 1997, more than double the national average level of 1996. In 1996, the national per capita urban income was 4,377 yuan. XINHUA BUSINESS WEEKLY, March 9, 1998.

195. Target for 1998, according to new Minister of MOFTEC Shi Guangsheng. Mark O'Neill, *Big Push to Lower Surplus*, S. CHINA MORNING POST, Mar. 10, 1998, BUS. POST, at 4.

measures work as a subsidy to a discrete group who are the disadvantaged by accession, amortizing the costs of the free trade system and ensuring the overall benefit.

On its face, this exception might seem sufficient to absorb the shock to domestic markets and production caused by surges in competitive imported goods following China's accession and phasing in of WTO requirements. An understanding of the true complexity of China's SOE reform and the gravity of its potential failure, however, reveals that discrete safeguards measures cannot provide the relief that longer phase-ins and more sensible accession terms can. The limited scope and temporary nature as well as high threshold for invoking the escape clause make it ill-adapted to serve as a device to relieve the pressure of economic dislocation on potentially over 100 million disadvantaged Chinese SOE employees and pensioners.

In order to invoke the "escape clause" exception, China must show that increased quantity of imports of like, or directly competitive foreign products, cause or threatens to cause serious injury to its counterpart domestic industry. Causation is critical. The increased imports and serious injury or threat must result directly from the China's GATT obligations and *unforeseen* developments.¹⁹⁶ If the phase-in period provided in China's accession protocol unreasonably short, China will be required per its GATT obligations to lower its tariffs, opening its borders to increased imports of like or directly competitive foreign products. There is little doubt that this will result in a "significant overall impairment" of its domestic industry.¹⁹⁷ Reference to the test to determine "serious injury" under U.S. law underscores this point. The Trade Act of 1974 requires the International Trade Commission (ITC) to consider "the significant idling of productive facilities in the domestic industry, the inability of a significant number of firms to carry out domestic production operations at a reasonable level of profit, an *significant unemployment or underemployment within the domestic industry.*"¹⁹⁸ These factors already exist throughout China's state-owned sector, comprising the bulk of its capital-intensive industries. Over 50% of SOEs operate at a loss. Underemployment has been a problem since early in the reform period,¹⁹⁹ while mass *de facto*

196. GATT, art. XIX.

197. The Uruguay Round Agreement on Safeguards defines "serious injury" as "significant overall impairment of domestic industry". A threat of serious injury must be "clearly imminent". GATT, annex 1A.

198. Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978, 2012 (1975) (emphasis added).

199. See *Final Report of the Asian Development Bank on State Enterprise Insolvency Reform in the People's Republic of China*, TA No. 2271 — PRC, March 1996.

unemployment of furloughed workers "down off the production line" (*xiagang*) has in recent years created an atmosphere of growing uncertainty, dislocation and opposition to the reform process.²⁰⁰ The causation requirement is also met. Increased imports of directly competitive foreign products will aggravate the existing problems, raising them to a new order of magnitude.

Application of safeguard measures will also fail on the issue of foreseeability. In view of China's current domestic situation, there will be nothing to support a claim that serious injury or clearly imminent threat thereof is a result of unforeseen developments in tandem with GATT obligations. The Chinese, the WTO and the U.S. should all be able to foresee the colossal dislocation this will cause.

Even if circumstances warranting safeguards measures can be shown, China would only be able to suspend GATT obligations or modify concession for a reasonable period.²⁰¹ When Article XIX authorizes measures, the Uruguay Round Agreement on Safeguards permits temporary, limited remedies "only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment".²⁰² It puts quantitative limits on measures allowing only the freeze of imports at an average level; decrease in the quantity of imports is not permitted.²⁰³ Safeguards may be implemented for a maximum duration of 4 years, extendable to 8 years only under certain conditions, subject to review.²⁰⁴ The Agreement also prohibits the use of voluntary export restraint agreements and other gray area measures.²⁰⁵

In sum, Article XIX and the Uruguay Round Agreement on Safeguards Measures are too narrow to resolve problems on the scale of those posed by China's ongoing industrial restructuring. Safeguards measures, however, may offer a viable temporary solution to the imbalances caused by expected increased imports of Chinese goods into the U.S. and other countries following Chinese WTO accession. The exception was designed, after all,

(detailing widespread underemployed labor (*chenyu laodongli*) and the legal, social welfare, and financial dimensions of SOE insolvency, bankruptcy and restructuring) (on file with author).

200. See discussion on China's political dilemmas, *supra*, Section I.

201. By comparison, §201 of the U.S. Trade Act of 1974 does not require the increased quantities of imports be due to unforeseen development & GATT concession; defines causation more precisely; and offers a much broader remedy, not merely withdrawal or suspension of GATT concessions. Trade Act of 1974, *supra* note 198, at 2011-14.

202. GATT, Agreement on Safeguards, art. 5.

203. *Id.* An exception may be permitted based on clear justification that a different level is necessary to prevent or remedy serious injury.

204. *Id.*, art. 4.

205. *Id.*, art. 11.

to remedy precisely this type of problem. Indeed the industrialized countries have considered this issue at length and in a confidential draft protocol even proposed setting up a procedure to provide for general safeguard with an unlimited duration. These measures would allow the withdrawal of unlimited concessions from China if China and any WTO member failed to resolve a dispute under GATT or any other WTO agreement.²⁰⁶ Reserving the right to 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.

1. *GATT & Development Issues*

GATT Part IV outlines nonbinding commitments on trade and development and offers certain preferences for developing countries, which allow them to preserve their balance of payments and encourage infant industries through import substitution. These preferences include independent negotiation of favorable tariff bindings combined with the unilateral ability to raise their own tariff bindings, and the important differential gradual phase-in of GATT obligations.²⁰⁷ To be eligible for developing country preferences, a member's economy must support only a low standard of living and be in the early stages of development.²⁰⁸ A developing country may also have some degree of protection from safeguards measures adopted against the import of its products into other member countries.²⁰⁹

Considerable debate and heated rhetoric have surrounded the determination of China's status for purposes of applicable developing country preferences.²¹⁰ Based on China's significant

206. See *Special Report*, INSIDE U.S. TRADE, January 27, 1995, at S-2 (reprinting confidential draft protocol proposing unlimited safeguards measures); see also Jackson, *supra* note 188, at 899 (proposing a two-track safeguard system as an "interface mechanism" to guide China's transition and integration). China remains firmly opposed to any special safeguards for the U.S. and others in excess of those explicitly permitted under GATT art. XIX.

207. The U.S. counterpart, the Generalized System of Preferences, 1974 Trade Act §§501 et seq., designates criteria for beneficiaries. Trade Act of 1974, *supra* note 198, at 2066-71.

208. GATT, art. XVIII, ¶ 4.

209. "Safeguards shall not be applied against a product originating in a developing country Member as long as its share of imports of the product concerned in the importing Member does not exceed 3 per cent." GATT, Agreement on Safeguards, art. 9, para. 1; Developing country members may extend its own application of safeguard measures for 10 years. *Id.*, art. 9, para. 2.

210. See GREGORY J. MASTEL, CHINA AND THE WTO: ECONOMY AT THE CROSSROADS, 30-34 (1994) (Mastel argues against granting China developing country status for WTO accession purposes.).

overall trade surplus and widely-touted double-digit economic growth, the U.S., the E.U. and other trading nations argue that China is not a developing country as contemplated in Part IV of GATT. Long Yongtu and others, in response, have pointed out that China's development to date has been uneven; wealth and growth are concentrated in coastal regions while inland provinces remain backward and poor. In effect, neither side is wrong.

D. CHINA: NECESSARY EXCEPTION OR DANGEROUS PRECEDENT?

Management of complex interdependent international economic relations requires a standing institution that can oversee rulemaking, enforcement and dispute resolution between sovereign states. The WTO has become that institution. Together with the IMF and the United Nations, the WTO forms a system to regulate international problems through international laws, hopefully to the benefit of all nations. Whether special dispensation for China's accession should be viewed as a necessary exception or as setting a dangerous precedent for other marketizing countries applying for WTO membership is a question of the WTO's commitment to representing all trading nations. Adherence to the view that modifying WTO requirements to incorporate marketizing economies will undermine the integrity of the WTO framework paradoxically has just that effect. The WTO's stated commitment to address the challenges of integration implicitly recognizes that a world trading system that excludes China, Russia and others, over one-quarter of humanity, is a contradiction in terms.²¹¹ For the WTO fully to assume the role of a key international institution it has to modify its basic approach to incorporation of new members.²¹² It is in this sense that China's accession will set an important precedent.

211. See WTO Singapore Ministerial Declaration, adopted on 13 December 1996:

We the Ministers, have met in Singapore . . . in particular to . . . address the challenges of an evolving world economy. . . . We believe that the scope and pace of change in the international economy . . . and the increasing integration of economies offer unprecedented opportunities for improved growth, job creation, and development. These developments . . . pose challenges to the trading system. We commit ourselves to address these challenges.

Singapore Ministerial Declaration, Dec. 13, 1996, 36 I.L.M. 218, 220-21 (1997).

212. John Jackson, the leading scholar in international economic relations, has noted,

[I]t is important for China to be a member of the WTO. . . . You can't really leave out that great part of the world and hope that you will have an institution that can fulfill its several different purposes. . . .to prevent war, to preserve the peace, and to continue a reasonable degree of stability and peaceful operation of the world.

V. POSSIBLE SOLUTIONS AND CONSEQUENCES OF ADMITTING CHINA TO WTO (OR NOT)

By any traditional reckoning, China is not ready to join the WTO. Without important modifications in its Protocol of Accession to reflect its special circumstances, the WTO members must either exclude China from the institution until they decide it is ready or admit China "as is." Not surprisingly, each of these options entails significant adverse consequences both for China and the WTO as an institution. Closer examination shows that neither of these options is feasible or desirable. The unique issues and far-reaching consequences of China's accession demand a unique solution — a negotiated solution.

Withholding the benefits and international recognition of membership creates a strong disincentive for China to comport with international norms, one that will have an important impact on China's economic and political behavior. The U.S. has been the main advocate of holding to this hard line. Unfortunately, few American policymakers, particularly in Congress, and few commentators have bothered to consider the implications of their views either for China domestically or for the WTO as an institution. The rising U.S. trade deficit in the wake of the Asian currency crisis no doubt has contributed to the anti-trade liberalization atmosphere in Congress.²¹³ Frustration with the perceived lack of reciprocity in market access as well as human rights issues and uncertainty concerning China's military intentions has motivated Congress' hardline attitude toward China in general.²¹⁴ Thomas J. Duesterberg, former Assistant Secretary of Commerce for international economic policy (1989-93), argues that non-trade issues such as China's arms proliferation, military threats toward Taiwan, and poor human rights record make it "difficult to conceive of why the West would want to reward China in the economic sphere [with WTO membership]."²¹⁵

John Jackson, *The Institutional Ramifications of China's Accession to the WTO*, in ABBOTT, *supra* note 75, at 76.

213. The U.S. trade deficit reached its highest level in nine years in 1997, driven up in the last quarter of the year primarily by a surge in Asian exports the U.S. following mass currency devaluation there. Richard W. Stevenson, *Trade Deficit for '97 Is Biggest in Nine Years*, N.Y. TIMES, Feb. 20, 1998, at D1, available on WESTLAW at 1998 WL-NYT 9805003602.

214. Alleged Chinese government involvement in improper political contributions to President Clinton's 1996 reelection campaign may also have contributed to this malaise vis-à-vis China. Also see generally Jeff Gerth, *U.S. Business Role in Policy on China Is under Question—Aid to Military Is Feared*, N.Y. TIMES, Apr. 13, 1998, at A1.

215. Thomas J. Duesterberg, *China's Not WTO Material*, WALL ST. J. Apr. 23, 1997, A18.

Gregory Mastel, vice president of the Economic Strategy Institute, a Washington-based think tank, who writes frequently on China and the WTO, has argued that China must be forced to wait until it is ready to comply fully with WTO rules to join.²¹⁶ Otherwise exemptions for China could set a dangerous precedent for Taiwan and other countries applying to join the WTO, undermining its credibility.²¹⁷ Mastel and others insist the U.S. now enjoys leverage over China that will be lost once it joins the multilateral trade regime, squandering an important opportunity to liberalize China's economy.²¹⁸ Moreover, there is no risk to the WTO or the U.S. in this approach because China cannot afford to quit the negotiations.²¹⁹ The lack of rule of law and China's poor record of enforcing bilateral agreements with the U.S. on intellectual property and market access, in Mastel's view, suggest that China will not enforce the broad WTO regime.²²⁰ The rule of law in China, he says, "must precede WTO membership."²²¹

The cultural chauvinism inherent in these views aside, their narrow focus misunderstands the institutional consequences on the WTO and China of U.S. intransigence as well as the systemic obstacles to the rule of law in China. Levering China with demands for unrealistic market access concessions and absolute procedural guarantees is a deeply flawed tactic for several reasons. First, actively excluding China will, in fact, deprive the U.S. of the ability to influence China either through "carrot" incentives or "stick" coercion and risks creating an international "loose cannon".²²² This hardline approach reinforces the

216. See Gregory J. Mastel, *Clinton-Jiang Summit, Round Two*, J. COM., Dec. 3, 1997, at 7A; *China's WTO Bid: Transition Key Question*, Dow Jones Int'l News Serv., Apr. 23, 1997, available in WESTLAW, ALLNEWSPLUS database. See, e.g., Gregory J. Mastel, *The More Important Debate*, WASH. POST, June 24, 1997, at A15; Gregory J. Mastel, *Is WTO Ready for China?*, May 8, 1997, FAR E. ECON. REV., 29. See generally GREGORY J. MASTEL, *THE RISE OF THE CHINESE ECONOMY: THE MIDDLE KINGDOM EMERGES* (1997); MASTEL, *supra* note 205.

217. *Id.*

218. See Thomas J. Duesterberg, *China's Not WTO Material—Yet*, WALL ST. J., Apr. 23, 1997, at A18.

219. See *China's WTO Bid: Transition Key Question*, *supra* note 216.

220. See *Clinton-Jiang Summit, Round Two; China's WTO Bid: Transition Key Question*, *supra* note 216. Mastel cites a statement by former NPC Chairman Qiao Shi that the persistence of the rule of man has impeded the rule of law in China. While this is not entirely untrue, Mastel underestimates the degree to which legal reform since 1978 has changed China. Furthermore, he ignores the specific historical background—the Cultural Revolution during which Mao reigned supreme as emperor—to which Qiao was alluding. And he also fails to recognize the statement as Qiao's skillful use of the prestige of law and his position as China's chief legislator to make political barbs against his archrivals, Premier Li Peng and President Jiang Zemin.

221. Gregory J. Mastel, *Is the WTO Ready for China?*, *supra* note 216.

222. See Robert S. Ross, *Enter the Dragon (China and international trade)*, FOREIGN POL'Y, 18, Sept. 1, 1996 ("Chinese isolation from the WTO and the resulting

Chinese perception that the U.S. is attempting to contain China's development as a world power and infringe on its sovereignty. The result is an antagonistic, uncooperative relationship marked by displays of unfettered nationalism and brinkmanship. The Chinese navy's "military exercises" and missile tests in the Taiwan Strait in 1996 are a case in point.²²³

Part of the problem is that the hardline this approach fails to appreciate the reasons behind China's somewhat anachronistic concept of sovereignty and how this affects its perceptions of the U.S. and the ongoing WTO accession negotiations. The historical memory of imperial China's repeated humiliation at the hands of 19th century Western and Japanese gunboat diplomacy has indelibly colored China's fragile national psyche. In many ways, the pressure and demands of the U.S. — the dominating world sovereign — are perceived as infringing China's absolute sovereignty. Chinese leaders more readily accept requirements of membership into a multilateral international institution because it is much easier for them to justify the acceptance at home. The Chinese perceive the requirement as necessary to "get on the international track" (*yu guoji jiegui*), hence integral to reform and opening. Bending to U.S. demands — gunboat market access — however, is bowing to foreign aggression.²²⁴ In spite of recent warming, nearly a decade of often fractious bilateral negotiations on market access, protection of intellectual property rights and the annual debate in Congress over the renewal of China's most-favored nation status — all fraught with politics — have marred the Sino-U.S. relationship.²²⁵ The "carrot and stick" approach to annual MFN renewal and economic relations

Chinese resentment of the major trading powers will likely enhance Beijing's proclivity to pursue mercantilist policies for national power rather than merely short-term protectionist policies for economic development."); see also Robert S. Ross, *Beijing as a Conservative Power (Chinese foreign relations)*, 76 N. 2 FOREIGN AFFAIRS 33, Mar. 13, 1997.

223. Former Secretary of State Henry Kissinger has also identified this debilitating trend in Sino-U.S. relations, and has argued that the periodic recurrence of such crises is "nearly guaranteed if each side's perception of the other remains unchanged." See Henry Kissinger, *The Stakes with China*, WASH. POST, Mar. 31, 1996, at C7.

224. This concern for a fragile sense of national identity has manifested itself at intervals throughout the reform process in campaigns to stop "spiritual pollution" (*jingshen wuran*), "bourgeois liberalization" (*zichan jieji ziyouhua*), codewords for "all-out Westernization" (*quanpan xihua*). In contrast to the periods of retrenchment (*shou*), these campaigns were motivated by political considerations, not economic indicators.

225. Kissinger argues U.S. policy should seek common interests with the People's Republic of China, not forcibly to change it. See Kissinger, *supra* note 223.

in general, has created an unhealthy dynamic that makes bilateral negotiations onerous and impedes progress on all fronts.²²⁶

Excluding China with no fixed date for its accession also illustrates the misunderstanding of the systemic obstacles to the rule of law in China and the important role WTO membership will play in domestic reform. Internally, such a move works counter to building a rule of law by depriving domestic reformers of important political leverage over those entrenched interests at both the central and local levels who see their own vital interests at odds with continued reform and opening and compliance with WTO norms. The question of whether the WTO should attempt to influence domestic reform is moot. It has already had irreversible impact on the shape of Chinese reform. Rather the question is how long China will take to reach the point where it is "ready" for membership and whether this process can be accelerated by bringing China into the multilateral framework.

Admitting China earlier but with only a minimal phase-in period, on the other hand, will cause friction between China and its major trading partners that threatens to overload the WTO's Dispute Resolution Body (DSB). How China will balance immediate concerns that might require violating WTO commitments and thus, international law, with its longer term interests is unclear. Premier Zhu Rongji has set out ambitious goals to overhaul SOEs, revamp the banking sector and slash the bureaucracy by half — all within three years. But the sheer scale of the undertaking and the near certainty of considerable resistance from career cadres facing the loss of their "iron rice bowls" has made some observers skeptical Zhu can complete the task that quickly.²²⁷ Until reformed Chinese industry can compete on a more equal footing with foreign competitors, it is likely that even Zhu will not have the political wherewithal to force strict compliance with GATT requirements. Further issues would arise when countries try to enforce DSB decisions against China. Strict compliance with WTO provisions will inevitably require politically difficult reforms, reforms that now appear likely to occur, but only in due time. In the meantime, conflicts could impair other

226. Much of China's obstructionism may be tit-for-tat retaliation against the U.S. An example is the ongoing dispute concerning China's refusal to purchase American wheat because of a fungus called TCK smut. The U.S. claims it is harmless, but China insists it is harmful. China is one of the world's biggest wheat importers and until 1997 had been the biggest purchaser of American wheat. See Lynne O'Donnell, *Wheat Ban Seen as a Problem for China's WTO Hopes*, REUTERS WIRE SERVICE, Oct. 9, 1997.

227. See Eckholm, *supra* note 2; see also Xu Xing, *Modernizing SOEs: Easier Said Than Done*, OPEN MAGAZINE (Kaifang), Oct. 1997, at 29-31. "Iron rice bowl" refers to the traditional job and benefit security enjoyed by cadres and workers alike under the socialist system.

members' ability to ensure their WTO benefits and have considerable institutional ramifications for the WTO.

A. THE OPTIMAL OPTION — THE FRAMEWORK FOR A NEGOTIATED SOLUTION

China's accession to the WTO presents unique issues that require a unique solution. The duality and paradox of its anomalous "market socialism" hybrid, its rapidly developing coastal regions and poor, underdeveloped hinterland,²²⁸ its 1.3 billion population, its annual trade volume of \$US 345 billion,²²⁹ and total GDP of \$US 2.323 trillion,²³⁰ all underscore the importance of incorporating it into a multilateral framework. WTO Director-General Renato Ruggiero has noted:

China's economic relations with the world are simply too large and pervasive to manage effectively through a maze of arbitrary, shifting and unstable deals. China's best guarantee of coherent and consistent international trade policies is found inside the rules-based multilateral system. . . . China's entry into the global trading system is about more than trade. It is about China's future role as a world economic leader. And it is about the future direction of the global economy and our global community.²³¹

Uncertainty concerning China's commitment to economic liberalization and willingness to adhere to WTO rules should not in and of themselves constitute reason to keep China out of the WTO. A compromise solution will best serve everyone's interests. Negotiators should focus on getting specific yet realistic commitments on market access for goods and services. The WTO members should require China to comply closely and timely with its commitments to lower tariffs, eliminate NTBs, and guarantee intellectual property protection. In return, China should get a longer period to phase-out certain SOE subsidies and preferences. With the exception of certain industries where SOEs predominate, there should be a rebuttable presumption that Chinese exporters are operating under market conditions for purposes determining whether dumping has occurred. Finally,

228. Per capita income of the residents of Guangzhou, capital of the rapidly developing Guangdong province, for the first time exceeded 10,000 yuan (about \$1,204) in 1997, more than double the national average level of 1996. In 1996, the national per capita urban income was 4,377 yuan. XINHUA BUSINESS WEEKLY, March 9, 1998.

229. Target for 1998, according to new Minister of MOFTEC Shi Guangsheng. *Big Push to Lower Trade Surplus*, S. CHINA MORNING POST, Mar. 10, 1998, at 4.

230. China's total GDP ranks second in the world. 1990 figures. EAST ASIA ANALYTICAL UNIT, AUSTRALIA DEP'T. OF FOREIGN AFFAIRS AND TRADE, CHINA EMBRACES THE MARKET, at 46, Table 1.4. (1997).

231. Renato Ruggiero, *China and the World Trading System*, <<http://www.wto.org/wto/speeches/china.htm>>.

WTO members should be able to apply safeguards as provided under GATT Article XIX if SOE products materially disrupt their markets.²³²

B. POTENTIAL CONSEQUENCES OF ACCESSION — ASSURING COMPLIANCE AND WTO INTEGRITY

Assuming that China joins the WTO pursuant to a compromise solution, there must be a strong commitment on the part of the U.S., the E.U. and the other major trading nations combined with an institutionally strong WTO in order to minimize the disruption caused by China's accession.

1. *Advantages of Multilateral International Institutions*

The multilateral framework provides the best forum for the cooperation and constant communication necessary to achieve such a common strategy. It is the most effective mechanism for all parties concerned to protect their interests and to enforce WTO commitments. The E.U. and the U.S. can act in concert to lay the ground rules for China's accession, which are then, in turn, exercised through the WTO institution. This process will have a far stronger legitimacy and persuasive force over China than the U.S. can possibly bring to bear bilaterally, even with all of the "leverage" it fears it will lose when China accedes. Because it represents all of the trading nations, the WTO can wield a stronger force yet one that encourages China to comply without forcing it to lose face internationally.

Interaction and engagement with international institutions over the past decade and a half has had a marked effect on the Chinese legislation and institutional behavior.²³³ Participation in international institutions reduces uncertainties and increases the flow of information. Individual sovereign governments within a international multilateral regime recognize that violation of international covenants may justify retaliation by other countries.²³⁴ Thus a state acting rationally to maximize its own self-interest within that framework will normally opt to comply rather than risk the opprobrium of its counterparts. By this logic, it is reasonable to assume that China, like other states, will act rationally to maximize its own self-interest. Hence WTO membership

232. Compare Gregory J. Mastel, *Dealing with State-Owned Firms*, J. COM., Apr. 28, 1997 at 6A. (arguing for provisional accession with special [unlimited] safeguards for SOE products). See also Gregory J. Mastel, CHINA AND THE WTO: ECONOMY AT THE CROSSROAD, at 3, 39-42.

233. See JACOBSON & OKSENBERG, CHINA'S PARTICIPATION IN THE IMF, *supra* note 168.

234. See ROBERT O. KEOHANE, AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY, 90-100.

will promote China's compliance with international norms and do so far more effectively than have bilateral agreements or threats of retaliation.

2. *Overload? — WTO Dispute Resolution Body and Procedures*

The potential for disputes between China and its trading partners to overload the WTO Dispute Resolution Body (DSB) is in one sense a valid concern. Particularly if China refuses to comply with adverse decisions, it will harm the integrity of the WTO dispute resolution mechanism. Flouting the authority of the DSB would certainly send a message that the WTO is an ineffectual enforcer of international trade rules and norms.²³⁵ Many American policymakers and commentators worry that China's accession will deprive the U.S. of its leverage over China, exercised through annual review of China's MFN status,²³⁶ making the DSB the adjudicatory organ of last resort in the event of major trade disputes. It is important to consider, however, how China will balance domestic problems that might cause it to violate WTO commitments with its broader, long-term interests.²³⁷ If the Protocol of Accession commits China to a realistic transition program with suitable provisions for mutual adjustment, the Chinese government will have little reason to tolerate GATT violations by its subnational governments and enterprises.

3. *Limiting the Free-rider Effect*

The best way to limit the free rider effect is for the WTO and China to agree to a Protocol of Accession that provides a clear timetable for the phased opening of China's goods and services markets. The timing of a phased opening should be realistic, giving China enough time to make necessary adjustment to its domestic economic structure. This will sharply reduce the chances that China will not live up to its commitments. By offering China full rights and privileges of WTO membership in the

235. John Jackson has noted that disputes involving China arising out of non-violation nullification of states' WTO benefits may pose particularly difficult issues and cause DSB credibility problems. See John Jackson, *The Institutional Ramifications of China's Accession to the WTO*, in ABBOTT, *supra* note 78, 78-79.

236. WTO Appellate Body Reports do not directly address whether annual review of a WTO member's U.S. MFN status under the Jackson-Vanik Amendment (19 U.S.C. §2432) violates WTO commitments under GATT Article I. See Abbott, *supra* note 7, at 3-4. We can well imagine, however, that China, if admitted, would make a strong case that Jackson-Vanik does violate GATT.

237. See James Feinerman, *Chinese Participation in the International Legal Order: Rogue Elephant or Team Player?* in CHINA'S LEGAL REFORMS, 186-191 (Stanley B. Lubman ed.).

meantime, the U.S., the E.U. and other major trading states will accelerate this adjustment process.²³⁸

Since it joined the World Bank and the IMF in 1980, China has proven itself a responsible member of these institutions, and has become an important source of economic stability in Asia.²³⁹ Not only have its cycles of boom and bust growth have not caused instability, China's continued commitment to maintain the value of its currency has served to stabilize the region in the wake of the Asian financial crisis.²⁴⁰

C. RULE OF LAW: WTO ACCESSION AND STATE-OWNED ENTERPRISE REFORM

When integrating economies in transition that have yet to fully implement the basic premises of the GATT (transparency, reciprocity, and the rule of law), the conflict that potentially arises between the sovereignty of a member state or an aspiring member state in the implementation of its own domestic policies and the integrity of the international norms and law underlying states' WTO commitments is especially acute.

Interdependence and openness — the premises of a global economy — have permanently altered notions of absolute sovereignty, often escalating the tension between these competing aims. In effect, international law now incurs directly in matters that were formerly considered the strict realm of the sovereign. WTO Director-General Ruggiero commented, "Fifty years ago the focus was only on tariffs and border measures; today WTO rules extend well inside the border, to encompass technical standards, services, intellectual property, trade-related investment, and a host of other economic policies that were once considered domestic."²⁴¹ The other major difference is that eighty percent of today's 130 WTO members are developing countries or economies in transition, whereas from 1947 until the 1980s nearly all GATT members were industrialized nations. The growing complexity of the rules and diversity of membership, far from weak-

238. Premier Zhu, visiting Britain for the Asia-Europe Economic Summit in April 1998, announced the approval of a British insurance company to set up operations in China. Speaking to reporters, Zhu said, "Now that we have approved the first, others will certainly follow." See *FIN. TIMES*, 6 Apr. 1998, at Abstracts 25; also *Agence Fr.-Presse*, 5 Apr. 1998, at 1998 WL 2255474 and *Wall St. J.* 30 Apr. 1998, at R11.

239. China is also important to the political and military stability in the region, an area of considerable concern to the U.S.

240. See Gary Hufbauer, *China as an Economic Actor on the World Stage: An Overview*, in ABBOTT, *CHINA IN THE WORLD TRADING SYSTEM: DEFINING THE PRINCIPLES OF ENGAGEMENT*, at 48.

241. Ruggiero, *supra* note 231.

ening WTO, has strengthened it. As the network expands, it is legitimated.

China's accession will have important consequences for the development of domestic legal institutions. Transparency and independent judicial review in international trade and investment matters will promote the role of law in governing all economic relations. The important sanctions that GATT and other WTO agreements provide may give the central government leverage in recalibrating the imbalance of power between the center and the regions. Particularly as SOEs engage in international business, they will be forced to comply with international norms, notwithstanding local interests that would militate otherwise.

D. FACILITATING CHINA'S ACCESSION THROUGH ENGAGEMENT AND MUTUAL ADJUSTMENT

The success of China's integration into the world trading system depends on the success of domestic economic and legal reforms. The WTO, the U.S., and the E.U. must work together with China prospectively to create a mechanism for mutual adjustment. A proactive approach that encourages engagement and mutual adjustment is the key to systemic reform, greater transparency and more even enforcement of the laws.

To be sure, engagement with China is bound to be a long and difficult process, longer and more difficult than U.S. or E.U. policymakers may understand. As Jeffrey Garten has pointed out, China's entry into the WTO will, by definition, entail dislocation for China and the rest of the world.²⁴² China's huge population, GDP, trade surplus, and thirst for foreign capital will have broad repercussions. But in the end of the day, engagement is still the only choice. Harold Jacobson and Michel Oksenberg have argued that key international economic organizations play an important role in smoothing the transition of marketizing economies into the international economic order.²⁴³ Integrating a state like China into this order is by definition a gradual process.²⁴⁴ A mature partnership is forged only through engagement and mutual adjustment.

A compromise solution would give China important international recognition as well as tangible benefits that would give domestic reform an important boost. Such a solution will entail granting a reasonable period to phase-out SOE subsidies combined with strict compliance to commitments in other areas and a

242. See Jeffrey Garten, *Rogue Elephant Rampant?*, FIN. TIMES, Oct. 21, 1997, at 18.

243. See JACOBSON & OKSENBERG, *supra* note 168, at 11.

244. See *id.*, at 107-08.

timetable for market access. The major trading states, and the U.S. in particular, must work closely with China to defuse the SOE economic time bomb. Increasing SOE bad debts hobble financial reform which has a collateral effect on investment and openness.

VI. CONCLUSION

The argument of those hardline proponents of blocking China's membership to the WTO altogether, until it has demonstrated genuine commitment to WTO rules, ultimately fails because it is short-sighted. Their argument does not recognize that the U.S. and the international community cannot, and should not, attempt to marginalize or contain the PRC. A world trading organization that attempts to do so is a contradiction in terms. The privileges of WTO will not benefit only the princelings who run the international trade arms of the People's Liberation Army, as certain uninformed American views misperceive.²⁴⁵ To the contrary, Chinese reformers as well as millions of ordinary Chinese have benefited and will continue to benefit from increased trade and the wealth and openness it produces. International peace and stability also depend in large part on integrating China into a shared system of international institutions.²⁴⁶ This means understanding and acknowledging its needs and interests.²⁴⁷

Nor should we confuse the issue with human rights and other arguments.²⁴⁸ This is about trade and how to encourage the Chinese Government and people to incorporate certain free trade ideas as they develop their own modern legal and economic system. Not only is it impractical, but it is putting the cart before the horse to insist on a fully developed legal system and protection of human rights per the standards of U.S. Congress before WTO membership can be allowed. For trade — the free flow of

245. An editorial in a major newspaper in North Carolina, home state of influential Senator Jesse Helms, a vocal opponent of China, claimed: "American trade with China provides money and technology to the Chinese war machine." The editorial suggested collusion between "China's rulers and their American business allies" in getting China into WTO. Richard A. Stimson, *China Is No Developing Nation in World Trade*, Jan. 13, 1998, GREENSBORO NEWS & REC. (N.C.), at A6.

246. See Abbott, *supra* note 8, at 1.

247. Robert Ross argues that Chinese participation is crucial to a stable post-Cold War international order, and that "[e]ngagement must mean more than simply offering China the opportunity to follow the rules. It requires . . . negotiating solutions . . . [and] . . . multilateral collaboration with Chinese interests." *Beijing as a Conservative Power*, *supra* note 222.

248. Henry Kissinger has argued for a balance between U.S. human rights and other policy aims vis-à-vis China. He notes that the U.S. "has achieved such a balance with Russia, which has inflicted incomparably greater casualties on Chechnya . . . than China did at Tiananmen Square." Kissinger, *supra* note 223.

goods and information — necessarily precedes political reform. Other sovereigns can seek to influence China's domestic development only to the extent international institutions and international law legitimately preempts China's sovereign prerogative. Ultimately, it is to the Chinese to shape their own way. They have over the past two decades created a framework of legislation and legal institutions to structure economic activity and protect related rights where before there was none. Even though these institutions are still formative and emerging, they signify the gradual development of notions of legal rights and their importance to an international market economy.

It is important to remember that the animating principles of the WTO — free trade, rule of law, fairness — are ideas closely linked to the Western cultural tradition. And it would behoove policymakers and negotiators to recall the point that State Councillor and former Minister of Foreign Trade, Madame Wu Yi and others have made so eloquently.²⁴⁹ The development of advanced market economies and legal systems took several hundred years to achieve in the West. It is not realistic to hasten this process in China. This does not mean waiting 100 years, rather recognizing that there is a process at work, one which we should take care how we attempt to influence.

The past twenty years have brought unprecedented sweeping economic reform to China, fundamentally altering the country's social and political structures. The degree of openness and civil society that currently exists in major urban areas was unthinkable just a few years ago. Foreign economic relations have played a key role. Exports and foreign investment have driven economic growth; the World Bank has estimated that foreign trade turnover represents between 18-26% of GDP.²⁵⁰ At the same time, economic reform has brought a tremendous decentralization of political power which is proving an obstacle to the establishment of a true rule of law. The most fundamental systemic flaw is the Party's inability to allow law supremacy. Until it does China's legal system is bound to retain its legal instrumentalist characteristics.

Beijing University historian, Luo Rongqu has noted that the U.S. should recognize that it has always overestimated its influence on Chinese policy and underestimated China's ability to

249. See, e.g., Stanley B. Lubman, *There's No Rushing China's Slow March to a Rule of Law*, L.A. TIMES, Oct. 19, 1997, at M2.

250. See World Bank, *CHINA: FOREIGN TRADE REFORM*, Washington 1994, at 20. Note comparable figures for the U.S. are 16%. See also George D. Holliday, *China and the World Trade Organization*, in *CHINA'S ECONOMIC FUTURE: CHALLENGES TO U.S. POLICY*, at 461.

choose its own policy.²⁵¹ The U.S. and others might do well to reflect on this in considering China's accession. In fact, as a multilateral institution, the WTO can provide far more effective means to monitor and enforce China's compliance with WTO norms. China's membership in WTO will be a catalyst to ensure continued reform and give political leverage to domestic reformers. It will ease Sino-U.S. tensions and provide a better basis to resolve common problems. The important task for the U.S. is to negotiate commercially fair terms that commit China to a realistic schedule for opening its services and other markets and to building a system of administrative law that is transparently uniformly enforced by agencies and courts throughout the country. Accession is, after all, merely the beginning, and WTO membership requires further trade and investment liberalization.

China's accession to the WTO will mark its full membership in the club of world powers. A country of that size cannot but cause some disruption by its entrance. But if achieved in a way that holds China to realistic commitments on market access and elimination of non-tariff trade barriers, while providing a forum to resolve fairly issues and disputes that arise, and to promote mutual adjustment, there should be minimal disruption to free trade internationally. Such a solution will cement the WTO's prestige and consolidate the rule of law in international trade. The U.S., E.U. and other major trading states need to form a common plan that anticipates problems and commits to mutual adjustment. Excluding China is ultimately to no one's advantage. Outside the system of international rules, China will never reach the point where the U.S. and other countries deem it "ready" to join WTO. It is only operating within the multilateral framework that China and the WTO and its members can work constructively together.

251. See Luo Rongqu, *Political Choice in a Changing World Climate: A Chinese Perspective Toward the Sino-US Relationship*, 150 BEIJING UNIV. J. (Philosophy and Social Sciences Edition) 1, 3-4 (1992). Many Chinese scholars have framed the conflict arising out of China's growing prominence in the international political arena as a cultural conflict. See, e.g., HE XIN, DONGFANG FUXING (REBIRTH OF THE EAST).